

November 9, 2021

**R-49**

HONORABLE MAYOR AND CITY COUNCIL  
City of Long Beach  
California

**RECOMMENDATION:**

Request the City Attorney prepare an Ordinance amending Long Beach Municipal Code, Chapter 21.67, regarding Inclusionary Housing, to include recommendations proposed herein;

Request the City Attorney prepare an Ordinance amending Long Beach Municipal Code, Chapter 21.11, regarding No-Net-Loss, to include recommendations proposed herein; and,

Request the City Attorney prepare a Resolution amending the method of establishing an Inclusionary Housing In-Lieu Fee, to include recommendations proposed herein. (Citywide)

**DISCUSSION**

At its January 19, 2021 and February 2, 2021 meetings, the City Council approved Ordinances related to mandatory inclusionary housing (Inclusionary Housing Ordinance) as well as no-net-loss requirements (No-Net-Loss Ordinance), both related to housing construction in Long Beach. The City Council also adopted an Inclusionary Housing In-Lieu Fee Resolution (Resolution). As part of those actions, the City Council requested policy refinements of the inclusionary housing and no-net-loss provisions to:

- Evaluate the ability to extend the affordability covenants beyond 55 years for both Ordinances;
- Ensure that inclusionary in-lieu fees are used to support the production of new very low-income housing units;
- Evaluate tying the annual in-lieu fee adjustments to an annual index based on construction and land cost;
- Remove the 2025 no-net-loss expiration date; and,
- Evaluate the feasibility of requiring that all no-net-loss units be replaced onsite rather than offsite.

An initial report back to the City Council was provided on June 3, 2021 (Attachment A – June 3, 2021 Memo to Council). Staff reviewed the requested inclusionary housing policy changes with the assistance of Keyser Marston Associates (KMA), who prepared the attached report titled, “Inclusionary Housing Ordinance Potential Modifications” (KMA Report) (Attachment B –

KMA Report), and offers the following recommended modifications to the Inclusionary Housing Ordinance and Resolution, and No-Net-Loss Ordinance to address the City Council's requests:

- 1. Extend the minimum term of the inclusionary housing affordability covenants from 55 years to 55 years or the life of the project, whichever is longer (Inclusionary Housing Ordinance).**

The KMA Report indicates support for extending the affordability covenants for rental units in perpetuity or for as long as the property is developed with a residential use. The KMA Report advises against extending the affordability covenants for affordable ownership units due to limited value appreciation, and the potential for limited owner-investment in maintenance and capital improvements.

The KMA Inclusionary Housing Financial Evaluation prepared prior to the adoption of the Inclusionary Housing Ordinance recommended a 45-year covenant period for ownership units, with the ability for the first owner to sell the unit at market rate. Instead, the Inclusionary Housing Ordinance was adopted with a 55-year covenant for ownership units, with no ability to sell the unit at market rate during that period. Since this structure may already create the negative outcomes mentioned in the previous paragraph, a change from a 55-year term to perpetuity will likely have the same outcome as the existing structure.

*Recommendation No. 1:* Modify the covenant period from a 55-year term to 55 years or for so long as the property is developed with a residential use, whichever is longer, for both rental and ownership inclusionary units.

- 2. Evaluate how to ensure Inclusionary In-Lieu Fees (In-Lieu Fees) are dedicated to the production of new very low-income units and not used for rehabilitation or to subsidize existing rental units (Inclusionary Housing Ordinance).**

The Inclusionary Housing Ordinance requires In-Lieu Fees to be deposited into the Affordable Housing Trust Fund and accounted for separately in an inclusionary housing program subaccount. The Inclusionary Housing Ordinance also requires that at least 70 percent of the funds be used to assist with the development of low-income units, with the remaining 30 percent allowed to be used for the development of moderate-income units.

In reality, the majority of new affordable housing units are very low-income units, and there are still no programs to fund moderate-income units. That said, the relatively small amount of funding that could be used for moderate-income units would likely be difficult to use for that purpose. Modifying the Inclusionary Housing Ordinance to require the funds to be used for the development of new very low-income rental housing units would be beneficial to the lower-income community.

*Recommendation No. 2:* Modify the Inclusionary Housing Ordinance to require that all In-Lieu Fees deposited into the Affordable Housing Trust Fund be used for the development of new very low-income rental housing units (no rehabilitation or subsidization of existing units).

**3. Request to tie the In-Lieu Fees to an annual index based on changes in construction costs as measured by the Engineering News Records Construction Cost Index; and land costs measured by using the proxy of change in median condominium sales prices (Resolution).**

The Resolution, as currently written, does not require an annual adjustment in the In-Lieu Fee amount. Rather, the Resolution proposes that the In-Lieu Fee be reviewed at least every three years and that any changes to the In-Lieu Fee be directed by a future action of the City Council. The KMA Report advises that an annual update methodology should be simple and easily administered and should be tied to a readily accessible published source. Since the proxy of change in median condominium sales prices is not a published source, it will be time consuming and costly to gather this data on an annual basis. Furthermore, KMA, as an expert in economics and housing programs, does not know how it would be possible to combine data from the Engineering News Records Construction Cost Index and land costs measured by using the proxy of change in median condominium sales prices to update the In-Lieu Fee, as they are two separate and unique methodologies.

The KMA Report recommends that the City use an index of the annual percentage change in new home values as the foundation of the annual in-lieu fee adjustments. A home's value is comprised of the land acquisition costs plus the construction costs plus the developer profit. The Real Estate Research Council of Southern California publishes the median price of newly constructed homes in Los Angeles County each year. The KMA Report recommends that the City revise the Resolution to require an annual update of the In-Lieu Fees and tie the update to the annual percentage change in new home values as published by the Real Estate Research Council. This will capture a comprehensive change in land acquisition and construction costs and can be administered efficiently.

*Recommendation No. 3:* Revise the Resolution to require an annual adjustment of the In-Lieu Fees based on the annual percentage change in new home values as published by the Real Estate Research Council.

**4. Extend the minimum term of the no-net-loss affordability covenants from 55 years to 55 years or the life of the project, whichever is longer, and remove the expiration date of 2025 (No-Net-Loss Ordinance).**

As with the inclusionary program, staff supports extending the affordability covenants until the end of the life of the project for units produced under the no-net-loss program. Staff also expects a housing affordability crisis to continue beyond 2025 and supports removing the expiration date of 2025.

*Recommendation No. 4:* Modify the covenant period from a 55-year term to 55 years or the life of the project, whichever is longer, for both rental and ownership no-net-loss replacement units and remove the expiration date of 2025.

**5. Require that all no-net-loss units be replaced onsite rather than offsite (No-Net-Loss Ordinance).**

Currently, the No-Net-Loss Ordinance allows replacement units to be located onsite or offsite. This applies to both the new construction of a residential building and a change of a principal residential use to another principal use, such as a commercial or commercial office use (Non-Residential). The offsite option is allowed only when affordable housing set-aside units are required pursuant to the City's inclusionary housing requirements, the units are located within two miles of the principal housing development project in an area with known displacement risk, and the construction of such units does not require the removal of more units requiring replacement. The Inclusionary Housing Ordinance does not provide a by-right option to provide offsite units but does allow a developer to provide an offsite plan for consideration by the City Council. When a project is proposed that consists of a Non-Residential use, it would be impossible to require onsite replacement. Also, there are a limited number of lots in the City where residential units cannot be replaced onsite, such as lots subject to sea-level-rise, flooding, or seismic risks that would prohibit new residential construction.

*Recommendation No. 5:* Modify the No-Net-Loss Ordinance to remove the by-right offsite option for residential projects and require that any offsite residential compliance plans be considered and approved by the City Council; and continue to allow the by-right offsite option for new Non-Residential projects.

This matter was reviewed by Deputy City Attorney Richard F. Anthony on October 20, 2021 and by Budget Management Officer Rhutu Amin Gharib on September 21, 2021.

**TIMING CONSIDERATIONS**

City Council action is requested on November 9, 2021, to allow these program changes to be made prior to the end of 2021.

**FISCAL IMPACT**

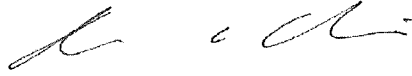
The proposed annual update to the Mello Act in-lieu fees will result in in-lieu fees more consistently attune to the housing market than the current triennial update. Given that Mello Act provisions have not been triggered in the last decade, an estimate of new revenues generated by an annual update cannot be estimated with accuracy at this time. The proposed fee adjustments will be reviewed as part of the Mid-Year Fees and Charges Schedule slated to go to the City Council for approval in mid-Fiscal Year 2022. This recommendation has no staffing impact beyond the normal budgeted scope of duties and is consistent with existing City Council priorities. There is no local job impact associated with this recommendation.

HONORABLE MAYOR AND CITY COUNCIL  
November 9, 2021  
Page 5 of 5

SUGGESTED ACTION:

Approve recommendation.

Respectfully submitted,



OSCAR W. ORCI  
DIRECTOR OF DEVELOPMENT SERVICES


ATTACHMENTS: ATTACHMENT A – JUNE 3, 2021 MEMO TO CITY COUNCIL  
ATTACHMENT B – KMA REPORT


APPROVED:



THOMAS B. MODICA  
CITY MANAGER

Date: June 3, 2021

To: Thomas B. Modica, City Manager 

From: Oscar W. Orci, Director of Development Services 

For: Mayor and Members of the City Council

**Subject: Update on Inclusionary Housing Report Back Items**

---

At its January 19, 2021 meeting, the City Council approved ordinances related to mandatory inclusionary housing as well as no-net-loss requirements, both related to housing construction in the City. As part of that action, the City Council requested changes to the inclusionary fee resolution for the use of all fees towards new units not on rehabilitation, which was effectuated and adopted by the City Council on February 2, 2021 alongside the second reading for the underlying inclusionary ordinance. The City Council also requested a report back within 120 days regarding additional policy refinements of those inclusionary and no-net-loss provisions to:

- Evaluate the affordability covenants for both inclusionary and no-net-loss ordinances being extended beyond 55 years to perpetuity or the life of the project.
- Evaluate a recommendation on how to ensure in-lieu fees captured from inclusionary housing rental projects are dedicated to the production of very-low-income units.
- Evaluate a tie of the in-lieu fees to an annual index based on construction and land costs.
- Remove the no-net-loss expiration date of 2025.
- Provide a recommendation to ensure that all no-net-loss units are replaced onsite rather than offsite.

On the same January 19, 2021 agenda, the City Council also continued consideration of the Mello Act Ordinance for updates related to similar issues of no-net-loss of housing units, determinations of affordability and income, as well as onsite versus offsite replacement. This report back was directed within 90 days (April 2021) but is now anticipated to be heard by the City Council in July 2021.

Delays on these items resulted from a complicated policy interconnection between the three ordinances (Inclusionary, No-Net-Loss, and Mello Act) and the need to resolve issues surrounding the Mello Act update prior to completing the inclusionary housing items. Additionally, some staff within the Department of Development Services (Department) were diverted to staffing Emergency Rental Assistance Program (ERAP) as well as the update to the City's Housing Element. More recently, the lead staff member responsible for coordinating these policy efforts transferred to the Office of the City Manager leaving a critical vacancy within the Department.

Notwithstanding any delays in report-back items, the City's inclusionary policy did become effective on March 4, 2021. All new entitlement requests within the affected Downtown and Midtown areas for projects of ten units or more are subject to inclusionary housing requirements and all projects citywide are subject to no-net-loss protections.

Staff have now analyzed all City Council requests related to inclusionary housing and no-net-loss. Based on that review and discussions with other jurisdictions, staff expect that all City Council requested changes can be made. Staff will be working with the Office of the City Attorney to bring amending ordinances back to the City Council prior to the end of the calendar year.

If you have questions, please contact Deputy Director of Development Services Christopher Koontz at (562) 570-6288 or [christopher.koontz@longbeach.gov](mailto:christopher.koontz@longbeach.gov).

CC: CHARLES PARKIN, CITY ATTORNEY  
DOUGLAS P. HAUBERT, CITY PROSECUTOR  
LAURA L. DOUD, CITY AUDITOR  
LINDA F. TATUM, ASSISTANT CITY MANAGER  
KEVIN JACKSON, DEPUTY CITY MANAGER  
TERESA CHANDLER, DEPUTY CITY MANAGER  
REBECCA GUZMAN GARNER, ADMINISTRATIVE DEPUTY CITY MANAGER  
MONIQUE DE LA GARZA, CITY CLERK (REF. FILE [#21-0041](#), [#21-0056](#))  
DEPARTMENT HEADS





**KEYSER MARSTON ASSOCIATES™**  
ADVISORS IN PUBLIC/PRIVATE REAL ESTATE DEVELOPMENT

## MEMORANDUM

**ADVISORS IN:**  
Real Estate  
Affordable Housing  
Economic Development

**BERKELEY**  
A. Jerry Keyser  
Timothy C. Kelly  
Debbie M. Kern  
David Doezenia  
Kevin Feeney

**LOS ANGELES**  
Kathleen H. Head  
James A. Rabe  
Gregory D. Soo-Hoo  
Kevin E. Engstrom  
Julie L. Romey  
Tim R. Bretz

**SAN DIEGO**  
Paul C. Marra

**To:** Patrick Ure, Bureau Manager  
City of Long Beach

**From:** Kathleen Head

**Date:** June 25, 2021

**Subject:** Inclusionary Housing Ordinance: Potential Modifications

At your request, Keyser Marston Associates, Inc. (KMA) reviewed the following items that the Long Beach City Council (City Council) flagged during the Inclusionary Housing Ordinance (Ordinance) adoption process:

1. The potential to extend the income and affordability covenants beyond 55 years to perpetuity or to the life of the project.
2. The advisability of pegging the annual in-lieu fee adjustment to an index based on construction and land costs.

### COVENANT PERIOD MODIFICATIONS

The adopted Ordinance imposes 55-year income and affordability requirements on both apartment and ownership housing development. The City Council has requested that the City of Long Beach (City) staff evaluate the impacts associated with increasing the covenant periods for both residential types to a perpetual requirement. The requested modification includes a provision that the covenant can terminate at the end of the life of the project.

It is KMA's opinion that significant differences exist in the characteristics of apartment versus ownership projects. As such, KMA evaluated the covenants issues separately for the two development types.



## Apartment Development

As was discussed in the KMA Inclusionary Housing: Financial Evaluation, the covenant period for Inclusionary Housing units in apartment projects is commonly set at 55 years. This covenant period is also applied by the California Government Code Section 65915 density bonus and the federal Low Income Housing Tax Credit program. However, both of these programs defer to longer covenant period requirements that are imposed by other governmental entities.

Recognizing the impact of tenant displacement at the end of a covenant period, a number of jurisdictions have established covenant periods in excess of 55 years. To maximize the benefits some programs have imposed covenants that remain in place in perpetuity. Although, a common caveat is that the covenant requirement terminates when the property is no longer put to a residential use.

### APARTMENT COVENANT STRUCTURING ISSUES

It is KMA's opinion that properly structured perpetual covenants can appropriately be imposed on apartment development for the following reasons:

1. Ownership Characteristics:
  - a. Apartment projects are originally developed by a single entity and are sold and resold to single entities.
  - b. Apartment tenants do not have an ownership investment in the project, and as such do not anticipate receiving profit when the project is sold and resold.
2. Impact on project value:
  - a. Prospective purchasers of apartment projects can factor the impact of the income and affordability covenants into their purchase price offer.
  - b. The Inclusionary Housing requirements are only imposed on 11% of the units in an apartment project. The other 89% of the units are not subject to any rent rate controls.

## APARTMENT COVENANTS RECOMMENDATIONS

KMA recommends that the covenants for the Inclusionary Housing apartment units should remain in place for as long as the property is developed with a residential use, but for not less than 55 years. To avoid constraining future planning efforts, the covenants should be allowed to be removed at some point following the initial 55-year period if the property is rezoned and subsequently put to a non-residential use. This recommendation comports with the standard the City Council identified for evaluation.

## Ownership Housing Development

### LONG-TERM IRREVOCABLE RESALE CONTROL ISSUES

The primary factors to consider in reference to long-term irrevocable covenants on ownership housing units are:

#### ***Limited Value Appreciation***

1. A home is typically the most valuable asset that a household owns. When a household purchases a home they anticipate that it will appreciate in value over time.
2. Homes that are subject to long-term irrevocable income and affordability covenants cannot be anticipated to generate a significant amount of appreciation. This is because the resale price is limited by the following factors:
  - a. The allowable home price is established based on a percentage of the Los Angeles County median income (AMI). The Los Angeles County AMI does not increase significantly from year-to-year.
  - b. Mortgage interest rates have been at generationally low rates for the past several years:
    - i. This positively impacts the mortgage amount that can be obtained by moderate income households, which increases the affordable sales price.

- ii. As mortgage interest rates increase, the affordable sales price decreases.
- c. Property tax increases are capped at 2% per year, while the other costs associated with home ownership tend to increase at an inflationary rate.

The combination of the preceding factors severely constrains the opportunity for the home owner to receive appreciation on the resale of their home. In fact, it is possible for the affordable sales price to decrease over time, particularly as mortgage interest rates increase. In recognition of these constraints, purchasers of homes that are subject to irrevocable income and affordability covenants demand a significant discount from the prevailing market rate prices.

### ***Maintenance and Capital Improvements***

- 1. Each home is individually owned by households with varying levels of financial capacity.
- 2. Each homeowner chooses the level at which they will maintain and improve their home.
- 3. The combination of the limited appreciation potential and increasing housing costs creates an implicit disincentive for home owners to invest in capital improvements to their home.

### **OWNERSHIP HOUSING COVENANTS RECOMMENDATIONS**

The KMA Inclusionary Housing: Financial Evaluation recommended that that the covenant period for ownership housing units be set at 45 years. KMA further recommended that the first resale of the home could be at an unrestricted market price. In return, the home owner would be required to repay to the City the affordability gap that existed when the home was originally purchased plus a proportionate share of the equity appreciation that was achieved when the house is resold at a market rate price.

The City Council ultimately decided to impose irrevocable resale controls on the Inclusionary Housing units over a 55-year period. This is longer than typical, but it falls within the range of covenant periods imposed by Inclusionary Housing programs being implemented in California.

For the following reasons KMA believes that the imposition of perpetual resale controls on ownership housing units creates an onerous burden on the home owners the program is meant to assist:

1. In cases where the allowable resale price is less than the amount the home owner paid for the Inclusionary Housing unit there is potentially an incentive for the home owner to allow their mortgage to go into default.
2. The limited potential for appreciation implicitly creates a construct where Inclusionary Housing ownership units will be subject to a lack of capital investment which will ultimately negatively impact the surrounding neighborhood.

### IN-LIEU FEE ADJUSTMENT METHODOLOGY

It is KMA's opinion that the objectives that should be applied in selecting an index to use for updating the in-lieu fee schedule annually are:

1. The update methodology should be simple and easily administered;
2. The terms of the update should be clear and objective, not subject to interpretation; and
3. The update should be tied to a readily accessible and neutral third-party published source.

The City Council objective is to establish an in-lieu fee adjustment mechanism that to an index based on construction and land costs. The following table describes commonly used indices that are readily available for use in adjusting the in-lieu fee amounts each year:

Potential In-Lieu Fee Adjustment Indices			
Index	Concept / Description	Advantages	Disadvantages
Construction Cost Index (CCI)	Fees go up or down based on changes in building construction costs  Published by Engineering News Record (ENR)  Available as a national average for 20 cities, including Los Angeles	Very well established  Consistent fee burden is imposed relative to changes in construction costs	May not trend with changes in development cost components such as land and soft costs  May not trend with the cost associated with producing affordable units
Building Cost Index (BCI)	Also published by ENR and similar to the Construction Cost Index, but with weighting towards structural costs	Very well established  Consistent fee burden is imposed relative to changes in construction costs	The CCI is likely the more appropriate of the two ENR indices since it more closely tracks labor costs
Consumer Price Index (CPI)	Published by the United States Bureau of Labor Statistics.  Available for major metropolitan areas	Very well established  Tracks with inflation generally  Produced by a neutral government agency	May not trend with construction costs, or the cost to produce affordable housing units

Based on the identified advantages and disadvantages of the three common indices, the CCI provides the best indicator of changes in residential construction costs. However, none of these indices includes a factor for changes in land prices. To our knowledge, there is not a published index that takes land values into account. To include land value in the in-lieu fee adjustment process, the City would need to independently research land prices throughout Long Beach each year.

It continues to be KMA's recommendation that the City use an index of the annual percentage change in new home values as the foundation of the annual in-lieu fee adjustments. This recommendation is based on the following factors:

1. A home's value is comprised of the land acquisition costs plus the construction costs plus the developer profit. Thus, the home's value represents a good surrogate for the effective cost of the home.
2. The Real Estate Research Council publishes the median price of newly constructed homes in Los Angeles County each year; and
3. The annual adjustments to the in-lieu fee schedule are meant to be applied over a relatively short period of time. It is anticipated that every five years the City will re-evaluate entire Inclusionary Housing program.