



Accessory Dwelling Units in our Backyards: Affordable Housing for Santa Cruz¹

Sustainable Systems Research Foundation
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Much of Coastal California, stretching from San Diego in the south to Santa Rosa in the north, is in the grip of an affordable housing crisis. This includes the City of Santa Cruz and, indeed, the entire Monterey Bay region. Are there any viable housing strategies that can be implemented relatively quickly, painlessly and at low cost?

SSRF is developing an ADU program for Santa Cruz, with a target of building 100-300 units per year for five years. These units will be attractive, two- bedroom, manufactured structures of 500-600 square feet, based on a few pre-approved design and materials, with interior finishing and utilities installed during manufacture and completed on-site. Solar photovoltaics will be optional. Construction will be co-financed by a revolving fund providing low-interest, 10-year loans to qualified homeowners. These loans will be forgiven if the homeowner agrees to rent to low-income tenants for a minimum of 5 of the 10 year loan period. Projects will be managed by a "one-stop-shop" public or private developer, which will also offer property management services.

What is the problem?

Housing prices in Santa Cruz are among the highest in the United States, with median rents for a one-bedroom apartment exceeding \$2,000. This is beyond the reach of many tenants, including those professionals on whom community well-being depends— teachers, police, firefighters, construction and service employees, janitors-- but who cannot afford to live in the city where they work and serve.

Although there are numerous causes of the housing crisis, a primary one is the high cost of land. For example, in the 1960s, a 2,000 square foot home on a lot in Live Oak cost \$25,000 to purchase. Today, as a result of Proposition 13, its assessed value is about \$80,000, of which 25% is land cost and 75%, structure. A very

similar house nearby, sold only a few years ago, is currently assessed at \$800,000, of which 75% is land value and 25%, structure. Due to land prices, a newly-built house of 1,400 square feet might cost \$300,000 to build and \$1 million to purchase. There are other factors that play a role in the high costs and scarcity of housing, but land is the primary one.

What is the solution?

There are a number of ways to increase the supply of affordable rental housing: Infill development and high-rise construction are touted as solutions, but they are expensive, time-consuming and often delayed due to building regulations and local opposition. Proposition 13,² passed in 1979, makes it difficult and costly for long-time homeowners to downsize by moving, thereby limiting the supply of housing, on the one hand, while motivating conversion of multifamily housing into expensive condominiums, on the other.

Accessory dwelling units (ADUs) offer a third alternative. An ADU is an "additional, self- contained housing unit that is secondary to the main residence,"³ ranging in size from 200 to 1,200 square feet. They come in a number of forms: free-standing, additions to existing houses and "over- the-garage" units (see illustrations below). Whatever their form, there are several advantages to "infill" ADUs :

- There is no land cost, since the property is made available by the homeowner;
- The construction impact is localized and time-limited than for new structures;
- Utilities are readily available from the primary structure on the property;
- Neighborhood opposition to low-profile ADUs is likely to be minimal and
- If construction costs can be held down, monthly rents could be less than \$2,000 (compared to a HUD "fair market rent" of almost \$2,800 for a two bedroom apartment in Santa Cruz).

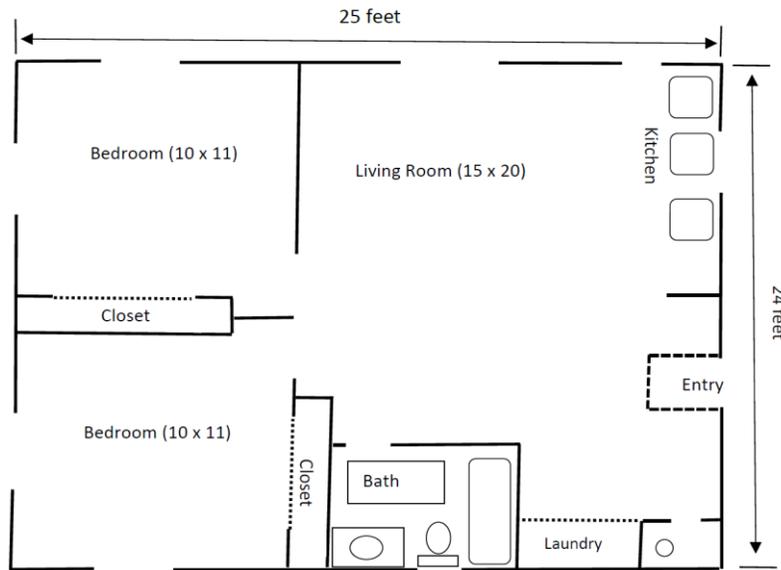
In recognition of these advantages, many cities have instituted programs to encourage homeowners to build and rent such units. What does an ADU cost? Discussions with city building and planning staff, and on-line research, suggests that a "stick-built" stand-alone unit can cost anywhere from \$150,000 to \$300,000 (\$250-500 per square foot), depending on area, design and other features. But these are the costs of "designer" ADUs; we believe that an attractive manufactured structure could bring the total cost per unit down to around \$100,000 and possibly less. At that price, rents would be very affordable.

¹ This paper is based on a longer report that will be available from the SSRF in early November, 2019. The authors are Ronnie Lipschutz, Justin Farris, Tom Nsson, William Bravo, Cori Strell and Liane Bauer.

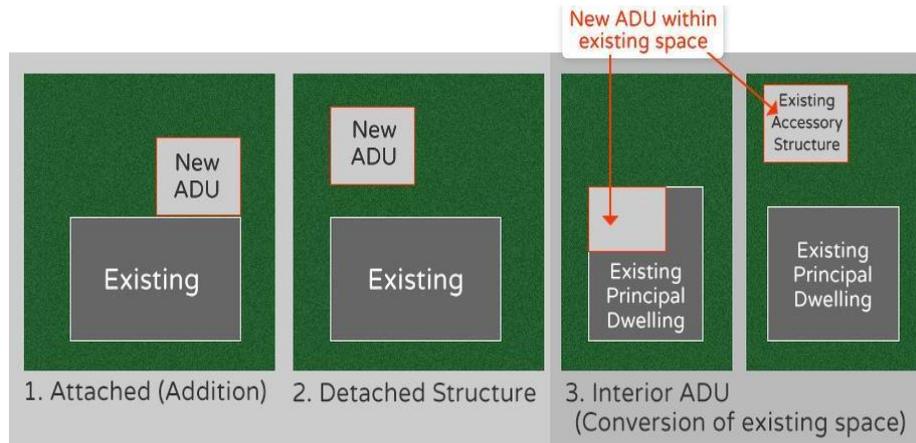
² Proposition 13 was an amendment to the California Constitution, passed in 1978, caps property tax assessments to 1% of market value, limits annual increases in property taxes to 2%, and prohibits reassessment except for new construction or when a property changes hands ("What is Proposition

13," California Tax Data, at: <https://www.californiataxdata.com/pdf/Prop13.pdf> (accessed June 30, 2019).

³ City of Santa Cruz, "Accessory Dwelling Unit Manual," 2003, p. 1, at: (SC ADU Manual, 2003: 1), at: <http://www.cityofsantacruz.com/Home/ShowDocument?id=8875> (accessed July 10, 2019).



Conceptual design of a 2-bedroom, 600 square foot ADU



Spatial placement of ADU alternatives

There are as many as 950 legal and illegal ADUs in Santa Cruz, built over the last 100 years, but the potential for more is considerable. To put a number on that potential, SSRF undertook a GIS survey of residential parcels in the City, and identified more than 5,000 lots with adequate space for a free-standing unit of 600 square feet

(ADUs can range from 200 to 1,200 square feet; we have settled on size close to the median). There are probably an equal number of houses to which “junior” ADUs could be added.

Running the regulatory gauntlet?

As with any construction project, ADUs are governed by a mix of both state and local laws and regulations. The latter can differ considerably from one jurisdiction to the next, and getting approval has, historically, been both labyrinthian and byzantine in many cities. In recognition that ADUs can make significant contributions to affordable housing, both the state and localities have begun liberalized the rules governing ADU construction, by all accounts, the approval process remains daunting, and can take a considerable time. Moreover, because most ADUs are uniquely-designed units, each is subject to individual review.

All new residential structure must undergo an architectural review, to ensure that a design is feasible and will not fall down if built according to the plan. All units must have utility (gas, electricity, water, sewer) hookups, and permits are required for these connections. Some of these fees may be waived in the interest of encouraging ADU construction. In recognition that ADUs can make significant contributions to affordable housing, both the state and localities have begun to streamline and simplify the ADU safety review, permitting and approval process.

Specific building and safety requirements are based on recognized national standards and may be supplemented by additional requirements imposed by the local jurisdiction (city or county). Although state, county and city have significantly

Zoning laws have also been a major obstacles to construction of affordable housing and ADUs. Zoning defines permissible construction, both residential and commercial, in particular areas of a city. Often, some are zoned only for single family houses, and apartment buildings and ADUs are not allowed. The new California laws try to change this, but the state cannot require jurisdictions to change their zoning, however, any jurisdiction that does not must follow state standards. In other words, zoning can no longer be invoked to prevent ADU construction.

Standardized plans could reduce the time required for initial review, although all units would have to undergo inspection. If such designs received blanket approval, the permitting and review process could go more quickly. A few organizations offer full-service “ADU Management and Delivery,” which reduces the burden on and the risk to the homeowner.

Paying for an ADU

For an ADU to be affordable to tenants, it must also be affordable to the homeowner, which is a function of financing, taxes and maintenance. Financing a new ADU is not a trivial proposition, even if the numbers are favorable.

The most common method is through a “HELOC” a home equity line of credit or second mortgage on a property. Not everyone can afford to do this. To encourage homeowners, some jurisdictions have offered loans that are forgiven if the ADU is rented to a low-income tenant for a specified period of time. A number of “innovative” financing methods are being proposed (see table below), and some have been put into practice. Others are more theoretical and are yet to be tried. All assume that the homeowner holds sufficient equity in their home to secure a loan. But there could be arrangements in which the funder pays all costs, holding a lien on the property, with the homeowner simply providing the land and taking title to the ADU after 10 years.

There are other ways to ease the burdens of building an ADU. Normally, the homeowner is both developer and contractor, and must shepherd a project through the permitting process, often with considerable delays along the line, arrange financing and find an architect and contractor. All of this can be daunting. A few companies and organizations now offer full-service “ADU Management and Delivery,” which reduces the burden on and the risk to the homeowner. The managing entity can be non-profit or for-profit. It identifies interested homeowners, presents them with several pre-approved designs from which to choose, arranges financing, handles permitting, hires contractor-builders, delivers the key at completion and even functions as a property manager. The organization might even own the ADU for 10 years, paying ground rent for 10 years and then transferring title to the homeowner. If the financing and building model is sufficiently attractive and offers a high rate of return, financing could come from a variety of sources, including venture capitalists and high net worth individuals.

SSRF is exploring, designing and developing a large-scale ADU program for Santa Cruz as described above. For more information, please contact SSRF (see contact information below).

Some ADU financing methods

Name	Explanation
Renovation mortgage	new or refinanced mortgage based on a property's value after renovation or flexible terms; ADU cost internalized in mortgage
ADU-Specific Home Equity Line of Credit	backed by home equity; revolving lines of credit with shorter repayment terms and interest on the balance drawn; Homeowner finances the entire ADU
Community Development Financial Institution/Local Partnership Loan Programs	allow projected rental income from unbuilt ADUs to count as income toward local qualification; Local bank provides financing in economically-disadvantaged communities
Local Government Grant and Loan Programs	partial financing loan in exchange for repayment at sale, with commitment to low income tenant or homeless accommodation; sometimes offers loan forgiveness if homeowner fulfills the terms of low income housing agreement
Shared equity financing	company provides partial financing in exchange for future home appreciation or sale value; May require home sale or repayment within a specified time period; no interest or payments
Peer-to-peer lending	investors provide direct financing to homeowners in exchange for higher-risk interest rate; May drive up rents in order to pay high interest rate
Revolving fund	public or private fund provides partial financing with repayment from rents; Homeowner repays fund with portion of rental revenues; could be financed with bonds
Land trust financing & ownership	community land trust signs term-limited land rental agreement (15-20 years), finances, builds and owns the structure, pays land rents to homeowner for contractual period after which title is transferred to homeowner
ADU Delivery & Management	private company finances, sites, gets permits for, manages rental ADU, shares rent with homeowner or pays ground lease

Robert Liberty, Kol Peterson & Dan Hardcastle, "Innovations in Financing for Accessory Dwelling Units," Urban Sustainability Accelerator, at: <https://accessorydwellings.files.wordpress.com/2019/05/financing-for-accessory-dwelling-units-may-14-version-rl.pdf> (accessed August 26, 2019).

The Sustainable Systems Research Foundation (SSRF) is a Santa-Cruz based non-profit dedicated to designing and implementing the global, multi-generational project of building a sustainable and just civilization through the development and implementation of local and regional initiatives and projects that are pragmatic, well-designed, replicable and scalable. SSRF focuses are local, national and global, with particular commitment to environmental issues and policies in the Monterey Bay region, the Central Coast and Northern California presently. These include next generation sustainable energy production and distribution; urban agriculture; water infrastructure; waste reduction; transportation policy; urban land use planning; affordable housing design and development; and sustainability education. We seek to develop cooperative projects and programs with partners in the public, private, and non-profit sectors, including educational institutions, students exploring a future in the green economy, local governments, businesses, non-governmental organizations, and interested citizens.

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