Community Development Commission/Housing Authority of the County of Los Angeles

September 7, 2018

TO: Board of Supervisors

FROM: Monique King-Viehland, Executive Director

SUBJECT: REPORT BACK ON AFFORDABLE HOUSING COSTS

At its meeting on June 6, 2018, the Board of Supervisors directed the Community Development Commission/Housing Authority of the County of Los Angeles (CDC/HACoLA) to report back on the cost of housing per unit and cost of land, as they relate to the production of affordable housing. To gather information associated with these costs, CDC/HACoLA worked with the Terner Center for Housing Innovation (Terner Center) at the University of California, Berkeley to obtain information specific to Los Angeles County. The Terner Center is a collaboration between the College of Environmental Design and the Fisher Center for Real Estate and Urban Economics at the Haas School of Business and leverages applied research and best practices to inform and advance innovation in the planning, financing, design and development of the built environment.

CDC/HACoLA also conducted general research related to the drivers of costs in the industry statewide and received recommendations and input from the California Community Foundation (CCF). One of CCF's focus areas is the housing program, which combines grant making, lending, and advocacy to support effective homeless housing, affordable housing, and better jobs for working families. Since 2000, CCF has granted almost $30 million to provide safe, supportive, and stable homes to area residents.

Factors Influencing Costs

Housing construction in the U.S. continues to recover from the great recession of 2007-2009, but the recovery is incomplete and there are fewer homes being built each year than was the historical norm. Coupled with the sluggish rate of recovery for construction, costs associated with the production of housing have been rising across housing markets - both the market rate and affordable housing sectors.

While "affordable housing" means that the rent is set at varying levels of affordability relative to the target population(s) being housed, this housing type still must be built to building standards code and compete for land, labor, and materials with all other construction activities. Across the U.S. and in California particularly, construction costs are steadily rising. As of July 2018, construction costs have increased for the 21st straight month, according to a leading indicator for wage and material inflation for the engineering, procurement and construction sector. Additionally, steel prices in the U.S. are at or near

peak levels, and labor costs continue to increase in all regions of the country. Also adding to costs are increased interest rates for borrowing funds from private lenders. Although rates have not increased as much as was predicted after the 2016 presidential election, there is lingering concern that interest rate hikes will occur.

According to research conducted by the Terner Center and numerous other housing research and advocacy groups, the costs of construction are rising rapidly, especially in California. The cost of constructing housing has been steadily increasing from the levels seen during the recession and continues to escalate. San Francisco, Oakland, and Los Angeles are currently ranked first, second and third for construction costs in the state, and those costs are rising quickly. Between January 2011 and January 2016, construction costs rose by 13.6% in Los Angeles, 12.6% in San Francisco, and 11.8% nationwide. Exacerbating this problem of rising costs, the Terner Center notes that the construction industry's productivity has been in decline and, unlike other sectors of the economy, residential housing is still being built in the same way as it was fifty years ago, with few advances in methods have could to savings and improvements. This decline in productivity has been widely reported, with Los Angeles County showing an extreme shortfall in the availability of affordable housing. According to the California Housing Partnership and the Southern California Association of Nonprofit Housing, Los Angeles County needs approximately 568,000 new units to meet the demand of low-income renters.

When it comes to the workforce needed to produce housing, the Terner Center highlights that following the great recession, the construction industry did not grow to meet the current demand of housing production, remaining relatively small. Their study asserts that the diminished number of subcontractors, in particular falls short of meeting California's housing demands. Across the U.S., the employment rate of construction workers has recovered from the recession, but the construction workforce has substantially diminished – many who left the industry during the recession have not returned and fewer young people are entering the construction workforce.

Measuring this workforce shortage can be done by reviewing unmet demand in the construction industry, which is indicated by the difficulty of hiring workers. According to a leading labor market firm, construction jobs are remaining unfilled for longer periods, which increases competition (and the cost) for that labor. According to this measure, California is seeing the third highest labor shortage in the U.S. and construction labor costs in the state are approximately 120% of the U.S. average. Between 2005 and 2015, the average hourly wage for construction workers increased by 27%.

State-Level Information

Many studies have been undertaken to understand the forces at play in California relative to the costs associated with developing multifamily, affordable housing projects. A large-scale, year-long study was published in 2014 by the state's four housing agencies - the California Tax Credit Allocation Committee (CTCAC), the California Debt Limit Allocation

Committee (CDLAC), the Department of Housing and Community Development (HCD), and the California Housing Finance Agency (CalHFA).

This state-level study found that the factors influencing costs are multifaceted, and no single factor explains all or even most of the costs of developing affordable housing. This stems from the diversity of the types of projects, the unique circumstances of the occupants it was intended to house, the time period and location in which a project was developed, and the characteristics of and choices made by the developer, among other factors.

Although the specific project circumstances prevent wholesale comparisons, the state's study did find that the size of the project and the size of the units within a project, can influence development cost. To this point, the state study found that for each 10% increase in the number of units in a project, the cost per unit declines by almost 2% as a result of economies of scale. Additionally, each portion of the development process, and the partners involved, plays a role in influencing project costs.

Los Angeles vs. Other Jurisdictions

The state's housing cost study, published in 2014, showed Los Angeles County as the fifth highest cost region, behind San Francisco County, North and East Bay Region, Central Coast Region, and the South and West Bay Region, respectively. At that time, the average per unit cost in Los Angeles County was approximately $365,000 per unit, while San Francisco County had a per-unit cost of $406,000. It is important to note that the study excluded land cost, but CDC/HACoLA's recent data shows that by including land, the average cost per unit in Los Angeles County would have been approximately $400,000 to $407,000 at the time of the study. Comparative land cost data on San Francisco County was not readily available.

The Terner Center's research addressed more recent data and showed that costs in Los Angeles County rose from approximately $400,000 per unit in 2015 to approximately $487,000 per unit in 2017/2018[1]. At the same time, costs in San Francisco rose to an average of $627,000 per unit during 2014-2017. In May of this year, three projects in San Francisco showed costs per unit of $710,000, $762,000, and $965,000.

According to the state's study, generally speaking, local factors, such as community opposition, regulations, and availability of land each impact costs to varying degrees. Overall, the sources of development cost for affordable housing projects were found to be as follows: construction costs (69%), demolition/site preparation (8%), developer fees (7%), permitting/impact fees (6%), architectural/engineering/surveys (4%), acquisition costs (1%), offsite improvements (1%), all other costs (4%).

[1] Both figures include land costs.

Market Rate vs. Affordable

There is a severe shortage of information on market rate housing development costs with which to compare against affordable housing costs. The state's study requested information from 80 developers in an effort to capture such data, but was able to collect information on only 22 projects. This is most likely due to developers wishing to protect sensitive or proprietary information in a competitive market. While limited in scope, the comparison found that affordable housing units were, on average, about $13,000 per unit less expensive than market rate projects, although when taken on a cost per square footage basis, the costs were roughly even between the two housing types. The utility of this data is limited, however, because of the small number of market rate projects evaluated.

Local Data

In an effort to further identify influences on costs at the local level, rather than statewide, the Terner Center compiled data on Los Angeles County affordable multifamily housing projects that used Low Income Housing Tax Credit (LIHTC) financing, which is the most commonly-used financing tool for such projects. This review included both types of LIHTC financing - 9% and 4%. The data covers approximately two-thirds of new construction LIHTC projects funded from 2008-2018 and separates City of Los Angeles projects from greater Los Angeles County. To allow the 10 years of projects to be compared, costs were adjusted for inflation to 2018 as the base year.

Table 1: Number of Projects by Location 2008-2018

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
CA	40	61	84	89	93	76	96	54	60	55	24
LA County	12	17	22	24	24	22	20	13	18	15	6
LA City	7	12	14	20	18	11	12	8	8	8	3

Source: Terner Center LIHTC Database, New Construction, 2008-2018. Note: CTCAC has not yet approved LIHTC projects for the second half of 2018 so the final project total will be higher.

Using this data, the Terner Center found that the development cost in Los Angeles County has risen by a total of approximately $87,000 per unit since 2015, which is driven by a number of different factors, including:

- Projects in Los Angeles County are more likely to be four to five stories, which tends to cost more than one to three story buildings (but less than taller buildings).

- The majority of Los Angeles County projects are of the large family type, which include more bedrooms per unit.[2]
- Buildings that are 100% studio/one-bedroom consistently cost more per bedroom than buildings with larger units.
- Los Angeles County projects devote a greater share of space to non-residential uses than the statewide average.[3]
- Parking square footage has trended down over time, similar to the statewide average.
- Most projects in Los Angeles County pay prevailing wage[4].
- Construction costs appear to be driving cost increases, not land or developer costs, although rising construction interest, fees, and contingency costs also play a role.

Table 2: Type of Projects 2008-2018

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Large Family	9	10	10	15	12	10	10	5	7	4	2
Special Needs	0	1	3	2	8	8	7	6	8	7	4
Senior	2	6	7	5	3	4	3	2	3	4	0
Total	12	17	22	24	24	22	20	13	18	15	6

Source: Terner Center LIHTC Database, New Construction, 2008-2018. Note: CTCAC has not yet approved LIHTC projects for the second half of 2018 so the final project total will be higher.

All of the data gathered for Los Angeles County led the Terner Center team to conclude that drivers of cost appear to be linked to three main areas, although additional research is needed to determine cost per unit fluctuations over the past two years:

- Construction costs and contingencies[5].
- Greater share of Special Needs projects over time.[6]

---

[2] It should be noted that in recent years, the share of special needs projects in Los Angeles County has overtaken the share of large family projects.

[3] This is potentially due to the fact that Los Angeles County focuses funding on homeless and special needs housing types, which require office and supportive services spaces and community rooms.

[4] It should be noted that County funds administered by CDC/HACoLA typically do not trigger the payment of prevailing wages; this a product of the layered financing seen in affordable housing projects. Federal funds administered by the CDC/HACoLA do, however, trigger the payment of federal prevailing wages.

[5] This includes hard and soft cost contingencies, as well as project-specific reserves.

[6] Such buildings tend to cost 20% to 25% more per bedroom than family projects, potentially due to greater non-residential space and multiple layers of financing and time to complete.

- Projects in Los Angeles have a greater share of non-residential space than the statewide average, which adds to the cost per unit (a 10% boost in share of non-residential square feet can add $8,000 to $20,000 to unit cost even after controlling for other project features).

Local Initiatives

One of the potential cost drivers identified by research involved the differences in requirements by affordable housing funders and the layers of complexity this may bring to projects. Although somewhat anecdotal, projects were said to include more amenities, or were forced to abide by multiple facets of funding regulations than otherwise might be the case if only one funding source was used. To alleviate this potential problem, over the past two years CDC/HACoLA has been working with the City of Los Angeles Housing and Community Investment Department (HCID) and HCD to harmonize funding requirements. CDC/HACoLA also worked to closely match CTCAC regulations as well. This effort has led to project requirements during evaluation, loan underwriting, and construction closely tracking with the other major funders. Additionally, CDC/HACoLA, HCID, and the County and City Housing Authorities are working towards using a universal application, which will further streamline project development.

In addition to working to reduce costs and the time associated with accessing affordable housing funds, CDC/HACoLA has been researching modular, or prefabricated housing and has been working with other County departments and developers to gain insight on this construction type. The goal of this work has been to explore the feasibility of modular/prefabricated housing at the local level and the local development community's reaction to this construction type. Although not yet widely used, this housing construction type has the potential to decrease costs associated with the production of affordable housing if it can gain a greater presence in Los Angeles County.

The Department of Regional Planning (DRP) is also implementing policies and initiatives that should provide cost relief to affordable housing projects in the unincorporated county, including implementation of SB 35, which streamlines affordable housing permitting. Additionally, in February of this year, the Board instructed DRP to initiate a Homeless Housing Ordinance to include compliance with SB 2 (2007), streamlining and incentivizing permanent supportive housing and motel conversions, and consideration of how reasonable accommodations support homeless housing. DRP is also updating Los Angeles County's Density Bonus Ordinance, which encourages developers to provide low-income housing by providing additional density and other zoning incentives.

It should be noted that there is also an ongoing discussion of alternative housing models that are not widely funded by local governments. The Homeless Initiative is currently accepting applications for its Housing Innovation Challenge that seeks scalable, low-cost housing solutions and CDC/HACoLA is working with the Department of Mental Health on an alternative housing models NOFA that, likewise, seeks housing models that are not currently widely used by the development community. Both of these efforts should inform

future policies and provide alternatives that may decrease housing production costs and/or decrease the time needed to deliver affordable housing solutions.

One housing model – single room occupancy (SRO) housing – has been proposed as a viable low-cost housing type. These units have no individual bathrooms and minimal, if any, kitchen space, meaning these features are shared among residents on each floor. Despite the cost savings, it appears that there are valid reasons why this housing model is no longer supported by local funding agencies and experienced mission-driven supportive housing developers.

Feedback solicited from supportive service experts, developers with SRO units in their portfolios, and the Department of Health Services (DHS) was unanimous in their concurrence that SRO housing was not conducive for permanent supportive housing. Despite the limited availability of supportive housing, they all cited a demonstrated difficulty in identifying clients willing to fill SRO units and are experiencing extremely high turnovers once filled. One developer with a portfolio of 700 SRO units indicated that many of their homeless clients choose to live on the street rather than live in a SRO unit, that resident conflicts were exacerbated in their SRO buildings, and that it limited the residents' ability to stabilize or live independently.

Additionally, the lack of individual bathrooms is an obstacle for the many homeless clients that have high-medical needs, higher mobility needs, or are aging. This was particularly relevant for the chronically homeless and high-acuity populations. Reference was also made to the number of claims made by residents living in SRO units for reasonable accommodations to enable them to get their own bathrooms. While SRO units may not be a good fit for permanent supportive housing, it is acknowledged to be a suitable model for bridge housing when coupled with appropriate levels of case management.

Conclusion

Research indicates that there is great complexity in isolating factors contributing to affordable housing costs and a variety of factors are at play in driving those costs up in recent years. Many of these factors are market-driven and not easily controllable by local governments. However, some factors that can be influenced by local governments pertain to regulations and policies that can reduce the time associated with the construction of affordable housing, which in turn, could lower costs. Additionally, efforts to solicit alternative housing models may hold promise for cost-reduction strategies.

CDC/HACoLA will continue to work with local funding agencies, County Departments, and the development community to explore ways to reduce the time and cost associated with the production of affordable housing and will continue to explore ways to reduce the overall cost of affordable housing delivery.

c: Sachi Hamai, Chief Executive Officer
Cecilia Zavala, Acting Executive Officer