The Economics of Land Use

Report

Market and Development Feasibility Analysis of Inclusionary Housing Requirements in Montebello

Prepared for:
San Gabriel Valley Council of Governments
City of Montebello

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1. Executive Summary

Introduction

Inclusionary housing programs require that new market-rate residential development projects include a certain percentage of housing units at rents or sale prices that are affordable to lower-income households. These programs also may include the option for new development to pay a fee in-lieu of providing affordable units on-site, as an alternative means of compliance. Inclusionary housing programs are one of many tools cities can use to achieve more affordable housing in their communities. These programs are also often referred to as "inclusionary zoning" because such policies are implemented through the zoning code.

Economic & Planning Systems, Inc. (EPS) was retained by the San Gabriel Valley Council of Governments (SGVCOG) to conduct an inclusionary housing economic feasibility study on behalf of the City of Montebello (City). The study is intended to identify and understand the impacts that inclusionary housing program requirements would have on the economic feasibility of building new, market-rate housing in the City. The intention of the study is to assist the City in adopting policies that balance the simultaneous goals of creating more affordable housing while continuing to encourage market-rate housing development, so as to best serve the needs of all City residents.

Background Context

The State of California requires every jurisdiction to adequately plan for its community's housing needs, as specified by the Regional Housing Needs Allocation (RHNA). The RHNA breaks down the amount of housing units needed in each jurisdiction by income category, ranging from Very-Low Income to Above Moderate Income. The definitions of the State's income categories are provided in more detail in the following sections of this report.

Currently, jurisdictions within the Southern California Association of Governments (SCAG), which includes Los Angeles County, have adopted or are working towards adopting their 6th Cycle (2021 through 2029) Housing Elements, which contain policies and strategies required to meet current RHNA numbers. The City of Montebello has a certified 6th Cycle Housing Element as of July 11, 2022, and is currently in compliance with State housing law, as determined by the Department of Housing and Community Development (HCD).

Montebello has a RHNA of 5,186 total units, representing 4.4 percent of the overall allocation for the San Gabriel Valley cities. **Table 1** displays the City's RHNA breakdown by income levels.

Table 1 RHNA for Montebello

Affordablility Category	Units	Percentage
Very Low Income	1,314	25.3%
Low Income	707	13.6%
Moderate Income	777	15.0%
Above Moderate	2,388	46.0%
Total	**5,186**	**100.0%**

Source: SCAG; Economic & Planning Systems, Inc.

Montebello's Housing Element includes a program (Program 8) to adopt an Inclusionary Zoning and Density Bonus Ordinance within one year of adoption of the Housing Element. The program indicates that the proposed Inclusionary Zoning Ordinance will require, and the proposed Density Bonus Ordinance will provide incentive for new development to include percentage of affordable housing on larger sites within the high resource areas.

Study Objectives

This economic feasibility analysis tests whether new market-rate residential development in San Dimas is financially feasible, and if so, whether it can absorb the additional financial impact of an inclusionary requirement. Such an analysis is intended to provide cities with additional context regarding the implications of adopting inclusionary requirements – namely, whether the additional cost associated with an inclusionary requirement is too great for new residential projects to absorb, thereby rendering new residential development in the city extremely challenging or even completely financially infeasible. While cities are generally not legally required to consider these financial impacts when adopting an inclusionary housing requirement, they are often studied and incorporated into the development of these policies to align a jurisdiction's overall housing goals with its local real estate market conditions.[1]

[1] An exception to this statement is Assembly Bill (AB) 1505, which allows the State's Department of Housing and Community Development (HCD) to request an economic feasibility study for inclusionary housing policies that include a requirement that more than 15 percent of total *rental* units developed be affordable to households earning 80 percent of area median income (AMI) or below.

Study Recommendations

The key findings and recommendations stemming from the feasibility analysis for inclusionary housing in Montebello are summarized below. The subsequent chapters of this report provide details on the methodology, key assumptions, and the detailed results of the feasibility analysis.

- The feasibility analysis indicates that the development of market-rate lower and mid-density ownership products (e.g., single family detached homes and attached townhomes) appear financially feasible, whereas higher-density ownership products (e.g., condos) appear infeasible to build at market rates, and multifamily rental product is challenging to build at market rates.

- At this time, only mid-density ownership products (e.g., townhomes) demonstrate <u>sufficient</u> development feasibility to absorb the additional impact of a robust inclusionary program, as shown in **Table 9**. However, given that the overall pace of new, market-rate development is currently limited, adopting an inclusionary requirement - even if limited to mid-density product - may undermine the City's overall housing production objectives.

- While the development of market-rate single-family development is financially feasible, the addition of an inclusionary housing requirement would likely reduce the revenue potential (or increase development costs) to a level that would result in financial infeasibility. However, the City may consider a modest inclusionary requirement, and/or a low in-lieu fee on this product type.

- In light of the considerations described above, EPS does not recommend that the City proceed with the adoption of a Citywide inclusionary housing program at this time. However, an inclusionary program that is focused on areas of the City where there are higher density allowances and lower parking requirements could be effective. EPS evaluated the feasibility of higher density allowances and lower parking requirements at the request of City staff, and the findings of this evaluation are included in **Appendix B.** In addition, the "Next Steps" section at the end of this report outlines a number of other options the City may want to consider to support the development of affordable units in the community.

2. Local Market Context

To evaluate the potential to introduce an inclusionary program in Montebello, EPS researched several key local residential market activity indicators. Utilizing a variety of data sources (including California Department of Housing and Community Development (HCD) Progress Reports (APRs), CoStar, Redfin, and City Staff input), EPS first sought to answer the following questions:

(1) Is market-rate development occurring in Montebello?

(2) What are the market-rate rents and sales prices of new development?

Residential Market Activity Indicators

An inclusionary program is only effective if new, market-rate residential development is occurring, and can achieve prices or rents that can support the additional costs of including affordable units. To make this judgement call, EPS sought to understand the local development landscape and the extent of new residential development activity in the City and subregion. In addition, EPS explored the City's new development capacity by reviewing the City's Draft Housing Element and adopted Specific Plans. This provided insight into any zoning or plans that could accommodate new residential developments in the future.

To the greatest extent possible and to maximize transparency, EPS aimed to use publicly-available data, such as information collected and posted by HCD, the US Census, Tax Credit Allocation Committee (TCAC) applications, and local planning documents and zoning codes. EPS additionally vetted and confirmed assumptions through discussions with local planning staff and market-rate and affordable developers active in the region.

Household Income and Affordability

Households in the City of Montebello have a median annual income of $68,741 and an average household size of 3.30 people per household. For context, a three-person household with earnings of nearly $69,000 (i.e., the "typical" household in Montebello) would be considered a Low-Income household according to the 2023 HCD Income Limits for Los Angeles County.

For Sale Housing

Based on standard thresholds for housing affordability, the median household in the City can afford a home price of $375,000. [2] As of early 2023, the median sales price in the City is $635,000 for a detached single-family home. Given this price point, the City's "typical" three-person household cannot afford the median-priced single-family home in the City.

Rental Housing

There has been very little recent multifamily apartment development in the City. As of early 2023, the median apartment rent across the San Gabriel Valley is $2,671 per month, which equates to $32,052 annually. To feasibly afford a rental unit at the regional median rent, a family of three would have to earn approximately $107,000 annually, which would be considered an Above Moderate-Income household according to the 2023 HCD Income Limits for Los Angeles County.[3] Given the City's median household income, the median apartment in the region is not affordable to the "typical" household in Montebello.

Future Development Trends

There has been limited new, market-rate development in Montebello in the past several years. However, there are several large multifamily projects in the development pipeline and the City is anticipating significant new capacity in the Montebello Downtown Specific Plan Area. These trends are summarized below.

For Sale Housing

Between 2019 and 2021, six attached townhome units were permitted in the City but none were completed. There are 1,200 townhome units in the development pipeline in the Montebello Hills Specific Plan Area.

Rental Housing

Between 2019 and 2021, two rental units were completed in the City. In addition, a project of approximately 200 units is under review. Although multifamily development has been limited, the City has had success entitling 100 percent affordable housing projects.

Development Capacity Potential

The City expects most of its new residential development capacity to be within the Montebello Downtown Specific Plan Area, where the City has identified several large sites suitable for potential larger-scale housing projects.

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[2] Assumes that no more than 35 percent of an owner-occupied household's income is spent on housing costs, and that the house is purchased with 30-year mortgage with a fixed 5 percent interest rate and a 10 percent downpayment.

[3] Assumes that no more than 30 percent of a renter-occupied household's income should be spent on housing costs.

3. Development Feasibility Analysis

The economic feasibility analysis tests whether new market-rate residential development in San Dimas can absorb the financial impact of an inclusionary requirement. This assessment reflects that building affordable units represents a cost to market-rate projects, and it is possible that the additional cost will cause the project to be financially infeasible.

Methodology

To support an inclusionary program, a development prototype must demonstrate feasibility in excess of the feasibility threshold, as described in more detail below. Based on this criterion, the feasibility analysis demonstrates if an inclusionary housing program is an appropriate tool to adopt at this time, and, if so, identifies inclusionary requirements that could be feasibly absorbed by different types of new market-rate projects in the City. The analysis utilizes information gathered on market rents and sale prices in the City, as well as the costs to develop new multifamily, condo, townhome, and single-family home units in the region.

Assumptions

Product Prototypes

The prototype residential products used in the feasibility analysis were informed by EPS research on the local housing market. They are intended to reflect the types of new residential development projects City staff expects to occur in the coming years. Research included review of recent developments and proposed projects, discussions with developers active in the subregion, and discussions with City staff.

The prototypes include one rental prototype – multifamily apartments - and three for-sale prototypes – condominiums, attached townhomes, and detached single-family homes. The critical differentiator between the for-sale prototypes is the density at which they are built, with the "condominium" product assumed to be built at more than twice the density (60 units per acre) as the "townhome" product (25 units per acre). The "single-family detached" product is assumed to be developed at an even lower density (10 units per acre). Given its density, it is assumed that the condominium units would be contained within a single multi-story building, while the townhome and single-family units would be built as distinct units, each with its own ground-floor entrance. The analysis also assumes that the prototypical condominium is smaller than the prototypical townhome, which in turn is smaller than the prototypical single-family home. In some cases, there may be additional design factors – such as whether a unit is detached or attached, or how the lot is subdivided – that are used to define a project as a condominium, townhome, or single-family home within a city. This analysis does not account for those types of factors, only differentiating the prototypes based on density and unit size.

The unit characteristics for each prototype are meant to represent average unit sizes, with the resulting analysis demonstrating feasibility for an average residential project. The findings of this analysis assume that the unique unit mix of any particular project will, in aggregate, conform to these average unit sizes. However, any specific project will have its own cost and revenue factors that may be impacted in part by its unit mix.

The characteristics of each development prototype analyzed for Montebello are summarized in **Table 2**.

Table 2 Prototype Residential Products for Montebello

Item	Apartment Units	Condominium Units	Townhome Units	Single-Family Detached Units
Tenure	Rental	For Sale	For Sale	For Sale
Building Type	Multifamily	Multifamily	Attached	Detached
Density	60 units/acre	60 units/acre	25 units/acre	10 units/acre
Unit Bedrooms	2 Bedrooms	2 Bedrooms	2 Bedrooms	3 Bedrooms
Unit Square Feet	900	1,200	1,600	2,000
Parking Type	Structured Garage	Structured Garage	Attached Garage	Attached Garage

Development Cost Assumptions

Housing development costs categories include land acquisition, site preparation, hard costs (e.g., construction labor and materials), and indirect or "soft" costs (e.g., architecture/engineering, entitlement, financing, marketing, etc.). **Appendix A** provides additional detail about the development cost categories. For projects at densities that will require structured parking (i.e., one or two above-grade levels of parking below residential), which includes the apartment and condominium prototypes, EPS identifies parking costs as a separate line item. Data from recent developments and land transactions in the City have been combined with information from interviews with developers who are active in the region to inform the development cost assumptions used in this analysis.

Table 3, **Table 4**, **Table 5**, and **Table 6** below detail the cost assumptions and estimated costs per unit for the apartment, condominium, townhome, and single-family residential unit product prototypes, respectively.

Table 3 Market-Rate Rental Apartment Product Prototype Unit Cost Assumptions

Item	Montebello Assumptions		Per Unit
Development Program			
Parcel Size	1	acre	
Density	60	units/acre	
Unit Size	900	sq.ft.	
Amount of Parking	2.0	per unit	
Development Costs			
Land Costs	$3,000,000	per acre	$50,000
Site Preparation	$40	per sq.ft. of land	$29,040
Hard Costs	$275	per sq.ft.	$247,500
Parking Costs	$50,000	per space	$100,000
Subtotal, Direct Costs			$376,540
Soft Costs	25%	of direct costs	$94,135
Subtotal, Indirect Costs			$94,135
Total Development Costs			**$520,675**

Table 4 Market-Rate For-Sale Condominium Product Prototype Unit Cost Assumptions

Item	Montebello Assumptions		Per Unit
Development Program			
Density	60	units/acre	
Unit Size	1,200	sq.ft.	
Amount of Parking	2.0	per unit	
Development Costs			
Land Costs	$3,000,000	per acre	$50,000
Site Preparation	$40	per sq.ft. of land	$29,040
Hard Costs	$250	per sq.ft.	$300,000
Parking Costs	$50,000	per space	$100,000
Subtotal, Direct Costs			$429,040
Soft Costs	25%	of direct costs	$107,260
Subtotal, Indirect Costs			$107,260
Total Development Costs			**$586,300**

Table 5 Market-Rate For-Sale Townhome Product Prototype Unit Cost Assumptions

Item	Montebello Assumptions		Per Unit
Development Program			
Density	25	units/acre	
Unit Size	1,600	sq.ft.	
Development Costs			
Land Costs	$2,500,000	per acre	$100,000
Site Preparation	$40	per sq.ft. of land	$69,696
Hard Costs	$125	per sq.ft.	$200,000
Subtotal, Direct Costs			$269,696
Soft Costs	25%	of direct costs	$67,424
Subtotal, Indirect Costs			$67,424
Total Development Costs			**$437,120**

Table 6 Market-Rate Single Family Ownership Product Prototype Unit Cost Assumptions

Item	Montebello Assumptions		Per Unit
Development Program			
Density	10	units/acre	
Unit Size	2,000	sq.ft.	
Development Costs			
Land Costs	$2,000,000	per acre	$200,000
Site Preparation	$40	per sq.ft. of land	$174,240
Hard Costs	$125	per sq.ft.	$250,000
Subtotal, Direct Costs			$424,240
Soft Costs	25%	of direct costs	$106,060
Subtotal, Indirect Costs			$106,060
Total Development Costs			**$730,300**

Value Assumptions

Market Rate Residential

This analysis focuses on the values of newly-constructed housing units because, if adopted, an inclusionary housing program would only apply to new development.

The value for rental apartments is based on annual net operating income (NOI), which is calculated as annual rent minus annual operating expenses. For the apartment prototype in Montebello, annual rent is assumed at $35,100 per unit (equivalent to $2,925 per month), and annual operating expenses are assumed at $10,000 per unit.

For the for-sale prototypes, the value of the unit is equal to the estimated sale price. The average market rate prices of all single-family homes in the City are typical of the surrounding region; however, newly-constructed units are commanding higher prices than the overall existing inventory. Specifically, the premium for new construction in the San Gabriel Valley subregion is approximately 40 percent. The assumed price points for new for-sale products in Montebello include $420,000 for a condominium, $720,000 for a townhome, and $850,000 for a single-family home.

Affordable Residential Revenue Assumptions

An inclusionary program requires that a certain percentage of onsite units be provided at rents or sale prices affordable to lower-income households, which affects a development project's revenue potential. Affordable rents and sale prices for below-market-rate (BMR) units are based on maximum housing costs affordable to households at various household income levels. Income levels in the County of Los Angeles are set by HCD on an annual basis, which are in turn based on income limits published by the U.S. Department of Housing and Urban Development (HUD). The income level for each category differs by household size. This analysis assumes a two-bedroom unit is occupied by a three-person household and three-bedroom units are occupied by a four-person household.[4] For 2023, the Area Median Income (AMI) in Los Angeles County is defined at $88,400 for a household of three and $98,200 for a household of four.

In general, Very Low-Income households are defined as those earning up to 50 percent of AMI; Low-Income households earn up to 80 percent AMI; and Moderate-Income households earn up to 120 percent of AMI. However, within Los Angeles County, the maximum income defining Very Low- and Low-Income households is adjusted upwards from the associated percentage of AMI. HCD applies this adjustment in counties with relatively high housing costs and/or relatively high or low household incomes. Due to this adjustment, the maximum income for a Low-Income household—$90,850 for a three-person household and

[4] Based on California Health and Safety Code Section 50052.5.

$100,900 for a four-person household—is actually higher than the area median income.

Based on the maximum household income, EPS calculated the maximum spending towards housing costs that would be considered affordable at each income level. Consistent with HCD guidelines, the analysis assumes that households in deed-restricted units spend 30 percent of their gross annual income on total housing costs. In this analysis, housing costs for rental units just include rent. For for-sale units, housing costs include mortgage and interest payments, insurance, property taxes, and Homeowners Association (HOA) fees. To calculate the maximum affordable sale price for these units, EPS assumed that these other housing costs represent approximately 10 percent of household income, and, therefore, the maximum income available for a mortgage payment is 20 percent of annual household income. This mortgage payment was converted into an affordable home sale price assuming a 10 percent down payment and a 30-year mortgage with a fixed interest rate of 5 percent, reflecting a long-term, historical average.

Table 7 indicates the maximum annual incomes for County households associated with each income category for the associated household size, as well as the affordable rents and sale prices associated with each category.

Table 7 Maximum Unit Values for Affordable Housing for Los Angeles County

Item	Very Low Income (50% AMI)	Low Income (80% AMI)	Moderate Income (120% AMI)
Rental Apartments			
Maximum Household Income [1]	$56,750	$90,850	$106,050
Income Available for Housing Costs/Year [2]	$17,025	$27,255	$31,815
(less) Operating Expenses per Unit/Year [3]	($7,500)	($7,500)	($10,000)
Net Operating Income	$9,525	$19,755	$21,815
Capitalization Rate [4]	5%	5%	5%
Unit Value [5]	***$190,500***	***$395,100***	***$436,300***
For-Sale Townhomes or Condos [6]			
Household Income [1]	$56,750	$90,850	$106,050
Income Available for Housing Costs/Year [7]	$11,350	$18,170	$21,210
Supportable Mortgage [8]	$174,477	$279,317	$326,050
Affordable Home Price [9]	***$193,864***	***$310,353***	***$362,277***
For-Sale Single-Family Homes			
Household Income [1]	$63,050	$100,900	$117,850
Income Available for Housing Costs/Year [7]	$12,610	$20,180	$23,570
Supportable Mortgage [8]	$193,847	$310,216	$362,329
Affordable Home Price [9]	***$215,385***	***$344,685***	***$402,587***

[1] Reflects 2023 HCD Income Limits for a three-person household for apartments and townhomes, and a four-person household for single-family homes.
[2] Assumes that no more than 30% of a household's income should be spent on housing costs for housing to be considered affordable.
[3] Operating expenses are generally based on EPS feasibility studies in the region and are inclusive of utility costs; units at or below 80% of AMI are assumed to be built as non-profit and are therefore exempt from property taxes. Property taxes are assumed to comprise a share of the operating expenses for the moderate income category.
[4] The capitalization rate is used to determine the current value of a property based on estimated future operating income, and is typically a measure of estimated operating risk. Obtained for multifamily developments in the San Gabriel Valley subregion from CoStar.
[5] The unit value is determined by dividing the net operating income by the capitalization rate.
[6] Townhomes and condos are both assumed to include two bedrooms and house a three-person household; therefore, the affordable price for these prototypes is the same.
[7] Assumes that no more than 20% of household income is spent on mortgage payments. This reflects that total housing costs should not exceed 30% of income, and takes into account other housing-related costs, such as taxes, insurance, and HOA fees.
[8] Assumes a 30-year mortgage and a fixed 5% interest rate.
[9] Assumes a 10% down payment.

Source: CA HCD; CoStar; Economic & Planning Systems, Inc.

Feasibility Thresholds

The assessment of financial feasibility for real estate development products is based on calculating financial return metrics for the products and comparing them against typical industry target thresholds. In the case of residential development, relevant return metrics are based on comparing total project revenues to total project development costs.

- For for-sale housing products (which in this analysis includes condominiums, townhomes, and single-family homes), the estimated cost of development shown in **Table 4**, **Table 5**, and **Table 6** is subtracted from the estimated value in order to calculate profit. The profit is then divided by the estimated development cost to calculate the relevant feasibility metric, profit margin, which is the percentage by which total project value exceeds total project cost. Based on EPS research and feedback from the developer community, the analysis assumes that developers in the greater Los Angeles region will require a projected profit margin of at least 15 percent in order to move forward with a for-sale development project. Therefore, a prototype attaining a profit margin at or above 15 percent at market sale prices would be considered feasible in this analysis. A profit margin *in excess of* 15 percent would be required to support any additional costs, such as an inclusionary requirement.

- For rental housing products (which in this analysis includes multifamily apartments), the feasibility threshold is based on the return metric of "yield on cost," which is calculated by dividing the annual net operating income (NOI) by the total costs of development.[5] Based on EPS research and experience, the analysis assumes that developers in the greater Los Angeles region will require a projected yield on cost of at least 5.5 percent in order to move forward with a multifamily rental development project. A yield-on-cost *in excess of* 5.5 percent would be required to support any additional costs, such as an inclusionary requirement.

It is important to note that these return metrics do not account for the time value of money and are not based on any assumption regarding project timeline.

[5] Net operating income reflects total rent collected minus operating costs.

Feasibility Findings

EPS assumptions for prototype revenues and costs used to calculate the return metrics are detailed below in **Table 8**.

Table 8 Feasibility of Market-Rate Product Prototypes in Montebello

Item	*Minimum Feasibility Threshold*	Montebello
Rental Apartments		
Development Costs Per Unit		$520,675
Net Operating Income Per Unit		$25,100
Yield on Cost	*5.50%*	***4.8%***
For-Sale Condominium		
Development Costs Per Unit		$586,300
Average Sale Price		$420,000
Profit		($166,300)
Profit Margin	*15%*	***-28%***
For-Sale Townhomes		
Development Costs Per Unit		$437,120
Average Sale Price		$720,000
Profit		$282,880
Profit Margin	*15%*	***65%***
For-Sale Single-Family Homes		
Development Costs Per Unit		$730,300
Average Sale Price		$850,000
Profit		$119,700
Profit Margin	*15%*	***16%***

As shown, the analysis indicates that single family detached homes built at 10 units per acre and attached townhomes built at 25 units per acre meet market-rate feasibility thresholds. However, only the townhome product demonstrates sufficient development feasibility to support the costs of an inclusionary requirement. While the single-family detached home exceeds the minimum feasibility threshold, the addition of an inclusionary housing requirement would likely reduce the revenue potential (or increase development costs) to a level that would be considered financially infeasible. The other prototypes (rental apartments and for-sale condos) do not achieve feasible return thresholds at market rates, suggesting that on average, it is challenging to develop these housing types in the City, and that the additional costs of an inclusionary requirement would exacerbate those challenges and potentially limit new housing development in the community.

It is important to note that this analysis only reflects average prototypical projects and does not mean that the prototypes shown as infeasible above will never be built in the City. There are many factors that can impact the financial feasibility of any particular development project. For example, if a project can acquire land at a lower price or build at a higher density than what is represented in the above assumptions, the project may become financially feasible. Similarly, a developer may find that there is sufficient demand to achieve rents or sale prices higher than those assumed in this analysis. Indeed, the City may find that even though this analysis shows specific types of development to be infeasible at market rates, they still receive proposals to build these types of projects. Therefore, the analysis should not be considered deterministic regarding the future of housing development in the City. Rather, it should be taken as informative regarding the obstacles to housing development under average conditions and the resulting need for careful consideration before introducing an additional cost in the form of inclusionary housing requirements.

4. Recommendations and Next Steps

Program Recommendations

At this time, EPS does not recommend that Montebello proceed with the adoption of a citywide inclusionary housing program, because only the mid-density townhome product is demonstrating sufficient feasibility to support a robust inclusionary requirement. However, if the City were to proceed with the adoption of a citywide inclusionary housing program, **Table 9** provides a summary of feasible inclusionary requirements that could be supported by product type. As shown, an overall requirement of approximately **10 percent, targeting ½ Low and ½ Moderate-income households** and an associated in-lieu fee of **$15 per square foot of market rate development**, would represent a feasible inclusionary program.

Table 9 Feasibility Summary

Montebello Prototypes	Onsite Inclusionary Requirement	Very Low	Low	Moderate	In-Lieu Fee (per sq.ft.) Recommended Target	In-Lieu Fee (per sq.ft.) Max. Feasible
Multifamily Apartment (Rental)	**0%**	0%	0%	0%	$15.00	n/a
Single Family Detached (Ownership)	**2%**	0%	0%	2%	$4.00	$4.42
Townhome (Ownership)	**10%**	0%	5%	5%	$15.00	$118.10
Condominium (Ownership)	**0%**	0%	0%	0%	$0.00	n/a

Source: Economic & Planning Systems, Inc.

While the feasibility analysis indicates a higher inclusionary requirement and a higher in-lieu fee may be financially feasible, higher requirements may put the City at a competitive disadvantage relative to other jurisdictions without inclusionary requirements or may discourage development of mid-density residential units. While inclusionary requirements and in-lieu fees vary widely among jurisdictions with inclusionary programs, a 10 percent inclusionary requirement and $10 to $15 per square foot in-lieu fee for ownership products is a common level.

Given the feasibility demonstrated for the lower-density single-family product, the City could consider adopting a very modest inclusionary requirement on this product type—two percent of units, targeting Moderate-Income households, and an associated in-lieu fee of $4 per square foot of market rate development. While EPS does not recommend the adoption of such a modest requirement, given its likely limited efficacy in producing affordable units, it would represent a feasible requirement based on the above analysis.

EPS does not recommend targeting Very Low-income households in an inclusionary program for ownership product as it can be very challenging to qualify Very Low-income households for home ownership.

Next Steps

While the feasibility analysis indicates limited potential for a Citywide inclusionary housing program in Montebello at this time, this is not a deterministic conclusion. The feasibility analysis is a point-in-time assessment of typical new market-rate development projects, and as stated above, it does not mean that these types of developments cannot or will not happen in Montebello, as there are many variables that can impact costs and values and resulting feasibility. Similarly, future market conditions can also change the potential for inclusionary housing policies.

At this time, the City may want to consider the following "next steps" or actions:

1. Continue to monitor residential production trends, development costs, and market prices/rents in the City.
2. Continue to educate the community and elected officials about inclusionary housing so that when/if the opportunity arises, the City can act efficiently.
3. Monitor other inclusionary programs in the San Gabriel Valley subregion.
4. Reevaluate the feasibility of an inclusionary program in two to three years.
5. Consider a local density bonus program to incentivize affordable housing, ensuring that such a program does not undermine State Density Bonus law.
6. Reinforce that the State Density Bonus is an incentive-based tool that is available to developers regardless of whether a city has a local inclusionary requirement.
7. Consider adopting an inclusionary program with an in-lieu fee that is lower than the equivalent of providing units on-site, knowing that developers will choose to pay the in-lieu fee (unless providing units onsite advances other objectives such as the State Density Bonus).
8. Consider adopting inclusionary requirements in targeted areas of the City (such as Specific Plan areas) where zoning allowances (e.g., higher density and lower parking requirements) may improve feasibility of new residential projects (see **Appendix B**).

APPENDIX

Appendix A: Development Program and Cost Categories

Item	Description	Sources
Development Prototype		
Density	Units permitted per acre, for each development prototype.	City zoning code and staff input
Unit Size	Average size of a unit.	CoStar; Zillow; Developer input; City staff input
Parking Requirement	Number of parking spaces required per unit.	City zoning code and staff input
Development Costs		
Land Costs	Acquisition of land. Varies by location and prototype.	CoStar, vacant land transactions where underlying zoning allows residential development; Developer input; SGVRHT pro formas
Site Preparation	Demolition (if needed), grading, horizontal infrastructure.	Developer input; EPS experience
Hard Costs	On-site work (labor and materials), vertical construction, general requirements, overhead and builder fees (excl. parking costs). Varies by prototype, with denser development costing more on a per square foot basis.	Developer input; Cost estimators (RLB, Marshall & Swift); EPS experience
Parking Costs	Hard costs specific to parking. Multifamily development assumes one to two levels of above-grade, podium-style parking beneath residential. Costs can range from $40,000 to $60,000 per space, or higher if undergrounding is required. Analysis assumes $50,000.	Developer input; Cost estimators (RLB, Marshall & Swift, Watry); EPS experience
Soft Costs	Architecture and engineering; entitlement and fees; project management; consultants; marketing, commissions, and general administration; financing and charges; insurance; and contingency. Assumed to be a percentage of hard costs.	Developer input; EPS experience

Appendix B: Evaluation of Financial Feasibility of Inclusionary Requirements for Targeted Areas of City

Based on the findings of the feasibility analysis detailed in the above report, the City requested that EPS evaluate the potential for adopting an inclusionary requirement in targeted areas of the City where new zoning allowances may be adopted. These allowances may include higher density, up to 80 units per acre, and lower parking requirements, down to one space per unit. Such allowances are being considered for the City's Downtown Specific Plan Area and the TOD District Specific Plan Area.

EPS revised the development programs for the multifamily rental apartment and higher-density ownership condo products to reflect these allowances. The development costs per unit for these revised programs are shown in **Table 10** and **Table 11** below. The assumptions for achievable rent ($2,925 per month) and sale price ($420,000) for these prototype units stayed the same as in the primary analysis.

Table 10 Market-Rate Rental Apartment Product Prototype Unit Cost Assumptions for Revised Zoning Allowances

Item	Montebello Assumptions		Per Unit
Development Program			
Parcel Size	1	acre	
Density	80	units/acre	
Unit Size	900	sq.ft.	
Amount of Parking	1.0	per unit	
Development Costs			
Land Costs	$3,000,000	per acre	$37,500
Site Preparation	$40	per sq.ft. of land	$21,780
Hard Costs	$275	per sq.ft.	$247,500
Parking Costs	$50,000	per space	$50,000
Subtotal, Direct Costs			$319,280
Soft Costs	25%	of direct costs	$79,820
Subtotal, Indirect Costs			$79,820
Total Development Costs			**$436,600**

Table 11 Market-Rate For-Sale Condominium Product Prototype Unit Cost Assumptions for Revised Zoning Allowances

Item	Montebello Assumptions		Per Unit
Development Program			
Density	80	units/acre	
Unit Size	1,200	sq.ft.	
Amount of Parking	1.0	per unit	
Development Costs			
Land Costs	$3,000,000	per acre	$37,500
Site Preparation	$40	per sq.ft. of land	$21,780
Hard Costs	$250	per sq.ft.	$300,000
Parking Costs	$50,000	per space	$50,000
Subtotal, Direct Costs			$371,780
Soft Costs	25%	of direct costs	$92,945
Subtotal, Indirect Costs			$92,945
Total Development Costs			**$502,225**

Using these revised costs, EPS re-calculated the return metrics for these two prototypes. As shown in **Table 12** below, the higher-density ownership product is still infeasible even at higher densities and lower parking requirements. However, the yield on cost for multifamily rental apartments increases to 5.7 percent under the revised development program, above the minimum threshold of 5.5 percent.

Table 12 Feasibility of Market-Rate Rental Apartment and For-Sale Condo Prototypes in Montebello Under Revised Zoning Allowances

Item	*Minimum Feasibility Threshold*	Montebello
Rental Apartments		
Development Costs Per Unit		$436,600
Net Operating Income Per Unit		$25,100
Yield on Cost	*5.50%*	***5.7%***
For-Sale Condominium		
Development Costs Per Unit		$502,225
Average Sale Price		$420,000
Profit		($82,225)
Profit Margin	*15%*	***-16%***

Given the increased yield on cost under this development program, EPS estimates that it would be feasible to adopt an inclusionary requirement of **10 percent of units targeting Low-Income households**, and an associated in-lieu fee of **$15 per square foot of market rate development**, on multifamily rental projects in the areas of the City with these higher density zoning allowances.