Mixed Income Housing Advisory Group:

Workforce Housing Options in Los Angeles

Considerations for the City of Los Angeles

ULI Los Angeles

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About ULI Los Angeles

ULI–the Urban Land Institute is a 501(c) (3) nonprofit research and education organization supported by its members.

Founded in 1936, the institute now has more than 40,000 members worldwide representing the entire spectrum of land use and real estate development disciplines, working in private enterprise and public service. The members of the Urban Land Institute are community builders, the people who develop and redevelop neighborhoods, business districts, and communities across the United States and around the world.

As the preeminent, multidisciplinary real estate forum, ULI facilitates the open exchange of ideas, information and experience among local, national and international industry leaders and policy makers dedicated to creating better places.

The mission of the Urban Land Institute is to provide leadership in the responsible use of land and in creating and sustaining thriving communities worldwide.

Members say that ULI is a trusted idea place where leaders come to grow professionally and personally through sharing, mentoring, and problem solving. With pride, ULI members commit to the best in land use policy and practice.

ULI Los Angeles stands for the best in land use policy and practice in the counties of Los Angeles, Ventura, Kern, San Luis Obispo, and Santa Barbara. Continue to celebrate with ULI Los Angeles and the difference we are making as we endeavor to raise the bar of leadership in this region as to the responsible use of the land.

Acknowledgements

ULI Los Angeles wishes to thank the Advisory Group members for providing their expertise and knowledge to the development of these recommendations. We would also like to extend our gratitude for our national ULI Housing experts for their guidance and advice: John McIlwain, Sr. Resident Fellow, ULI and J. Ronald Terwilliger Chair for Housing; and Richard Haughey, Senior Research Director, ULI's Center for Balanced Development in the West. In addition, this program could not have been made possible without the ULI Los Angeles Land Use Leadership Committee under the direction of Co-Chairs John Whitaker, Ron Altoon, and Mitchell Menzer. We would also like to thank Dhiraj Narayan, Senior Financial Analyst at Forest City Development, for providing his expertise on financial considerations for the real estate industry.

About the Mixed Income Housing Advisory Group

In response to this proposal, the Urban Land Institute, Los Angeles District Council (ULI LA) through its Land Use Leadership Committee, created a Mixed Income Housing Advisory Group to provide a private sector, market sensitive perspective to this policy proposal. The Advisory Group is comprised of local developers with significant development experience in the production of affordable housing. In addition, ULI LA has involved national and local housing experts who have authored numerous articles and books on the subject of affordable housing and who have completed substantial national research on the topic. ULI LA and the Advisory Group are providing this analysis as a resource and tool for decision makers.

Members of the Mixed Income Housing Advisory Group

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Workforce Housing Options for Los Angeles

Urban Land Institute, Los Angeles District Council

Executive Summary

December 2008

The City of Los Angeles is enduring a critical affordable housing shortage. In response to increasing concerns about the impact this condition places on the growth and health of our economy, "Los Angeles: Housing That Works" has been introduced by the Mayor's office to address this issue. In this blueprint for housing, a commitment to a 5-Year Action Plan is proposed which includes a series of recommendations to leverage city resources, to encourage public/private partnerships, and to build and preserve affordable housing for working people. A key element of this proposal is to introduce a Mixed Income Housing Policy that seeks to mandate inclusionary housing requirements for all new developments over a certain size.

In response to the proposed housing plan and specifically mixed income housing element, the Urban Land Institute, Los Angeles District Council (ULI LA) through its Land Use Leadership Committee convened a group of seven experienced, local developers of mixed-income development projects and recruited ULI national housing experts to participate in the ULI LA Mixed Income Housing Advisory Group. The goal of the ULI LA Mixed Income Housing Advisory Group is to provide the City of Los Angeles with a market sensitive, private sector voice into the process of developing the mixed income housing policy. The Advisory Group began by asking the following question: "What is the right mix of incentives/programs that will enable private sector builders to build affordable housing in Los Angeles?"

The findings of the Advisory Group are broken into three sections:

1) **10 Principles for a Mix of Housing –** general policy principles aggregated from a national template of cities for consideration in crafting an Inclusionary Zoning policy;

2) **Development Feasibility Criteria** –development cost considerations which clarify project feasibility as determined by a developer/builder;

3) **Los Angeles Market Considerations** – summary conclusions from the Advisory Group as to what considerations could be made in proposing an inclusionary zoning ordinance in the City of Los Angeles.

There are many positions that have emerged over the issue of inclusionary zoning in Los Angeles; however, the purpose of the Group is to inform the decision makers in the formulation of this policy.

ULI LA is committed to contributing toward the responsible use of land and to that end providing assistance in the City's effort to identify feasible options to the preservation and development of housing that is affordable in the City of Los Angeles.

Workforce Housing Options for Los Angeles

ULI Los Angeles

In Los Angeles, the affordable housing challenge is a perpetual and ever-constant public policy issue of debate. However, for thousands of people and families living in Los Angeles, it is a basic, essential need for safe and adequate housing. In a bold response to this critical issue, the Mayor of Los Angeles has introduced a housing plan to directly address the problem. In “Los Angeles: Housing that Works - A Housing Plan for LA’s Families,” programs to combat the foreclosure crisis and homelessness conditions of the City have been outlined. A key element of the plan is a proposal to address the production of affordable housing in the form of a “Mixed Income Housing Policy.” As outlined in the plan, the Mixed Income Housing Policy serves as a method to ensure the development of housing for various income levels through a mandatory, inclusionary requirement for new developments over a certain size throughout the City of Los Angeles.

In response, the Urban Land Institute, Los Angeles District Council (ULI LA) through its Land Use Leadership Committee, created a Mixed Income Housing Advisory Group to provide a private sector, market sensitive perspective to this policy proposal. The Advisory Group is comprised of local developers with significant development experience in the production of affordable housing. In addition, ULI LA has involved national and local housing experts who have authored numerous articles and books on the subject of affordable housing and who have completed substantial national research on the topic. ULI LA and the Advisory Group are providing this analysis as a resource and tool for decision makers. As equal investors in the health and vibrancy of the Los Angeles real estate economy, ULI LA offers these recommendations for consideration.

The findings of the Advisory Group are organized in three sections. The first section is titled “10 Principles For A Mix of Housing.” The principle author, John McIlwain, Senior Resident Fellow and J. Ronald Terwilliger Chair for Housing at ULI, provided the template upon which these principles can be adapted for Los Angeles. The second section is a development assumptions checklist that identifies a series of development indicators which clarify project feasibility as determined by a developer or builder. The checklist is a tool to assist decision makers in understanding the perspective of the developer and the considerations they go through in pursuing a project. The last section, "Los Angeles Market Considerations," is a series of unique real estate and development factors decision makers might consider in moving the Mixed Income Housing Policy agenda forward. These observations are offered by the Advisory Group to identify areas for further discussion, however, these are not the only issues.

The goal of the ULI LA Mixed Income Housing Advisory Group is to provide decision makers with critical information in developing a mixed income housing policy for the City of Los Angeles. In addition, ULI LA is committed to extending its resources – both in terms of real estate professionals and research data – to the efforts of the City and work in partnership to meet the housing needs of our growing community.

Section I

10 Principles for a Mix of Housing

[Adapted from "The Mix of Housing," by John McIlwain, Senior Resident Fellow, ULI/J. Ronald Terwilliger Chair for Housing, *Multifamily Trends*, September/October 2007]

In an effort to address the affordable housing need in cities throughout the country, there is on-going debate about the use of inclusionary zoning and it is not going away. The run-up in housing prices and rents in the past ten years has so outstripped incomes for the majority of Americans that moderate-income households are being pushed out of the communities in which they work. Even with the correction of the housing market, housing prices will not return to the ratio of incomes-to-housing prices of the more affordable levels of the 1990's.

The response from local governments has been to consider mandatory inclusionary zoning as they struggle to find tools to allow teachers, police officers, firefighters, young families and others to continue living near where they work. In fact, mandatory inclusionary zoning can be one of the most effective tools to provide affordable housing. However, it is not the only tool, and not the only solution, but an effective addition to an overall policy and a set of tools to address this endemic challenge.

The key to creating a successful inclusionary zoning program is to understand what does and what does not work, then bring together developers, both for-profit and nonprofit, with housing advocates and local officials to make sure that an ordinance is written properly. When the private sector simply opposes inclusionary zoning, the result all too often is that a law is passed anyway but with the wrong provisions.

The following 10 Principles can result in an ordinance that everyone can live with happily, and that will produce a reasonable number of affordable units. They are intended to be a basis for crafting an ordinance that has the potential of working for all concerned – homebuilders and developers, housing advocates, local governments, and most importantly, homebuyers and renters.

If one thing is clear, it is that there is no one ordinance that can serve as a model for all communities: each ordinance needs to be designed for local conditions. It is the process of creating an ordinance that will determine its success or failure over time.

Principle One: Do No Harm

The worst thing a community can do is further restrict its housing market with an inclusionary zoning ordinance that reduces the financial incentives to the private sector to build housing. This will only limit the supply of housing, further driving up home prices and rents.

In order to encourage the production of housing, it is necessary to keep the return on investment at least the same with an inclusionary zoning ordinance as it would be without one. This is essential in order to keep investors putting their money to work building homes in communities.

The only way the profit from building homes can remain the same with or without inclusionary zoning is to provide offsetting incentives, such as density bonuses, housing trust funds, tax abatements, reduced impact fees or other fees, accelerated processing, or subsidies.

Los Angeles Market: All housing markets are local. In a city as big and complex as Los Angeles there are numerous local housing markets with a wide variety of conditions. Sensitivity to how the program impacts the overall Los Angeles housing market is critical. Given the disparate market conditions of various parts of the City, consideration should be given to avoiding possible unintended negative consequences that could affect one neighborhood more than another.

Principle Two: It Only Works in Strong Markets

There are not many strong markets in the U.S. right now, so this is not a good time to implement a new program. It is, however, a very good time to begin the process of designing a program to put in place when a healthy market returns, which may well be 2010 in many parts of the country.

Los Angeles Market: As noted in Principle One, given the size and complexity of Los Angeles, it is difficult to craft one policy that applies equally across the City. While the overall market is generally weak, some markets are stronger than others calling for flexible program requirements that vary by neighborhood. Again, possible unintended negative consequences could affect one neighborhood more than another.

Principle Three: Make It Mandatory

This is important from the developers' perspective and makes the program far more effective than if it is voluntary. There are two advantages for mandatory programs over voluntary programs:

1. Developer realizes what requirements are being imposed on the development before buying the site, knowing more clearly how much to pay for it.
2. A mandatory program provides a level playing field because there is less room for negotiations with the local government – negotiations that can result in one development cutting a better deal than another.

Mandatory programs are also better for communities than voluntary programs simply because experience shows that mandatory programs produce far more affordable housing than voluntary ones. Properly crafted, they can also be simpler to administer.

Los Angeles Market: Given the size, complexity, and market variations within its own City boundaries, the City of Los Angeles would benefit from a regional approach to addressing the housing issue. In this arena, Los Angeles could serve in a leadership capacity to work with regional entities and other cities to develop a coordinate response to the housing crisis.

In addition, the concept of certainty is far more important than the issue of mandatory vs. voluntary. Certainty lowers risk and lower risk allows for more affordability.

Principle Four: Target the Affordable Units to the Workforce

Workforce housing is generally defined as housing for teachers, police officers, and other government workers, as well as young families starting out and moderate-income workers in all sectors. The incomes of these groups are often in the range of 60-120% of the area median income (AMI), or even more in some very-high cost areas. The upper range depends on the local housing market and local incomes.

These households may not be able to afford housing produced by the private market, but they can pay more than lower-income families. More affordable units thus can be produced through an inclusionary zoning ordinance. Where it is deemed desirable to include lower-income families, additional local subsidies can be provided for more affordable units. It will take fewer subsidy dollars to bring the cost of housing down to a level that lower-income households can afford if the dollars are applied to units already made less expensive by an inclusionary zoning program.

Los Angeles Market: In the City of Los Angeles, the workforce housing benefits would assist more working families seeking to purchase homes if the income levels were increased to 150% or 200% of AMI. Given the incomes of the targeted groups and the conditions of our local market, increasing the range to the upper levels may be an effective tool in providing access to affordable housing to more working families. Providing housing for this group is as much an issue of maintaining the economic viability of the City as it is an issue of fairness.

Principle Five: Keep It Simple

Keep the process simple. Each time a developer has to meet with the local administrator, time is added to the approval process, adding costs to both the development and the administration of the program.

Los Angeles Market: Significantly limiting discretionary review will potentially eliminate the need to negotiate the terms of the policy on a project by project basis therefore saving time and money.

Principle Six: Allow Buyouts Only Under Limited Circumstances

One of the great benefits of inclusionary zoning is that it creates mixed-income developments and communities. The history of affordable housing in the U.S. has shown that mixed-income housing is very successful, and that it provides benefits for the families in affordable housing that they would not receive were they living in developments isolated from market-rate households.

Inclusionary zoning ordinances that allow developers to pay a linkage fee instead of including affordable units in their developments can easily result in all the affordable units produced by the program being located far away in a lower-income part of the community. Limiting developers' opportunities to buy out of the program allows communities to avoid this problem.

Another option is to require a developer that has a good reason not to include the affordable units in a development to build the units nearby – within a quarter to a half a mile of the project. Often in these circumstances a developer will partner with a local nonprofit to build, own, and operate the affordable housing – a solution that both helps the developer and supports the local nonprofit housing community.

There are circumstances in which it may make sense to not include affordable units in the actual development. High-rise luxury condominium buildings located in high-cost downtown areas are often problematic, given the high costs of construction and high monthly fees and amenity charges they entail. When a developer is allowed to pay a fee instead of including the units in the development or constructing them nearby, the fee should go directly to a housing trust fund that is actively financing development of affordable housing mixed-income properties.

Los Angeles Market: An off-site option within the community plan area could be a reasonable alternative to reaching the goals of affordable housing production.

Principle Seven: Inclusionary Zoning is Only One Arrow in the Quiver

As useful as a well-designed inclusionary zoning ordinance can be in creating affordable housing, it will not solve the problem to meet the need for affordable housing units. Each community needs its own comprehensive housing plan to find the best way to meet the needs of all its citizens.

A housing plan should include a number of programs to provide housing that is affordable to people at all income levels and ages. Inclusionary zoning will contribute affordable units that would not otherwise be developed, but it needs to work in combination with other tools and programs to make a real dent in meeting this growing challenge.

Los Angeles Market: As the City is developing a range of programs to keep Los Angeles affordable to live in, it should also develop a method of evaluation to determine the right mix of strategies that best accomplish its housing goals. Tracking and monitoring the production and preservation of affordable units can assist in improving the programs that work and removing the programs that do not. This same assessment should also be applied to the mixed income housing policy proposal.

Principle Eight: Preserve the Affordability, But Not Forever

The affordability of the units created by an inclusionary housing program needs to be preserved, but for how long? This is a question with no one right answer, although there are certain general principles to consider.

With regard to homeownership units, there is tension between maintaining the affordability over time and allowing unit owners to share in any home price appreciation. There are many ways to keep the homes affordable and give a share to the homebuyers. This is an area where the issue has to be hammered out locally; looking at the many creative ways other communities have accomplished this is valuable. Administration of the program sharing home price appreciation can be simplified by placing the agreed-upon requirements in the deed or as an easement on the property.

The process for keeping rental units affordable is fairly straightforward, and the requirements can also be placed in the deed to the property. The most contentious question is how long the affordability of the units should be maintained. A restriction of 30 years is the general rule because units are likely to need complete renovations around that time. Some jurisdictions are moving to permanent affordability, but the impact of this on the long-term physical and financial well-being of the properties has not been tested.

The community does need to have an active oversight program to ensure that units remain rented to people with the required incomes. It may be easier to use the same oversight rules that are used for the Low Income Housing Tax Credit Program because they are well tested and widely understood by the rental industry and government regulators.

Los Angeles Market: In the City of Los Angeles, inclusionary zoning applied to the for-sale housing market is significantly challenged due to the high cost of land. In urban markets like Los Angeles where the land is scarce and the holding costs are low, land owners are unmotivated to sell or sell at a low price. Therefore, the impact of this policy on the for-sale housing market could be substantial.

Principle Nine: Be Generous with Incentives

It is important not to reduce the return on investment that developments provide if the investment is to continue to flow into housing. As we have seen, market conditions can change in a few months—a far shorter period than it takes a local legislative body to react. Therefore, benefits should be designed to be generous; they may be overly liberal in some conditions and then become tighter later. The goal is to keep producing housing so that affordable units can be provided as well.

Los Angeles Market: The complex real estate market of the City of Los Angeles is unique and therefore creating a robust range of incentives is critical to support the production of affordable units. One consideration might be to retool the LA Housing Trust Fund to enable a larger pool of developments to benefit from the program without adequate subsidies or incentives.

Principle Ten: It is All About The Process

There is no one model program a community can copy from somewhere else. Each inclusionary zoning ordinance has to be specifically crafted for local conditions. This requires a process that includes developers and builders, housing advocates, and local government officials working together toward a common goal. There will be numerous points of disagreement, but if these 10 Principles are generally agreed to, the likely result will be an ordinance that developers and builders can support, and one that achieves the goals of housing advocates and local officials as well.

It is sometimes useful to bring in a person or group to help facilitate this process and to guide the discussion. Such a person or group needs to know how inclusionary zoning works and to have the confidence of housing advocates, builders, and the local government. A local ULI District Council can effectively play this role, supported by ULI North America. Another group that has been effective in helping craft well-balanced inclusionary zoning ordinances is Policy Link, a national nonprofit organization. The National Housing Conference and its affiliate, the Center for Housing Policy, support such a policy as well.

Los Angeles Market: The development of a mixed income housing policy or inclusionary zoning program is an opportunity for all stakeholders (public, private, and community) to engage in the process of designing a program that meets the needs of its residents. It is important to create a policy that promotes housing that is affordable by a range of people and will provide the flexibility for on-going production and preservation of affordable units.

Full article text: "The Mix of Housing," by John McIlwain, Senior Resident Fellow and J. Ronald Terwilliger Chair for Housing at ULI, *Multifamily Trends*, September/October 2007

Section II

Development Feasibility Criteria

In making decisions to pursue a project, developers evaluate proformas to determine if the project is financially feasible. The proformas include development costs (hard and soft) and project income. In every project, there are a range of reasonable development costs that are assumed.

In evaluating the impact of an inclusionary zoning requirement on new developments, the ULI LA Mixed Income Housing Advisory Group considered a series of baseline assumptions. The proformas were reviewed for only for residential projects, not mixed-use projects which are typical development types found in urban markets. The parking ratios were calculated to meet market demand. Importantly these assumptions are made in a stabilized real estate market which may not occur until 2010.

The following are proforma assumptions for Type V wrap, low rise apartment and Type III podium, mid-rise apartment construction.

<u>Type V Wrapped Development Product – typical project of 120 units @ 60 DU per acre (non-CBD areas)</u>

Market Rate			Per Net Sq. Foot	Per Dwelling Unit (Avg SF 725)
	Rent (Avg SF 725)	$2.25 pnsf		
	Operating Expense	30% of EGI		
	Parking per stall	$20,000 (1.5 per unit)		
Hard Costs	Site, Parking, Owner/GC Contingencies		$270	$197,000
Soft Costs	A/E, Permit Fees, Marketing, FF&E (furniture, fixtures, equipment), Legal, Accounting		$76	$55,000
Financing Costs	Finance costs and Interest Reserve		$28	$20,000
	Total Development Cost		$375 psf	$272,000 per unit

Type III Podium Development Product – typical project of 230 units @ 115 DU per acre (CBD areas)

Market Rate			Per Net Sq. Foot	Per Dwelling Unit (Avg SF 725)
	Rent (Avg SF 725)	$2.75 psf		
	Operating Expense	30% of EGI		
	Parking per stall	$35,000 (1.5 per unit)		
Hard Costs	Site, Parking, Owner/GC Contingencies		$325	$235,000
Soft Costs	A/E, Permit Fees, Mkting, Legal, Accounting		$76	$55,000
Financing Costs	Finance costs and Interest Reserve		$34	$25,000
	Total Development Cost		$435	$315,000 per unit

For the purposes of this exercise and to establish the baseline, *the proforma assumptions did not include the following:*

1. Land Costs –Land costs were assumed to be $0.
2. Prevailing Wage – No prevailing wage costs were included in the proforma baseline evaluation. In addition, no community benefits package costs were included. Based on discussions with industry experts, prevailing wage costs increase 15-20%.
3. Entitlement costs – No entitlement costs (pre-development or project approvals) were included. Fully entitled land is assumed. Entitlement costs can run between 4-6% of the total development cost.
4. Financing costs – No financing costs or interest costs were included.

Again, the proforma assumptions illustrate the costs of construction in a stabilized market. The purpose of the development assumptions checklist is to provide decision makers with inputs that comprise a project. The caveat is that these proforma assumptions do not include any of the forementioned costs which can be steep. As previously noted, land costs in urban districts tend not to decrease as limited land supply holds land values steady. Coupled with low holding costs, land owners are not motivated to sell or sell at a lower value. Prevailing wage is also a cost that was not included but does place an additional constraint on the proforma. Given the anticipated conditions of a protracted down market, this could be an opportunity to explore ways to ensure development continues and construction jobs are maintained in Los Angeles.

In addition, entitlement costs can add millions of dollars to the pre-development budget. These costs include environmental analysis, legal counsel, architectural and engineering expenses and overhead to move the project forward. And last, no financing or interest costs were included in the proforma assumptions.

Market Rate Threshold Returns

The Developer looks at certain return metrics in their underwriting of development deals. These include the Return on Cost (Net Operating Income over Total Development Cost), Return on Equity (Net Operating Income less Debt Service/Equity in the deal), or an Internal Rate of Return over a holding period of 3 to 5 years. If these returns meet their threshold requirement, then the developer will be motivated to proceed with the deal.

In today's world, returns are thin even with no inclusionary zoning requirement due to insufficient market rents that can offset the high land and construction costs. Therefore, any inclusionary zoning requirement will require sufficient offsetting mechanisms which render it cost or revenue neutral to developers.

The difficulty in the real estate finance market is simply that financing becomes too risky for investors to invest in development deals. As commercial lenders are now requiring 60% and in some cases nearly 50% equity from the developer in the deal, developers are struggling to find ways to finance their projects. The current challenge is knowing what the real estate recovery will look like and when will the economy emerge from recession. Because that future is hard to predict, investors, lenders and developers are more likely to sit on the side line and wait until conditions improve or at a minimum are more predictable than they are today.

In considering an inclusionary zoning policy at this time, it is important to carefully evaluate all of the potential impacts on real estate development. The development assumptions checklist is intended to provide information to decision makers about how developers determine project feasibility. There are many moving parts in any development deal. Therefore, factoring in the impact of affordable housing requirements with no financial incentive or mechanism to fill the gap of those additional costs, the outcome could be the reverse of the policy objective which is produce more housing.

One relevant and informative article clearly outlined the effectiveness of an inclusionary zoning ordinance from a public sector perspective which is provided below.

Predicting the Effectiveness of an Inclusionary Zoning Ordinance		
	Generous Economic Incentives	***Few Economic Incentives***
Strong Market	-Very Effective -Minimal Impact on Market Rate Housing Prices	-Moderately Effective -Significant Impact on Market Rate Housing Prices
Weak Market	-Moderately Effective -Minimal Impact on Market Rate Housing Prices	-Ineffective -Minimal Impact on Market Rate Housing Prices

Source: Read, Dustin, "The Potential Advantages and Disadvantages of Inclusionary Zoning Ordinances," p. 24[i].

As previously stated, developers evaluate proformas to determine if the project is financially feasible. And in every project, there are a range of reasonable development costs that are assumed. Including new costs that are not offset in some way either through financial incentives or other mechanisms could result in severe impacts on development. The key to an effective inclusionary zoning policy is to provide generous economic incentives to avoid causing a negative impact on the Los Angeles housing market.

[i] "The Potential Advantages and Disadvantages of Inclusionary Zoning Ordinances," A Report Prepared by the Center for Real Estate and the Metropolitan Studies Group at UNC Charlotte, Dustin Read, 2008.

Section III – Part I: Los Angeles Market Considerations

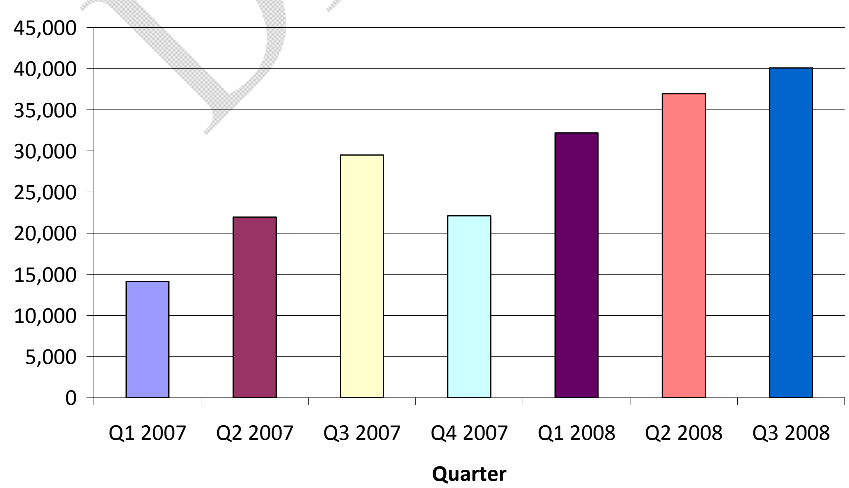
The deterioration of the Los Angeles real estate market over the past year has resulted in a staggering series of regional economic impacts. The ripple effect has yet to be fully realized as the fallout continues to impact sector after sector and spilling over to every community in the region. For these reasons, the national and local economic conditions need to be considered as significant factors affecting the Los Angeles real estate market.

Los Angeles Statistics

Housing Market

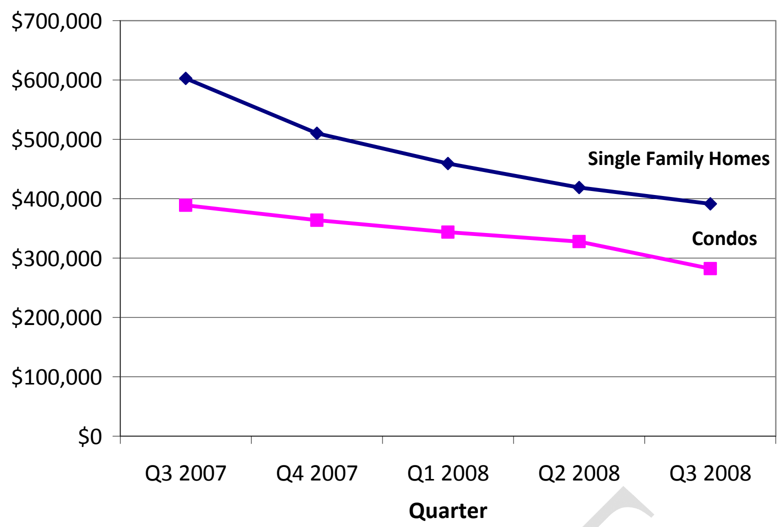
In the third quarter of 2008 alone, over 40,000 homes in Los Angeles were in foreclosure which represents nearly 1 in 304 housing units[i]. It is predicted that foreclosures will continue to affect the Los Angeles housing market well into 2010[ii]. In September 2008, the median home price in Los Angeles had fallen to $360,000, a drop of 31% from the previous year. Rents are falling as unemployment rises and condo rentals enter an already inventory rich rental market.

Number of Foreclosures in Los Angeles/Long Beach area



Source: Extrapolated from quarterly REALTYTRAC® U.S. Foreclosure Market Reports, 2007-2008

Median Sales Price of Existing Homes

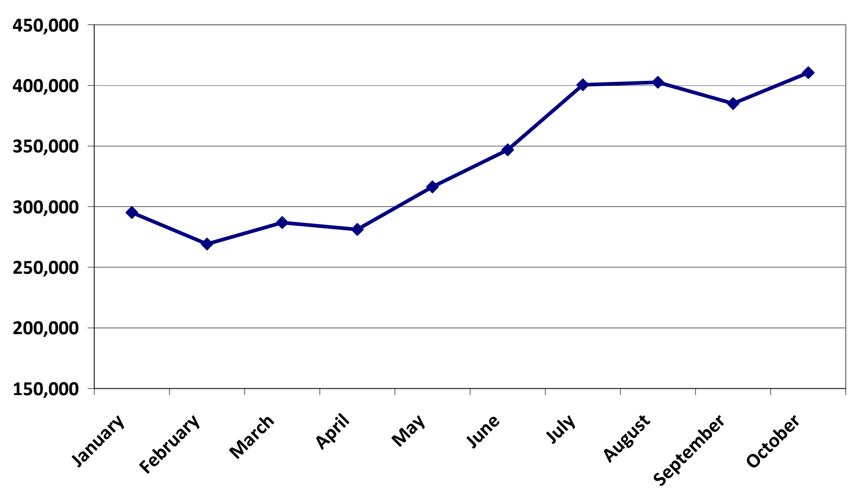


Source: National Association of REALTORS®, Nov. 2008

Unemployment

The real estate industry affects sectors far beyond the core areas of development and construction. The collapse of the financial markets and mortgage lending institutions and the start of the recession have resulted in historically high unemployment levels and a weakened job market. Unlike other parts of the state, Los Angeles stands to fair better than other cities due to its diverse employment base but the blow to the economy will be severe.

2008 Unemployment Numbers in Los Angeles County



Source: California Employment Development Department, Nov. 2008

Construction Costs

As the real estate development industry reels from the turmoil of the financial markets, construction costs (for hard costs only) are predicted to slowly drop as financing for development becomes more difficult to secure and equity requirements are trending toward a 50% loan-to-value. However, construction costs are relatively unchanged despite these issues and are a major impact when calculating the development costs of a project. According to construction industry leaders, the following are cost estimates as of October 2008[iii]:

Hard Cost Estimates Only
Type V - $150-165 per gross square foot
Type III - $165-180 per gross square foot
Retail - $150 per gross square foot (shell only)

Given the harsh economic realities of Los Angeles – the devaluation of the entire housing market, increasing unemployment levels, and construction costs – the prognosis for near term (2-3 years) recovery is significantly handicapped. While this will not be the permanent state of affairs, all indicators point to a withdrawal of development projects from the pipeline and in some cases withdrawal of projects currently in the entitlement process.

Land Costs

One of the biggest challenges to development in the Los Angeles market is the cost of land. While the land prices are beginning to fall in other parts of the region, in urban markets like Los Angeles, land values are very slow to change downward where the land is scarce. The result is that developers are required to overpay for land, a cost that then passed on to the buyer or renter resulting in higher sales prices or higher rents.

One important distinction in Los Angeles is the surplus of land zoned for commercial development. As residential development is taking place in commercially zoned corridors due to a lack of multi-family zoned areas, land owners are able to choose the more favorable option of a commercial development which imposes less regulatory requirements than residential development. A reduction in land values resulting from mixed income requirements can cause land owners of commercially zoned land to hold out for commercial development rather than convert to a residential development unless there are adequate incentives or subsidies.

Challenges in Predicting the Outlook of the Next Real Estate Cycle

The ULI LA Mixed Income Advisory Group has incorporated the current market conditions affecting development into their observations. The members of the Advisory Group recognize that although these conditions are temporary, the assumption is that market stabilization will return albeit possibly as late as 2010. One thing is clear -- a permanent restructuring of the housing market is underway.

The challenge at this point is to predict the outlook of the next real estate cycle. When will the debt markets open up and return to making investments in real estate? What will be the new financing terms on future development deals? What will the mortgage lending industry look like? Will there be an adjustment in land costs and if so, at what level?

These and other questions remain unanswered but in spite of these conditions and for the purposes of informing the process of developing a mixed income housing policy, there is still an urgent need to identify how to ensure the availability of affordable housing in the City of Los Angeles.

[i] RealtyTrac, California Foreclosures, October 2008 data, website reference.
[ii] *Emerging Trends 2009*, ULI/PricewaterhouseCoopers Annual Report.
[iii] Morley Builders, Mark Montoya, Phone Interview November 25, 2008.

Section III – Part II: Los Angeles Market Considerations

The City of Los Angeles has enacted some well-known strategies to increase affordable housing production. These include the creation and funding support of the L.A. Housing Trust Fund and density bonuses to encourage development of affordable units. In fact, there are currently a number of areas where 'inclusionary' programs exist. These include the project areas of the Community Redevelopment Agency of Los Angeles with a general requirement standard of 15% minimum and in certain specific planning areas which have proven to be effective tools in the production of affordable housing in the City. However at this time, these tools are insufficient to meet the affordable housing needs of today or in the future, either in preserved or newly produced units.

In the Mayor's "Housing That Works" plan, several proposals have been outlined to supplement the City's toolbox of programs designed to meet the targeted affordable housing goals for Los Angeles. As it pertains to the Mixed Income Housing Policy proposal, there are many factors that should be considered in weighing the implementation of an inclusionary zoning ordinance. The ULI LA Mixed Income Housing Advisory Group has considered the proposal and offers the following observations.

Inclusionary Zoning

There are many issues that should be factored into the decision to pursue a mixed income, inclusionary zoning policy. The ULI LA Mixed Income Housing Advisory Group referred to recent publications on the topic to examine the advantages and disadvantages of inclusionary zoning. In Los Angeles County, nine cities have enacted inclusionary zoning ordinances with both mandatory and voluntary structures[v]. According to one instructive article on the topic, following the evaluation of a variety of ordinances, the final conclusion was that the results were mixed when it comes to actual production of affordable housing[vi]. The determining factor for successful outcomes was the careful crafting and implementation of the policy.

As the City contemplates this policy proposal, the ULI LA Mixed Income Housing Advisory Group offers the following for consideration:

1. **Target the Goal**

If the desire is to focus on the preservation and production of housing for households with incomes at 60-120% of AMI, the *target of the deliverables for the program* may be directed toward that range of housing assistance to gain the greatest outcome given the goal of the policy. Therefore, focusing the incentives toward those goals will transform the 'sticks' into 'carrots' thereby releasing the development value into the market place. The case could also be made that the income range should be extended to 150% of AMI based upon the incomes of the targeted groups and the conditions of the Los Angeles market.

2. **Layer the Incentives**

The *layering of the incentives* makes phenomenal sense given the tools that are available to public entities for housing assistance. While this is discussed in the proposed Mayor's Housing Works Plan, specifically creating bundles of funding buckets makes it easy for the developer to pursue a package deal and therefore pursue a development deal. For example, coupling transit funds, tax credits and other agency funds can make a deal more lucrative and attractive for developers to pursue. The time may be ripe to explore the restructuring of the L.A. Housing Trust Fund to enable a larger pool of projects to obtain funding from the program therefore assuring an ongoing production of affordable units.

3. **Phased Strategy for Implementation**

Given the current market conditions, real estate development is going to be stagnant for a while. Therefore, crafting a *gradual, market sensitive policy* that provides an appropriate amount of time for the real estate industry to get back on its feet again is a sensible consideration given the economic environment. It also demonstrates a real willingness to reach the objectives of the policy in the spirit of partnership with the development community.

4. Connect the Transit Dots

Part of a phased strategy could begin with transit nodes as initial focus areas leveraging existing infrastructure to reveal unseen opportunities. For example, the first phase could be a directive that zeros in on all transit nodes (bus rapid transit, light rail and subway) and elevates those areas for initial implementation. One tool could be to immediately *relax onsite parking requirements or place parking maximums* which would potentially reduce the full development cost of the project. In addition, given that the cost of transportation per person in Los Angeles is nearly 14% of a household budget, a significant savings could be seen by working families through transit.

5. Program Flexibility will Deliver Results

According to the research and experts, *the key to creating a successful program is flexibility*. Designing a program that enables a variety of ways for developers to comply is critical. This can include flexibility in design standards and amenities, in lieu fees, property tax abatement, and fee waivers. It is important to consider that flexible design allowances for the affordable units could potentially shave hefty development hard costs therefore making the project more feasible. These are only a handful of the numerous tools public entities can control in the process.

An important and sensitive area is the prevailing wage requirement that can significantly handicap a development project by adding between 8-15% to the costs of the project depending on the size and construction type of the building. With the prognosis that the real estate industry will struggle for potentially 18-24 months, it may be in the best interests of all concerned to engage in constructive dialogue to meet the policy objectives of the City.

6. Consider Acquisition of Covenants

The *acquisition of covenants on existing privately owned apartments* could also be a tool for the protection of housing affordability throughout the City. Potential investors and affordable housing companies could participate in the acquisition of covenants on existing privately owned buildings or of covenants on units with the goal of creating and maintaining a supply of workforce and affordable housing in different neighborhoods. The Mayor's "Housing That Works" plan outlines a preservation strategy toward affordable housing but this concept supplements the preservation of existing stock and gradually increases the pool of affordable units in the future.

7. Role for Regional Collaboration

The Mayor's "Housing That Works" plan is ambitious and it proposes many initiatives. One additional role that *Los Angeles could play is as a regional conveynor* by exploring affordable housing solutions beyond the boundaries of the City. The urgent nature of the issue requires a regional response and with landmark land use legislation such as SB 375, the need for regional stewardship on critical matters such as quality, affordable housing is ground zero for a vibrant, healthy economy. The opportunity presents itself for leadership in this arena from the largest City in the region.

These observations are made by the ULI LA Mixed Income Housing Advisory Group as a step forward in promoting housing which is affordable. This is not the final list nor is it the only list of observations but merely points worthy of a discussion. It is critical to understand the implications of the policy and to ensure that both positive and potentially negative impacts of the proposed policy are fully evaluated.

ULI LA Mixed Income Housing Advisory Group

Conclusion

The mission of the Urban Land Institute is to provide leadership in the responsible use of land. To that end, the ULI Los Angeles District Council (ULI LA) through its Land Use Leadership Committee convened an expert group of respected developers to participate in the ULI LA Mixed Income Housing Advisory Group. In addition, ULI LA recruited housing leaders from our headquarters in Georgetown to assist in the effort thereby assembling the best team possible for the task at hand. The issue on the table is the Mixed Income Housing Policy, a key element of the Mayor's "Housing That Works" plan. However, the goal is much larger than merely addressing a policy proposal. It is to reckon with the largest issue facing families in our city, our region, and at this time, our country.

Universally and without question, all participants in this process support and believe in access to adequate and safe housing for all. The preservation and production of affordable housing is the cornerstone of a healthy economy. Today, the housing industry is literally under assault by global financial currents that have not yet taken their final toll but the impact continues to roll through neighborhoods in every community. For every foreclosed home, a new window emerges for an opportunistic buyer but at the terrible cost of a displaced worker or family.

In order to move in this direction for increased affordability in light of the current financial conditions, the ULI Los Angeles Mixed Income Advisory Group puts forth a critical question: "What is the right mix of incentives and or programs that will enable private sector builders to build affordable housing in Los Angeles?" An Inclusionary Zoning Policy will only work with a) a strong market and b) an economically meaningful package of incentives.

Based on the Advisory Group's analysis, there is no simple answer to solving the affordable housing crisis, however, there are options to explore. Working in partnership with public, private and community stakeholders, the City can begin to weave together the best designed strategy for Los Angeles – a strategy that meets the demands for affordable housing and meets the feasibility requirements for the developer and investor alike. It will take the best ingenuity combined with sheer persistence, but there is a will to find a solution, and therefore there is a way.

As it has been noted, there are many positions that have developed over the years on the issue of inclusionary zoning in the City of Los Angeles. The goal from the beginning of the ULI LA Mixed Income Housing Advisory Group was to inform the decision makers in the formulation of this policy objective.

In providing this analysis and in assembling the team of experts, ULI LA provides this contribution toward the City's effort to identify feasible options to the preservation and development of affordable housing in the City of Los Angeles.

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[v] "Can Inclusionary Zoning be an Effective and Efficient Housing Policy? Evidence from Los Angeles and Orange Counties." Mukhija, Vinit, Lara Regus, Sara Slovin, and Ashok Das, @2008, pp. 9.
[vi] "The Potential Advantages and Disadvantages of Inclusionary Zoning Ordinances," A Report Prepared by the Center for Real Estate and the Metropolitan Studies Group at UNC Charlotte, Dustin Read, 2008.

ABOUT THE COMMITTEE

Tom Cody

Cody is Principal with Gerding Edlen Development, headquartered in Portland, OR. He is responsible for Gerding Edlen's California real estate development and specializes in large scale, mixed-use, urban development and are environmentally responsible development. Gerding Edlen Development have completed approx $4B and have another $3B currently in development.

Cody is a former Director of Development of Opus NW and a board member of the Architectural Foundation of Oregon.

John Given

Given is a Principal, Development at CIM Group in Los Angeles. For over 30 years, Mr. Given has worked on building partnerships between public development agencies and private real estate development companies engaged in high priority redevelopment projects and transit-oriented development.

Prior to joining CIM, he was the City Planner for Greeley, Colorado He has also served at the Los Angeles Community Redevelopment Agency .

Given is a founding board member of the Hollywood Entertainment District and was chairman of the City of Santa Monica Housing Commission.

Con Howe

Howe as the Managing Director of CityView's $150 million Los Angeles Fund partners with homebuilders and developers to entitle land and build workforce housing in greater Los Angeles. CityView, founded by Henry Cisneros, has financed over 7000 units of housing in over 40 projects in California and throughout the United States.

Previously Howe was Director of the Urban Land Institute's Center for Balanced Development in the West.

Howe served as the Director of Planning for the City of Los Angeles from 1992-2005.

Ehud Mouchly

Mouchly is Vice President and General Manager of UniDev, LLC's West Coast Office. UniDev is a national leader in the design, development, financing and management of workforce housing communities.

He is a real estate industry veteran, with over 30 years' experience in development, management and financing of master planned communities (MPCs), mixed-use development projects (MXDs) and public/private ventures. Ehud has been the owner of READI, LLC, and General Manager of Anaverde / City Ranch.

Dan Rosenfeld

Rosenfeld is a Founding Principal at Urban Partners, LLC, an entrepreneurial real estate firm focusing on urban infill and transit-oriented developments in the Western United States.

He worked previously with The Cadillac Fairview Corporation, Tishman/Speyer Properties and Jones Lang LaSalle.

Rosenfeld served as an appointee of Governor Wilson and Mayor Richard Riordan, directing the real estate operations of the State of California and City of Los Angeles.

Renata Simril

Simril is Senior Vice President of Forest City Residential West, a subsidiary of Forest City Enterprises, Inc. The company is an owner, developer and manager of a diverse portfolio of premier real estate located throughout the nation, with approximately $9 billion in total assets.

Simril is responsible for managing and implementing Forest City's residential businesses in the Southern California region.

Prior to joining Forest City, Simril served as Deputy Mayor for Housing and Economic Development in the Hahn Administration.

Bill Witte

Witte is the President and Managing Partner of Related California, one of the largest developers of urban and multifamily housing in the state. Related currently has over 6,000 units of affordable and mixed-income housing, and 3,000 units of market-rate housing developed or under development in California. It has developed projects in San Francisco, Oakland San Jose, Los Angeles, San Diego, and the Counties of Los Angeles, Orange, San Bernardino and San Diego. Related has $1 billion of development under way in California in addition to the $2.7 billion Grand Avenue project.

ABOUT THE NATIONAL HOUSING EXPERTS

John McIlwain

McIlwain is the Senior Resident Fellow/J. Ronald Terwilliger Chair for Housing at the Urban Land Institute in Washington, D.C. He leads ULI's research efforts to seek and promote affordable housing solutions in the U.S. and other nations, including development and housing patterns designed to create sustainable future environments for urban areas.

Prior to joining ULI, McIlwain founded and served as Senior Managing Director of the American Communities Fund for Fannie Mae in Washington. In this capacity, he was responsible for structuring, underwriting and closing equity investments in more than $700 million of residential and neighborhood retail developments in lower-income communities around the country.

He previously served as executive assistant to the Assistant Secretary for Housing/Federal Housing Commissioner at the U.S. Department of Housing and Urban Development.

Rick Haughey

Haughey is the Senior Research Director for the ULI Center for Balanced Development in the West. The center, located in downtown Los Angeles, focuses on infrastructure, climate change & sustainability and workforce housing in the Western region. Prior to working at the center, he served as ULI's Director of Multifamily Development. In this position, he was project manager or author of numerous books, publications and articles including six editions of *Dollars and Cents of Multifamily Housing*.

Haughey's areas of expertise include workforce housing and higher density development. He previously worked as a real estate market analyst and Chief of Redevelopment and Land Use for a suburban Maryland county.

ABOUT THE LAND USE LEADERSHIP COMMITTEE

Mitchell Menzer

Menzer is a Partner in the Paul Hastings Los Angeles office and a member of the firm's Global Real Estate Group.

He represents investors and developers in all aspects of real estate transactions, including land use and entitlement matters, joint ventures, acquisitions and dispositions, financing, equity investments, environmental issues and construction contracts.

Menzer served on the Los Angeles City Planning Commission from 2000 to 2004 and was the President of the Commission 2002 – 2003. During that time, he served on the Mayor's Development Advisory Group and the Mayor's Industrial Land Task Force.

He chairs the board of the Center for Creative Land Recycling and serves on the California Advisory Board of the Trust for Public Land.

John Whitaker

Whitaker is a Partner at DLA Piper US LLC. He practices in the areas of sale, acquisition, and development of real property, including transfers of excess density rights and negotiation of agreements with redevelopment agencies. He also advises clients on eminent domain issues affecting their property. His clients include domestic and foreign developers of major downtown Los Angeles.

Some of his clients include: The Related Companies, CIM Group, The South Group, IDS Real Estate Group, Moinian Group, Merco Group and Park Fifth Associates.

Whitaker was previously a member of the TFAR Task Force which developed the City and CRA policies on transfers of floor area rights between downtown property sites for commercial projects.