ADU Financing Report

Paramount ADU Project

August, 2023

Prepared for the City of Paramount, CA

With funding from SCAG

Prepared by Woodsong Associates

Overview

The Woodsong Associates team presents the following Financing Report as part of Task 2.10 of the Paramount ADU Project.

This report is funded through The Southern California Association for Governments (SCAG) by the Regional Early Action Planning (REAP) grant from the State of California Department of Housing and Community Development (HCD). This report was prepared for the City of Paramount, California.

This Financing Report includes the following:

- a review of existing ADU financing tools
- an analysis of the ADU rental market
- an assessment of ADU development costs, including all fees
- an analysis of ADU affordability for renters and owners
- a pro forma analysis for ADU development in the City
- a review of best practices for ADU financing
- a summary of opportunities to increase access to ADU financing options

The contents of this report reflect the views of the author, who is responsible for the facts and accuracy of the data presented herein. The contents do not necessarily reflect the official views or policies of SCAG or State of California - Business Consumer Services and Housing Agency. This report does not constitute a standard, specification or regulation.

ADU PROGRAM

Paramount ADU Project

Acronyms and Abbreviations

AB	Assembly Bill
ADU	Accessory Dwelling Unit
AHSC	Affordable Housing and Sustainable Communities
AMI	Area Median Income
APR	Annual Progress Report
BAHFA	Bay Area Housing Finance Authority
BIPOC	Black, Indigenous, and/or People of Color
CalHFA	California Housing Finance Agency
CCEDA	California Community Economic Development Association
CDFI	Community Development Financial Institution
CDLAC	California Debt Limit Allocation Committee
COG	Council of Governments
EPA CAN DO	East Palo Alto Community Alliance and Neighborhood Development Organization
GCHFT	Gateway Cities Housing Finance Trust
GHG	greenhouse gas
HCD	Department of Housing and Community Development

HCV	Housing Choice Voucher
HELOC	Home Equity Line of Credit
HUD	U.S. Department of Housing and Urban Development
LTV	Loan to Value
MFI	Median Family Income
OCHFT	Orange County Housing Finance Trust
RHNA	Regional Housing Needs Allocation
ROI	Return on Investment
SB	Senate Bill
SCAG	Southern California Association of Governments
SDC	System Development Charge
SDHC	The San Diego Housing Commission
SDHC	San Diego Housing Commission
sf	square foot/square feet
SGC	Strategic Growth Council
SMCU	San Mateo Credit Union
TPA	Transit Priority Area

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Executive Summary

In the City of Paramount, over half of renters are cost-burdened, meaning they are spending over 30% of their income on housing costs, indicating a need for more affordable rental housing in the City. This is due to minimal housing development and rising housing demand in the region, leading to increasingly higher real estate prices. In the last decade the cost of real estate has more than doubled in the City. As home prices reach an all-time high, the cost burden is disproportionately shared by those least able to accommodate the higher prices. This same story is true for much of California.

In 2016, the State began to address the severe housing deficit through the promotion of accessory dwelling units, commonly referred to as ADUs. Over the last six years, ADU laws and housing policy have continued to evolve to hasten this process. Paramount has made great strides to meet the ongoing development of ADU standards set by the State. In 2018, the City adopted an ADU ordinance in accordance with State statutes. Between 2018 and 2022, the City received more than 175 ADU building applications in the last four years (up from approximately zero in prior years).

Despite the success of ADU development, there is still a scarcity of affordable housing, exacerbated by high development costs coupled with steep rental market rates. In order to progress in solving the housing crisis *and* allow all residents the opportunity to reap the benefits of ADUs, homeowners must be granted the financial tools to develop ADUs affordably, whilst ensuring affordable housing options for renters.

Purpose

The aim of the Paramount ADU project is to provide planning assistance to the City to help the jurisdiction develop effective ADU implementation policies and programs, while meeting statewide standards. Specific goals of the project are to support and promote ADU production to meet community and regional housing demand through efficient permitting and approval of ADU applications, by providing useful information to owners about how to build an ADU, and through other means to encourage ADU construction.

Objectives

The intent of this **Financing Report** is to evaluate existing financing options for homeowners, identify areas of opportunity to further promote ADU development by lower- and moderate-income homeowners, and encourage the production of affordable ADUs.

Key Findings

- While small studio ADUs may be able to provide housing for low-income households, at current market rates, **ADUs larger than a studio are not expected to provide affordable rental opportunities for low-income households** with annual incomes below 80% of the AMI. (*see page 21*)
- Between 2018 and 2021, **100% of the very low- and low-income housing production in Paramount was made up of ADUs**. (*see page 34*)

- The CalHFA grant helped homeowners **reduce the long-term financing** required to construct ADUs in a dramatic way. (*see page 43*)
- A loan product that requires homeowners to rent their ADUs to Section 8 tenants can **increase the availability of very-low income housing** without reducing monthly income for homeowners. (*see page 41*)
- Under the current provisions of AB 345, **monthly mortgage payments** for ADUs purchased separately from the primary dwelling may in some cases be **more affordable than market rental rates**. (*see page 24*)
- Estimated ADU sale prices for one, two, and three-bedroom units are **not expected to meet affordability requirements for prospective low-income buyers** below 80% of the AMI. Even moderate-income earners are not expected to be able to afford three-bedroom units. (*see page 23*)

Summary of Recommendations

- Work with Gateway Cities Housing Finance Trust to **develop and participate in an ADU construction loan program** that provides deferred payment funding to low-income homeowners and incentives for them to rent their ADU to low-income tenants at an affordable rate. (*see page 39*)
- Partner with a local nonprofit or consultancy to **offer free or discounted technical assistance** and services in exchange for an affordable rental unit. (*see page 42*)
- Partner with a nonprofit, like a Community Land Trust, who would **build ADUs and sell them to low-income residents**, as allowed by state ADU laws. It is possible that AHCS or CalHome grant funds could be used for such a program. (*see page 43*)
- Join other jurisdictions to **lobby for the renewal of the CalHFA ADU grant**, or the adoption of a similar program. Alternatively, the City could develop this program individually to be offered only to Paramount residents, or work with Gateway Cities Housing Finance Trust to develop a program for member jurisdictions. (*see page 43*)
- **Join the Los Angeles Public Bank** by purchasing a non-controlling share to become a charter member, potentially allowing its citizens to obtain access to Bank financing for ADU construction. (*see page 46*)
- The City of Paramount could **implement parking benefit districts** in its residential areas, in order to manage increases in demand for on-street parking due to ADU development, and to develop a revenue stream to help offset potential increases in costs for additional city services for increase in population due to ADU development. (*see page 46*)
- We recommend that the Legislature **implement a fix to California's property tax system** that assigns a greater share of growth in property taxes from residences to local jurisdictions, especially cities that promote, encourage, and receive infill housing development. The City of Paramount should join other jurisdictions through the League of California Cities and GCCOG to direct legislative lobbing efforts to advocate for this change. (*see page 45*)

Introduction

ADUs are often seen as an affordable housing strategy as they are typically less expensive to construct than apartments of a similar size, and are often rented to family members or friends of the homeowner for below the market rate.

They also provide rental income to the homeowner and increase the property's value, building generational wealth over time. The financial benefits of ADUs are significant, but so can be the barriers to constructing them.

Although ADUs are often less expensive than other forms of housing, they still require significant financial resources to build. The average ADU construction cost in California in 2018 was $150,000.

Most homeowners do not have this type of money on hand, and instead use a combination of cash and a loan product, like a mortgage or construction loan, to fund the construction of their ADU. Lower-income households face bigger barriers to ADU construction, as they likely have less available cash to invest in such a project, and may have more limited access to financing resources than wealthier residents.

Financing products designed to **aid low-income homeowners** build ADUs are needed in order to ensure that ADUs do not inadvertently broaden the wealth gap. Moreover, financing products should also **ensure that at least some of the ADUs constructed are priced at affordable rates** for low-income renters. Creating programs with these criteria in mind will guarantee that the impact of ADUs on California's housing crisis is meaningful, and does not produce housing units that only few can afford to live in.

Yet ADU-specific financing products are still largely in development, as ADUs continue to gain popularity.

The California Housing Finance Agency (CalHFA) ADU grant was the first statewide ADU financing product, which allocated $100 million in grants to homeowners in order to cover up to $40,000 in soft costs, like permitting. However, the funds for this grant have been fully expended as of May of 2023, and it is not expected to be renewed.

Several individual jurisdictions have also launched pilot or permanent financing programs for ADUs, offering products like low interest loans, forgivable loans, and fee waivers. The funds for these programs have come either from the jurisdictions' various funds, or from state or federal funding sources.

This report will discuss how the City of Paramount could follow a similar path by designing a financing product that fits the needs of the community and allows homeowners of all income levels the opportunity to construct an ADU.

It will also discuss the current ADU market in terms of rental rates and potential income, housing cost-burden, and cost of ADU development, supported by the findings of a pro forma analysis.

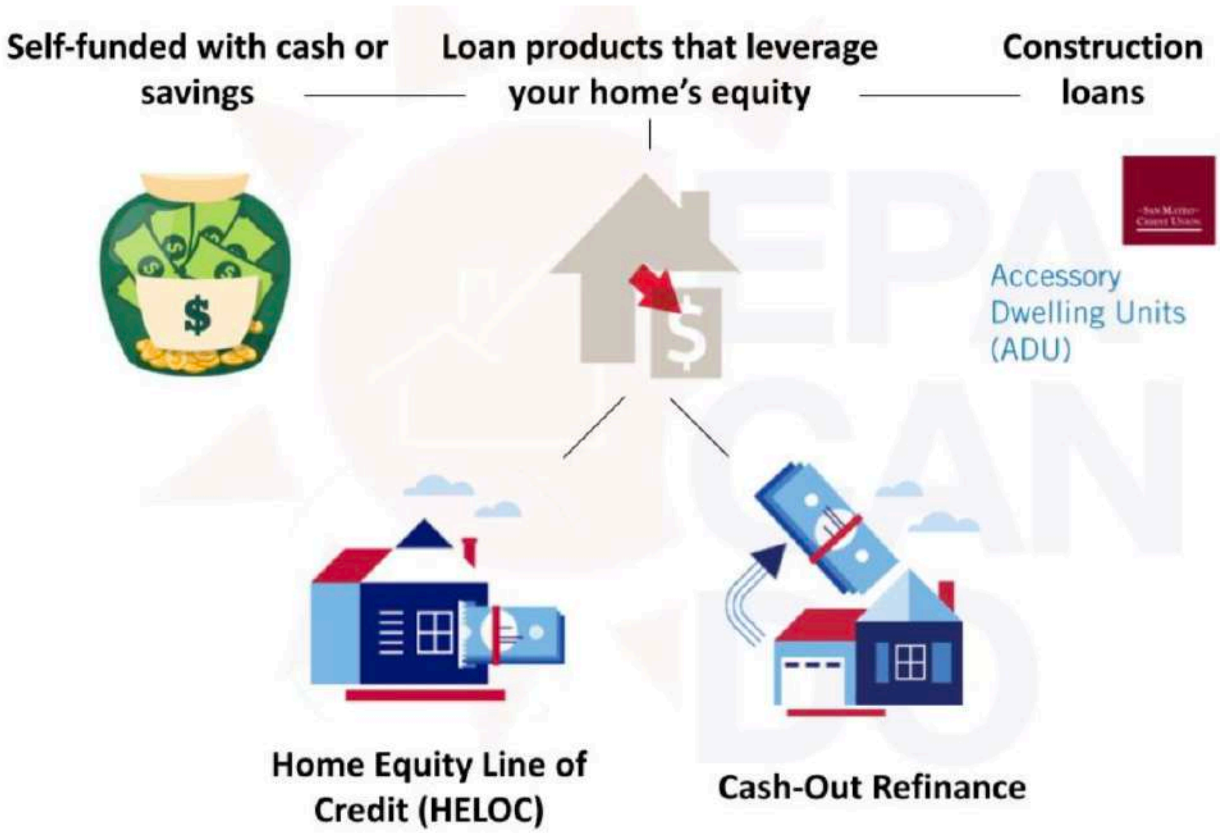

Figure 1: Chart of some popular ADU financing options provided by East Palo Alto nonprofit organization EPA CAN DO.

Existing ADU Financing Assessment

Tools available to the City of Paramount

Several state or federal funding sources to aid in the development of affordable housing and infill growth exist. These programs are available to several different entities depending on the program, like local jurisdictions, developers, and nonprofits. The City of Paramount could design a program that would boost affordable housing production, allow low-income homeowners to build ADUs, or both, and propose such a project to these funding sources in able to finance the program. Some of the potential programs that could be utilized by the City are described below.

CalHome

The California Department of Housing and Community Development (HCD) administers the CalHome program, which provides grants to local public agencies and nonprofit organizations for various financial and technical support services related to home buying and owning for low- and and very low-income households. The City could partner with a nonprofit organization to apply for this funding, creating a program to provide technical assistance or perhaps a low-interest, deferred-payment loan program for ADUs.

Similar projects have already taken place in places like East Palo Alto, which will be further discussed later in this report.

For more information visit *https://www.hcd.ca.gov/grants-and-funding/programs-active/calhome*.

Affordable Housing and Sustainable Communities (AHSC)

The Strategic Growth Council (SGC) administers the AHSC program with the mission of building healthier, holistic communities that are less dependent on personal vehicles and ultimately reduce greenhouse gas (GHG) emissions. Funds are available to local governments and other entities which seek to develop or renovate affordable housing, or develop sustainable transportation infrastructure.

It is possible that individual jurisdictions, or larger entities like the Southern California Association of Governments (SCAG) could propose projects that use the AHSC funds to promote ADU development, as infill growth is a key pillar of creating sustainable cities and aligns with the program's vision.

Historically, the majority of the program's previous housing projects have been affordable multifamily residential developments, but it's possible that this could become an avenue for affordable ADU development as well.

For more information, visit *https://www.hcd.ca.gov/grants-and-funding/programs-active/affordable-housing-and-sustainable-communities*.

Tools available to homeowners

Because few ADU-specific financing products existing in the current market, homeowners thus far have primarily used standard financing products to build their ADUs. These often require leveraging their home's existing equity to take out a new loan.

Home equity loans

Home equity loans allow homeowners to borrow against their home's value, including how much the home has appreciated in value, and how much of the mortgage has been paid off, minus what is owed on the mortgage. A Home Equity Loan is a good ADU financing option (as well as for any other large-scale renovation project); it is often also known as a second mortgage. With a Home Equity Loan, the entire amount of the loan is received up front in a lump sum. The downside to this is having to pay interest on the full amount of the loan (unlike with a Home Equity Line of Credit). The upside is the interest rate can be fixed rather than variable.

Home Equity Loans will always have a higher interest rate than a primary, first mortgage, and will often have a payback period that typically ranges from 5 to 15 years. The loan will usually require a similar underwriting process to a standard mortgage, including an appraisal, credit checks, income verification, etc. The amount of financing a borrower qualifies for is based on a calculation of how much equity is in the home, as determined by the appraisal and the amount remaining on the primary mortgage.

Home Equity Line Of Credit (HELOC)

Like a Home Equity Loan, a Home Equity Lines of Credit (HELOC) allows a homeowner to borrow against the equity in their home. A HELOC is essentially a second mortgage that comes in the form of a a revolving credit line structured similar to a credit card: as much or little of the loan may be withdrawn or paid back anytime, and interest is paid based on the amount withdrawn. Usually, a HELOC loan is relatively quick and cheap to accomplish with minimal closing costs.

However, this loan may come with a higher interest rate than other loans, likely with a variable interest rate that may go up over time. Also, depending on the lender, the term of this loan can range from 10-30 years, either interest-only or fully amortized.

Personal property loans

Also knows as a chattel mortgage, a personal property loan is similar to a traditional mortgage, but is used to finance moveable property, such as automobiles and mobile homes. They are typically shorter term and with higher interest rates, but provide the benefit of being completely separate from the home's primary mortgage.

In California, per Section 18007 of the Health and Safety Code, a detached ADU could qualify for a personal property loan, but we have yet to find any companies which specifically offer these types of loans for ADUs.

Construction loans

Construction loans generally pay for plans, permits and fees; labor and materials; and closing costs. A construction loan may look at the appraised improved home value, once construction is complete, instead of the current home value. There are two main types of construction home loans: construction to permanent loans or construction-only loans.

Construction to permanent loans allow the money borrowed to build your ADU to turn into a permanent mortgage. Construction-only loans are taken only during the construction of the ADU; once completed, a new permanent mortgage pays off the construction.

Bridge financing

A short-term financing option is a bridge loan, or a second-position mortgage which can be used to fund ADU construction. Bridge loans typically have higher interest rates and are flexible enough to fit a wide range of scenarios. When the ADU stabilizes, meaning a record of steady rent collection has been established for a period of time such as one to two years, the homeowner must pay off the bridge loan by refinancing their first mortgage or taking out another longer-term loan.

Though bridge financing programs for ADUs are relatively new, certain banks such as the San Mateo Credit Union (SMCU) offer this type of loan. We expect that its availability will increase as ADUs gain popularity.

Ground leases

A ground lease, in terms of ADUs, is an agreement between a company and a homeowner whereby the owner leases the land to the company, and the company constructs and manages an ADU on their property. During the lease term, the homeowner receives a small portion of the rental income and when the term ends, the homeowner becomes the owner of the ADU, or in some cases, must buy it at market value.

The number of companies that currently offer this as an option are few, and homeowners should be cautious and consider this option, and the contract terms, carefully. As this financing option is relatively new to the ADU market, it is not strictly regulated by the government and thus could pose risks to owners if the ADU company goes out of business.

However, it may also be attractive to homeowners who want the rental income of an ADU without being able to make any upfront investment of their time and money.

Shared appreciation models

Shared appreciation contracts are agreements between a homeowner and a company in which the company pays the homeowner a lump sum of upfront cash in exchange for a share of the home's future value. A few such companies exist, like Point, Unison, and Unlock. First, the home is appraised by a third party who determines an estimate of the home's upfront value, and the lending company pays the homeowner approximately 10% of that. The homeowner could then use this money to construct an ADU, and at the end of the contract term, pay an amount back to the company, which is determined by the company's terms and based on the home's appraised end-of-term value.

This model may be attractive to homeowners who would rather avoid a monthly payment or may not have the creditworthiness to acquire a traditional loan.

On the other hand, because this model is relatively new to the ADU financing space, it is largely unregulated and thus could breed predatory lending. Homeowners should consider if this option is right for them, taking into account how dramatically the property's value may increase over the term of the loan.

Figure 2: It's possible that pre-fabricated ADUs like this one may be eligible for personal property loans.

Personal loans

Banks, credit unions, and lenders offer personal loans, which are based on an applicant's creditworthiness and financial profile and are paid back in monthly installments. They typically range from $1,000 to $50,000, so while they may not cover all of the costs of constructing an ADU, they could be used in tandem with another financing strategy.

Personal loans are unsecured, meaning they don't require collateral and therefore will not be attached to any other loans like a homeowner's primary mortgage. Essentially, personal loans are similar to a credit card, meaning they may have high interest rates that are not ideal for financing an entire ADU project.

CalHFA ADU Program

Until April of 2023, the CalHFA offered ADU grants, with up to $40,000 available

Figure 3: Banner advertising CalHFA's ADU grant program.

to households making up to $180,000 a year (in LA County, as of 2022) to reimburse pre-development costs, such as (but not limited to): architectural designs, permits, soil tests, impact fees, property surveys, pre-construction site work, and energy reports.

The CalHFA grant program required the homeowner to place ADU construction funds into a construction escrow account, and work with a lender, nonprofit, or other qualified entity to pay the funds out at construction milestones, following independent site inspections. This ensured that the ADU construction process is successfully completed to deliver a new housing unit to the market, so that the money of the people of California is not wasted on a project that does not get completed.

As of spring of 2023, the funds allocated to CalHFA for the administration of the program have been fully expended, and the program is not anticipated to be renewed. However, it is our recommendation that CalHFA consider reinstating the grant program, as it has proven to significantly reduce the long-term debt financing required for homeowners to construct ADUs.

Tools available to developers

There are certain State and Federal programs that are available to developers, particularly larger developers of multifamily housing units.

So far, the majority of ADUs in Paramount have been built in single-family zones. However, further promoting the development of ADUs in multifamily zones will continue to further infill development and has the potential to create a greater variety in ADU configurations, locations, and sizes, as ADUs in multifamily zones generally have looser developmental standards than those in single-family zones. Diversifying the ADU rental market may allow more types of renters to reap their benefits, *and* further infill growth. Some programs may be available to developers directly, or through coordination with a nonprofit organization.

Qualified Residential Rental Project Program from the California Debt Limit Allocation Committee (CDLAC)

Developers may apply for tax-exempt bonds from State and local government agencies in order to acquire new units or rehabilitate existing units. These bonds lower the interest rate paid by developers, who then produce affordable rental housing for households making less than 80% of the AMI.

It is possible that developers could apply for this funding to develop multifamily structures that include ADUs.

For more information, visit *https://www.treasurer.ca.gov/cdlac/applications/qrrp/index.asp*.

AHSC

Like jurisdictions, developers are also eligible to apply for funding from AHSC for affordable housing development projects.

The program funds projects that support infill and compact development in order to reduce GHG emissions. This funding can be used to acquire or rehabilitate dwelling units, or to convert nonresidential structures into dwelling units. A portion of these funds could be used to construct ADUs in existing and new multifamily structures.

For more information, see *https://www.hcd.ca.gov/grants-and-funding/programs-active/affordable-housing-and-sustainable-communities*.

Summary of Market Conditions

Market Analysis

To understand the role that financing plays in ADU development, one must first understand the underlying market conditions, such as rental rates and sale prices, income levels, housing cost-burden and its relationship to tenure, and the development costs of ADUs.

Changing laws surrounding ADUs and other small-scale housing developments will also continue to reshape how ADUs perform in the market in terms of affordability and potential income. With strict affordability provisions for some of these new statutes like AB 345, it is critical to assess if separately sold ADUs will actually be the affordable housing option for low- and moderate-income residents that the Legislation anticipates.

Rental rates

There is not much data to predict the rental rates of newly constructed ADUs in the City of Paramount. At the time of the analysis, searches on Craigslist, Apartments.com, and Facebook Marketplace yielded no identifiable results for ADU rentals.

In fact, it was difficult to assess the true average rental rates of all housing types in the city because the sample pool was relatively small.

As of May 2023, there were approximately 14 available rental units on Apartments.com within Paramount. The majority were one- or two-bedroom apartments, with only one three-bedroom house. There were no studio apartment rentals within city limits or in the immediate area. The average price per

Bedroom Count	Average price per sf
Studio	N/A
1	$2.67
2	$2.80
3	$2.37

Table 1: Average price per square foot for available housing units in Paramount on Apartments.com (May 2023).

square foot of all evaluated properties can be seen in **Table 1**.

All of the 11 available units that listed the year of the property's construction were built prior to 1990. A newly constructed ADU would likely charge a higher price per square foot than existing units like the ones assessed.

Additionally, because many ADUs may not have separate utility meters, assumed utility costs are often factored into the monthly rent, which will also cause the price per square foot (sf) to exceed that of a standard rental unit.

Income

Median household income

In 2021, the median household income in the city was about $60,456 a year. While higher than other cities in the southeastern LA County area, this is well below LA County (about $76,000) and State of California (about $84,000) median income values.

Median household income is calculated by the US Census Bureau to provide yearly income estimates across geographic scales. When determining median household income, the income of all persons over 15 years of age regardless of job status or familial relationship is used. For this reason, it is common for household income to be less than other income measures defined at the family level, such as Area Median Income (AMI).

Area Median Income (AMI)

Often used interchangeably, AMI and median household income are measured using different calculations and by different agencies.

Income level	% of AMI	Annual income
Extremely low	0-30%	$0 - $27,330
Very low	30-50%	$27,331 - $45,550
Low	50-80%	$45,551 - $72,880
Moderate	80-100%	$72,881 - $91,100
Above moderate	> 100%	> $91,100

Table 2: Income levels for a family of four established by HUD based on the LA County 2022 AMI.

AMI, sometimes called Median Family Income (MFI), is the midpoint of the region's income distribution based on family size. The Department of Housing and Urban Development (HUD) sets low-income thresholds (e.g., less than 50% of AMI) to determine the eligibility of applicants for a number of state, federal, and local programs, most notably affordable housing.

For example, the AMI of LA County for 2022 is $91,100 for a standard family of four. Between 50% and 80% of the AMI is considered low-income in LA County, meaning that a family of four would be considered low-income if they have an annual income between $45,550 to $72,880.

In Paramount, low-income households (29%) make up the highest proportion of income distribution of any income level (**figure 4**). Further, more than half of the total families in the city are considered very low income (30-50% AMI) or extremely low income (0-30%). This means that **more than half of the families in Paramount were making less than**

$40,000 a year (less than 50% AMI) in 2022.

Housing cost-burden

Housing cost-burden is characterized by a monthly housing cost of over 30% of one's gross monthly income. Someone is severely housing cost-burdened if over half of their monthly income goes toward housing costs. About 1 in 4 households in Paramount are severely cost-burdened, while well over half (67%) of residents are spending more than 30% of their income on housing.

Black and Pacific Islander households are the most cost-burdened, with over half paying above 30% of their incomes to housing costs.

Acknowledging that **housing cost burden has a relationship to race** is an important step to creating effective financing programs for marginalized communities. For the ADU program, this may mean supporting grassroots nonprofit entities, particularly those that work with people of color, in the building of ADUs as an affordable housing alternative, or providing pathways for low-income residents to live in an ADU, like are explored in this report.

Tenure

Much like the relationship between race and housing-cost burden, a similar relationship exists with tenure. As shown in **figure 5**, renters in Paramount are much more likely to be housing cost-burdened than homeowners.

Over half of all renters experience housing-cost burden in some way, compared to 36% of homeowners. The dramatic rise in housing prices over the last ten years likely plays a role in this, as it is possible that homeowners in Paramount bought their homes at significantly lower prices than they would be valued at today. In this way, long-term owners are able to enjoy similar housing costs to those they secured at the purchase of their home, while renters are subject to increasing rents year after year.

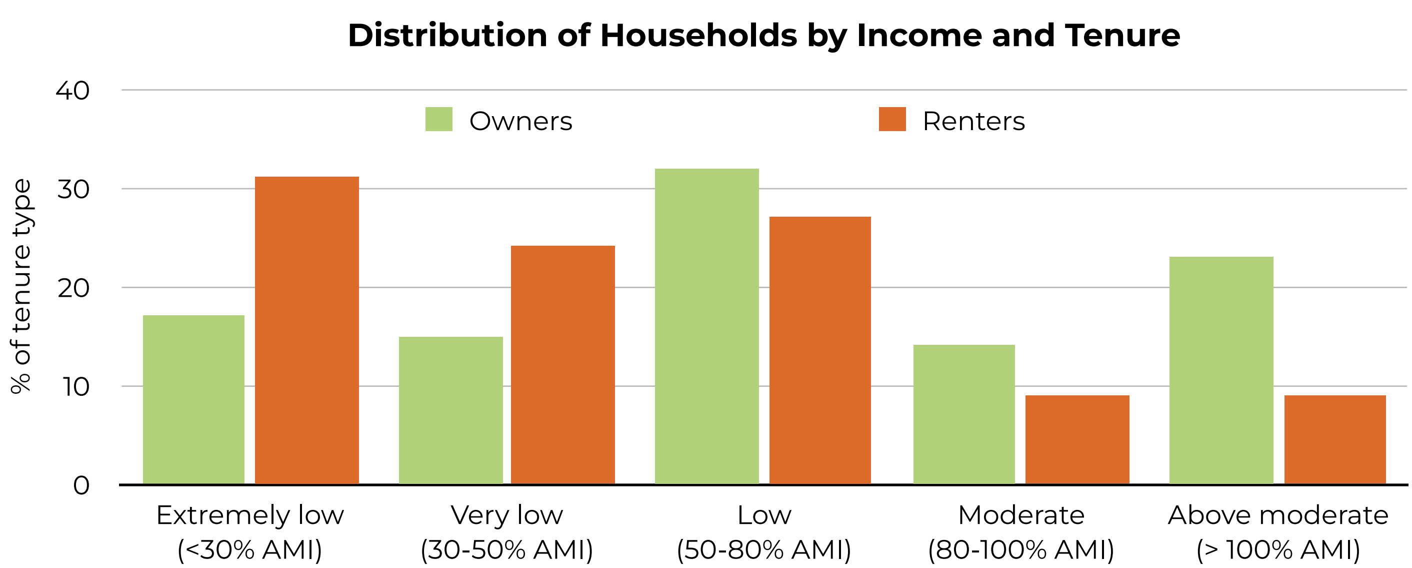

Figure 4: Income level distribution by tenure for households in Paramount in 2022. For income boundaries of each category see **Table 2**.

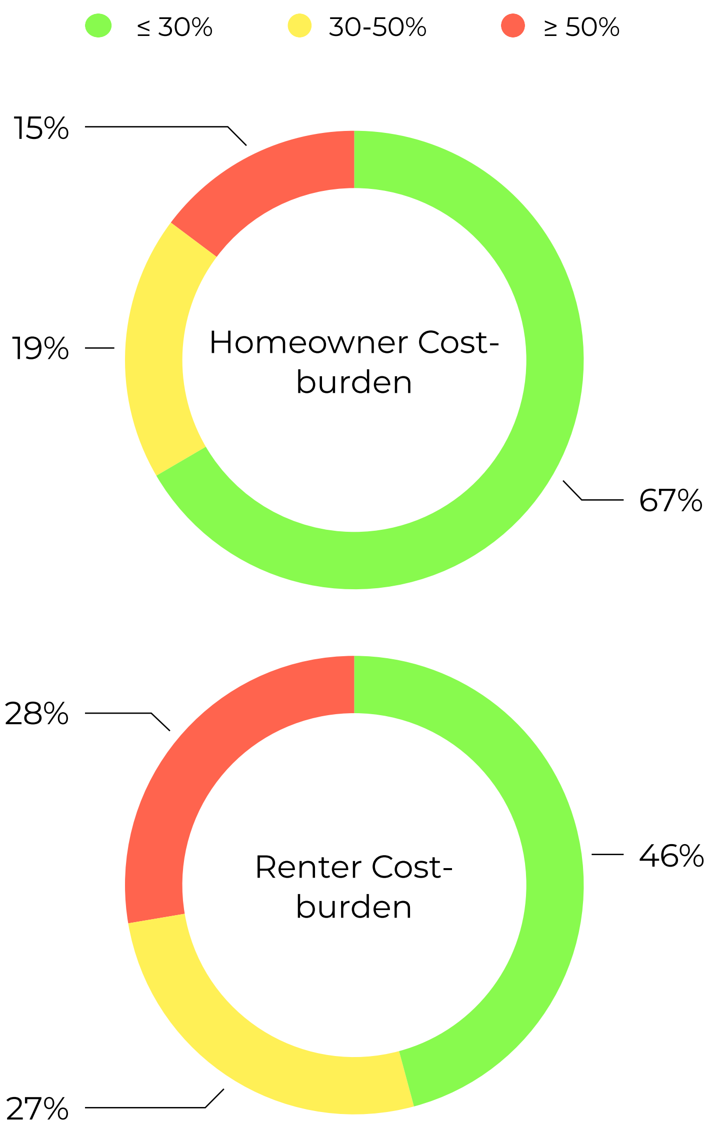

Figure 5: The percentage of all renters or homeowners who spend less than 30% of their income on housing and therefore are not housing cost-burdened (in green); those who are housing cost-burdened and spend between 30% and 50% of their income on housing costs (in yellow); and those who spend over 50% of their income on housing costs, making them extremely cost-burdened (in red).

Development costs

There are several types of costs associated with ADU development, all of which can vary greatly depending on a number of factors. ADU costs can be categorized into construction, design, and permitting costs.

Construction

Construction costs for an ADU are expected to be between $300 and $400 per sf. This can vary widely depending on the type of ADU, systems and appliances installed, materials, and location.

The general rule in development projects is that costs per sf typically decrease the larger the unit. This happens because some of the heaviest fixed costs of an any development project like its foundation, kitchen, and plumbing are more spread out the larger the unit. With ADUs, there is limited square footage for the costs to be amortized over in the same way, though a 400 sf ADU will still likely cost more per square foot than a 1,000 sf ADU.

It is also important to note that while average costs per square foot of ADU construction can be a helpful tool to homeowners trying to estimate what they might spend on an ADU, they should always budget for unexpected additional costs along the way.

Design

Design and engineering costs are difficult to evaluate because they may vary widely based on the complexity of the ADU design, the layout of the property, whether or not the design is using an existing structure, and more. However, the standard range for design, architect, and engineering costs is between 5 and 15% of construction costs.

This range is for a custom ADU designed from scratch. Design costs may go down significantly if the homeowner is using pre-designed plans from a third-party company, or the five pre-approved ADU plans offered by the City of Paramount.

Even if a homeowner uses pre-approved plans, they will still need to work with an architect, designer, or engineer in order to create a site plan for the ADU. Because pre-approved ADU plans are a relatively new practice, there are not yet many precedents available to reference concerning the costs of hiring a professional to create a site plan to be used with existing plans.

Permitting

Much like the other costs associated with ADUs, the total costs of permitting an ADU have a wide range depending on its size and, in the case of impact fees, the floor area ratio between the ADU and the primary dwelling unit.

Permitting fees are those which are associated with the costs of processing applications and issuing building permits. They are often based on valuation and thus increase as the size or complexity of the ADU does. They cover things like staff wages and overhead costs.

On the other hand, development impact fees are charged in order to defray the costs of City services like urban forestry, improvement projects, sewer maintenance, updating the City's general plan, and more.

Based on the results of a pro forma analysis, we found that total permitting costs ranged from $3,595 for a 440 sf studio ADU, to $7,652 for a 1,000 sf three-bedroom ADU.

School impact fees, which are not charged to units below 500 sf, ranged from $1,782

Figure 6: Development of architectural designs.

for a 600 sf one-bedroom ADU to $2,970 for a three-bedroom.

This puts the total fee costs for an ADU in Paramount between about $3,000 and $11,000.

Pro-forma analysis

The Woodsong Associates team has conducted a pro-forma analysis of the costs to construct an ADU and the potential income that one could bring, in order to help quantify the financial benefits, burdens, and opportunities of ADU development for both homeowners and renters.

The pro-forma analysis was conducted using the Envision Tomorrow™ Return on Investment (ROI) Model v4.0.2 Beta. The ROI Model is a versatile, easy-to-use tool that can be used to test the physical and financial feasibility of a proposed development, or existing development regulations. The ROI Model considers a range of factors including parking, height and use requirements, and costs associated with construction, fees, rents and subsidies.

The ROI Model allows single-use and mixed-use buildings to be modeled for development feasibility at a range of

Typology	Floor area (sf)	Rent per sf
Studio	440	$2.90
One-bedroom	600	$2.67
Two-bedroom	750	$2.80
three-bedroom	1000	$2.37

Table 3: Sizes of each ADU typology used in the pro forma analysis. Any result which refers to one of these typologies is assumed to be of the corresponding square footage. Rents come from the May 2023 analysis of available units on Apartments.com, but because there were no studio housing units in Paramount at that time, we used the studio rent per sf value from the October 2022 Area Guide, which was $2.90 per sf.

scales. This allows for analyses such as the level of affordability that could be attained with policy changes; the amount of income that an enabled development could provide; or policy changes required to make a development type feasible under a given set of assumptions.

Assumptions

The possible rent per sf is based on Apartments.com listings of rents for existing units, whereas this analysis models new construction. For instances where an ADU is shown as producing a negative net income, the rent per sf is adjusted to be closer to the highest rent per sf listed for any size unit on apartments.com, to account for "noise" in the data, and the difference between new and older rental pricing.

The floor area sizes which correspond to bedroom configurations are listed in **Table 3**.

Construction costs are held at $300 per sf, based on information from Sidekick Homes. This is a reasonable hard cost assumption; some ADUs can be built more cheaply, and it's certainly possible to spend more.

Site development costs were held at $2 per sf for each 5,000 sf lot, totaling $10,000.

In the analysis, the HCD-reported LA County AMI of $91,100 a year was used.

Professional fees, such as architectural, design, or engineering costs were factored in at a rate of 10% of total hard costs.

For financing the ADU, a 30-year mortgage with 70% Loan to Value (LTV) and a 6% interest rate was used. Any other financing products tested were used in tandem with this scenario.

Fee assumptions

All applicable development impact and permitting fees charged by the City of Paramount were factored into the analysis.

These included the building permit fee, all plan check fees, utility fees, Administrative Action fee, and permit issuance fees.

Paramount also charges a Storm Drain Master Plan fee and a General Plan fee, both of which our team believes to be impact fees, based on the definition set forth in Ca. Government Code § 66000. Although impact fees are only allowed to be charged to units 750 sf or greater, these fees were charged to all units in the pro forma analysis to reflect the City's current practices, as it has yet to change the designation of these fees.

The school district impact fee was charged to all units of 500 sf or greater at a rate of $2.97 per sf.

Rental affordability

The findings suggest that rental of ADUs is likely to be an affordable option for households making at least 80% to 100% of the AMI for LA County (**Table 4**).

Bedroom Count	Monthly Rent	% AMI Required	Required Annual Income
Studio	$1,232	77%	$63,770
1	$1,500	88%	$72,880
2	$2,100	102%	$81,990
3	$2,700	114%	$91,100

Table 4: Estimated monthly rents and affordability for each ADU size typology based on market rates. Corresponding floor areas and rents per sf can be found in **Table 3**. Annual required income has been adjusted for household size.

Because none of the ADU sizes modeled are expected to be affordable to low-income households, this suggests a **strong need for a financing product that incentivizes homeowners to offer their ADUs at an affordable rental rate** to households making up to 80% of the AMI. The data indicates that market factors alone may not be enough to produce affordable ADUs for the average low-income renter, and therefore it is imperative that the City, SCAG, and/or the State intervene in some way to ensure that ADUs are accessible to a greater diversity of renters.

Rental income estimate

Using the rates per sf determined through the analysis of available rentals on Apartments.com (**Table 3**), we estimate that homeowners who rent their ADU at the market rate could expect to make between $1,276 for a 440 sf studio and $2,370 for a 1,000 sf three-bedroom unit per month (**Table 4**).

Of course, this number does not factor in operating costs, which greatly reduce the monthly net income. Still, homeowners who build a studio ADU could expect to make about a $150 monthly profit in year two, even with standard financing. Furthermore, this monthly income increases over time, so that by year ten, the homeowner could be receiving a net income of $400 per month.

Although larger ADUs earn a higher monthly income, the relationship between size and net income is not as linear. As shown in **figure 7**, a three-bedroom ADU might actually produce the least net income in the first ten years. This is because the increased rents commanded by units with more bedrooms and the lower cost per sf for larger properties are not enough to offset the high total project cost. Larger ADUs are also disproportionately costlier than units less than 750 sf, which incur the least impact fees.

However, it should be noted that the return on investment varies greatly based on the rental rate per sf, which may not accurately reflect actual market rates. Specifically, because our analysis of rental properties on Apartments.com only yielded one three-bedroom property, it's important to recognize that a higher rental rate would generate more net income from a three-bedroom ADU, or any size, for that matter.

Nevertheless, higher rates also decrease the affordability for renters, resulting in a

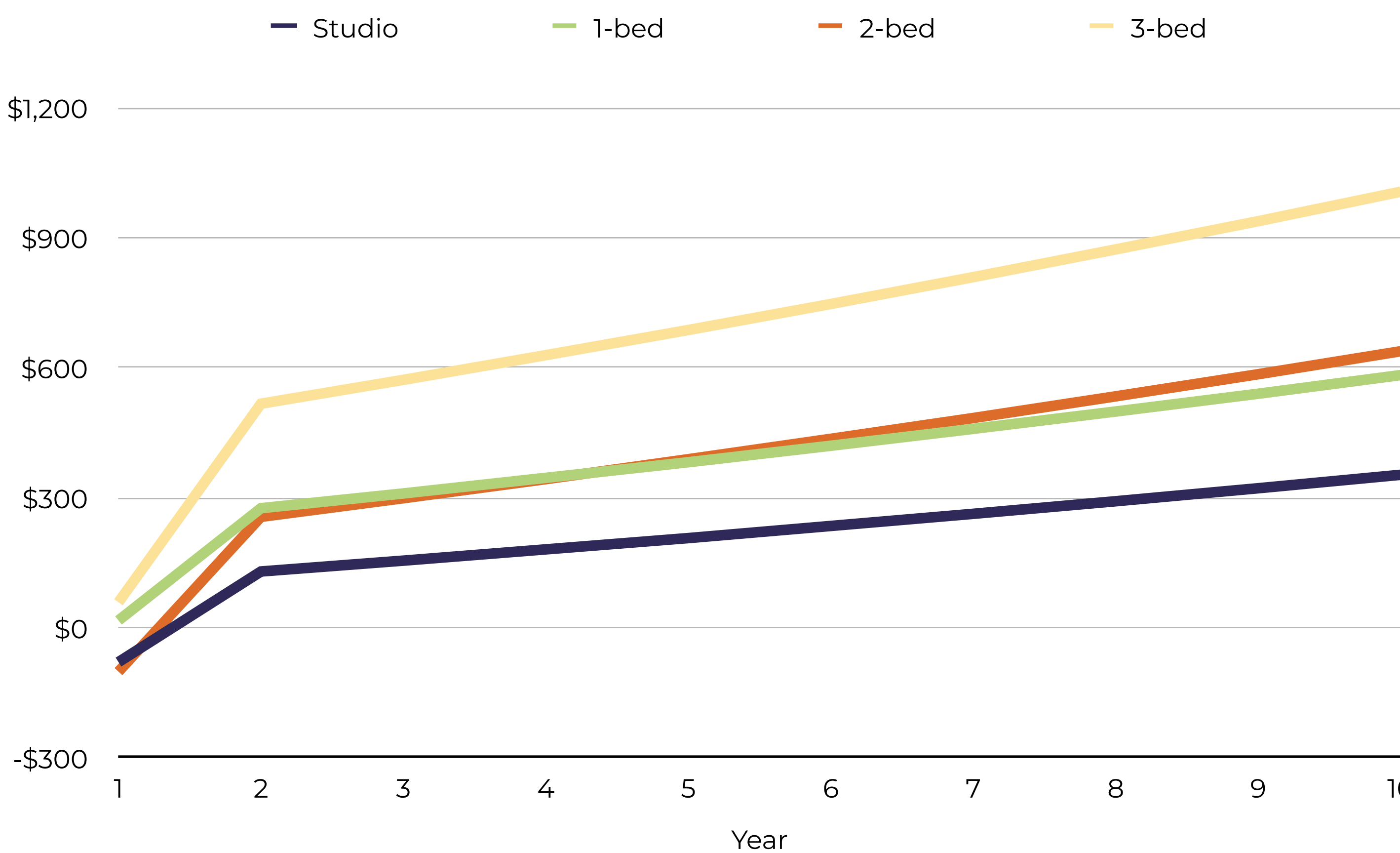

Figure 7: Monthly net income over ten years for a homeowner renting out an ADU, for the four ADU size typologies studied.

larger gap between the housing cost burden of renters and homeowners. For this reason, financing products, as well as policies, that stabilize affordable rates for renters while still allowing homeowners to earn a meaningful profit that motivates them to build ADUs is vital. This will ensure that ADUs are making a difference in the housing crisis, rather than furthering wealth disparities.

Sale prices

Until January of 2023, the City of Paramount did not allow the separate sale of ADUs from the primary residence, as was required by state law.

However, Assembly Bill 345 (AB 345) requires that local agencies allow ADUs to be sold separately from the primary residence under certain conditions. First, the ADU or primary unit must have been built or developed by a qualified nonprofit corporation. Also, the ADU must be sold to a qualified low- or moderate-income buyer, and an affordability restriction will also need to be in place for at least 30 years to ensure that it remains a low- to moderate-income housing unit.

The buyer must also occupy either the primary dwelling or the ADU, meaning that if they only bought the ADU from the nonprofit, they would not be able to use it as a rental property unless they also bought the primary dwelling.

Bedroom count	Household size	Maximum affordable purchase price	Pro forma estimated sale price	Income required to afford (% AMI)[1]
0	1	$263,560	$203,280	77%
1	1.5	$282,300	$265,800	89%
2	3	$338,813	$338,625	100%
3	4.5	$391,500	$447,000	114%

Table 5: ADU purchasing affordability for households making 100% or less of the LA County AMI. These values are the maximum amounts that a moderate-income household could afford while not exceeding 30% of their gross monthly income. Maximum affordable purchase price is calculated by using the affordable monthly housing cost for each household size to determine the total unit sale price with a 30-year mortgage, 20% down payment and 5% interest rate. It includes insurance and property taxes.

[1] AMI adjusted for household size.

Because this change only took effect in January of 2023, there is little to no information on the sale prices of ADUs separate from the primary dwelling unit. However, using the total project costs for ADUs determined by the pro-forma analysis, we can estimate that the minimum sale price for a 440 sf studio ADU in Paramount may be around $203,000.

This number is determined by adding 15% to the total project cost in order to account for realtor expenses and fees of a nonprofit, but does not include the cost of land.

Land costs may be split between the primary dwelling and the ADU, or the primary dwelling could absorb all of the land value, so that only the ADU itself is sold. The ADU could be sold as a condominium unit, separate from the land beneath, so therefore the main dwelling retains the rights to the whole remainder of the original parcel, with the except of the ADU and a limited common area, such as a patio or porch for the ADU. Or, the primary home and the ADU could be converted into a cooperative, with occupancy rights for the main home and the ADU sold as shares in the cooperative, which could legally sit on top of the original home and property via a land lease agreement.

While these estimated costs of for-sale ADU are significant, they are still much less expensive than most new single-family homes in LA County. In this way, this model may grant more low-income households the opportunity to buy a home, which can be a great way to build generational wealth.

However, as shown in **Table 5**, while studio, one-, and two-bedroom units may not have a problem meeting affordability restrictions, larger units likely will. Only studio ADUs are expected to be affordable for low-income households making less than 80% of the AMI; moderate-income households likely could afford 1- and 2-bedroom ADUs; and a 1,000 sf three-bedroom ADU may not be affordable for any but above-moderate-income households.

Nonprofits may have to find ways to subsidize costs for prospective low- and moderate-income homebuyers, as even the estimated project cost — excluding any administrative fees — for the one, two, and three-bedroom units exceeds the affordable purchase price for households making up to 80% of the AMI.

According to Zillow.com, the average home value in Paramount as of June 2023 was $582,441. With a 30-year mortgage, 80% LTV, and an interest rate of 6%, the estimated monthly payment would be around $3,200. Assuming a housing cost burden of 30% of the household's gross income and a household size of 4.5, this would only be affordable for someone making at least 142% of the AMI. Comparing this with the ADU affordability values in **Table 5**, we can see that ADUs may be a more affordable purchase option than single-family homes, particularly for smaller households. In fact, based on current rental rates, the comparison of rental affordability versus purchase affordability from a qualified nonprofit (**Table 6**) indicates that **monthly mortgage payments for ADUs may in some cases be even more affordable than rents** in Paramount.[1]

Bedroom Count	Monthly rental affordability (%AMI)	Monthly mortgage affordability (%AMI)
0	77%	77%
1	88%	89%
2	102%	100%
3	114%	114%

Table 6: Comparison of affordability as a factor of AMI for ADUs rented at the market rate versus purchased from a qualified nonprofit developer.

The pattern of greater mortgage than rental affordability holds true for all sizes except the three-bedroom ADU. We expect this to be the case because while the pro forma estimated sale price increases with floor area, the rent per sf decreases. Both of these changes are seen most dramatically in the 1,000 sf unit, which is the same reason that the profits gained from building and renting a three-bedroom ADU are the lowest out of any size, based on our assumptions (**figure 7**). In general, mortgage affordability decreases as size increases because although the AMI is adjusted for larger household sizes, it is not enough to offset the higher development costs that come with more square footage.

Of course, purchasing may not be an accessible option for residents who do not have the cash on-hand required for a down payment, and monthly affordability levels would surely decrease as the LTV increases. In this case, it is possible that nonprofit ADU developers could apply for CalHome grant funds which can be used for downpayment assistance and mortgage financing.

Despite the fact that not all renters may be able to access the cash or down payment assistance for an ADU in order to reduce their monthly housing payment, the

[1] Notably, this is likely only the case due to the presence of the nonprofit developer. If ADUs were allowed to be sold separately from the primary dwelling without any restrictions, they would succumb to market forces and their sale prices would be expected to increase. This is supported by the fact that the rental incomes of homeowners far outweigh their costs because of high market rates, allowing them such significant profits.

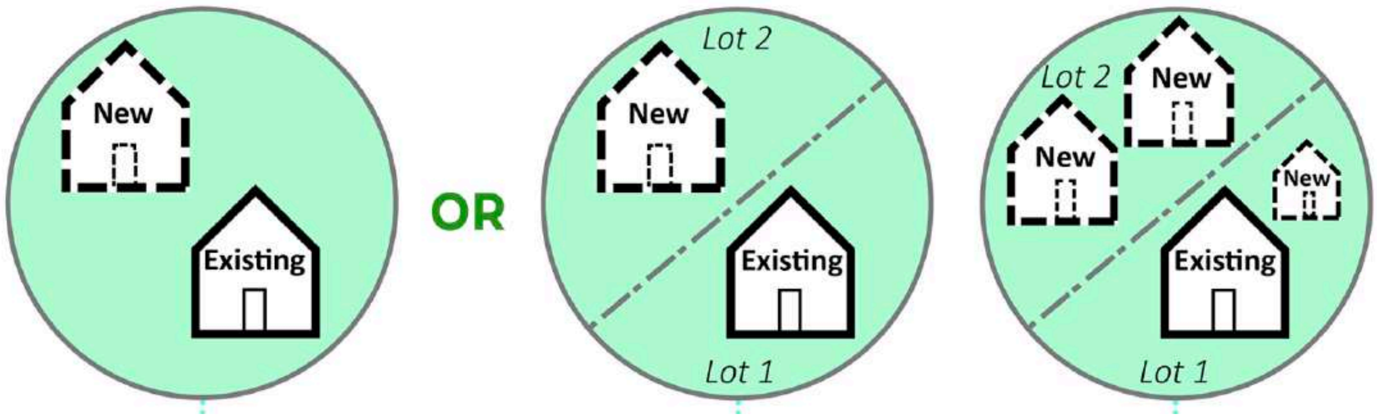

Figure 8: Graphic demonstrating some of the new possibilities for single-family lots under SB 9.

finding that ADUs produced under AB 345 may be more affordable than renting shows support for the nonprofit development provision of the bill, suggesting that this model may be an effective way to close the wealth gap.

Nevertheless, the findings indicate that **medium and larger-sized ADUs may not be a viable option for low-income households in Paramount to purchase**. Strategies to increase homeownership access for those making less than 80% of the AMI should be further explored.

The new exception allowing separate sale of ADUs developed by a nonprofit may not yet be widely applicable, as it is likely that most, if not all ADUs in Paramount were built by individual homeowners or property owners. Yet, it holds significant potential for expanding homeownership opportunities in the future, and could be the precursor to a change in law that allows separate sale of *any* ADU, regardless of development by a nonprofit. In fact, this has already been proposed to the California Legislature in 2023 by AB 1033 (Ting).

Although a model like this may take years to gain traction, the City of Paramount could promote it by partnering with local affordable housing development nonprofits and/or a Community Land Trust. Investing in this pathway recently required by state law could be an effective way to allow more low-income residents

Home	Floor area (sf)	Price	Price/SF	ADU % of Primary	ADU % of Total
Primary #1	1,848	$516,600	$279.55	-	-
ADU #1	576	$311,900	$541.49	60%	38%
Primary #2	1616	$715,000	$442.45	-	-
ADU #2	672	$303,800	$452.08	42%	30%

Table 7: Values of ADUs sold separately from the primary dwelling, from the Sabin Green micro-development in Portland, OR. Pricing listed on Zillow.com is from a mix of “zestimates” and recorded sales.

to enjoy the benefits of homeownership and reduce inequities in the city.

SB 9

Senate Bill 9 (SB 9) is a relatively new California State law that went into effect on January 1, 2022. Its purpose is to allow greater density on single-family lots by allowing two primary dwelling units per parcel, and allowing urban lot splits, or the subdivision into two parcels from one.

This new legislation effectively allows for up to four units per original lot. A lot with an existing single-family home and an ADU can add a second detached single-family home which is also entitled to its own ADU. Alternatively, a homeowner could attach a second single-family home to theirs, perform a lot split, and build a second duplex on the new empty lot.

Although standard single-family homes are allowed one ADU and one JADU, SB 9 limits parcels to two dwelling units per lot, meaning that a split-lot primary dwelling is only granted one ADU or JADU.

This bill allows homeowners to greatly increase their lot's value by building more livable space, and even selling an entire parcel. Although ADUs would still not be subject to separate sale, a homeowner could split their lot, construct a new primary dwelling unit and ADU and sell those.

Further investigation to determine how an ADU increases a property's value should be performed in California, as little real-world data concerning comparable sales of ADUs exist today. **Table 7** shows an example of the case study of Sabin Green in Portland, OR, which was developed as a

Figure 9: ADU advertised by EPA CAN DO's ADU program.

community of two primary homes and two ADUs on two parcels with shared common area. This example shows that, when the ADU is listed for sale separate from the primary dwelling, it is able to command a higher price per square foot than the primary home (reflecting its smaller total size), and can be sold for a price that is roughly 30-38% of the sum total of the sales prices of the ADU and of the primary home; and that the sales price of the ADU may range from 42 to 60% of the total sales price of the primary home.

Figure 10: 3D rendering of a nine unit three-story ADU building behind an existing triplex in San Diego, built under the provisions of its ADU Bonus Program. *Source:* PALO (palo.us)

Existing ADU Financing Programs

ADUs provide benefits of both affordable housing provision and the generation of wealth to homeowners through rental income. As such, we have broken down ADU financial best practices into two categories: financing programs for homeowners, and programs which ensure the production of affordable housing for renters.

Loans

East Palo Alto, CA

A program administered by the City of Palo Alto and funded by a $2 million CalHome grant provides low-interest, deferred payment loans to homeowners for ADU or JADU construction. The City partnered with local nonprofit EPA CAN DO (East Palo Alto Community Alliance and Neighborhood Development Organization), which provides free technical assistance to income-qualified homeowners participating in the program.

To qualify for the loan program, the applicant must first be enrolled in the CAN DO ADU technical assistance program administered by EPA CAN DO. Homeowners may be eligible if they make less than 80% of the AMI, or if they agree to rent their future ADU to a household making less than 80% of the AMI.

The CalHome program requires that both of these criteria are met,[2] and awards ADU loans of up to $80,000, or 50% of the total project costs, whichever is lower, with a low interest rate of 3%.

For more information, visit *https://www.ci.east-palo-alto.ca.us/housing/page/calhome-loans-adusjadus*.

San Diego Housing Commission

ADU Bonus Program

The San Diego Housing Commission (SDHC) has instituted multiple best

[2] Although the CAN DO ADU program does not specify how long the unit must be rented as affordable, the City's CalHome grant requires that it is rented as an affordable unit for the entire term of the loan.

practices regarding ADUs, one of which is their ADU bonus program. This program allows for homeowners to build multiple ADUs on their property, so long as one out of every two units (beyond the first ADU and JADU allowed by state law minimums on every parcel) are deed-restricted to households with incomes below 110 percent of the AMI for 15 years, below 80 percent of AMI for ten years, or below 60 percent of AMI for eight years.[3]

In Transit Priority Areas (TPAs), there is no limit to how many bonus ADUs can be built; outside of these areas, each parcel is allowed one standard ADU and one deed-restricted ADU.

Conditions of the program include that the deed-restricted housing shall be comparable in size, bedroom mix, amenities, and features to the accompanying market-rate ADU; developers are not required to make off-site improvements beyond those to support a typical single-family home project; and parking is also not required for units built through the Program.

A program like this allows homeowners to take advantage of available space on their properties, increase their financial stability, help their city reach its RHNA goal faster, and ensure the provision of **affordable rental housing**, aiding in the solution to California's housing crisis.

Construction Loans and Technical Assistance

SDHC also offers a loan and technical assistance program similar to East Palo Alto's. This program is available to eligible homeowners who make 80% or less of the AMI, and grants them deferred payment construction loans of up to $200,000 with a 1% fixed interest rate.

Upon completion of construction, the homeowner will refinance the loan into a permanent mortgage with a partner lender provided by SDHC, or a lender of the homeowner's choice.

Also similarly, the ADU is required to be rented as affordable for seven years. In this case, affordability means that the tenant's household income must be 80% or less of the AMI, and that the tenant must not be housing cost-burdened. In other words, the monthly rental payment may not exceed 30% of their monthly household income.

SDHC also provides participants with a free ADU consultant who advises the homeowners in matters throughout the building process, like pre-design, permitting, vendor selection, and more.

For more information on both of these programs, visit SDHC's website at *https://www.sdhc.org/housing-opportunities/adu/*.

Oakland, CA

The City of Oakland has instituted a low-income, deferred payment construction loan program similar to the others outlined, yet this program is specifically geared toward homeowners with an existing unpermitted secondary dwelling unit within or next to their home. The goal of the program is to **aid homeowners in the process of legalizing their nonconforming structure** to ensure the

[3] For a full review of San Diego's ADU Bonus Program, see the Terner Center policy brief about it here: *https://ternercenter.berkeley.edu/research-and-policy/san-diego-adu-bonus-program/*

provision of safe rental units which meet all building code requirements.

The City offers this through a construction loan of up to $100,000 with a 3% simple interest rate. No periodic payments are required, meaning the homeowner can repay the loan at their own pace, but the property must remain owner-occupied. There is no rental affordability requirement for this program.

This program provides homeowners a pathway that incentivizes legalizing their unpermitted structures, benefitting renters, cities, and the homeowners themselves. This may be an attractive option for jurisdictions that have high numbers of nonconforming ADUs and high housing needs.

For more information, visit *https://www.oaklandca.gov/resources/accessory-dwelling-unit-loan-program*.

Fee waivers

Vista, CA

Several jurisdictions have instituted fee waiver programs when certain conditions are met. In Vista, CA, homeowners may apply for a fee waiver that will exempt them from the obligation to pay any development impact fees, which are already waived for ADUs under 750 sf. Homeowners can participate in the program if they vow to rent the unit to an eligible household for the first ten years, and record this commitment through a restrictive covenant with the City Attorney.

Eligible tenants are households making up to 80% of the San Diego County AMI, or a family member or caregiver providing regular care to the owner or occupant of the primary unit.

Several other jurisdictions like Encinitas, CA and Portland, OR have also instituted development impact fee waiver programs. In Portland, under the current program, applicants may qualify to have all impact fees waived if they commit to not use their ADU as a short-term rental for ten years, so that the ADUs being built actually contribute to the city's housing stock. A previous version of the program simply waived impact fees (called System Development Charges, or SDCs, in Portland) for any new ADUs, and was partially responsible for an ADU construction boom in Portland during the first two decades of the 21st century.

Marin County

Contrasting with jurisdictions that only waive *impact* fees for qualifying units, Marin County has a fee waiver program that covers permitting fees instead. All properties are eligible for a waiver of up to $2,500, but the fee waiver can reach up to $10,000 if the homeowner commits to renting the unit to a low-income household (<80% AMI).

The affordability covenant does not expire, meaning homeowners will be required to continue renting the unit as affordable indefinitely, or have to pay back the difference in fees that the waiver covered, plus 5% simple interest. While this system ensures the production of affordable housing in the short-term, it also provides flexibility for homeowners who may later decide to opt out of the program in order to increase their monthly cash flow by renting at the market rate.

However, it is possible that some homeowners could see the fee waiver as a sort of “loan" from the County, renting affordably for only a couple of years until they've saved enough money to pay back the waived fees, and then increase the rent, only temporarily increasing the affordable housing stock.

For this reason, a fee waiver program with no fixed term may be a risky option for jurisdictions that desperately need long-term affordable housing stock. On the other hand, it may attract homeowners to participate in the program, knowing that they have the flexibility to be able to opt out at any time, and do not have to make a long-term commitment.

For more information, visit *https://www.marincounty.org/-/media/files/departments/cd/housing/affordable-housing/adu-affordablity/faqs-for-adu-fee-waiver-programvfinal.pdf?la=en*.

San Diego County

The County of San Diego has recently rolled out free pre-approved ADU plans, offering six different configurations. Alongside this, they are offering the waiving of ADU permit and impact fees for a period of five years, which began on January 9th, 2019.

It appears that the only required conditions are that the ADU must be on a lot with an existing single-family home, and both the plans and the waiver are only available in the unincorporated areas of the county.

For more information, see *https://www.sandiegocounty.gov/content/dam/sdc/pds/bldg/adu_info/aduletter9_19.pdf*.

Forgivable loans

Napa County

The County of Napa has instituted a **forgivable loan program** with loans of up to $105,000 for ADUs that are rented affordably for five years. Rents must be suitable for households making up to 80% of the AMI. As long as the affordability covenant is complied with, 20% of the loan is forgiven per year.

The program offers fixed base loan amounts dependent on the configuration of the ADU, and other incentives are available to boost the total loan amount. For example, if homeowners use the pre-reviewed plans provided by Napa Sonoma ADU, they are eligible for an additional $2,500.

The program was launched at the beginning of 2023, and by February of 2023 had already received 120 eligible applications, exceeding the total available loan capital after only about a month of existence. This indicates that there is a significant demand for financing products like this, in comparison to other affordable ADU products tested elsewhere.

Although this program is targeted to assist renters by creating affordable housing, it benefits homeowners as well by reducing their total debt required to construct an ADU, thus boosting their net income from the unit.

For more information and eligibility requirements, visit *https://www.countyofnapa.org/DocumentCenter/View/28112/NAPA-ADU-Guidelines-ENGLISH-PDF?bidId=*.

Napa, CA

Similarly to the County, the City of Napa also has a forgivable loan program available, but with slightly stricter terms.

First, the program is only available to JADUs or conversions. In this program, the borrower must commit to charging an "affordable rent" for 20 years. Affordable rent is defined as a monthly rent not exceeding 1/12th of 30% of 60% of the AMI, adjusted for household size. Additionally, it must be rented to an income eligible household, which is one making up to 80% of the AMI. Only homeowners of single-family homes are eligible for this program, and one of the units must be owner-occupied.

If these (and additional) conditions are met, homeowners may be eligible for a deferred payment, 0% interest, forgivable loan of up to $75,000 for JADUs and an additional $25,000 non-forgivable 0% interest loan for ADU conversions.

Grants for ADU design and engineering costs are also available, as well as free technical assistance and schematic designs.

For more information, visit *https://www.cityofnapa.org/747/Junior-Unit-Initiative-Program*.

ADU Financing Best Practices

Although all of the programs described above provide benefits to certain resident groups, such a variety of options may be overwhelming. Moreover, certain programs might work better in some jurisdictions than others, depending on the housing and demographic characteristics of each.

We have compiled a list of best practices that the City of Paramount might consider when designing a financing product that fits its needs.

1. Avoid long-term affordability restrictions

Shorter-term affordability restrictions of five to ten years are preferable over long-term, multi-decade covenants. This is because most homeowners don't feel comfortable making such a long commitment and may shy away from the program for that reason.

Perhaps homeowners need the monthly cash from a rental ADU and therefore would be willing to restrict the rental rate in exchange for a deferred payment loan. But, a 20-year loan term, and thus, an agreement to keep the ADU rent at an affordable rate, may discourage them from pursuing the program or building the ADU at all.

Providing the flexibility to opt out or continue after a certain number of years may represent a workable balance of a compromise between providing long-term affordable housing and allowing homeowners future flexibility.

2. Allow homeowners to exit the program whenever they want

Whether or not it has a long-term restriction, any program's conditions should allow homeowners to leave the program on their own accord at any time. Leaving would allow them to increase the rent to a market rate, but they would also be required to pay back the remainder of the loan or grant amount at that time.

All of these conditions should be made abundantly clear through the program's marketing.

3. **Ensure that the value of incentives match the restrictiveness of the requirement**

Homeowners may be deterred by exceptionally restrictive requirements in order to qualify for a financing program. For this reason, it is necessary that the incentives offered are at least equally as beneficial to the applicant as the restrictions they must comply with are to the community.

For example, a requirement of renting the ADU to a Section 8 Housing Choice Voucher (HCV) recipient, someone who makes no more than 50% AMI, is more restrictive than renting to someone who makes up to 80% of the AMI.

If the program does set more restrictive requirements, it should balance them out by offering a bigger loan or grant amount, or one with better conditions. This could mean the difference between a 1% interest rather than 3%, a shorter time commitment, or a higher loan amount.

Furthermore, the City could also provide options like the City of San Diego has done, and allow applicants to choose between a higher monthly rent maximum with a longer time commitment, or the inverse.

4. **Provide transparent, straightforward marketing and guidelines for the program.**

Establishing clear, easy to interpret guidelines for an ADU financing product is essential to ensure that homeowners are aware of all of the program's conditions and understand their eligibility before applying.

Clear online materials including a fact sheet, program summary, detailed list of conditions, and FAQ list will help to smooth out application processing by City staff by improving the quality and eligibility of applications, and reduce the number of questions from residents. Transparency in the program will also build trust with the community.

Importantly, the low- and moderate-income households that such a program would target may be less likely than wealthier residents to understand the complexities of financing a development project, and have less knowledge of how to maximize the benefits of the program.

Therefore, openly advertising all possible benefits of the financing program, and advertising them through various channels like social media, flyers, and the City website will ensure that homeowners are aware of the program's existence and what it could do for them.

Opportunities to Increase Access to ADU Financing Options

Assessment of barriers

An ADU financing program should help to lower the barriers that are preventing homeowners of all income levels from building affordable ADUs.

To determine what types of ADU financing programs may be appropriate for the City of Paramount, it is important to determine what those barriers are by considering a number of contributing factors. These

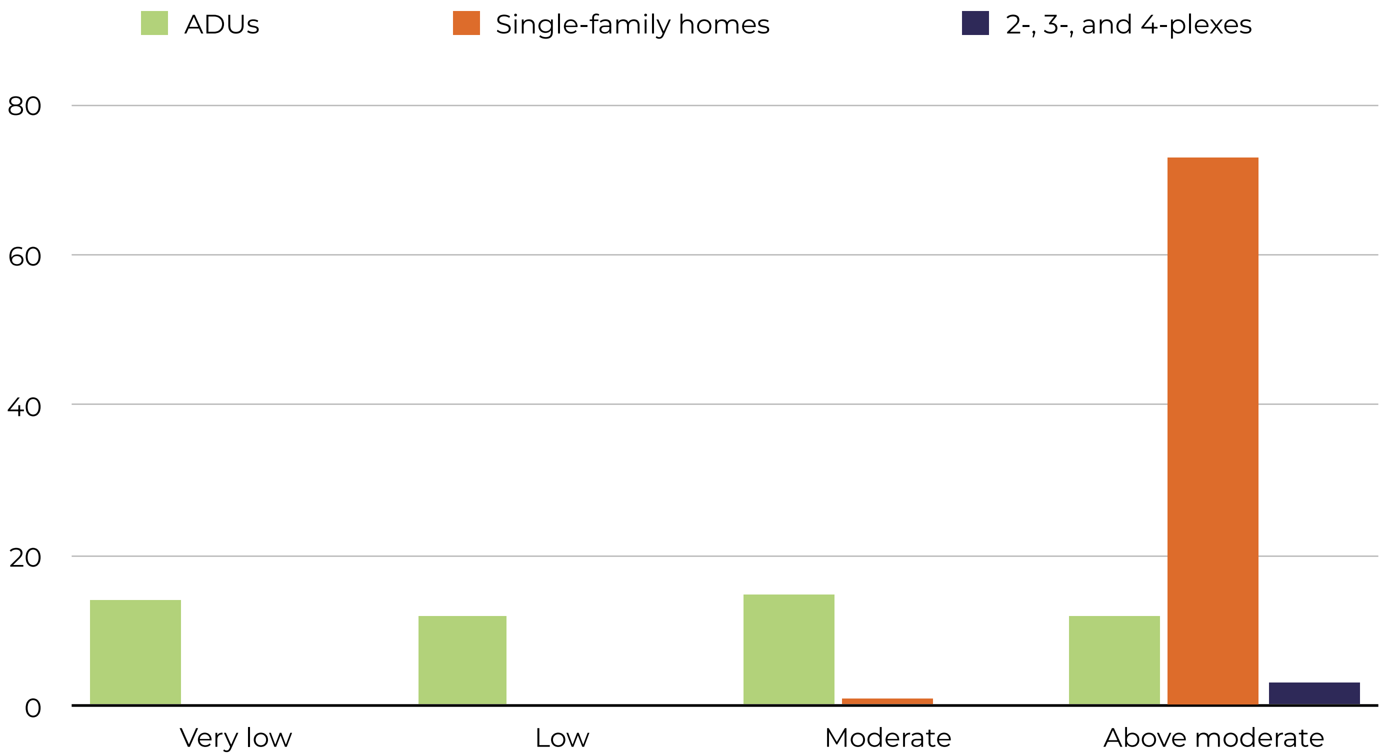

Figure 11: Housing production in Paramount by income level and structure type from 2018-2021. Production is measured by building permits issued. *Data source:* HCD Annual Progress Report (APR)

include the overall goals of the program, the demographics of the city's residents, the characteristics of the existing housing stock, the city's fee structure, the housing needs of the city, and more.

Many of these barriers were identified in the *ADU Opportunities and Constraints Report*, a previous deliverable of this project.

Housing needs

To meet housing demand in California, HCD puts together a Regional Housing Needs Allocation (RHNA) Plan. The RHNA Plan determines and allocates the total number and affordability level of new homes that will need to be developed in a jurisdiction to meet the current and future housing needs of the region.

The current RHNA Plan for the City of Paramount requires the construction of 364 new dwelling units over the current eight year period (2021-2029). To meet this goal, Paramount would need to build about 44 new homes each year in the current RHNA cycle.

If the current level of production continues (54 ADUs a year), ADUs are on pace to fulfill all of the RHNA requirements for the City by 2027, and have the potential to add about 500 new dwelling units before 2029.

Because Paramount is already on track to meet its RHNA goal, providing a financing product that promotes quality over quantity may be the best path forward.

Meaning, the City might choose to offer a larger award amount in the form of a

$50,000 forgivable loan to 20 households rather than a $5,000 fee waiver to 200 households.

Although the former option would help fewer households, its individual effect on those households would be much more significant than the latter. Furthermore, a program like the former would likely draw more applicants and more significantly lower the barrier to ADU construction, whereas the smaller financial aid of the second option might not be enough for low-income homeowners to overcome that barrier.

On the other hand, if the number of low-income homeowner households is very high, a program that helps as many as possible might be preferable.

Income levels

Renters

The income demographics of the city, and their relationship to housing tenure, are critical factors to account for when designing an ADU financing program.

If there are many low-income renters but not many affordable units, it may be the most beneficial to design a program whose main priority is the production of affordable housing.

For example, 82% of households who rent in Paramount are making less than 80% of the AMI, meaning the vast majority of those households would be income-eligible renters for most of the financing programs discussed above. Conversely, only 64% of owner households are within that income level, meaning less people would be eligible for programs that target low-income homeowners.

Furthermore, 25% of Paramount's current RHNA goal is allocated to the production of very low-income homes (for those making up to 50% AMI), yet only 11% of the total building permits issued from 2018-2021 were for very low-income units.[4] This indicates that the city might benefit from a program that **specifically targets Section 8 HCV holders**, who earn up to 50% of the AMI. Notably, 100% of those very low-income units, and those permitted in the low-income category were **all ADUs** (**figure 11**), showing that ADUs have a high potential of meeting all or most of the housing needs for low-income residents in Paramount if promoted and further incentivized.

Homeowners

Although more low-income households in the city are renters rather than owners, still over half of homeowners are making less than 80% of the AMI. Thus, it is important to design a program that benefits both groups and encourages low-income homeowners to build ADUs.

For this reason, the City could consider instituting a program like East Palo Alto's, which requires that both the homeowner and the future renter earn less than 80% of the AMI.

Current housing stock

Analyzing the existing patterns of the types and sizes of ADUs being built in the city can help us understand the gaps that remain and to design a program that fills them in, creating a diverse and balanced

[4] According to the City's Annual Progress Report (APR) submitted to HCD.

ADU housing stock that meets the needs of residents.

For example, designing a program similar to Napa County's that awards a different loan amount depending on the bedroom count of the ADU may help promote the building of larger units, instead of offering a flat rate that is the same for all ADUs, irregardless of bedroom count. The former model may be especially beneficial to jurisdictions that allow larger ADUs.

On the other hand, jurisdictions that have a significant discrepancy between single-person households and studio or one-bedroom units may benefit more from a program like the City of Napa's, which is focused specifically on the production of JADUs (but also provides funding for conversions).

In Paramount, 52% of the households in Paramount have four or more members. However, only eight percent of homes have four or more bedrooms, indicating that larger housing units are desperately needed in the city.

On the other hand, because constructing a four-bedroom ADU under the current floor area maximum of 1,000 sf would be relatively tight, it may be more logical in some cases for homeowners to live in the ADU and rent out the primary dwelling.

Because this is the case, it is important that if owner occupancy is required as a condition of the financing program, **living in the ADU rather than the primary dwelling** still meets this qualification.

City fees

If a city has significantly higher total fee costs for ADUs than surrounding jurisdictions, then a fee waiver program may be effective in promoting the development of ADUs.

As we determined in the *ADU Opportunities and Constraints Report*, neither permitting nor impact fees charged by the City of Paramount are likely to be a constraint on ADU development.

At the same time, just because fees are not unduly constraining does not mean that their removal would have no effect in influencing homeowners to consider building an ADU. In other words, fee waivers may still be a more attractive financing tool than loans, for example, because the fees do not typically have to be paid back.

In this sense, a fee waiver program is somewhat similar to a grant, which are often more highly valued by homeowners than loans.

Racial demographics

Race, housing, and financing have a long and complex relationship rooted in discriminatory policies of the past. The effects of these policies have literally governed how our cities are designed and continue to manifest in the social inequities thus perpetuated.

For this reason, it is essential to consider the racial demographics of a city's population when considering what types of financing programs may best serve them.

The majority of residents in Paramount are Hispanic (73%) and about 14% of residents are Black. Only about 7% of the population identifies as non-Hispanic White (**figure 12**).

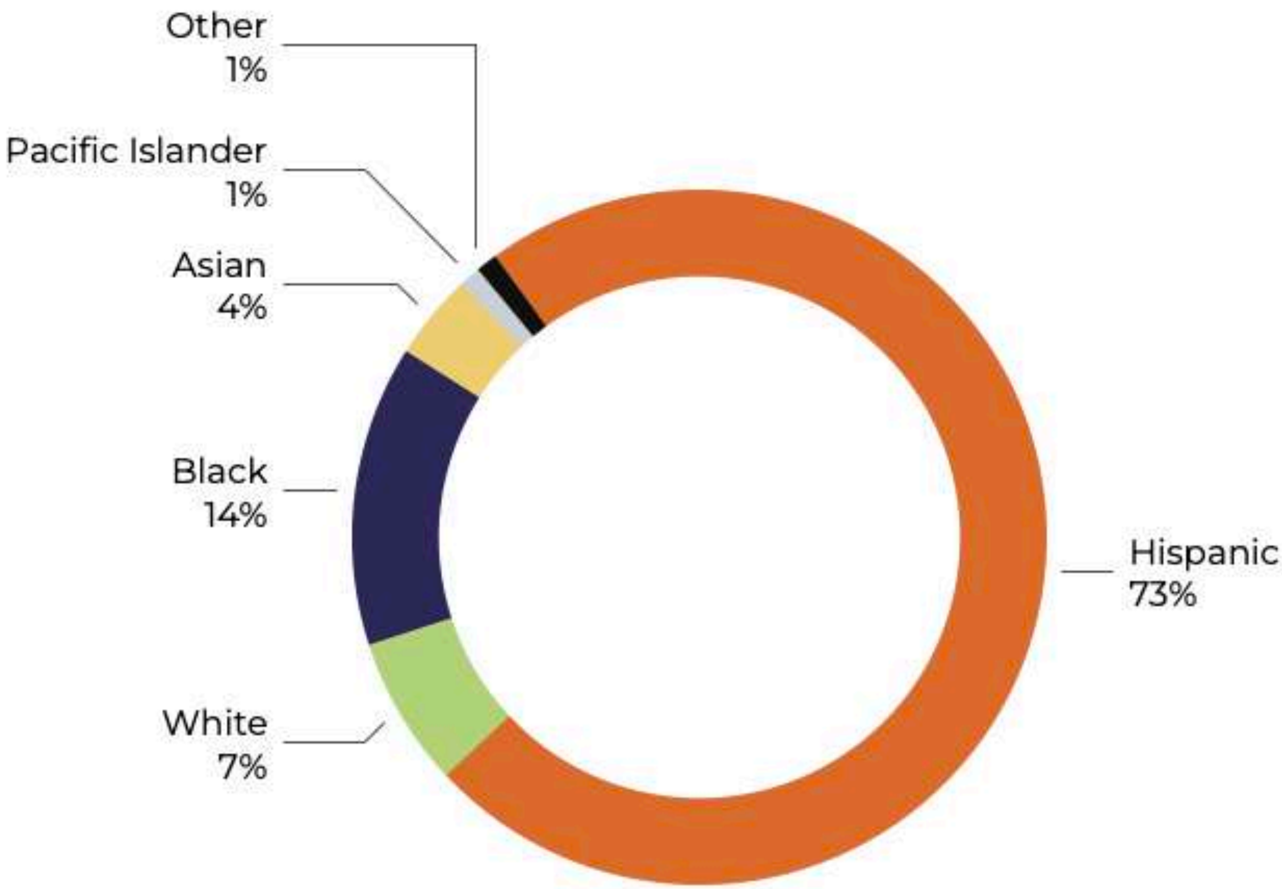

Figure 12: Racial demographics by households in Paramount. *Data source:* HUD CHAS, Table 9, 2014-18 (ACS)

Further, Black households are disproportionately more likely to be renters than White households.

With such a high Hispanic population, it is critical that the City of Paramount acknowledges this fact when designing its ADU financing program, and understands how to promote the program to Hispanic households, some of whom may be restricted by language barriers or immigration status.[5]

To ensure this, it is essential that **all materials are available in Spanish**.

The City should also allow homeowners to use a Social Security or Individual Taxpayer Identification Number (ITIN) when applying for the program, to ensure than undocumented homeowners are not excluded.

It is also important that as a condition, **family members** (or at least low-income family members) **are allowed to live in**

[5] Aiken, C., Reina, V. J., & Culhane, D. P. (2021). Understanding Low-Income Hispanic Housing Challenges and the Use of Housing and Homelessness Assistance. *Cityscape: A Journal of Policy Development and Research*, *23*(2). https://www.huduser.gov/portal/periodicals/cityscpe/vol23num2/ch7.pdf

the homeowner's ADU, as some BIPOC (Black, Indigenous, and/or People of Color) communities may value multi-generational households for financial or cultural reasons.

Furthermore, grants or forgivable loans are superior to standard loans. Because of discriminatory, predatory lending policies of the past, BIPOC homeowners may be averse to debt and may be skeptical of City-sponsored loan programs. At the least, the program's conditions must be very clear so that homeowners are completely aware of the process and trust is built throughout. Providing free technical assistance as part of the program might also aid in this.

Designing a financing program

Once the priorities of the program have been decided, its logistics can be designed. The most common ADU financing program models so far fall into three categories:

1. Fee waivers
2. Low-interest, deferred payment loans
3. Forgivable loans

These may also be supplemented with free technical assistance or materials such as pre-approved ADU plans.

The City of Paramount is already in the process of launching its pre-approved plans, designed by Sidekick Homes as a deliverable of this project. The City could support this offering by partnering with a local nonprofit organization, such as the California Community Economic Development Association (CCEDA),[6] that offers technical assistance surrounding ADUs to homeowners, similarly to EPA CAN DO's CAN DO ADU program.

The following sections explore the benefits and drawbacks of each tool, and ultimately provide guidance for the City in the decision to pursue (or not) an ADU financing program that will increase the availability of affordable rental units and the ability of low-income homeowners to construct them.

Because most of the programs that employ these mechanisms are relatively new, little research has been done to determine the efficacy of each. We recommend that if the City of Paramount does institute an ADU financing program, they carefully monitor and analyze the rate of applications to the program and total ADU applications to determine its success and compare to other program models.

Fee waivers

Of the several cities that offer fee waivers as a financing resource, each have slightly different terms and applicability. Some existing models include fee waivers for the use of pre-approved plans, for the legalization of nonconforming ADUs, or for a commitment to rent to a low-income household. These waivers may cover up to a certain amount of the fees, all of them, or require the homeowner to pay a reduced flat rate fee.

Fee waivers may be a good option for jurisdictions who want to reach a large number of homeowners, because the

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[6] CCEDA offered technical assistance to homeowners seeking to participate in CalHFA's ADU grant program: *https://cceda.com/advocacy/programs/adu/*

individual award is relatively small compared to a loan.

For example, with a $1 million fund, the City could offer 20 loans of $50,000, or 200 fee waivers of $5,000.

On the other hand, an award of only $5,000 may not be significant enough to allow homeowners who were previously unable to build an ADU to do so. Nonetheless, an award of any amount is better than none, and having access to any financial assistance might inspire homeowners to continue seeking funding through other avenues.

Low-interest, deferred payment loans

Many homeowners looking to build an ADU will need to take out some type of loan to do so, but these loans might come with high interest rates and be inaccessible to some lower-income homeowners. A City-sponsored loan program could allow more homeowners to access loans, and offer the advantage of a below market rate interest rate and deferred payments. The payments could be allowed to be deferred for a set time period, or until the end of the loan term, in which case the borrower could refinance the loan with another lender.

Jurisdictions like Oakland have a 30-year term on their loan program, but since the City of Paramount would likely benefit from requiring low-income tenancy, a shorter loan term would be preferable to avoid deterring applicants with a long term commitment. Paramount might consider a five- to ten-year term, ensuring affordable housing for a significant time period, without being too intimidating. If a longer loan term is used, a smaller interest rate should be applied than the inverse.

A loan program like those previously described in places like East Palo Alto, San Diego, and Oakland may be the most financially impactful option, though they would have a smaller reach than programs that offer smaller awards.

The City could of course adjust the number of available loans by decreasing the total loan value, but further analysis should be done to determine the best formula for the greatest impact.

If the City institutes a loan program, the terms should clarify that owner-occupancy can be fulfilled by the owner living anywhere on the property, including in the ADU.

When the City eventually recoups the money, it should be rolled back into the program, so that initial program funding can be used as seed capital that can fund multiple generations of projects.

Forgivable loans

An alternative to a low-interest loan is a forgivable loan. These types of loans are not required to be paid back either partially, or in full, when certain conditions are met. As they are often forgiven, these sorts of loans are less likely to be a part of a sustainable financing program that can fund multiple generations of projects from the same initial capital investment.

Because this type of program allows for a much greater ROI for the borrower, the conditions will likely be much more stringent than that of a low-interest loan like was just described. For example, in some cases like LA County's pilot ADU program, the County offered forgivable ADU loans of $75,000 to homeowners who committed to using their unit to house people transitioning out of homelessness for a minimum of ten years. In other places, the requirement might be for Section 8 voucher holders.

Santa Cruz County's forgivable loan program had a term of 20 years that required affordable renting of the unit for the entire time. This is a similar model to the program in the City of Napa.

Napa County's surprisingly short five-year loan term seems to be an anomaly in this type of model, and in turn the program was exceedingly popular.

The benefit of a model like this is that it is a very attractive option to homeowners, who might be able to justify the commitment to rent their ADU as affordable for a long term period. **Allowing the loan to be forgiven by some amount per year** is also considered a best practice, so that if a homeowner does choose to exit the program, they still enjoy the benefits of the forgivable loan, although they will be required to pay back the remainder. Instituting a low to moderate interest rate of 3% would incentivize borrowers to remain in the program and carry out the commitment for the total term to secure full forgiveness.

For homeowners who do choose to exit the program, the City could use recouped funds to invest back in to the program to fund a future generation of affordable ADUs.

Recommendations

In order to allow low-income homeowners greater access to ADU financing and to promote the production of affordable housing in the city, the Woodsong Associates team offers the following recommendations.

ADU financing programs

Programs to finance ADU construction for low-to-moderate income homeowners

85% of the residents of the City of Paramount are of low to moderate income; this indicates possible widespread need for financing programs that provide construction capital to households that may have difficulty showing sufficient income and cash reserves to qualify for a loan to finance the construction of an ADU. Such programs may be less necessary for the 15% of households in Paramount who make an above-moderate income, or at or above the AMI, which represents the average income for Los Angeles County as a whole.

Programs to provide homes for low-income tenants

The Orange County Housing Finance Trust (OCHFT) is currently developing an ADU financing program which would offer deferred payment ADU construction loans of $100,000 to residents of its 26 member cities plus the County of Orange. The trust has secured $4 million in funding from CalOptima Health, which has never before offered funds for permanent affordable housing.[7]

The goal is to create safe, supportive housing for the most vulnerable residents. Michael Hunt, CEO of CalOptima Health

[7] See for more: *https://www.prnewswire.com/news-releases/caloptima-health-awards-29-9-million-in-grants-to-boost-services-for-orange-county-s-homeless-892088063.html*

Section 8

The Housing Choice Voucher program funded and administered by HUD grants subsidized rental housing vouchers to qualified households. Households may be eligible if they make less than 50% of the AMI, but by law, 75% of voucher holders must be making no more than 30% of the AMI.

The voucher amount is determined using the area's fair market rent and the household size of the voucher holder. The voucher holder is expected to pay between 30-40% of their monthly gross income for the unit and the public housing agency (PHA) that administered the voucher will reimburse the landlord for the remainder of the monthly rent.

In this way, renting through Section 8 can be beneficial to landlords because they are able to charge the market rate, they can always expect to get at least 70% of the rent on time, and tenants go through an initial screening process by the local PHA. Furthermore, because most cities have extensive waiting lists for HCVs, the high demand in relation to supply means that tenant turnover and vacancy is relatively low, leading to less headache in finding new tenants and a more predicable income.

On the other hand, even though refusing Section 8 voucher holders is illegal, many landlords still choose not to offer their properties to HCV holders because of requirements for move-in and annual inspections, processing delays in initial rent payments, limits to annual rent increases, and stricter regulations than if they rented their unit in the standard market.

Therefore, incentivizing homeowners to rent their ADUs as Section 8 housing will be a key step in creating greater access to safe, affordable housing units that make a difference in solving the housing crisis.

stated that, "by providing stability, permanent housing becomes the very foundation for accessing medical and behavioral health services."

OCHFT's program will offer deferred payments loans of $100,000 with 0% interest for the first 10 years to homeowners who rent their ADU to a Section 8 voucher holder. If they fulfill this requirement, half of the loan will be forgiven after 10 years. At this point, the loan may remain deferred, but a moderate interest rate of the federal prime rate plus 1% will be assumed.

After the next 10 years, a balloon payment of the full note amount is due. If the borrower cannot pay this amount at the end of the 20 year term, the loan reverts to the federal prime interest rate plus 6%.

Although Paramount is not affiliated with OCHFT, the Gateway Cities Council of Governments (GCCOG) has recently founded the Gateway Cities Housing Finance Trust (GCHFT) which may institute a similar program. Paramount is already a member of the Trust.

We recommend that the City work with the GCHFT to participate in a similar ADU

	Year 2	Year 3	Year 4	Year 5	Year 6
Without construction loan	$167	$193	$220	$248	$277
With construction loan	$489	$515	$542	$570	$599

Table 8: Comparison of monthly cash flow for a 440 sf studio ADU in Paramount with and without participation in this program. The table assumes a $100,000 no-interest, deferred payment loan. Values are shown starting at year two for stabilization. Because payment is required after 10 years, monthly income would decrease slightly after the 10 year mark as payments begin.

financing program that offers $100,000 construction loans to homeowners. Because of the difficulty of Section 8 holders finding landlords who will accept their voucher, despite Fair Housing laws that prevent discrimination against tenants based on the source of income they use to pay for rent,[8] it is recommended that this program follow the model of OCHFT's and require tenants to be voucher holders. Additionally, to increase access to financial resources for lower-income homeowners, the program should require that homeowners earn up to 80% of AMI annually.

This will allow homeowners who may not have had access to the same financial resources as wealthier residents to enjoy the benefits of ADUs. The rental income gained from the ADU will help them to create generational wealth and reach their long-term financial goals.

Program terms

It is recommended that the program follow some of the established best practices documented in this report, such as allowing owner occupancy anywhere on the parcel. This provision would allow homeowners to live in the new ADU and rent out the primary house, which would be beneficial for increasing the stock of larger rental properties for families.

Allowing family members of the homeowners to be eligible tenants, as long as they are HCV holders, will also help to keep larger families close together.

Furthermore, it's important that homeowners are aware that they can opt out of the program at any time, and that they know what conditions need to be met to do so. In this case, they must repay the remainder of the loan.

One of the most important aspects of any ADU financing program is that its incentives match the restrictiveness of the requirements. If this is not the case, homeowners may not be attracted enough to the program to make it succeed.

Although some of the requirements of Section 8 landlords are more stringent than those in the open market, it is our

[8] Laws banning discrimination against Section 8 voucher holders are rarely enforced, per: *https://nextcity.org/urbanist-news/lawsuit-los-angeles-enforce-housing-voucher-discrimination-ban*

belief that because homeowners can still earn the market rate rent, the program will be an attractive option to homeowners in need of ADU financing.

Table 8 shows the dramatic increase in monthly net cash flow that participants of the program could see. By participating in this program and renting their ADU to a HCV tenant, in Year 2 they could see a 193% increase on their return on investment!

Documentation

One of the biggest barriers to ADU development that Paramount residents cited in the ADU survey administered by an earlier phase of this project was that the building process is too complicated, and they wished there were more online materials available. Developing and publishing transparent, straightforward marketing for the program in both English and Spanish will help to create a better informed public who feel that they have access to the information that they need to successfully navigate, and are not overwhelmed by, the ADU development process.

This marketing package should include multiple handouts, including a quick fact sheet, a program summary, and a detailed list of eligibility and rental requirements and loan terms. Jurisdictions like Oakland and Napa County which have published ample informational handouts on their websites are taking positive steps intended to aid homeowners curious about ADUs in taking the next steps towards becoming ADU owners, and certainly may receive fewer clarification questions from residents than cities with less specific information posted.

Technical assistance

For homeowners who are unfamiliar with housing development, the planning, construction, and renting processes can be equally as daunting as financing the ADU. Developing a program or partnership that offers residents free technical assistance would be an extremely impactful action, even if the funding necessary to offer a financial aid program is not available at this time.

Typically, programs that offer free technical assistance have also required homeowners to commit to renting their ADU an at affordable rate for a period of years.

Some jurisdictions have partnered with local housing and planning nonprofits or consultancies to include this type of assistance as a facet of their financial aid programs, although it could also be offered independently. This best practice **lowers the time and mental burdens that come with building an ADU** for homeowners.

The technical assistance offered can range in type, from free project management, to assistance with permits, or perhaps discounted design costs. These offerings would depend on the capabilities of the City's partner organization.

Our team recommends that the City, acting alone or with other jurisdictions through the framework of the Gateway Cities Council of Governments (GCCOG), partner with a local nonprofit or consulting firm that works in housing development, architecture, urban planning, or a related field to develop a technical assistance program for homeowners interested in building an ADU.

Some relevant options might include Sidekick Homes, Office of Office, CCEDA, or HomePlex.

Partner with a nonprofit to develop ADUs for separate sale

The City of Paramount could take advantage of the exception in state law which allows the separate sale of an ADU that has been developed by a nonprofit organization.

Paramount could partner with a nonprofit organization, like a Community Land Trust, who would build ADUs and sell them to low-income residents. This could be done through a few different avenues. Nonprofits could buy vacant lots and develop single-family homes and ADUs on them, selling the ADUs separately.

Alternatively, nonprofits could purchase existing single-family homes on the open market, build an ADU, and sell each unit separately.

These could be standard properties, those created by an SB 9 urban lot split, the property could be converted to a condominium to allow the ADU to be sold separately, or the property could become a cooperative to allow for separate sale of the ADU from the primary home

It is also possible that nonprofit organizations could partner with homeowners to develop and sell an ADU on their property. In this case, more work would need to be done to determine the legal requirements of such a situation.

To ensure that the ADU remains affordable housing, either a deed restriction would need to be put in place, or the property would need to be placed in a Community Land Trust, so that increases in value from potential property appreciation and growth in equity are shared in a predictable way between the property owner and future property owners by capping allowable annual increases in the potential sale price. This cap on resale profits ensures that the housing remains affordable for the next owner, while allowing the current owner to gain the benefits of paying off their mortgage, and of some share of appreciation.

This model would create an opportunity for lower-income residents to buy property of their own, even if they lack the financial resources necessary to buy a single-family home.

In this case, it is possible that the City might be able to apply for funds through CalHome, which provides grants to local public agencies and nonprofits in order to allow low- and very low-income households to become or remain homeowners. In fact, recently proposed bill AB 671 (Ward) would require that Community Land Trusts are eligible to use CalHome funds to construct ADUs.

Join other cities to lobby for the renewal of the CalHFA grant

As shown through the pro forma analysis, the CalHFA grant helped homeowners reduce the long-term financing required to build an ADU to a meaningful degree.

The grant covered up to $40,000 in pre-development costs, such as site prep, architectural designs, permits, impact fees, and closing costs.

	Year 2	Year 3	Year 4	Year 5	Year 6
Without CalHFA grant	$167	$193	$220	$248	$277
With CalHFA grant	$244	$270	$297	$325	$353

Table 9: Comparison of monthly cash flow for a 440 sf studio ADU in Paramount with and without the CalHFA grant applied. Standard financing in the form of a 30 year, 70% LTV mortgage with a 6% interest rate is used. Values are shown starting at year two for stabilization.

In Paramount, only the 1,000 sf 3-bedroom ADU typology maxed out the grant amount. The studio unit incurred only half of that amount of pre-development and permit fee costs.

Yet as discussed in the *ADU Needs Assessment Report*, homeowners were able to use the remainder of the grant amount to purchase mortgage discount points, or fees paid to the lender in order to reduce the interest rate. Mortgage points typically cost 1% of the mortgage each, and the scale by which they reduce the interest rate is dependent on the loan program. In our analyses, we assumed that the balance of the grant not used on soft costs would be used to buy points at a rate of $2,000 per point, and thus the interest rate was reduced from 6% to as little as 4.97% for a studio ADU. Consequently, this would reduce the total monthly mortgage payment from $706.25 to $630, an annual savings of $915 and thus an increase in cash flow (**Table 9**).

Buying mortgage points with the remainder of the CalHFA grant was an effective way for eligible homeowners to take advantage of the entire grant amount in order to reduce the long-term debt service required.

In order to increase opportunities for low-income homeowners to access ADU financing, the City of Paramount could join other jurisdictions through the League of California Cities to advocate for the reinstatement of the CalHFA grant.

This action would lower the barriers to entry for ADU development for lower-income residents across the entire state without requiring additional City financial resources.

To ensure that all homeowners are able to take advantage of the full grant amount, it should be clear that **recipients are authorized to buy mortgage discount points** with the remainder of the grant not used for pre-development costs. This will prevent wealthier homeowners who are able to invest more upfront capital for a larger ADU from having an advantage that smaller ADU builders do not.

The City of Paramount, working alone or through GCCOG and/or the GCHFT, could also apply for state or federal funding to develop their own grant program similar to CalHFA's that would only be available to Paramount residents, or to residents of the Gateway Cities. This may be more feasible if the City joins GCHFT in the loan program, so that it does not have to secure its own funding for two separate financing programs, or use other City funds.

Lobby for a change in the State property tax system

A significant amount of additional property revenue could be generated solely through the development of ADUs, in Paramount and in other cities. These funds could be used to **develop city programs,** finance community development projects, and provide necessary public services, except that due to the dysfunctional nature of California's property tax system, the City of Paramount is likely to see little to none of the funds generated from the increase in in property tax revenue brought by ADUs.

The Legislative Analyst's Office (LAO), as far back as 1992-93, concluded that:

> *California's existing 'system' of government clearly does not work together to achieve the public's goals. Rather, in our system, the component parts have no common conception of mission, and often work at cross-purposes with each other. Local governments complain that state requirements interfere with their ability to satisfy local community needs. The state, in turn, issues more requirements to ensure that its service objectives are uniformly achieved. Governments compete amongst themselves to obtain larger shares of dwindling resources. Citizens observe declining levels and quality of services and find that they cannot hold any particular agency responsible. In short, we find that California's existing 'system' of government is dysfunctional.*[9]

A greater share of the revenue from the increased ADU production could come to Paramount, if the Legislature were to ever complete the long overdue task of reforming California's property tax system. In 2000, at the request of the State Legislature, the LAO provided suggestions on how to fix the property tax system. Yet, in the 23 years since that report was published, the Legislature has consistently failed to implement any of the LAO's recommended fixes.

We recommend that the Legislature implement a fix to California's property tax system that assigns a greater share of growth in property taxes from infill residential development to local jurisdictions.[10]

The City of Paramount should join forces with other jurisdictions in the SCAG region to direct legislative lobbying efforts to advocate for this change. The City could facilitate this through the League of California Cities (Cal Cities), an advocacy organization that works to expand and protect local control and resources for cities. Introducing, or reintroducing, property tax reform through the organization may highlight it as a bigger issue which, if solved, could bring greater

[9] LAO. "Making Government Make Sense: A More Rational Structure for State and Local Government". Source: *https://lao.ca.gov/analysis_1993/MGMS_reprint_02-93.html*

[10] Alternatives III, IV, and V from the LAO's February 3, 2000 report, *Reconsidering AB 8: Exploring Alternative Ways to Allocate Property Taxes (https://lao.ca.gov/2000/020300_ab8/020300_ab8.html)*, would implement a system where the City would receive a substantial increase in its share of the revenue from housing production within its borders.

financial resources back to the cities through housing production. This success would be multi-fold. As cities would be further incentivized to promote housing production, knowing the financial resources it could bring, they would grow closer to the fulfillment of their RHNA allocations while simultaneously bolstering their funds for other improvement projects. The City could also work with their local Council of Governments (COG) to advocate for this change.

Specifically, we recommend a change to **allocate a greater share of property tax revenue to the cities promoting housing development**. The additional revenue could help to support the City in developing and implementing ADU programs.

Ultimately, it is our belief that the current property tax system does not appropriately incentivize ADU production, or housing production in general, to meet the demands of the current housing crisis in the State of California, nor the legislative intent of the legalization of ADUs in 2016 (SB 1069; Ca. Gov. Code § 65852.150). While we recognize that existing beneficiaries of the current system might complain over a potential decrease in their share of the revenue stream from property taxes, the simple fact of the matter is that it is local jurisdictions that are materially participating in and encouraging the development of new infill residential development; it is local jurisdictions that must serve this development with additional city services; and it is therefore local jurisdictions that should benefit most directly and to the highest degree from the growth in property tax revenue that flows from residential infill development. This nexus itself should be the strongest argument for making this change.

Work with Public Banks

In October 2019, the State of California passed AB 857, a historic law to charter 10 local public banks, including the Los Angeles Public Bank.[11] The City of Paramount could purchase a non-controlling share in the Los Angeles Public Bank to become a charter member, allowing Paramount residents to gain access to the services provided by the bank.[12] These services could include loans for ADU construction, made available for those who may have difficulty obtaining financing from other sources.

On-street parking permits

Due to the flawed municipal property tax revenue stream in California as described, the City of Paramount receives very minimal proceeds of its own earned property taxes. One way to bring in more revenue to the City in order to fund housing development programs, like an ADU financing program, might be to revise the existing program for paid, on-street parking permits. This strategy would further manage the increased demand of on-street parking that population growth and increased housing

[11] *https://www.publicbankla.com/*

[12] Per “CONSTRUCTING THE DEMOCRATIC PUBLIC BANK: A Governance Proposal for the Los Angeles Public Bank” by Michael Brennan, Research Fellow, The Democracy Collaborative, available at: *democracycollaborative.org*

		Hard Costs: $300 per sf		Hard Costs: $230 per sf	
Bedroom count	Household size	Pro forma estimated sale price	Income required to afford (% AMI)	Pro forma estimated sale price	Income required to afford (% AMI)
0	1	$193,525	73%	$152,240	58%
1	1.5	$318,636	84%	$198,184	66%
2	3	$323,036	95%	$252,941	75%
3	4.5	$426,112	113%	$332,651	88%

Table 10: Potential ADU sales prices and purchase affordability using varied construction costs per square foot. Estimated sales prices are calculated by increasing the total project valuation by 15% to account for administrative fees.

production brings, while bringing in capital to invest back into the community. For more details on how a program like this might work, see *Appendix B*.

Recommendations for the State

Reinstate the CalHFA ADU grant

The State of California should allocate funding so that CalHFA is able to reinstate the $40,000 ADU grant. This opportunity helped over 2,000 California homeowners reduce their long-term financing for ADUs and was instrumental in their promotion.

Change the state property tax revenue distribution system

The Legislative Analyst's Office (LAO) has long identified the State's government system as ineffective, with local governments facing interference from state requirements and residents experiencing declining services without accountability. To address this issue, the Legislature must reform the property tax system, allocating a greater share of growth in property taxes from residential development to local jurisdictions. By incentivizing housing production, cities can meet their housing goals, improve their financial resources, and support ADU or other housing programs. Local jurisdictions actively contribute to and support residential development and should therefore benefit directly from the resulting property tax revenue. This change would establish a strong nexus and promote equitable distribution of funds.

Recommendations for the SCAG Region

Form a Regional Housing Finance Authority

SCAG could create a Southern California Regional Housing Finance Authority, similar to the Bay Area Housing Finance Authority (BAHFA),[13] to provide a secondary market for loans for ADUs and other needed housing finance products within the region. The Authority could then work with primary lenders, such as

[13] *https://abag.ca.gov/our-work/housing/bahfa-bay-area-housing-finance-authority*

credit unions and Community Development Financial Institutions (CDFIs), to make loans for ADU construction available to households who may otherwise struggle with access to finance.

Legislation currently under consideration by the Legislature, SB 440,[14] would authorize the creation of a regional housing authority, with the power to place a measure on the ballot for voter approval to raise revenue through a parcel tax or other means, that would allow it to issue revenue bonds; it could then lend funds for affordable housing preservation and/or construction, including for ADUs.

Fund new technologies to bring down the construction costs of ADUs

As can be seen in **Table 10**, reducing the cost of ADU construction from $300 per sf to $230 per sf could have a significant impact on the level of affordability that is possible to obtain with ADUs. Stick-built ADUs (those built on-site with wood frame construction) generally cost in the range of $300 per sf or more.

Preliminary indications are that certain types of factory-built ADUs could be delivered for a cost in the range of $220 to $240 per sf; however, such a factory does not yet exist in the SCAG region.

A public investment in a sufficiently large order, such as for 500 ADUs, would be sufficient to allow such a factory to obtain financing for construction and initial operations, allowing it to deliver ADUs to the SoCal market at a price point that allows for deeper affordability (see **Table 10**) than is possible with stick-built construction. Factory automation, greater control over the supply chain, and more efficient use of materials are the primary pathways for this cost reduction potential.

Conclusion

While ADUs can be an excellent tool for homeowners to increase their monthly income and their property's value, the upfront costs can be too large of a barrier for many lower-income households to overcome.

Some jurisdictions have made strides to allow greater accessibility for homeowners of all income levels to construct ADUs by offering various financing programs that range from modest fee waivers of a few thousand dollars, to forgivable loans of over $100,000. These programs have been funded through housing trusts, city funds, state and federal funding programs like CalHome, and private grant programs.

The CalHFA grant also helped an estimated 2,500 homeowners across California gain access to the valuable funds required to invest in their own ADU. Although the $100 million grant fund has been fully expended as of May 2023, it is highly recommended that the State work to reinstate this or a similar program in the future to continue the promotion of ADUs as a solution to the housing crisis.

The City of Paramount should consider how it can create an ADU financing program of its own (or by working with GCCOG or the GCHFT) to help the more than 3,680 low-income homeowners in the city access the necessary financial

[14] https://leginfo.legislature.ca.gov/faces/billNavClient.xhtml?bill_id=202320240SB440

resources to create additional housing stock of their own.

A program that requires both the homeowner and the future tenant to be low-income will be the most impactful, as both parties reap multiple benefits. The homeowner gains both financial aid to build the ADU as well as monthly rental income, while the renter gains a newly constructed, safe, guaranteed affordable-rate home. Moreover, ADUs can help multigenerational households remain together, honoring cultural and family values and strengthening the community fabric.

The City (and/or GCCOG or GCHFT) could fund such a program through state and federal opportunities like CalHome, AHSC, or even through changes to the existing residential on-street parking permit program.

Ultimately, ADU financing programs that incentivize low-income housing production are a way to subsidize affordable housing with the help of the community. Incentivizing the participation of low-income homeowners helps to bridge the gap between low- and above-moderate income households, and ultimately may lead to greater equity in the city.

Appendix A: Summary of Recommendations

The Woodsong Associates team makes these specific recommendations for the increase of the ADU financing options for homeowners in the city.

These recommendations were developed based on the financing programs of other jurisdictions and ADU financing best practices.

Develop ADU financing programs

- Work with Gateway Cities Housing Finance Trust to **develop and participate in an ADU construction loan program** that provides deferred payment funding to low-income homeowners and incentives for them to rent their ADU to low-income tenants at an affordable rate. (*see page 39*)
- If the City institutes a loan program, the terms should clarify that **owner-occupancy can be fulfilled by the owner living anywhere on the property, including in the ADU**. (*see page 38*)
- Develop **transparent, straightforward marketing** for the program in both English and Spanish. (*see page 42*)
- Partner with a local nonprofit or consultancy to **offer free or discounted technical assistance** and services in exchange for an affordable rental unit. (*see page 42*)
- Partner with a nonprofit organization, like a Community Land Trust, who would **build ADUs and sell them to low-income residents**. (*see page 43*)

Investigate funding sources for financing programs

- **Apply for grants through AHCS or CalHome** to secure funding for an ADU financing product for low-income residents. (*see page 43*)
- **Join the Los Angeles Public Bank** by purchasing a non-controlling share to become a charter member, potentially allowing city property owners to obtain access to Bank financing for ADU construction. (*see page 46*)
- SCAG could **create a Southern California Regional Housing Finance Authority**, similar to the Bay Area Housing Finance Authority (BAHFA), to provide a secondary market for loans for ADUs and other needed housing finance products within the region. The Authority could then work with primary lenders, such as credit unions and Community Development Financial Institutions (CDFIs), to make loans for ADU construction available to households in Paramount who may otherwise struggle with access to finance. (*see page 47*)
- **Implement parking benefit districts** in residential areas, in order to manage increases in demand for on-street parking due to ADU development, and to develop a revenue stream to help offset potential increases in costs for additional city services for increase in population due to ADU development. (*see page 46*)

Advocate for State policy change and ADU financial aid

- Join other jurisdictions to **lobby for the renewal of the CalHFA ADU grant**, or the adoption of a similar program. Alternatively, the City could develop this program individually to be offered only to Paramount residents, or work with Gateway Cities Housing Finance Trust to develop a program for member jurisdictions. (*see page 43*)
- We recommend that the Legislature **implement a fix to California's property tax system** that assigns a greater share of growth in property taxes from residences to local jurisdictions. Specifically, we recommend a change to allocate a greater share of property tax revenue to cities that **promote, encourage, and receive infill housing development**. The additional revenue could help to support and encourage the City in developing and implementing ADU programs. The City of Paramount should join other jurisdictions through the League of California Cities and GCCOG to direct legislative lobbing efforts to advocate for this change. (*see page 45*)
- SCAG could **fund new technologies to reduce the construction costs of ADUs**, increasing their affordability and allowing low-income residents greater opportunities to purchase or rent at affordable rates. (*see page 48*)

Appendix B: On-street Parking Permit Program

California's Legislature has paved the way for increased parking pressures on the streets of Paramount, as well as other cities across the state, by removing the ability of cities to enforce minimum parking standards on ADUs and other infill development types near transit and in other situations. While removing minimum parking requirements is a great step forward to increase the efficiency of land use, it can have a side effect of increasing demand for on-street parking.

In order to ensure that this increased demand is managed fairly and equitably, we recommend that Paramount implement an on-street parking demand management protocol.

This protocol should involve five steps:

1) Consultation
2) Measurement
3) Identify solutions, such as permits
4) Scaled pricing
5) Adjustable pricing and operations

These steps should be taken in response to either a request for assistance from a local partner, such as a neighborhood association, or to other indicators of overfull parking, such as complaints or observations by staff.

In the future, automated methods could be used to identify problem areas in need of parking management interventions.

Regardless, the first step of a response must be to quantify the problem in order to identify the most appropriate response.

Step One: Consult

Before measurement, a consultation process should begin with neighbors and involved parties. The first step in this process should be a dialogue, the outcome of which is to identify areas where problems are observed to be occurring, and to identify when problems are most likely to occur.

For instance, neighbors may observe that they cannot find parking on weekday evenings near their house when they get home from work. The location of their house, and this identification of a time of week, should be sufficient to proceed to Step Two. However, feedback loops must be maintained between local residents, involved parties, and city staff at all stages of the process.

Step Two: Measurement

The next step is to determine where the problem is: where parking is overfull. A general standard[15] definition of overfull is the 85% rule: parking is overfull when more than 85% of the spaces are occupied on any given block face. Parking should, in general, be managed to aim for 85% of the parking spaces on a block face (or within a certain area) being full during peak demand hours.

Neighborhoods where residents and their guests cannot find parking within a short walk are usually those most ripe for parking management.

To measure the parking utilization rate, the total number of spaces are counted, and the total number of vehicles in those spaces are counted; the latter over the former produces the parking utilization rate.

The key to measuring parking utilization is to pick an appropriate peak demand time during which to take the measurement of the number of parked vehicles. In wholly-residential areas, parking peak demand can be measured most appropriately during the middle of weekday nights, when most residents are at home. In residential areas adjacent to schools, business districts, dining areas, or other attractions, however, the time of peak demand may be peak dining hours, or other times of day/week. This is why it's important to consult with neighbors before engaging in measurement.

Step Three: Identify solutions

Depending on the outcome of the measurement phase, a number of recommendations could be made for most appropriate management strategy. This strategy will most likely involve a paid parking permit system for residents, coupled with visitor permits, time limits, and/or parking fees for visitors.

The goal of the chosen management strategy should be to relieve on-street parking pressure, so that residents and visitors are likely to find a space when they need it.

Step Four: Scaled pricing

When on-street parking is free, there is no dis-incentive to over-use it. Households can purchase as many cars as they can afford, and park them for free on City streets. Even after those cars stop working, they can remain parked on City streets for free indefinitely.

On-street parking permits can begin to assign a cost to parking on city streets.[16] The next step is to increase this cost for each additional vehicle owner by a household. The permit cost could, for instance, double for each additional vehicle owner by a household and parked on city streets.

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[15] This standard and these steps are documented in DLCD's *Guide to Managing On-Street Parking in Residential Areas* (*https://www.oregon.gov/lcd/TGM/Documents/ManagingResidentialParking.pdf*)

[16] For more information on the use of on-street parking permit programs, including the Alphabet District case study, see the Northwest Parking District Overview at: *https://www.portland.gov/transportation/parking/northwest-parking-district/northwest-parking*

Under a scaled permit parking system, for instance, the first on-street vehicle parking permit could cost $75/year; this price could double to $150/year for a second on-street parking permit for the same household, and double again to $300/year for a third vehicle.

Because ADUs share the same lot as a primary home, and therefore the same parking supply, an argument could be made that ADUs not be considered a separate household for the purposes of calculating on-street parking permit fees; under this system, if the resident of the primary home wanted a parking permit, that would be $75, then if the ADU's resident also wanted a parking permit, that would be $150, as it would be the second permit assigned to that primary address.

Structuring costs in this way can also send an important market signal about the value of parking; this could influence the decisions of property owners and residents around how much off-street parking to pay to provide, as well as how many vehicles to purchase and own.

Step Five: Adjustable pricing and operations

Once a residential parking permit program is up and running, the next step is to measure performance and monitor results. In particular, this is critical to determine if the program is delivering on the desired 85% peak period parking utilization rate, or if parking utilization is still regularly exceeding 85%, and if so, where and

Case Study: Alphabet District Parking Management Program

The Alphabet District in Portland, OR has long experienced on-street parking demand in excess of available supply. In response to these pressures, the neighborhood worked with the City to adopt an **on-street parking management program** that includes:

- A **residential parking permit system** with an equitable low-income permit component that mitigates the burden on the neighborhood's most vulnerable residents
- A meter district that allows visitors to pay by the hour for on-street parking within limits; visitors can pay at kiosks, or using the ParkingKitty mobile app
- A Transportation and Parking Management Association (TPMA) for parking self-governance and parking revenue management in the District
- Annual permits cost $202.50 (as of July, 2023): $82.50 for the permit, plus a $120 surcharge
- Permits are limited to 1 per licensed driver and a maximum of 3 permits per address/unit
- Permits are intended for people who do not have off-street parking available to them; applicants are required to declare any off-street parking they have, and those with off-street parking available may not qualify for a permit
- Residents living on an income of 80% of Area Median Income (AMI) pay $82.50 for a permit (the surcharge is waived)
- New apartment buildings are limited to 0.4 permits per number of units in the building
- Parking permit surcharge revenue is allocated by a Stakeholder Advisory Committee to eligible projects within the District

While the residential permit program as currently instituted does not feature tiered pricing that increases the permit cost for each additional vehicle associated with each household, tiered pricing is recommended for future districts where there may be a greater prevalence of households with multiple vehicles parked on-street.

when.

Because parking permit programs are usually implemented through a series of districts, it is easy enough to identify parking utilization hot spots, and give those areas their own pricing structure.

The basic principle is to increase the price of parking until the utilization rate drops to roughly 85% during peak periods. The inverse of this is also true; if, after introducing parking pricing, occupancy rates fall to far below 85%, then it's possible that permit rates should be adjusted downwards.

Successful parking permit programs are also accompanied by some degree of enforcement. A good rule of thumb for enforcement is to use a warning-first approach, where the first one or two violations are warnings, or much lower cost. Progressive parking fines are also a related good practice, where the first ticket each year is a certain amount, which could then double for each subsequent ticket.

Revenue from permits and tickets should pay for enforcement costs, with sufficient remainder to also fund neighborhood improvements, such as through a Parking Benefit District,[17] where at least half of the revenue from permits and tickets go back to the neighborhood.

As such, residential on-street permit pricing can be a tool for the City to monetize infill development by gaining a revenue stream from on-street parked vehicles, one that could be shared with the neighborhood to provide funds for neighborhood improvement projects, such as tree planting, traffic calming, and neighborhood beautification. This revenue stream could also be used to provide funding for city services, as it would be unencumbered by restrictions on use aside from those that the City may wish to impose.

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[17] Parking Benefit Districts, explained: *https://www.mapc.org/wp-content/uploads/2017/10/Parking-Benefits-Districts_one-pager.pdf*