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May 27, 2016

Honorable Jose Huizar, Chair
Planning and Land Use Management Committee
Los Angeles City Council
200 North Spring Street, Room 395
Los Angeles, CA 90012

Attention: Sharon Dickinson, Legislative Assistant

**COMMITTEE TRANSMITTAL: FEASIBILITY OF IMPLEMENTING A "VALUE CAPTURE"
POLICY" COUNCIL FILE NO. 14-1325**

Dear Honorable Members of the City Council:

In light of the worsening housing crisis in Los Angeles and reduced resources available to address it, on September 30, 2014 a motion was introduced (CF 14-1325 - O-Farrell/Huizar) requesting the Department of City Planning (DCP) and the Housing + Community Investment Department (HCID) report on the feasibility of the implementation of a housing "value capture" policy. The Housing Committee and Planning and Land Use Management City Council Committees have both requested a written report on the item.

Specifically, the motion calls for an analysis of potential land use policies that would "establish a nexus between certain discretionary land use entitlements and affordable housing." Planning entitlement types identified in the motion include, but are not limited to, Zone Changes, Zone Variances, Development Agreements and General Plan Amendments (referred to collectively as "zoning changes" in this report). The motion suggests that projects obtaining land use incentive entitlements should provide a percentage of affordable housing in proportion to the land use benefit they accept.

In response to the requests outlined in the motion, this report seeks to describe how value capture is being used in other cities, and provide analysis regarding three different value capture options.

BACKGROUND

The City, in line with its General Plan, aims to direct most new housing to targeted growth areas including centers, transit nodes and mixed-use boulevards. The aim is to produce vibrant complete communities with a mix of commercial, civic and residential uses. A major challenge in maximizing the benefits of smart growth is how to ensure that communities maintain and

promote a diversity of residents over the long term. Preserving and producing housing for a range of household incomes is a critical strategy in minimizing displacement and limiting rent increases in these targeted growth areas.

There is a need for increased housing production across the income spectrum, including market rate housing and affordable housing. Affordability in Los Angeles, defined as the relationship between incomes and housing costs, is the lowest in the country and likely at its lowest point in history. Like all California cities, funding for affordable housing in Los Angeles has declined dramatically in recent years. Also during this period, an important planning and land use tool to address affordable housing - inclusionary zoning (on rental housing) - was found by the courts to be illegal in California.

Overall Housing Production Goals

State law says local governments "have a responsibility to use the powers vested in them to... make adequate provision for the housing needs of all economic segments of the community." (Gov. Code § 65580(a)). This responsibility extends to both the provision of overall housing production at levels commensurate with growth and need, and a responsibility to employ a range of affordable housing strategies to increase the percentage of affordable housing produced. Mayor Garcetti stated his goal of permitting 100,000 new housing units by 2021, importantly meeting and exceeding Los Angeles' regional housing needs allocation as determined by the 2013-2021 adopted Housing Element. As of April 30th of this year, 38,458 residential units have been permitted which places the city on track to achieve this goal.

Any program to require affordable housing as part of market rate development must be carefully balanced with market feasibility and demand so as to not negatively impact the overall rate of housing production. Development fees, exactions and requirements, including potential affordable housing fees and set-aside requirements under certain scenarios, can be an important public policy tool to advance public goals and interests and ensure broad accessibility to market rate development. However, such policies must be carefully balanced and paired with incentives and reasonable regulations to ensure that such public policy aims can be achieved within the operations of the private housing market. Simply put, housing in itself is a value.

There are important opportunities to develop policies to encourage mixed income housing is produced, how existing affordable housing may be preserved and retained, and how significant city incentives to provide or increase the levels of housing production can be paired with reasonable affordable housing provisions. This report explores one significant opportunity, in situations where the City offers significant zoning benefits to projects.

What is Value Capture?

The policies identified in the subject Council Motion (CF 14-1325) are identified as a form of Value Capture. The term Value Capture refers broadly to regulatory requirements that generate funding or actual public improvements when public actions, such as new infrastructure or changes in land use regulation, result in significant increases in land value.

In the realm of land use, Value Capture is often called Land Value Recapture (LVR) or Public Benefit Zoning (PBZ). Value Capture is differentiated from both incentive-based tools like density bonus and blanket requirements like inclusionary zoning, in that it is not already priced into the value of land. Instead, a specific public action creates an increase in land value and a portion of this value is, in turn, recaptured in the form of public benefits.

Value Capture in Light of Existing Policy Proposals

Any discussion of new Value Capture policies must include an assessment of existing and proposed affordable housing policies and development impact fees. For example, currently the Department of City Planning is developing an affordable housing linkage fee study to inform policy options for a linkage fee. Such a fee would be placed on new market rate development to provide some level of related affordable housing funding to offset demonstrated needs for affordable housing created by the type of development. In addition, the Department has developed other proposed development impact fees for park spaces (the proposed Quimby ordinance) and has submitted a proposal for a comprehensive look at all development impact fees to align and standardize such fees in a coordinated manner. All of these proposals further inform and frame the exploration of Value Capture policies.

Value Capture and Public Benefit Zoning Policies in Other Jurisdictions

The Value Capture method discussed in this report would focus on residential and mixed-use projects that receive significant increases in the number of units allowed on a particular site through an entitlement action.

Some cities in the United States (including Chicago, Boston and Honolulu) have instituted similar programs that require the provision of affordable housing (and/or in-lieu fees) in exchange for increased density resulting from a zone change. Though none of the US cities call their programs Value Capture, they fall under the definition used here. In other countries, the concepts are taken much further. The following section summarizes systems used by other cities in the US in order to inform what could be done in Los Angeles.

Chicago - Affordable Housing Requirements Ordinance

Chicago's Affordable Requirements Ordinance (ARO) requires residential developments requesting zoning changes that either increase density, or allow a residential use where it had been prohibited, to provide 10% of units at affordable prices. In 2015, Chicago modified the ARO's in-lieu fee option depending on the neighborhood. Fees now range from \$50,000 (per unit) to \$175,000.

Boston - Inclusionary Development Program

Boston's Inclusionary Development Program (IDP) applies to residential developments that will either require relief from the Boston Zoning Code or be developed on property owned by the City of Boston. Developers are required to either build affordable units on-site, build or acquire affordable units in an off-site location, or, provide an in-lieu contribution. In most of the city the number of affordable units is 18 percent and the in-lieu contributions are \$380,000.

New York City - Mandatory Inclusionary Housing

New York City has recently adopted Mayor DeBlasio's plan to make affordable housing mandatory wherever new housing capacity is approved through land use actions such as zoning changes. The requirements apply whether a property is rezoned as part of a City neighborhood plan or a private rezoning application. The program was developed to include flexibility in terms of the level of affordability required, depending on the particular needs of a community.

Honolulu - Unilateral Agreements Rules

Honolulu's Unilateral Agreement rules require 30% of housing, in projects requesting rezoning, to be affordable at between 80% to 140% of the Area Median Income (AMI). Of this 30%, a minimum 20% of the total units must be affordable to those earning up to 120% AMI, of which 10% of the total units must be affordable to those earning up to 80% AMI. Developments with fewer than 10 units are not subject to the requirements.

San Francisco - Eastern Neighborhoods Plan

The Eastern Neighborhoods Plan, covering the rapidly gentrifying Mission, East SOMA and Potrero Hill neighborhoods, established an incentive-based "Tier" approach to public benefits. The Plan also requires that in areas rezoned from industrial to mixed uses (mostly residential), more affordable housing must be produced than is required under the City's inclusionary program.

New Jersey - Public Law 46 of 2008

The State of New Jersey requires affordable housing on rezonings from non-residentially zoned land to residential use, including any project approved within two years of a rezoning. Local jurisdictions may vary their requirements based on economic feasibility studies.

Current Los Angeles Context

Today, housing developers seeking zoning allowances may have multiple options for requesting them. Most commonly, since the passage of SB 1818 in 2002, developers have requested a Density Bonus (DB), which allows a 35% increase in the number of units as well as additional zoning incentives in exchange for a provision of affordable housing. The other main vehicles for increasing residential density are Zone Changes (ZC) and/or Height District (HD) changes.

Table 1 below shows the number of applicants and proposed units under each of these planning entitlement types for 2014 and 2015. As can be seen, projects requesting Zone or Height District Changes applied to build about 15,000 housing units through that process, compared to 10,000 in Density Bonus projects.

Table 1: Number of Projects Requesting a Zone Change and Density Bonus, Along with the Number of Proposed Units, 2014-2015

Entitlement Type	Projects		Proposed Units		
	2014	2015	2014	2015	Difference
Density Bonus	130	64	5,892	4,392	(-1,500)
Zone Changes/General Plan Amendments	66	60	5,956	9,099	(+3,143)

Zone Changes May Not Align With the Density Bonus Program

In 2014, the state passed AB 2222, which introduced new requirements on Density Bonus projects, including a "one for one" affordable housing replacement and 55 year covenants (rather than 30). After the law went into effect in 2015, the number of Density Bonus cases dropped by almost half from the prior year's total (see Table 1 above). The exact reason for the decline may be linked to market conditions, to the uncertainty of the legislative intent and legislation, or to the additional cost of providing replacement affordable units. At the same time, the number of housing units being proposed through Zone Changes has increased by 53%. It is important to note that many zone change requests reflect a range of zones permitted and anticipated by the General Plan designation for the parcel, and may involve uses or intensities that are not applicable to a Density Bonus program. However, in limited instances, developers desiring zoning increases may decide to file for a Zone Change, where no consistent affordable housing requirements are imposed, instead of pursuing a Density Bonus project, which would require a specific percentage of affordable housing and the replacement of any designated low-income housing on the site.

Multiple Pathways to Achieve Public Benefits

While projects requesting Zone Changes are not specifically required to provide any affordable housing, negotiations over public benefits for major projects requesting multiple entitlements are common in Los Angeles, like other major cities. Discussions over public benefits sometimes occur through a more formal Development Agreement process (established in CA Government

Code Section 65864) or can be negotiated on a more ad-hoc basis through the entitlement process. Affordable housing or other "community benefits agreements" may be volunteered by developers as a good-faith gesture, while other times Development Agreements may be negotiated by the Department of City Planning or other stakeholders as part of the overall entitlement request. Such agreements are voluntary, and normally provide value to both the applicant (normally in terms of legal protection and an extended entitlement term) and the City. To some degree, these case-by-case negotiations may create a less than predictable entitlement climate for both applicants and community members. Policy makers must also attempt to calibrate an appropriate package of public benefits on the basis of available information and coordination with City policy goals and practices on similar projects in other areas of the City.

Existing Applications of the Value Capture Strategy

The City has adopted special zoning districts that in many ways incorporate Value Capture strategies. In particular, these strategies have been employed in locations where the pre-existing zoning was industrial and opportunities for changes to residential or mixed or hybrid uses were considered appropriate. In these situations, the special zoning districts established a base floor area ratio and opportunities to increase the floor area ratio were linked to the provision of affordable housing. Examples of these types of special zoning districts include the Cornfield Arroyo Seco Specific Plan, and the Hybrid Industrial zone. Several community plans under development are also evaluating versions of this approach, linking increased floor area incentives to the provision of affordable housing.

DISCUSSION

Further study of a set of Value Capture policies, as outlined in this report, may provide greater objectivity and transparency to the process of providing public benefits when significant zoning changes are requested. It would also help support the City's most important incentive to produce affordable housing, the Density Bonus program, in relation to the larger land use entitlement process, specifically General Plan Amendments and Zone Changes. Finally, it would ensure that projects that receive significant land use incentives contribute to the provision of affordable housing in the City. There are a number of key policy issues that need to be analyzed in greater detail.

What Types of Projects Could be Included in a Value Capture Policy?

General Plan Amendments, Zone Change, and Height District Changes

The most straightforward class of projects where a Value Capture affordable housing requirement may be useful are General Plan Amendments, Zone Changes and Height District changes. In the residential context, projects receiving these incentives in many instances are able to build more units and larger buildings than would otherwise be allowed. A subset of Zone Change projects also require a General Plan Amendment because the proposed Zone designation lies outside the range permitted by the designated General Plan Land Use designation. These three types of entitlements typically allow for greater zoning benefits than Density Bonus projects, but do not specifically require the provision (or replacement) of any affordable housing. The Department recommends these types of entitlements be included for further study in a Value Capture policy.

Eldercare Facilities

The Eldercare Facilities Ordinance was adopted in 2010 to facilitate the approval process for building new senior housing. In addition to creating a streamlined process for projects that include at least a portion of service-enriched senior units, it also allows for increases in density, height and floor area ratios, etc. if certain findings are made. Through this process, a Zoning Administrator is able to approve larger multifamily projects in single-family or other low-density

zoned property. Despite the zoning concessions being provided, the process is not tied to a specific provision of community benefits. However, the Zoning Administrator must find that the increased density and/or height is needed to serve the citywide housing needs of seniors. The Housing Element describes affordability and accessibility of housing as a top concern. It may be important to consider an affordability requirement as reasonable and appropriate when significant increases in density are approved through an Eldercare project.

Conditional Use Permit / Public Benefit Process for Density Increases More than 35%

The Zoning Code currently allows two ways for applicants to request a density increase greater than the maximum 35% permitted through the density bonus program. The first is a Conditional Use Permit (CUP), which may be requested pursuant to LAMC 12.24 U.26. The CUP process requires basic General Plan conformance and neighborhood compatibility findings. In addition, the decision maker (City Planning Commission) must also find that the project contains the requisite number of affordable and/or senior citizen units as set forth in California Government Code Section 65915(b). This provision is understood as requiring the same percentage of affordable housing required for a maximum 35% Density Bonus project, even though the applicant may be requesting a 50% or 100% increase in density or floor area.

Alternatively, a developer may apply as a Public Benefit project per LAMC 14.00 A.2 to request greater than 35% density increases. This process is approved by the Director of Planning if certain performance standards are met, including the same affordable housing requirement described above, as well as more specific development standards.

Both of these procedures permit increases in density without a set maximum, but limit specified affordable housing requirements to those required for a maximum 35% Density Bonus increase. Updating affordability requirements beyond this 35% threshold would provide greater consistency across the Zoning Code. The goal would be to have all projects subject to the same affordability requirements, no matter what entitlement process is chosen.

Development Agreements

As mentioned earlier, the Development Agreement process is established in CA Government Code Section 65864 as a way to provide complex, multi-phased projects requesting zoning modifications with greater certainty. The law specifically allows for the inclusion of community benefits including the financing of public facilities. Affordable housing has often been a part of these negotiations. The process for establishing how much affordable housing should be required has not been defined and therefore subject to somewhat divergent expectations among the City, the applicant, and community stakeholders. A Value Capture policy would allow for greater policy consistency and transparency, and in many ways could provide structure for development agreements which could then focus on other types of benefits.

Options for the Structure of Affordable Housing Requirements

There are different ways an affordable housing requirement can be crafted. Most U.S. cities that have similar policies (outlined above) have adopted a fixed requirement for affordable housing that applies the same to all General Plan or zone change projects (such as 18% low-income in Boston). Other cities have provided more detailed, multiple income targets (such as 20% moderate income plus 10% low income in Honolulu). Another option, based on the existing code in California, may be to mirror the affordability percentages in the state density bonus law SB 1818, which increases proportionally as the allowable density on a site is increased. Each of these three policy approaches are outlined below.

The specific affordable housing percentages outlined in the three scenarios below should not be viewed as specific policy recommendations. They are provided as a way to initially evaluate

potential pros and cons of the three different methods requirements offered as options. The Department would conduct further study and analysis to refine the most appropriate level of affordable housing requirements.

a. Fixed Requirement

The advantage of a fixed affordable housing requirement is that it is relatively straightforward. Any General Plan Amendment or Zone Change project (however defined) would trigger the same percentage set-aside regardless of the project size or details. It is important to note that this method does not account for variations in requested zoning modifications. That is, a developer requesting a 50% increase in density or floor area would provide the same affordable housing requirement as someone receiving a 500% increase. The required fixed percentage would, however, scale with the size of the overall project.

A good reference point for determining appropriate affordable housing requirements is the Density Bonus program. Using it, a maximum 35% increase in density is granted if the project includes either 20% low-income or 11% very-low income units in the development, as calculated on the base density. Zone Change requests for residential projects in Los Angeles are required to exceed what may be obtained through the Density Bonus program, pursuant to a October 24, 2012 Department policy memo. A typical Zone Change request may double the allowable number of housing units. Considering the increases normally requested through the entitlements covered by the proposed policy, a requirement of approximately 20% low income or 11% very low income, as calculated on the base density, could be studied for feasibility. Alternatively, a modified percentage could be calculated on the total project density. Any actual requirement would be subject to professional departmental analysis and robust stakeholder input.

b. Fixed Requirements - Multiple Income Targeting

The multiple income targeting option is similar to the fixed requirement above, except it would target more than one income category for each project. Rather than the simple 20% low income requirement described above, a multiple income targeting approach could provide housing for more than one income group in the same project. Requirements could be established to encourage a combination of low and very low income units, or the City could choose to target traditionally underserved categories such as extremely low income (30% AMI) and moderate income (80%-120% AMI).

To continue with the level of affordable housing considered in the fixed requirement example above, a multiple income targeting program could require the provision of both 5% very low income and 15% low income affordable housing, as calculated on the base density. Alternatively, a modified percentage could be calculated on the total project density. If a policy was developed to target underserved income groups, the equivalent requirements would be approximately 15% moderate income and 5% extremely low income.

c. Proportional Requirements (Using the Density Bonus Charts)

A fundamentally different approach from the two above would establish a proportional relationship between the amount of density or residential floor area increases and the requested entitlement. This is the method used by the Density Bonus program, which requires greater amounts of affordable housing as greater density increases are requested according to a series of charts established by state law (GCS 65915). These affordability charts could be extended past today's maximum 35% limit to apply to the types of projects discussed in this report.

An advantage of this approach is that it is more specific to the request of individual projects, and therefore more equitable to the array of projects it would cover. This prevents there from being a disincentive towards requesting smaller modifications and vice-versa. The proportional concept is also already well-established in California and the City of Los Angeles with the Density Bonus program.

To understand how this method would work in practice, the example below models a hypothetical Zone Change request for a 100% increase in density (e.g. a R3 to R4 or C1 to C2) to produce a 200 unit building. Table 2 includes the estimated number of units that would be produced using this method at different income ranges for both the project. The figures in the table below reflect that the Density Bonus program calculates the percentage of required affordable housing based off the *base* number allowable units, not the *total* number of units in the building that actually result from the bonus.

Table 2

Income Range	Affordable % (Total, applied to base)	Estimated Affordable Housing Production
Very Low or	(18.5%)	19 Units
Low Income or	(31.5%)	32 Units
Moderate Income	(50%)	50 Units

As shown in the example above, a Zone Change project would require the equivalent of 18.5% very low, 31.5% low income, or 50% moderate income housing based on extending the Density Bonus charts. These are sizable percentages, well in excess of the types of mixed-income projects seen in Los Angeles (because the Zone Change requests are much larger than what Density Bonus allows). It is also possible to devise a system that results in projects that serve multiple affordable income ranges. To evaluate the feasibility of either of these approaches, further economic study is needed.

It is important to note that Density Bonus programs, under many circumstances, are reviewed and granted at an administrative level, whereas the zone change process requires more extensive public hearings and approval by the City Planning Commission, City Council, and Mayor. To this end, the affordable housing requirements attached to any zone change process should take this extra level of uncertainty and entitlement complexity into account.

Preservation of Rent Stabilized Ordinance (RSO) Housing

Today, as a result of AB 2222 (2014), Density Bonus projects are required to replace in kind all low-income units lost as a result of a project, as well as any units subject to rent control or rent stabilization (like the RSO). Zone Change and the other projects covered by this report are not held to this important standard. A Value Capture policy could also evaluate the feasibility of including a replacement provision for existing affordable, or rent-stabilized units. A policy goal under this scenario would be to ensure there would be no reduction of affordable or rent stabilized units as a result of the project.

Other Options: In-Lieu Fees and Off-Site Units

Policies requiring the provision of affordable housing often allow alternative ways to comply with the requirements, in order to provide some flexibility for developers. A common approach is to allow an in-lieu fee option, whereby the waiver of each required affordable on-site unit is assessed a fee, which can be then allocated towards the city's housing trust fund to build affordable housing in other projects. The fee is normally calculated on the basis of what it typically costs the jurisdiction to create a unit of affordable housing, based on past practice. A fee option will increase complexity, may result in fewer mixed-income projects and may delay the construction of the actual affordable unit. At the same time, a fee option provides greater flexibility to an applicant. Encouraging mixed-income buildings and creating affordable housing

across the City is an important General Plan objective. However, this policy can be a way to provide resources for the Affordable Housing Trust Fund.

Another option is to allow developers to construct the affordable units off-site, or in partnership with another developer, usually within a given radius of the project site. This allows for some added flexibility and creativity in matching needy local affordable housing projects with immediate assistance. Often, there is a greater affordable housing requirement when constructed off-site rather than on-site. The off-site requirements and the distance from the original project are important and complex policy considerations.

Potential Impacts on Housing Production

A significant concern about placing new affordable housing requirements on a category of development is that it will result in fewer of those projects actually being proposed and constructed. When it comes to the production of housing, this potential impact needs to be carefully considered, given the current shortage of housing in the Los Angeles region (2.7% vacancy rate).

A Value Capture policy would seek to establish affordability requirements based on the amount of zoning benefits received, similar to the Density Bonus program. This "proportional" method, when applied correctly, has some level of economic benefit for many developers, evidenced by the fact that it has been a popular way to obtain density increases in recent years, inclusive of the requirement to provide affordable housing. The affordability charts developed by the state, which could be extended under the recommended policy, are structured to meet or exceed the additional costs of providing affordable housing by allowing for greater numbers of market rate units in exchange.

From a developer's point of view, a Value Capture policy increases the cost on overall development, due to the subsidy required for the affordable units. The policy has some value in determining up front what sort of public benefits are required. Today, there is a lack of certainty as to what level of public benefits may be required by the time the project is approved. This transparency allows everyone involved to have realistic expectations about prospective costs before real estate is bought or sold.

As stated above, additional analysis is needed to further evaluate and determine the impact of any proposal in greater detail. Included in that analysis should be the costs of providing affordable housing as well as the planning and zoning benefits obtained through the entitlement requests. In addition, the analysis should include the array of other incentives obtained when building affordable housing, including those provided by state law like parking (AB 744), CEQA (AB 226, SB 375) and the potential other zoning incentives and waivers (SB 1818). It should include an analysis of existing and proposed development impact fees, including any affordable housing impact fees such as the proposed linkage fee. It should also carefully analyze the difference between the types of General Plan Amendment, and zone change projects covered by this report and incentive based programs like the Density Bonus program which do not require legislative approval on a project specific basis. Careful consideration should also be given to particular development scenarios that may become infeasible as a result of any new requirements. Examples may include projects that include other substantial public benefits (such as historic preservation or open space) or that cross into a different construction type (such as high-rise construction).

Impact on Zone Change and General Plan Amendments

All Zone Change and Height District Change requests must be consistent with the City's General Plan. The addition of a Value Capture policy would not change the standards used to evaluate any entitlements. It would consider the addition of a new affordability requirement on

such projects. It is possible that the policy would result in fewer Zone Change and General Plan Amendment requests.

CONCLUSION

At a time when cities like Los Angeles are searching for ways to construct and preserve affordable housing, Value Capture/Public Benefit Zoning is a policy tool to consider. Such a study could explore policy options for the replacement of affordable housing units when units are demolished for large General Plan Amendment or Zone Change projects.

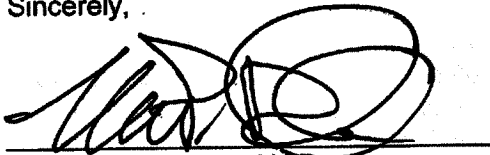
There are important policy questions to be considered as part of any Value Capture policy that seeks to require affordable housing in projects seeking significant zoning changes. Further study will be required to understand the balance between these requirements and market feasibility. The Department of City Planning would prepare a more detailed staff analysis, obtain public input on draft proposals, hold public hearings, and provide the recommendation of the City Planning Commission for later City Council consideration. This analysis would include:

- 1) What types of projects should be included in the requirements (i.e: Zone Change, Height District Change, Development Agreements, Eldercare Facilities and the CUP and Public Benefit processes to receive density greater than 35%);
- 2) What type of affordable housing requirement, if any, should be included (fixed, multiple income or proportional);
- 3) Whether an affordable housing replacement policy should be included;
- 4) Whether an in-lieu fee or off-site arrangements should be included as an alternative to including units on site.

To support further study, approximately \$300,000 in funding would be required for the Department to hire an economic consultant to carry out an economic feasibility assessment as part of the analysis prior to drafting any ordinance.

If you have questions on this matter, please do not hesitate to contact Matthew Glesne in the Department of City Planning at (213) 978-2666.

Sincerely,



Vincent P. Bertoni, AICP
Director of Planning