



## **CITY OF MENIFEE**

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SUBJECT: Menifee Housing Studies

MEETING DATE: June 19, 2024

TO: Mayor and City Council

PREPARED BY: Doug Darnell, Principal Planner

REVIEWED BY: Cheryl Kitzerow, Community Development Director

APPROVED BY: Armando G. Villa, City Manager

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### **RECOMMENDED ACTION**

1. Review and discuss the Housing Market Impact Study and Inclusionary Housing Feasibility Study and provide direction to City staff.

### **DISCUSSION**

#### **Background – Menifee Housing Element/Affordable Housing Considerations**

The City adopted its 6<sup>th</sup> Cycle Housing Element update in November 2022, as required to comply with State law. The Housing Element includes goals, policies, and programs to promote and accelerate production of housing and accommodate the City's housing need from 2021 to 2029.

From the City's recent 2023 Annual Housing Element Progress Report, Table 1 on the following page reflects the City's progress towards meeting its housing production requirement, known as the Regional Housing Needs Allocation (RHNA). This is the number of housing units the City is required to accommodate for the 6<sup>th</sup> Cycle Housing Element eight-year planning period (2021-2029). As shown in Table 1, the City has already exceeded its RHNA requirement for the above-moderate income category, however, is producing very few units in the affordable income categories.

Table 1: Building Permits Issued – Number of Units by Affordability – 6 <sup>th</sup> Cycle							
Income Category	RHNA	2021	2022	2023	2024 – 2029 (future)	Total Units to Date	Total Remaining RHNA
Very Low	1,761		4			4	1,757
Low	1,051		4			4	1,047
Moderate	1,106	1	5	14		20	1,086
Above Moderate	2,691	287	892	1,575		2,754	0
<b>Total RHNA</b>	<b>6,609</b>	<b>288</b>	<b>905</b>	<b>1,589</b>		<b>2,782</b>	<b>3,890</b>

No affordable housing units restricted to a specific affordability level have been built since the City's incorporation. The existing affordable units in the City do not count towards meeting the City's 6<sup>th</sup> Cycle lower income RHNA requirement because units must be built during the 6<sup>th</sup> Cycle Housing Element planning period (2021-2029) to count as production of housing units to accommodate the City's 6<sup>th</sup> Cycle RHNA.

Building affordable housing generally requires a multi-faceted approach that may include:

- Substantial funding, such as Federal HOME Investment Partnerships (HOME) Program funds, Community Development Block Grant (CDBG), Permanent Local Housing Allocation (PLHA) Program, etc.
- Successor Agency/Housing Authority-owned sites - Older cities that formerly had redevelopment agencies with 20 percent set-aside of their tax increment funds for developing affordable housing were able to continue development of affordable housing, as successor agency housing authorities.
- Available sites at higher densities within proximity to activity areas and with few environmental constraints (City of Menifee Housing Element Program Action 42, requiring the City to evaluate existing adopted density standards and development regulations for higher density residential development. Based on the outcomes of this evaluation, the City will propose amending the Zoning Code to increase density and development standards to further support the development of housing affordable to lower income residents.).
- Density Bonus provisions (City of Menifee recently updated for greater increases per State law with a Development Code amendment).
- Inclusionary Zoning and In-Lieu Fees– Inclusionary Zoning (IZ) refers to a range of policies and practices that mandate or provide incentives for the inclusion of affordable housing units in new developments or an in-lieu fee collected to encourage mixed-income neighborhoods and increase the supply of affordable housing.
- Linkage Fees - Linkage fees are a form of impact fee assessed on new commercial developments or major employers based on the need for workforce housing generated by new and expanding businesses. Revenues generated by the fee are then used to help fund the development of affordable housing opportunities within accessible commuting distance to the employment center.

- **Local Housing Trust Funds** – Local housing trust funds are dedicated funds that are held in trust to be used to provide affordable housing. The agencies that administer them can take many forms, such as a local housing department, a multi-city agency, or a private nonprofit organization. In July 2021, the Governor signed Assembly Bill (AB) 697 (Seyarto) into law to authorize the creation of the Western Riverside County Housing Finance Trust, a joint powers authority, for the purposes of funding housing, specifically assisting the homeless population and persons and families of extremely low, very low, and low income within the County of Riverside. This fund has yet to be established but could be in the future through collaboration with the Western Riverside Council of Governments (WRCOG) and Western Riverside County jurisdictions.

### **Discussion/Analysis – Menifee Housing Studies**

The City of Menifee Housing Element includes Program Action 29 (Housing Market Impact Study) to evaluate housing impacts and barriers to affordable housing in the City, and Program Action 30 (Inclusionary Housing Feasibility Study) to evaluate the feasibility of and identify an appropriate method or approach to consider adoption of an inclusionary ordinance. The Housing Market Impact Study and Inclusionary Housing Feasibility Study discussed in this report fulfill and implement Program Action 29 and 30 of the City's adopted 6<sup>th</sup> Cycle 2021-2029 Housing Element.

In late 2022, the City issued a Request for Proposals (RFP) for a consultant to prepare the Housing Study to fulfill Program Actions 29 and 30 of the Housing Element. Following a procurement process (review and rating of proposals and consultant interviews), in February 2023 the City selected PlaceWorks as the consultant to prepare the studies.

The studies reflect input from stakeholders including market-rate homebuilders, affordable housing developers, lenders, and realtors. City staff and PlaceWorks conducted interviews with each of these stakeholder groups in June 2023.

### **Housing Market Impact Study**

The Housing Market Impact Study assesses the overall demand for housing development in Menifee, the economic and market conditions underpinning that demand, and the types of housing that are needed. It also addresses constraints and barriers to affordable housing in the City. The Study provides baseline analysis, needs and gap analysis, barriers analysis, and policy strategy recommendations including:

- National and Regional Housing Market Context
- Menifee Housing Market
- Forecasts and Gap Analysis
- Recommendations

The continued entitlement for and construction of single-family detached housing and interviews with developers indicate that the City imposes no undue barriers to this portion of the market. In contrast, the analysis indicates that the market produces only limited development of single-family attached and multi-family housing. The developer interviews suggest that this is a market effect, which the City can do little to address. However, there are two local factors that may influence the production of these types of housing. In general, the Market Study concludes that:

- Generational and household demographics are steadily changing into smaller household sizes, in line with national trends.
- The City of Menifee still allows for “attainable housing” for single-family detached housing.
- There is not enough single-family attached or multi-family housing in the City, and the City should explore further opportunities to expand its High Density Residential (HDR) land use/zoning within proximity to activity centers.

### **Inclusionary Housing Feasibility Study**

The purpose of the Inclusionary Housing Feasibility Study is to help the City better understand how potential inclusionary housing requirements would impact the feasibility of new residential development. The goal of the Study is to determine how the City could best produce meaningful numbers of affordable housing units without imposing requirements that create a hardship for development of new projects and ultimately result in less development. With this goal in mind, the analysis considers the following:

- Feasibility of various levels of inclusionary requirements.
- Success with inclusionary ordinances in other jurisdictions and compare their housing market conditions to Menifee.
- The cost of providing affordable housing to determine an in lieu-fee.

Important considerations of the Inclusionary Study include:

- Balancing the interests of developers against the public benefit created by the production of affordable units.
- Ensuring inclusionary housing requirements do not deprive housing developers of a fair and reasonable return on their investment.

For clarification, an inclusionary study **is not** a nexus study for a development impact fee. Rather, a feasibility study for an inclusionary ordinance calculates the cost of providing affordable housing and determines an in lieu-fee to overcome the financing gap to produce an affordable housing unit.

**Development Scenarios** The Inclusionary Study evaluated six residential development prototypes that are representative of new and planned market-rate development in Menifee. The scenarios reflect generalized development patterns that are typical and/or allowable under current planning and zoning requirements of the City to provide a generalized indication of an inclusionary housing requirement. The six scenarios include:

- Large lot single-family detached housing
- Small lot single-family housing
- Townhouses
- Condos
- For-rent multi-family apartments
- For-rent mixed-use multi-family apartments and stand-alone commercial

The analysis of the above prototypes includes: 1) an estimation of typical market-rate sales prices and rents for each scenario product type; 2) calculation of the sales prices and rents reflecting affordable housing payments for the inclusionary units; 3) calculation of the percentage of units that could be designated as inclusionary housing units while maintaining project financial feasibility; and 4) calculating the Internal Rate of Return with the payment of in-lieu fees rather than constructing inclusionary units. From this analysis, the Study provides an affordable housing gap calculation based on recent affordable housing projects in Riverside County in 2022, as shown in Table 2 below.

Table 2 – Affordable Housing Gap Calculation	
Average Development Cost per Unit (Avg. of RivCo affordable housing)	\$405,157
Less Average Bank Financing per Unit (conventional financing)	-\$81,221
Less Average Tax Credit Equity per Unit (Federal tax credits)	-\$175,317
<b>Affordable Housing Gap per Unit</b>	<b>\$148,619</b>

From the gap calculation above and adjusting for inflation based on the Consumer Price Index (CPI), the Study estimates an in-lieu fee of **\$154,372** per affordable unit would be required to overcome the expected financing gap.

*Evaluation of Various Levels of Inclusionary Units Required* State law allows the California Department of Housing and Community Development to review inclusionary housing requirements over 15 percent, so the analysis first considered the impact of a 15 percent inclusionary requirement. It found that the provision of affordable housing should be financially feasible for medium-density townhouses and multi-family apartments. However, the other four residential development product types would not be financially feasible. The analysis also considered lower inclusionary housing requirements. It found that a five percent inclusionary housing requirement should be financially feasible for most residential development product types, with the exception of vertical mixed-use, at this time. If the City were to adopt an inclusionary housing requirement, it likely would not apply to the approximately 8,000 currently entitled but not yet constructed dwelling units, but likely would apply to the anticipated 22,800 housing units yet to be entitled and built under General Plan build-out.

The Study looked at affordable unit potential at various inclusionary requirement levels ranging from a five percent to a 15 percent inclusionary requirement:

- A **15 percent** inclusionary requirement could generate **3,420** housing units for low and very low incomes
- A **10 percent** inclusionary requirement could generate **2,280** housing units for low and very low incomes
- A **5 percent** inclusionary requirement could generate **1,140** housing units for very low incomes

Per the Housing Study, the City will need to consider the following key decisions, if it chooses to move forward with an inclusionary program/ordinance:

1. *Percentage of Affordable Units* – What percentage of new residential units should be affordable? The City would have a wide latitude in setting the inclusionary requirement. From a solely financial feasibility perspective, the analysis suggests an inclusionary requirement of five percent of housing units affordable to low income and very low-income households.
2. *Minimum Project Size* – An inclusionary ordinance would need to establish a minimum project size to be subject to the inclusionary housing requirement. The analysis suggests that development projects with ten or more housing units would have to provide affordable housing.
3. *Alternative Means of Compliance* – The City would need to identify one or more alternative means of compliance. The most common alternative is the payment of an in-lieu fee. The analysis suggests an in-lieu fee of \$154,372 per affordable housing unit required. This amount should provide the City with enough funding to leverage affordable housing developers to construct the required affordable housing units offsite, most likely in a fully affordable housing project. With a five percent affordability requirement, this fee would be \$7,719 per market rate unit, or \$3.23 per square foot of finished floor area (i.e., excluding garages). Table 3 below provides an example of how an in-lieu fee would work with a 100-unit residential project with a five percent inclusionary requirement.

Table 3 – 100-Unit Project Example
5% Inclusionary Requirement = 5 affordable units required
Developer opts to pay the in-lieu fee
5 units x \$154,372 = \$771,860 inclusionary fee (\$7,719 per unit of a 100-unit development project)
Fee per square-foot = \$3.23 based on an average unit size (2,389.7 sq. ft.)

In addition to the above, the City may wish to consider exempting for-rent housing from the inclusionary requirement in order to create an incentive for multi-family housing.

### **Inclusionary Requirements of Other Jurisdictions**

Most neighboring cities in the Western Riverside County region do not have inclusionary housing ordinances, and for some of them, affordable housing is made possible in other ways, such as through a housing authority with an inventory housing/successor agency-owned properties set aside for affordable housing projects, higher density zoning/more urban, and greater access to funding resources such as Federal HOME funds (Menifee does not qualify for HOME funds). Examples of various inclusionary requirements are provided in the attached “Inclusionary Housing Requirement Examples.” The attachment also includes information on a recent City of Riverside proposal to adopt an inclusionary ordinance. Since many neighboring jurisdictions do not have inclusionary requirements, the examples provided are those of jurisdictions most local to Menifee (five in the Inland Empire within approximately 20 to 40 miles of Menifee).

### **Inclusionary Zoning Pro/Con**

The upside of an inclusionary requirement (provided there is enough flexibility offering an in-lieu fee alternative or other alternatives), is that it will eventually lead to production of affordable housing units, which are not currently being built in the City. At this time, new residential developments in the City are exclusively built by market-rate developers and are primarily single-family residential units only affordable to above-moderate income households.

The downside of inclusionary requirements is that the added cost to market-rate developers to pay an in-lieu fee could reduce the production of market-rate housing and overall production of housing. Additionally, added costs of an in-lieu fee could be passed along to future homebuyers in an already strained market. This could price potential market-rate buyers out of the market, making housing less affordable overall.

### **Outreach Efforts**

On March 21, 2024, staff provided a summary overview of the studies to the Developer Stakeholder Group. The group understood the City's need to study the issue and to recommend ways to provide low-income housing. On April 22, 2024, the consultant and City staff provided an overview of the study recommendations to the local Building Industry Association (BIA) board representatives providing opportunity for questions and input. The BIA appreciated the City's effort and expressed concerns with the potential for an inclusionary ordinance to impact total production of market rate housing/overall production of housing, as well as adding increased costs to be passed along to future homebuyers in an already strained market. The BIA also expressed that an in-lieu fee requirement be minimized to the extent possible.

### **Planning Commission**

On May 22, 2024, staff presented the studies to the Planning Commission. The Commission acknowledged a new in-lieu fee may have an impact on the cost of housing, however providing housing for all residents is appropriate. The Commission was supportive of looking more into the options for providing affordable housing as well as other tools available.

### **Conclusion/Recommendation**

Options for next steps may include:

- Prepare inclusionary housing ordinance per study recommendations.
- Prepare inclusionary housing ordinance with modification to study recommendations.
- Other follow-up actions, such as other programs identified above such as linkage fees, local housing trust or other, in conjunction with or prior to moving forward with an inclusionary ordinance.
- No further action at this time, receive and file reports.

### **STRATEGIC PLAN OBJECTIVE**

Thriving Economy

### **FISCAL IMPACT**

There is no fiscal impact associated with the recommended action. Fiscal impact associated with Council direction for further study, or amendment to the Development Code would include staff time and associated costs related to that effort.

### **ATTACHMENTS**

1. Menifee Housing Study
2. Inclusionary Requirement Examples