



County of Santa Cruz

REDEVELOPMENT AGENCY

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TOM BURNS, AGENCY ADMINISTRATOR

April 22, 2002

Agenda: May 7, 2002

Board of Directors
County of Santa Cruz Redevelopment Agency
701 Ocean Street
Santa Cruz, CA 95060

Consideration of Incentives for Constructing Second Units

Dear Members of the Board:

During the October 2, 2002 Housing Workshop presentation and as part of the subsequent Housing Action Plan (presented November 6, 2001), the Board requested both Planning and Redevelopment staff to explore potential approaches to broaden the interest in developing more affordable housing through County's Second Unit Ordinance. On April 9, your Board considered policies allowing second unit construction on agriculturally zoned properties. On May 21, your Board will consider a report from the Planning Department on amnesty for second units. This letter reports on staff's findings regarding financial incentives for second units and provides recommendations for the Board's consideration.

Background

Last fall's housing workshop clearly outlined the housing crisis looming in Santa Cruz County. As a follow-up to the workshop, the Board set a goal of creating new lower income housing opportunities through a number of means, one of which is to place a stronger emphasis on creating new affordable rental units through the Second Unit Ordinance.

Recent Board letters reporting on the operational history of the Second Unit Ordinance indicated that the Ordinance has generally not resulted in creating new affordable rental units. Planning Department reports found that less than half (37%) of the second unit applications have resulted in units actually built since the Ordinance's adoption in 1984. Additionally, most of the second units created were preexisting second units legitimized through the resolution of code enforcement issues or built to house persons who are related to or are in stable family relationship with the property owner.

The November 6, 2001 Housing Action Plan supporting documents discussed some of the potential reasons why the second unit yield is so low. Feedback from property owners suggested that the rent level specified by the Ordinance does not provide adequate income

to cover the amortized cost of fees, unit pre-development, development and construction. Others indicated that tenant income screening and long term annual reporting and monitoring requirements are burdensome and discourage second unit construction. Your Board responded to these concerns by directing staff to explore options for the financial assistance for second unit construction.

Cash Flow Analysis

In order to verify feedback and comments on disincentives for second unit construction, and to structure any Agency financial assistance, staff evaluated the financial feasibility of building second units. Staff first established a reasonable estimate of all the costs to develop and construct a second unit. We then compared the developer's potential monthly loan payment to finance these development costs with the monthly rent for second units, required by the County's Second Unit Ordinance to be set at an affordable level for low income households.

Staff found that the monthly expenses to cover debt service payments needed to finance total development and construction costs and operational and maintenance costs for a typical second unit is roughly equivalent to the current restricted rent levels. Therefore, currently there are few financial incentives for building second units as low income rentals.

Review of Incentives for Creating More Second Units

Santa Cruz is not the only County experiencing problems with making second units more financially feasible. Staff reviewed incentives offered by other jurisdictions facing the challenge of creating economically feasible second units. Examples of incentives which can make second units more economically attainable include:

1. Providing financial and/or technical assistance to encourage second unit development and improve their affordability, particularly for property owners willing to commit to renting units to lower income households.
2. Providing priority processing for second units and encouraging second unit construction through simplifying the permit review process.
3. Permitting second units without discretionary permits in some cases if they meet all standards relating to size, parking, height, location and design etc.
4. Working with water and sanitation districts to allow shared meters for second units.
5. Pre-designing a "prototype" or model unit which meets all design requirements and provide that applicants using the designed model receive accelerated processing.
6. Removing the low income restrictions for second units by allowing rent levels to go to market rate.

Second Unit Financing Proposal

Almost all of the alternative incentives outlined above, whether through accelerated processing or additional forms of assistance, are aimed at lowering the cost of creating second units to a level where the costs can be supported by anticipated rents. One initial step, which has been raised by the Board, is for the Agency, through its Low and Moderate Income Housing Fund, to provide direct financing to second unit projects that result in a commitment to creating a low income rental unit.

Staff has explored a range of approaches to accomplish such financial assistance. At this time we are suggesting that a pilot program be established that would provide up to \$15,000 of Agency financing be available to property owners wishing to create a new low income rental second unit for the purpose of reimbursing direct costs for County fees, including discretionary, capital improvement, and building permit fees. This financial assistance would be in the form of a 0% loan, forgiven 1/20th per year. Staff recommends that your Board approve funding of \$150,000 for a Pilot Second Unit Program for FY 2002-03. This measure would have a similar impact to an initiative currently being explored in the City of Santa Cruz which would result in waiving fees as an incentive for second unit construction.

It is important to understand that any Agency restrictions attached to such assistance will need to work in concert with the current permit requirements for second units. While the County process allows such units to be rented to lower income households (at restricted rent levels) or family members (without regard to income or rent levels), the Agency's assistance would need to be restricted to only those units intended to be operated as lower income rentals.

Because of changing family circumstances or differing desires of changing owners, however, this program will need to provide some degree of flexibility. Rather than require a permanent commitment to operating a low income rental unit, we believe that the program should allow a homeowner to opt-out and allow the conversion of the unit to a non-income eligible family member as allowed by the County's Ordinance. In such an event, however, the property owner would be required to repay the Agency's loan. As well, such a loan structure would allow the Agency a straightforward enforcement mechanism (calling the loan due) in the case of discovering that an Agency-assisted unit is no longer being operated as a low income rental unit.

Need for an Interim Program

The staff recommendation for an interim, rather than permanent program at this time is prompted by a number of considerations. First, the program needs to be tested. Financial incentives alone may not be sufficient to stimulate an increase in second unit construction. In such a case other incentives or additional financial assistance may be required.

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Given the potential for second units to be developed in both the urban and rural areas and distributed throughout the unincorporated County, second unit development is an important housing strategy for the community. In addition, an effective second unit program will help meet the Housing Element's new housing goals. As a result, we are recommending an interim program be developed at this time, and the results of this program will be used to determine the type of long term recommendations made on second units.

Finally, there are emerging legal issues concerning second unit ordinances throughout the State. In several instances, ordinances regulating second units have been legally challenged, including our local ordinance. The core issue is whether such a legal challenge could undermine our current regulations which limit occupancy of such units to only family members or low income households. These emerging legal issues need time to be fully resolved as their resolution may ultimately affect the types of occupancy and affordability restrictions currently required by local jurisdictions in their second unit ordinances.

Conclusion/Recommendation

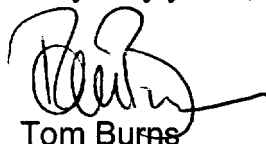
Construction of Second Units is a key component of the County's Affordable Housing strategy. Combining a pilot program to provide financial assistance to low income rental second units with other pending land use regulatory changes could make this program far more productive over time. The recommended interim program will allow a number of other key actions to progress to a point where additional program modifications will be appropriate.

It is therefore RECOMMENDED that your Board, as the Board of Directors of the Redevelopment Agency, take the following actions:

1. Approve an interim second unit financing program with a total allocation of \$150,000 for FY 2002-03 as outlined in this letter;
2. Authorize the Agency Administrator to institute a Second Unit Loan Program and approve loans consistent with this program, as outlined in this letter; and
3. Direct the Agency Administrator to report back to the Board no later than May of 2003 with a status report on the effectiveness of the pilot program and any recommendations for second unit financing program continuation or modification.

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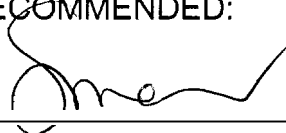
Very truly yours,



Tom Burns

Redevelopment Agency Administrator

RECOMMENDED:



Susan A. Mauriello

Redevelopment Agency Director

cc. RDA

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