

TECHNICAL MEMORANDUM

To: Christopher Macon, City of Laguna Woods
From: Julie Cooper and Thomas Gonzales
Subject: City of Laguna Woods Inclusionary Housing In-Lieu Fee Study; EPS #234001
Date: May 7, 2025

Introduction and Background

The City of Laguna Woods recently updated its Inclusionary Housing Program (IHP) to better reflect City goals and housing development market conditions. The IHP requires that a certain percentage of units in newly constructed, market-rate housing developments be priced at specific levels affordable to households making less than the Area Median Income (AMI) for Orange County.

Under Assembly Bill 1505 (2017), California law requires that cities provide alternative means of compliance with an inclusionary housing requirement for rental housing, other than on-site affordable housing construction. An in-lieu fee is a commonplace option for this alternative compliance, allowing developers to pay a fee to the city instead of building affordable units on-site within the development project itself.

Economic & Planning Systems, Inc. (EPS) was engaged to study and recommend an appropriate affordable unit in-lieu fee for Laguna Woods. The City's IHP allows for rental projects to satisfy the requirement to provide on-site affordable units by paying an in-lieu fee, subject to City Council approval. The fee amount is to be established by Council and reflect the approximate cost of constructing the inclusionary units on-site.

EPS suggests an in-lieu fee amount based on the estimated affordability gap for delivering subsidized units under the latest IHP requirements. The affordability gap can vary by project type, and EPS has calculated in-lieu fee amounts using the same development pro forma analysis previously used to evaluate the feasibility impacts on new projects under the IHP—as shared with the City in a technical memorandum dated June 13, 2024.

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In-Lieu Fee Recommendation

EPS recommends establishing an inclusionary housing in-lieu fee of \$642 per total square feet of required affordable units, which was calculated using an affordability gap methodology. The recommended fee level is based on a blended average of the maximum justifiable fee for two different prototype rental development projects, as shown in **Table 1**.

Given that the IHP requires new residential units to build affordable units similar to the project's market-rate units, EPS has determined that selecting a single fee for rental projects that relates to the otherwise required number of on-site affordable units (rather than the number of market-rate units) would be the most straightforward and appropriate approach. **Table 1** shows this single, blended fee amount on a per affordable square foot basis (the recommended format for implementation in Laguna Woods). It also shows the equivalent fee level per market rate square foot, another common format, to allow easier comparison with fee levels in other cities.

Table 1: Summary of Recommended Maximum In-Lieu Fees by Prototype

Product Category	In-Lieu Fee (per Affordable Sq. Ft.)	Equivalent Fee per Market-Rate Sq. Ft.
Multifamily Garden-Style Rental Apartment	\$608	\$30.42
Multifamily Wrap-Style Rental Apartment	\$676	\$33.81
<i>Blended Average Fee Amount</i>	<i>\$642</i>	<i>\$32.12</i>

Recommended Implementation Measures

EPS recommends that the fee be officially adopted by resolution by City Council and referenced in the City's Zoning Code. In addition, EPS recommends that the resolution establish an automatic annual escalation of the fee using a construction cost or inflation index,¹ which ensures that the fee scales with changes in building costs over time until such point that an updated fee study is conducted.

Inclusionary Housing Program Context

The City has established an inclusionary housing program that requires developers of new residential projects to rent or sell a portion of units on-site (within the proposed project)

¹ Recommended indices include the California Department of General Services' California Construction Cost Index (CCCI) (<https://www.dgs.ca.gov/RESD/Resources/Page-Content/Real-Estate-Services-Division-Resources-List-Folder/DGS-California-Construction-Cost-Index-CCCI>) or the Engineering News-Record's Construction Cost Index (<https://www.enr.com/economics>)

at rates below market pricing and affordable to households at specific income levels. The required affordable unit set asides under the current IHP are:

- 5 percent of units in new rental projects
 - Half (2.5 percent) for those at or below the Very Low Income level
 - Half (2.5 percent) for those at or below the Extremely Low Income level
- 10 percent of units in new for-sale project
 - Half (5 percent) for those at or below the Low Income level
 - Half (5 percent) for those at or below the Very Low Income level

The income levels noted above are defined by the California Department of Housing and Community Development (HCD) on a county-wide level and are based on the median income for that county (also called the area median income or AMI). Each year, HCD identifies maximum household incomes for a range of income levels, including Extremely Low, Very Low, Low, and Moderate; and for a range of household sizes. The 2024 HCD income limits for Orange County are shown in **Table 2**.

Table 2: Orange County 2024 Maximum Income Limits by Persons in Household

Affordability Category	Nominal Percentage of County Median	Number of Persons in Household					
		1	2	3	4	5	6
Extremely Low Income	30%	\$33,150	\$37,900	\$42,650	\$47,350	\$51,150	\$54,950
Very Low Income	50%	\$55,250	\$63,100	\$71,050	\$78,900	\$85,250	\$91,550
Low Income	80%	\$88,400	\$101,000	\$113,650	\$126,250	\$136,350	\$146,450
Median Income	100%	\$90,300	\$103,200	\$116,100	\$129,000	\$139,300	\$149,650
Moderate Income	120%	\$108,350	\$123,850	\$139,300	\$154,800	\$167,200	\$179,550

Sources: CA Department of Housing and Community Development; Economic & Planning Systems, Inc.

It is important to note that while the area median income and associated affordable income levels for Orange County may differ from median incomes for Laguna Woods households, affordable housing developers and operators must adhere to the county-wide income levels in developing and operating affordable projects, particularly if they are utilizing state and federal funding programs. Therefore, EPS uses these income levels in the following analyses.

It is also worth noting that, while the categories of income levels are nominally associated with various percentages of median income, the actual figures provided by HCD do not always adhere mathematically to those nominal categories. For example, the median income for a three-person household is identified as \$116,100. The Low Income category is nominally set at 80 percent of median income, but HCD shows the limit for Low Income households as \$113,650, which is 97.9 percent of the \$116,100 median income for that household size. HCD makes adjustments like this for areas with unique

market circumstances (e.g., high housing costs relative to incomes), and the figures are correct for use herein even if they do not reflect direct mathematical relationships.

In-Lieu Fee Review and Analysis

As noted above, City code under the recently updated IHP provides an alternative means of compliance in the form of paying an in-lieu fee for rental projects, subject to approval by City Council. The in-lieu fee amount is to be set “reasonably equal to the cost of constructing the inclusionary units” on-site.

Proposed Methodology

EPS has proposed an in-lieu fee level calculated based on the affordability gap, or the cost to a developer of subsidizing an affordable unit of housing as required under the IHP. The affordability gap reflects the difference between the total building cost, including developer profit and the cost of land, and the supportable value of each housing unit at a given level of affordability.

The cost of building a housing unit is generally the same whether that unit is to be rented at market-rate or at a more affordable level. However, the revenue a developer can expect from the affordable unit is generally less than the revenue from the market-rate units.

Thus, the supportable value of an affordable unit is typically lower than the market value and reflects the maximum amount that can be financed through revenue from rental income at the designated affordability level. The lower the income of the households being served, the lower the revenue, and the lower the supportable value. A lower supportable value in turn means a higher affordability gap, or subsidy necessary to feasibly construct the unit, and a higher resulting in-lieu fee.

Calculating an in-lieu fee based on the affordability gap is a common approach used to determine a maximum appropriate in-lieu fee to charge developers and is reflective of the true cost of building and financing a new affordable housing unit.

To calculate the in-lieu fee amounts, EPS used the same development pro forma model previously used to evaluate the feasibility impacts on new projects under the IHP—as shared with the City in a technical memorandum dated June 13, 2024. EPS had previously vetted the project prototypes and development value and cost assumptions with local market-rate and affordable developers in late 2023 as part of the firm’s work evaluating the feasibility impacts of the City’s IHP.²

² EPS spoke with two market-rate housing developers active within southern Orange County: City Ventures, which primarily builds for-sale townhomes; and The Hanover Company, which is currently building a multifamily rental wrap building in Laguna Niguel. EPS reviewed various analysis assumptions, including return metrics, construction costs, and market values, in order to confirm their reasonableness. EPS also asked developers about land values they have typically targeted and/or at which they have purchased land to confirm the reasonableness of the land cost assumptions.

EPS also spoke with affordable housing developers National CORE and Jamboree, who reported recent project costs at least as high as, if not higher than, those estimated by EPS for construction of new market-rate units: \$450,000 to \$550,000 per unit inclusive of land cost for garden-style housing projects

In-Lieu Fee Analysis based on Affordability Gap

Product Type Assumptions

EPS calculated the affordability gap at various affordability levels for two rental development prototypes. These hypothetical residential projects match the prototypes used for evaluating the feasibility impacts of the IHP:

1. A **garden-style multifamily rental apartment prototype** with one bedroom, 825 square feet of living area, surface parking, and developed at a density of 30 units per acre.
2. A **wrap multifamily rental apartment prototype** with one bedroom, 825 square feet of living area, structured parking garage, and developed at a density of 50 units per acre.

Based on EPS research on typical rental projects within nearby areas, one-bedroom apartments of approximately 825 square feet are the most common type of unit.³ The densities chosen for these two prototypes correspond to the minimum and maximum densities for the City’s Residential High Density zoning overlay district.⁴ The characteristics for the prototype development products are summarized in **Table 3**.

Table 3 Prototype For Rent Residential Products

Item	Garden-Style Apartments	Wrap Apartments
Building Type	Multifamily	Multifamily
Density	30 units/acre	50 units/acre
Type	1 Bedrooms	1 Bedrooms
Unit Size	825 square feet	825 square feet
Parking Type	Surface Carports	Structured Garage

The unit characteristics for each prototype are meant to represent average unit sizes, with the resulting analysis demonstrating the affordability gap 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. While any specific project will have its own cost and revenue factors that may be impacted in part by its unit mix,

and \$600,000 to \$750,000 per unit for podium-style housing projects (typically slightly more expensive than wrap-style projects).

³ EPS looked at CoStar data for projects built since 2014 within 10 miles of Laguna Woods. Out of a total 16,337 multifamily rental units in this area, 51 percent were one-bedroom units with an average site of approximately 817 square feet. EPS rounded this amount to the nearest 25 square feet.

⁴ Table N in Exhibit C of the City’s General Plan Housing Element identifies the Residential High Density overlay zoning district as accommodating the entirety of Laguna Woods’ development capacity for potential Very Low and Low income housing unit production.

this approach of using average unit characteristics is intended to robustly represent general development economics.

Land Cost Assumptions

In this analysis, the affordability gap is based on calculating total project costs inclusive of land cost. Land cost can reflect either the “land value” for a vacant site or the “existing use value” of a site with an existing land use, depending on the site in question.

EPS selected an estimated land price of \$4.0 million per acre based on collected information from actual property transactions, which showed that land values within Laguna Woods have ranged from \$2.6 million per acre to \$6.3 million per acre.⁵

To further confirm the land price estimate, EPS also conducted high-level analysis to confirm that the existing value of developed and active properties within the City’s developable land inventory are likely equal to or higher than the selected \$4.0 million per acre value.⁶ The price also aligns with previously completed developer interviews that revealed recent residential development projects within the area have been able to pay between \$4.0 million and \$4.6 million per acre to acquire land. Finally, the price estimate appears to be reasonable and conservative when compared with three recent land transactions located near Laguna Woods, which ranged from \$4.46 million to \$5.88 million per acre.⁷

Development Cost Assumptions

Beyond the cost of land acquisition, the cost of developing a new housing project includes several other cost categories: site preparation, direct/hard costs (e.g., construction labor and materials), indirect/soft costs (e.g., architecture, entitlement, marketing, financing, insurance), and developer profit. For multifamily projects, EPS also defines parking costs per unit as a separate line item.

EPS utilized customary assumptions for site preparation and indirect/soft costs, based on prior project experience. EPS assumed site preparation costs of \$10 per land square foot for multifamily rental apartment projects. For indirect/soft costs, EPS assumed that these would total 30 percent of the direct cost budget. EPS also applied a development cost contingency set at five percent of the combined direct and indirect costs, to account for potential cost overruns.

For direct/hard costs, EPS utilized cost estimates previously developed to evaluate the feasibility impacts of the Laguna Woods IHP at the end of 2023, with an inflation factor of

⁵ The Helm Center site sold for \$6.34 million per acre in 2023 and Saddleback Golf Cars sold for \$3.63 million per acre in 2017, while the 2022 appraisal reports for City Centre Park identified nearby land transactions in the range \$2.6 to \$2.8 million per acre.

⁶ EPS estimated current market valuations for six commercial properties listed in the Laguna Woods Housing Site Inventory, none of which had sold within the last five years. Values were estimated using data on rentable building area (square footage), in-place rental rates, market occupancies, and capitalization rates as reported by CoStar in January 2023. Values per acre ranged from \$4.49 million to \$7.26 million.

⁷ According to data obtained from CoStar, 1.4 acres on Alfonso Drive in Irvine sold for \$4.46 million per acre in March 2023, 31.86 acres on Bake Parkway in Irvine sold for \$4.58 million per acre in December 2023, and 0.85 acres at 23811 El Toro Road in Lake Forest sold for \$5.88 million in August 2024.

approximately two percent that accounts for year-over-year cost increases based on the California Department of General Services Construction Cost Index. These cost estimates were initially created based on a review of several sources to estimate construction costs, including Rider Levitt Bucknall and Marshall & Swift, as well as feasibility proformas from other EPS projects in Orange County. EPS additionally confirmed the appropriateness of those cost assumptions during subsequent developer interviews.⁸

EPS assumed developer profit for rental housing projects would be based on a “yield on cost” return metric of 5.5 percent. Yield on cost is equal to the annual net operating income (NOI) divided by the total costs of development including land.⁹ The 5.5 percent threshold for yield on cost reflect EPS research and experience in the region.

It is important to note that these generalized return metrics do not account for the time value of money and are not based on any assumption regarding project timeline. EPS assumptions for prototype revenues and costs used to calculate the return metrics are detailed in the following sections.

Table 4 on the following page details the full set of assumptions and estimated costs per unit for the two rental prototypes: garden-style apartment and wrap-style apartment.

⁸ The costs represent those typical of market-rate housing development, since those projects are subject to the City’s inclusionary housing requirements. EPS also spoke with local affordable housing developers Jamboree Housing and National CORE about the cost of constructing multifamily, dedicated affordable housing. They reported slightly higher costs in the ranges of \$450,000 to \$500,000 for garden-style projects and \$600,000 to \$750,000 for podium projects, inclusive of land costs. Podium projects are typically more expensive than the wrap style projects considered in this study’s analysis. The developers indicated that several factors contribute to higher cost for dedicated affordable housing projects, especially requirements from funding programs including mandates to pay prevailing wage rates, as well as limited opportunities for refinancing that constrain a project’s maintenance and renovation budgets (and necessitate upfront investment in more durable and expensive project materials).

⁹ Reviewing the yield on cost is a shorthand but very common approach used by developers when analyzing for income-producing properties (e.g., rental housing) to ensure that the project costs are less than the ultimate market value finished product, leaving enough profit to make the project feasible.

Table 4: Construction Cost by Prototype

Item	Multifamily Garden-Style Rental Apartment		Multifamily Wrap-Style Rental Apartment	
	Assumptions	Per Unit	Assumptions	Per Unit
Development Prototype				
Density	30 units/acre		50 units/acre	
Net Unit Size	825		825	
Efficiency Factor	90%		83%	
Gross Unit Size	917 sq.ft.		994 sq.ft.	
Number of Bedrooms	1.0 per unit		1.0 per unit	
Amount of Parking	1.5 per unit		1.5 per unit	
Land Cost	\$4,000,000 per acre	\$133,333	\$4,000,000 per acre	\$80,000
Development Costs				
Site Improvements	\$10 per land sq.ft.	\$14,520	\$10 per land sq.ft.	\$8,712
Direct Construction Costs [1]	\$270 per gross sq.ft.	\$247,590	\$285 per gross sq.ft.	\$283,290
Parking Costs	\$12,000 per space, carport	<u>\$18,000</u>	\$41,000 per space, structured	<u>\$61,500</u>
<i>Subtotal, Direct Costs</i>		<i>\$280,110</i>		<i>\$353,502</i>
Indirect Costs [2]	30.0% of direct const. costs	\$84,033	30.0% of direct const. costs	\$106,051
<i>Subtotal</i>		<i>\$364,143</i>		<i>\$459,553</i>
Development Cost Contingency	5% of direct and indirect costs	\$18,207	5% of direct and indirect costs	\$22,978
<i>Development Cost Total</i>		<i>\$382,350</i>		<i>\$482,530</i>
Total Project Costs incl. Land		\$515,683		\$562,530
Developer Profit Threshold	5.5% yield on cost		5.5% yield on cost	
Project Costs incl. Profit				

[1] Includes on-site work, offsite work, vertical construction, general requirements, overhead and builder fees.

[2] Includes costs for architecture and engineering; entitlement and fees; project management; commissions, and general administration; financing and charges; and insurance.

Sources: Interviews with local residential developers; Rider Levett Bucknall; Marshall & Swift; Economic & Planning Systems, Inc.

Revenue and Value Assumptions for Affordable Units

As noted, the supportable value for each affordable unit is based on the potential revenue from rents. Rents for affordable units are based on maximum housing costs affordable to households at a specified income level.¹⁰

Consistent with guidance in State law (Health and Safety Code Section 50052.5), this analysis assumes a one-bedroom, rental apartment is occupied by a two-person household. The analysis also assumes, consistent with HCD guidelines, that households spend no more than 30 percent of their gross annual income on total housing costs. For rental units, housing costs are assumed to include rent and utilities.

Table 5 shows, at various income levels, the supportable value of the rental prototypes. This amount can also be considered the maximum project cost that a developer could finance through rental revenue after meeting their profit threshold.

¹⁰ Income levels in Orange County are set by HCD on an annual basis and differ by household size, as shown in **Table 2**.

Table 5: Supportable Development Cost for Rental Prototypes at Various Income Levels

Item	Extremely Low Income (30% AMI)	Very Low Income (50% AMI)	Low Income (80% AMI)	Median Income (100% AMI)	Moderate Income (120% AMI)
Multifamily Garden-Style Rental Apartment					
Development Program Assumptions					
Number of Bedrooms	1	1	1	1	1
Household Size (Occupants) per 2-bedroom Unit [1]	2	2	2	2	2
Maximum Supportable Development Cost					
Household Income [2]	\$37,900	\$63,100	\$101,000	\$101,000	\$103,200
Annual Utility Cost Allowance	\$200	\$200	\$200	\$200	\$200
Income Available for Rent/Year after Utilities [3]	\$8,976	\$16,536	\$27,906	\$28,566	\$34,761
(less) Operating Expenses per Unit/Year [4]	\$12,000	\$12,000	\$12,000	\$12,000	\$12,000
Net Operating Income	(\$3,024)	\$4,536	\$15,906	\$16,566	\$22,761
Developer Profit Threshold (Yield on Cost) [5]	5.5%	5.5%	5.5%	5.5%	5.5%
Supportable Value	(\$54,982)	\$82,473	\$289,200	\$301,200	\$413,836
Multifamily Wrap Rental Apartment					
Development Program Assumptions					
Number of Bedrooms	1	1	1	1	1
Household Size (Occupants) per 2-bedroom Unit [1]	2	2	2	2	2
Maximum Supportable Development Cost					
Household Income [2]	\$37,900	\$63,100	\$101,000	\$101,000	\$103,200
Annual Utility Cost Allowance	\$200	\$200	\$200	\$200	\$200
Income Available for Rent/Year after Utilities [3]	\$8,976	\$16,536	\$27,906	\$28,566	\$34,761
(less) Operating Expenses per Unit/Year [4]	\$12,500	\$12,500	\$12,500	\$12,500	\$12,500
Net Operating Income	(\$3,524)	\$4,036	\$15,406	\$16,066	\$22,261
Developer Profit Threshold (Yield on Cost) [5]	5.5%	5.5%	5.5%	5.5%	5.5%
Supportable Value	(\$64,073)	\$73,382	\$280,109	\$292,109	\$404,745

[1] Consistent with guidance in State law (Health and Safety Code Section 50052.5), a 1-bedroom unit should be assumed to be occupied by a 2-person household.

[2] Reflects 2023 HCD Income Limits. Incomes are calculated for a two-person household.

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

[4] Operating expenses are generally based on EPS feasibility studies in the region and are inclusive of utility costs and property taxes.

[5] The yield on cost is a typical target financial return rate used by developers to determine whether to move forward with a project.

Sources: California Department of Housing and Community Development; Economic & Planning Systems, Inc.

Higher levels of affordability mean higher rents and more potential income for a developer, meaning a higher supportable (financeable) value of those units.

Affordability Gap Analysis Findings

As noted, the affordability gap represents the difference between the total project cost and the supportable value of each unit at a given affordability level. This amount is equivalent to the subsidy provided by the market-rate developer to build a unit at a given level of affordability for a given project.

EPS calculated the affordability gap, or subsidy, per unit, for each of the two prototypes at five different income levels, as shown in **Table 6** and **Table 7**. As is clear in the tables below, higher affordability levels correlate with higher supportable values, which means a smaller gap in financing that must be subsidized.

Table 6: Affordability Gap Analysis, Multifamily Garden-Style Rental Prototype

Item	Multifamily Garden-Style Rental Apartment				
	Extremely Low Income (30% AMI)	Very Low Income (50% AMI)	Low Income (80% AMI)	Median Income (100% AMI)	Moderate Income (120% AMI)
Development Program Assumptions					
Density (Units/Acre)	30	30	30	30	30
Gross Unit Size	825	825	825	825	825
Number of Bedrooms	1	1	1	1	1
Occupants per 1-bedroom Unit	2	2	2	2	2
Development Cost Assumptions					
Land Costs	\$133,333	\$133,333	\$133,333	\$133,333	\$133,333
Direct Development Costs	\$280,110	\$280,110	\$280,110	\$280,110	\$280,110
Indirect Development Costs	\$84,033	\$84,033	\$84,033	\$84,033	\$84,033
Development Cost Contingency	\$18,207	\$18,207	\$18,207	\$18,207	\$18,207
Total Project Costs per Unit	\$515,683	\$515,683	\$515,683	\$515,683	\$515,683
Supportable Value per Unit	(\$54,982)	\$82,473	\$289,200	\$301,200	\$413,836
Affordability Gap / Subsidy per Unit	(\$570,665)	(\$433,211)	(\$226,483)	(\$214,483)	(\$101,847)

Sources: HCD; Interviews with local residential developers; Rider Levett Bucknall; Marshall & Swift; Economic & Planning Systems, Inc.

Table 7: Affordability Gap Analysis, Multifamily Wrap Rental Prototype

Item	Multifamily Wrap Rental Apartment				
	Extremely Low Income (30% AMI)	Very Low Income (50% AMI)	Low Income (80% AMI)	Median Income (100% AMI)	Moderate Income (120% AMI)
Development Program Assumptions					
Density (Units/Acre)	50	50	50	50	50
Gross Unit Size	825	825	825	825	825
Number of Bedrooms	1	1	1	1	1
Occupants per 1-bedroom Unit	2	2	2	2	2
Development Cost Assumptions					
Land Costs	\$80,000	\$80,000	\$80,000	\$80,000	\$80,000
Direct Development Costs	\$353,502	\$353,502	\$353,502	\$353,502	\$353,502
Indirect Development Costs	\$106,051	\$106,051	\$106,051	\$106,051	\$106,051
Development Cost Contingency	\$22,978	\$22,978	\$22,978	\$22,978	\$22,978
Total Project Costs per Unit	\$562,530	\$562,530	\$562,530	\$562,530	\$562,530
Supportable Value per Unit	(\$64,073)	\$73,382	\$280,109	\$292,109	\$404,745
Affordability Gap / Subsidy per Unit	(\$626,603)	(\$489,148)	(\$282,421)	(\$270,421)	(\$157,785)

Sources: HCD; Interviews with local residential developers; Rider Levett Bucknall; Marshall & Swift; Economic & Planning Systems, Inc.

Recommended Fee Level

Based on the findings of the affordability gap analysis, EPS calculated a fee level that would be equivalent to the affordability gap, or subsidy, needed to meet the City’s affordability requirements under the IHP.

The calculation is shown below in **Table 8** for a hypothetical 80-unit project. EPS selected 80 units to represent a large project with inclusionary requirements that result in a round number of affordable units, which makes the calculation of fee amounts as

straightforward as possible. For both prototypes analyzed, the developer would be providing a total subsidy of over \$2,000,000 to build the required affordable units: two Extremely Low Income units and two Very Low Income units. This amount is equivalent to the combined affordability gap of all four of these units.

In-lieu fee amounts are then shown in three different formats: per the number of affordable units required at the project, per the project’s total combined square feet of affordable units, and per the project’s number of market rate units. Fee amounts are rounded to the nearest dollar per square foot, or \$100 per unit.

Given that the IHP requires new rental developments to build affordable units similar to the project’s market-rate units, the amount of square feet of affordable units can be calculated by taking the average size of the project’s market-rate units and multiplying it by the number of required affordable units. In the calculation in **Table 8**, this amount is 825 square feet times four units for a total of 3,300 “affordable square feet.”

These fee levels can be considered the maximum justifiable amount that could be charged to a developer as an alternative to building the units on-site. The City could reasonably charge an in-lieu fee equal to or less than the amounts shown. The potential fee revenue would be roughly equivalent to the cost to a developer of constructing affordable units on-site and could be used to subsidize similar units elsewhere.

Table 8: In-Lieu Fee Calculation for an 80-unit Project by Prototype under current IHP

	<i>Extremely Low Income</i>	<i>Very Low Income</i>	<i>Total</i>	Calculated In-Lieu Fee Amount			
				<i>per Affordable Unit</i>	<i>per Affordable Sq.Ft.</i>	<i>per Market-Rate Unit</i>	<i>per Market-Rate Sq.Ft.</i>
Multifamily Garden-Style Rental Apartment							
Units	2.0	2.0	4.0	4		80	
AMI	30% AMI	50% AMI					
Subsidy per Unit	\$570,665	\$433,211					
Total Subsidy Required	\$1,141,331	\$866,422	\$2,007,800	\$501,900	\$608	\$25,100	\$30.42
Multifamily Wrap Rental Apartment							
Units	2.0	2.0	4.0	4		80	
AMI	30% AMI	50% AMI					
Subsidy per Unit	\$626,603	\$489,148					
Total Subsidy Required	\$1,253,206	\$978,297	\$2,231,500	\$557,900	\$676	\$27,900	\$33.81
Blended Average Fee Amount				\$529,900	\$642	\$26,500	

Source: Economic & Planning Systems, Inc.

Under the current IHP affordability requirements, the potential fee amount varies from \$501,900 to \$557,900 per affordable unit, or \$25,100 to \$27,900 per market-rate unit, depending on the prototype.

Of the fee formats shown, EPS recommends setting the fee based on the square feet of affordable units required for a given project. This equates to a fee level of \$608 to \$678 for the two prototypes. EPS further recommends that the City select a blended average fee amount of \$642 per affordable square foot. The two fee amounts calculated are based

on generic project assumptions, and selecting an average between the two amounts can better account for the variability in potential project types, as well as simplify calculation.

Charging a fee based on the affordable units rather than based on the market-rate units ensures that the fee amount is equivalent to what the developer would have to build on-site. Specifically, it matches the fee to the number of required units for projects that require a fractional unit, which under the IHP may be rounded down to the nearest whole number of units if the fraction is below 0.5 and otherwise must be rounded up.

Furthermore, basing the fee on the total square feet in those affordable units rather than simply the number of units makes the fee more flexible and fairer. It avoids unduly penalizing projects that build smaller units or rewarding projects that build larger units.

Next Steps

Setting an in-lieu fee is an important step in ensuring compliance with State law and providing clarity for developers interested in working in the City. To better define exactly how the fee will be calculated, the City should consider implementing administrative rules or amending the IHP ordinance to specify how to determine the required affordable square footage.

In establishing a fee, the City should also consider how best to make use of future potential in-lieu fee revenue to advance affordable housing projects. Affordable housing developers typically need a source of local funds to leverage and attract state and federal funding sources. The City could use fee revenue to directly provide such funding for these projects, or it could pool its funds with other nearby cities. Direct funding would offer the City greater control over use of funds by focusing exclusively on projects within the City limits, while pooling funds could allow the City to contribute to larger projects and projects that may be able to move forward more quickly than projects funded by the City alone, even though those projects may not be located within the City itself.

To directly fund its own affordable housing projects, the City would need to establish a local housing trust fund, like the City of Laguna Beach has done recently, or another form of affordable housing program. To pool its resources, the City could consider participating in the Orange County Housing Finance Trust, which has over a dozen member cities, or work with neighboring cities to establish another shared fund.

Stakeholder Input on Use of Funds

During previous work to support the recent update to the City's IHP, EPS spoke with affordable housing advocacy stakeholders. They suggested that funds collected from an in-lieu fee could potentially be used to catalyze affordable housing development in partnership with faith-based property owners in Laguna Woods. Properties owned by faith-based organizations make up a large part of the developable land inventory within Laguna Woods, and recent California legislation has further streamlined the construction of affordable housing on land owned by faith-based organizations.¹¹

¹¹ Effective January 1, 2024, California Senate Bill 4 (SB4) makes it legal for faith-based institutions and non-profit colleges to build affordable, multi-family homes on lands they own by streamlining the permitting process and overriding local zoning restrictions.

EPS also spoke directly with two affordable housing developers active in the area: Jamboree Housing and National CORE. These developers confirmed interest in building affordable housing projects within the City and working with faith-based property owners, and they indicated that availability of local funds for such projects is a main driver for project success (due to matching requirements needed for many grant funding programs). One developer reported City-related entitlement challenges for a potential affordable housing project previously considered for a faith-based property. In discussing this comment with City staff, it should be noted that, at the time, the City's land use zoning only allowed housing on faith-based properties as an accessory use. Faith-based properties have since been identified for "by-right" housing in the Housing Element. Both developers expressed interest in working with the City on future projects.

Setting an in-lieu fee that reflects actual costs to build a new unit of housing can allow affordable developers to deliver a similar number of housing units in future projects, as well as potentially leverage these "local match" funds to access additional funding from state, federal, and private grant providers.