Durham Accessory Dwelling Unit Technical Assistance Project Report

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TRIANGLE J
COUNCIL OF GOVERNMENTS

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EXECUTIVE SUMMARY

The City of Durham Community Development Department (CDD) has requested technical assistance in researching how to reduce barriers to developing and financing accessory dwelling units (ADUs) in Durham, for the purpose of increasing homeowner equity, supporting affordable housing, and encouraging density and increased housing options while maintaining neighborhood scale. Triangle J Council of Governments conducted this research between December 2019 and June 2020 and results are compiled within this report. Research consisted of:

1. a scan of best practices, including financing products, pilot projects, and other program incentives that exist to reduce barriers to financing and building ADUs,
2. research and interviews with housing practitioners to identify local constraints for ADUs that increase the cost of development, and
3. recommendations for financing products or programs that could be sponsored or managed by the City of Durham to support ADU development for a variety of stakeholders.

This research has been compiled into a set of recommendations for the consideration of the Community Development Department to assist the City in determining next steps to support development of ADUs for the purpose of increasing homeowner equity, supporting affordable housing, and encouraging density and increased housing options while maintaining neighborhood scale.

Each recommendation will include information on:

- How to support or create financing options;
- Additional considerations to mitigate risk factors associated with financing, building, and managing ADUs within a potential pilot program; and
- Identification of any additional barriers that may need to be addressed to see the construction of more ADUs in Durham.

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3. Educate Appraisers and Advocate for Local Knowledge Sharing

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2. Create a Waiver or Reimbursement Program for Impact Fees
3. Identify a Suite of Support Services for Participating Homeowners

INTRODUCTION

Project Background

The City of Durham Community Development Department (CDD) has requested technical assistance in reducing barriers to developing and financing accessory dwelling units (ADUs) in Durham, for the purpose of increasing homeowner equity, supporting affordable housing, and encouraging density and increased housing options while maintaining neighborhood scale. Research for this project focuses on four *pieces*:

- Research a selection of projects and financial incentives focused on increasing ADU production and affordable housing options nation-wide.
- Identify existing regulatory landscape of Durham for ADUs and how it compares to other communities in which best practices are located.
- Identify drivers of cost to design and build ADUs in Durham.
- Identify regulations and risks associated with financing to construct an ADU.

This research has been compiled into a set of recommendations for the consideration of the Community Development Department. Recommendations are focused on helping the City create a pilot program or financing product to increase ADU's built by three potential groups: 1) property owners interested in constructing ADUs, 2) homeowners, regardless of income, or 3) low-income homeowners.

Each recommended strategy will include:

- Financing options for each of the three potential paths;
- Additional considerations to mitigate risk factors associated with financing, building, and managing ADUs within a potential pilot program; and
- Identification of any additional barriers that may need to be addressed to see the construction of more ADUs in Durham.

BARRIERS AND BEST PRACTICES

Regulatory Barriers

The City of Durham passed a Unified Development Ordinance (UDO) text amendment in September 2019 in relation to the Expanding Housing Choices Project, which allowed for "more, and more varied, housing choices to be created in a context-sensitive manner."[1] The text amendment included revisions for expanding the allowance of missing middle housing in certain areas, revising standards for varied housing types to be more in line with requirements for single-family housing, and increasing opportunities for ADUs. Since the UDO amendment, ADU-related regulations are much more in line with those in communities that are considered "best practices" for developing ADUs, though there are still some challenges that the City may want to address.

As a part of this project, TJCOG staff conducted research to identify pilot projects and other best practices for ADUs across the Country. Communities were scanned to identify what level of regulatory barriers existed in the other communities compared to Durham, to better understand the landscape of communities that were developing successful pilot projects. Compared to those communities, Durham is on par with decreasing regulatory barriers similar to Los Angeles, CA, Denver, CO, Portland, OR, and Seattle, WA. In some communities, like Los Angeles, Denver, and Portland, the impact fees for ADUs are waived. In some cases, a deed restriction must be placed on the ADU to receive the fee waiver to ensure affordability requirements. Currently, Durham does not provide fee waivers or fee reimbursements for impact fees for ADUs. A more detailed list of the findings are located in the table below.

Table 1: Scan of Regulatory Barriers for ADUs

Barrier	Best Practice(s)	Community	Durham?
ADUs not allowed "by right" in Single-Family Zoning Districts	Allow ADU's "by right" in all residential districts	Wilmington, NC Charlottesville, VA Minneapolis, MN[2] Portland, OR Seattle, WA	Allowed by-right on a residential lot with one or two primary dwelling units. ADUs also allowed for certain civic institutions, such as places of worship.
Maximum Square Foot Limits	No more than 75% principal building footprint, not to exceed an allowable square footage.	Portland, OR Raleigh, NC	Maximum size is 800 square feet. In RR district, no more than 50% of primary dwelling.

[1] https://durhamnc.gov/DocumentCenter/View/27597/CC_EXPANDING-HOUSING-CHOICES-MEMO?bidId=
[2] ADUs allowable on duplexes in Minneapolis, MN.

Parking Required for ADU	No additional parking space required for the ADU.	Minneapolis, MN Portland, OR Seattle, WA	No off-street parking required for ADU.
Excessive Impact or Development Fees	Various impact or development fees are waived for ADUs.	Portland, OR[3] Los Angeles, CA[4] Denver, CO[5]	Traffic impact fee, park and open space impact fee, system development fees all apply as if ADU is single-family home.

Primary challenges related to regulatory barriers were identified in conversations with City staff and local builders that increased cost for the development of ADUs in Durham include:

1. **Cost of Impact Fees**
   Development and receiving a Certificate of Occupancy for a new unit in Durham trigger the payment of impact fees. These fees can include a Street Impact Fee, Open Space Land Impact Fee, and Parks and Recreation Facility Impact Fee.[6] Currently, the fee schedule is broken down by type of land use and further by type of property. The fee schedules do not differ between single-family unit and ADU for the Street Impact Fee, and there are only single-family unit and multi-family unit designations within the Open Space and Parks and Recreation Impact Fees.

Table 2: City of Durham Impact Fee Schedule for Residential Units

Type of Fee	Land Use (Property Type)	Cost
Street Impact Fee	Single Family Unit	$293 - $1,405 (depending on Zone)
	Accessory Dwelling Unit	$293 - $1,405 (depending on Zone)
	Multi-Family Unit	$180 - $862 (depending on Zone))
Open Space Land Impact Fee	Single Family Unit	$222
	Multi-Family Unit	$176
Parks and Recreation Facility Impact Fee	Single Family Unit	$425
	Multi-Family Unit	$337

Based on a study completed by consultants for the City of Durham over 10 years ago, the existing fee schedules may not be aligned with the actual impacts of new development. Given that the size of the ADU is inherently smaller than the primary residence, an updated traffic impact study may need to be conducted by the Department of Transportation to determine whether the fee structure properly reflects the size and impact on traffic between the various unit types. This change could reduce the cost by at least $1,000, depending on where the unit is located in the City.

[3] System Development Chargers are waived for ADU projects not used as short-term rentals for 10 years.
[4] ADUs not required to pay a park fee in Los Angeles, CA.
[5] ADUs not required to pay linkage fee in Denver, CO.
[6] https://durhamnc.gov/DocumentCenter/View/1007/City-Impact-Fee-Ordinance-PDF

2. **Understanding the Permitting Approval Process**
   The current permitting approval process is designed to be efficient and easy to navigate – for those who understand the system. Staff mentioned that they make themselves available for questions from the public and provide information regarding the process and fees when the individual is provided the permit for the work other communities researched for this report provide a streamlined approval process for those developing ADUs, this was not a priority for the City of Durham at this time.

   However, both individuals in the Inspections and Planning Departments did note that for those who are less familiar with the City's development process, there is not sufficient information to communicate the process or fees associated with permitting, development, and inspections The City Planning, Community Development, and Inspections Departments should develop materials to assist those who are new to the process and require a pre-application meeting with the planning department for all homeowners who are applying to build ADUs within the City. Education around the development process and costs can also be achieved through the development of an ADU manual. It will be difficult to standardize costs but providing a baseline will be essential in homeowners determining if an ADU is a feasible option. Note that the Planning Department has also been interested in developing a similar manual, but sufficient progress has not yet been made at the time of this research.

Design and Construction Barriers

Hiring design and construction professionals to help develop an ADU contributes a large portion to the soft costs of the project budget. The importance of choosing the right professionals, in addition to considering cost containment strategies to reduce the project budget are two ways to reduce barriers to developing ADUs.

1. **Choosing Knowledgeable Design and Construction Professionals**
   The primary concern related to design and construction of ADUs by homeowners was the importance of choosing a design and construction team with local knowledge and experience building ADUs within the community. Design professionals with local experience can point homeowners in the right direction, regarding regulatory and other challenges, and may be better suited to design a structure that suits the surrounding neighborhood. Homeowners that choose to work with a Design-Build firm will have the added benefit of the same company overseeing the design and construction process. Firms like this are key to ensuring that the project stays on schedule and project costs remain within budget.

   Although the City faces restrictions in terms of being able to refer homeowners to specific individuals or companies, they may be able to provide a list of design and construction professionals who have experience working with ADUs within the region.

Alternatively, an outside organization, such as Triangle J COG could host this list as a resource to homeowners and developers building ADUs within the Triangle.

2. **Cost Containment and Modular Construction**
A second overall goal related to the design and construction of ADUs is focused on cost containment. Given that obtaining financing is a primary challenge for the development of ADUs, there is a significant interest in decreasing the cost to build them. Local Design-Build firm, Haven Developers/Haven Design Build, noted the firm's interest in pursuing modular construction as a potential to decrease the cost of construction for ADUs. However, they noted the cost to develop an ADU modularly would not decrease due to the lack of economies of scale.

There are a range of variables that impact hard and soft development costs for an ADU. Much of the cost is based on the materials and labor. Haven Design Build and Haven Developers has worked on multiple ADU custom ADU projects within the region, which are larger and tend to use higher end materials. Haven Developers noted that the higher-end, custom projects at market rate margins tend to run between $175 to $225 per square foot. An example of a recent project had an 800 square foot project with a development budget of around $165,000.

The firm is currently working on a more "affordable" modular design that may fall between $100 to $150 per square foot. Some examples of development costs for various ADU sizes are provided below.

Table 3: Potential Development Costs for "Affordable" ADUs from Haven Design Build & Haven Developers

Cost Per Square Foot	Size (sqft)	Total Development Cost
$100/sqft	600	$60,000
	800	$80,000
$150/sqft	600	$90,000
	800	$120,000

Many homeowners have the option of utilizing the equity they have built in their home over time to finance the cost to build an ADU. Market trends show that over the last years, the average sales price increased approximately $30,000 in Durham County, according to Triangle Multiple Listing Service.[7] These increases could provide many homeowners with a large amount of equity, but not enough to cover the cost the develop an ADU, even at the lowest cost estimate for a 600 square foot unit, as shown above.

[7] https://www.trianglemls.com/tmls/market-trends/?link=MarketTrends

Even with a cost-containment strategy, financing for low- and moderate-income homeowners is likely necessary to build an ADU.

3. **Pre-Approval of ADU Designs**

   Several communities have considered the idea of pre-approving a set of designs or floor plans for ADUs as a way to streamline the permitting and development processes. According to City Inspections staff, there has been significant efforts undertaken to centralize and streamline the permitting process overall through the establishment of the City's Development Services Center.

   While a pre-approved design would not be able to bypass the City's approval process, it might make the overall pre-development process more efficient. Utilizing a pre-approved or pre-designed plans would decrease the cost and timeline for an architecture firm to develop an ADU design and site plan.

   Haven Design Build noted the cost for designs services for their custom-built market-rate projects are about 8% of the total construction costs. In addition, it takes between one and two months to fully prepare the construction drawings to submit to the City. However, it would cost a homeowner significantly less to utilize a pre-designed ADUs – only a few thousand dollars – and would take much less time to modify the plan to be ready for submission to the City.
   Many cities in California and in the Pacific Northwest have worked with architects to create a set of designs for homeowners to use, if interested. San Jose has a list of pre-approved vendors that created ADU designs in line with City and State requirements.[8] They have also created a Universal ADU Checklist to assist homeowners in understanding whether their design is in compliance with the City's zoning code prior to submitting their plans for review.[9]

Financial Barriers

In addition to regulatory and development barriers, other challenges homeowners experience building ADUs including accessing finance and navigating various products, guidelines, and requirements. More specifically, the largest challenges that limiting access to financing for homeowners are with the valuation of ADUs, underwriting guidelines that limit low-income homeowners from taking on more debt, and the need for more financial literacy.

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[8] https://www.sanjoseca.gov/business/development-services-permit-center/accessory-dwelling-units-adus/adu-permit-plan-review-process/adu-single-family-master-plan-program
[9] https://www.sanjoseca.gov/home/showdocument?id=39038

There is currently a blocked market for non-affluent homeowners to access financing to either purchase homes with pre-existing ADUs or to construct new ADUs. Existing pathways to financing an ADU, whether for purchase of a pre-existing ADU or constructing a new ADU, are generally limited to homeowners who either have access to personal assets or home equity.

Loan products also exist to finance the construction of an ADU, including acquisition-rehab loans or construction loans. There are several products that are backed by Government-Sponsored Enterprises (GSEs) that are currently on the market, through from conversations with local lenders, no local banks are currently lending these products. In order for banks or credit unions to provide financing, they must tackle challenges to lending outlined below.

1. **Valuation Issues**

   Much variation exists in the appraised value of ADUs, causing lenders to be wary of providing financing for them to be developed. Appraisers can value ADUs using two different appraisal methods: the sales comparison approach and the income capitalization approach. Most ADUs are appraised using the sales comparison approach, which is traditionally used for single-family properties. This approach relies on comparing the recent sale of similar properties, which can be difficult to track, even if multiple comps exist. Because few comparable sales exist for properties with ADUs, determining the value of an ADU utilizing this approach varies widely, with one example in Portland ranging from $10,000 to $100,000.[10] The good news is that according to Fannie Mae and Freddie Mac, if ADUs are permitted by local zoning, only one sale is required to demonstrate marketability rather than the traditional three sales, which may allow for the value of already existing ADUs to be accurately reflected in bank appraisals.[11]

   The income-valuation approach derives value for an income-producing property by converting its projected rental income into property value. This approach relies on demonstrable rent and reflects current rents in the market. While this is a more reliable way to value ADUs, GSE-backed mortgages generally do not allow projected rental income to be included as part of the valuation of the property, as rules and regulations for mortgages versus commercial loans differ greatly. However, local lenders with portfolio products may be more willing to allow the income-valuation approach in their appraisals if more comps were accurately documented. It should also be noted that appraisers may need additional training to use this method in a home appraisal and appraisals that use the income-valuation approach also cost more than a traditional appraisal.

   According to local lending institutions, including Self-Help Credit Union, there is little that a bank or credit union can do when providing instructions to appraisers about how they

[10] https://accessorydwellings.org/2011/11/21/appraisals-and-gses-critical-issues-in-adu-financing-and-development/
[11] https://accessorydwellings.files.wordpress.com/2012/12/appraisingpropertieswithadusbrownwatkinsnov2012.pdf

would like to see the property appraised. An organization such as Triangle Community Coalition or the Home Builders Association of Durham, Orange, and Chatham Counties may be best suited to provide training or education to Triangle-area appraisers to improve their knowledge of rules and regulations regarding valuation of ADUs.

Banks such as HomeTrust Bank and others that provide construction to permanent financing to those building ADUs traditionally have appraisers use the projected as-built value of the ADU for the appraisal, using square footage as a basis for the value. In some cases in other parts of the country, appraisers will appraise the unit similar to how they might a unit in a duplex, rather than a single-family home. This is likely the type of valuation that will need to be used to get to a more accurate valuation of ADUs, despite the limitations of being able to use the income capitalization approach to calculate the ADU's value.

2. Underwriting and Rental Income from ADUs

Financing for homeowners without personal assets or home equity is further limited by a homebuyer's inability to borrower against the expected future income generated by the projected rental income from a future ADU. This is because traditional loan products from GSEs do not allow buyers to include projected rental income from an ADU in the value of the home or as a portion of the buyer's monthly income in qualifying for the loan.[12] Lenders that are smaller in size are less restricted than national lenders in their underwriting guidelines and also often offer portfolio loans, which also provide increased flexibility for underwriting debt-to-income ratios for homeowners.

Overall, the use of these products is further constrained by the GSE's strict underwriting guidelines, which generally prohibit the ability for homebuyers to use rental income from an ADU to qualify for the loan.

Table 4: Underwriting Guidelines for ADU Rental Income for Government Sponsored Enterprises

GSE	Underwriting Guidelines for ADU Rental Income
Fannie Mae	Generally, rental income from the borrower's principal residence (a one-unit principal residence or the unit the borrower occupies in a two- to four-unit property) or a second home cannot be used to qualify the borrower. Fannie Mae does allow some flexibility for accessory unit income through their HomeReady mortgage product.[13]
Freddie Mac	Freddie Mac states that "appraisals that rely primarily on the income or cost approaches to value in order to estimate market value are

[12] Ibid.

[13] https://www.fanniemae.com/content/guide/selling/b5/6/03.html#Rental.20Income.20from.20the.20Subject.20Property

	unacceptable". (See their *Single-Family Seller/Servicer Guide*, Section 44.15.)" However, Freddie Mac does allow some flexibility for accessory unit income through their HomePossible mortgage product.[14]
Federal Housing Administration (FHA)	Rental income cannot be used to qualify the borrower, even with a 203(k) renovation mortgage. The renovation loan is based on the increased property value after renovation, though this cannot be determined through rental income comps.

Similar to appraisal guidelines, smaller local or regional lending instructions have more flexibility in underwriting guidelines for products that they will hold in their portfolio, rather than sell on the secondary mortgage market. This flexibility may allow some lenders to incorporate the projected rental income from the ADU as part of the debt-to-income ratio calculation, which is used to identify how much debt a homeowner can feasibly take on through a calculated monthly payment. By incorporating the rental income from the ADU, homeowners with lower incomes have the ability to qualify for a loan they might not otherwise be able to.

Self-Help Federal Credit Union's pilot project to develop ADUs in collaboration with LA Mas allows homeowners to include up to 75% of the projected rental income from the ADU in the underwriting guidelines. This is an example of how a portfolio lender may be able to increase access to financing for homeowner who might not otherwise qualify for traditional lending products.

3. Types of Loans and Challenges for ADU Lending

Accessing Home Equity to Build an ADU

Given the rapidly expanding housing market within the Triangle, home equity for homeowners who have owned their homes for several years or longer has grown substantially. Homeowners can access home equity financing in two ways – through a Home Equity Loan or a Home Equity Line of Credit (HELOC). A Home Equity Loan is a fixed amount with a fixed repayment schedule, whereas a HELOC is structured as a revolving line of credit with a shorter repayment period. Whether you use a Home Equity Loan or a HELOC, both are considered a second mortgage. Both a Home Equity Loan and a HELOC are likely to have a shorter term than a regular mortgage product, which may make the monthly payment higher than is feasible for low- and moderate-income homeowners.

Cash-Out Refinance or a New First Mortgage

[14] http://www.freddiemac.com/singlefamily/pdf/guide.pdf

Another option for homeowners using the equity they have built to support the development of an ADU is through cash-out refinancing. For homeowners interested in entering in consolidating their existing mortgage into a new loan with new mortgage terms, this is the preferred option. Some lenders only provide first mortgage financing, which in this case, they may be able to provide homeowners a cash-out refinance for them to build an ADU. Compared to a HELOC, a cash-out refinance is likely to have a lower rate; however, there be more upfront costs associated with obtaining financing for a new first mortgage.

When considering a new first mortgage, a construction to permanent mortgage makes sense for a homeowner building an ADU. This type of structure allows homeowners to make interest-only payments during the construction period. Additionally, the lender will use the projected value of the as-built ADU to determine how much they can lend. If a homeowner has sufficient enough equity in their home, and the terms of the new mortgage are better than their existing mortgage, it may make more sense for them to pursue the new first-mortgage option through a cash-out refinance.

In a construction to permanent loan, lenders also approve the design as well as the construction team you choose. For homeowner without experience in managing a development, a construction loan creates a structure of accountability to keep track of the funds being spent and the timeline for development.

Gap Financing and Subsidies

Existing financing mechanisms outlined above do not traditionally reach low- and moderate-income homeowners due to lending constraints previously discussed, primarily including the challenge with the loan-to-value ratio of the ADU. For homeowners to be able to build ADUs, they will likely need to access more debt than is equal to the value of the ADU, with the long-term goal of improving the valuation of ADUs in the market overall. Gap financing can help low- and moderate-income homeowners who do not have sufficient cash-savings access financing and construct an ADU on their property.

Currently, a local developer and Design-Build firm, Haven Developers/Haven Design Build, provides a form of gap financing to homeowners whose home equity is insufficient to finance the entirety of the cost of construction. This gap financing is provided as a second or third lien position. The maximum loan amount is currently set at up to 20% of the total construction cost of the ADU with a shorter term rate (three to six years). This product is offered to homeowners who cannot access sufficient financing through their existing home equity and closes the gap required to meet the cost of construction for the ADU. There has been little utilization of this product at this time, as most of the firm's work has focused on custom-built higher-end ADUs, where homeowners have sufficient funds to complete the project.

Similar programs exist across the country that are backed by philanthropic or local government funding. These funding sources often have a below-market interest rate (traditionally around 0% - 3%) with a longer loan term. One consideration for this product would be that the homeowner would need to be required to rent out the ADU for the life of the loan, so that the lender and homeowner can ensure the homeowner has sufficient income to pay back the lenders. Additionally, if gap financing is being provided by a philanthropic or governmental entity, they may want to consider created a shared-equity and shared-risk model for when the homeowner sells the property. This would allow the homeowner to gain some equity in the home as the value increases from building the ADU, and would lessen their risk in losing money if the property is overleveraged.

4. **Financial Literacy and Other Training for Low- and Moderate-Income Homeowners**

Homeowner education was cited as a critical component of various pilot projects reviewed as a part of this research. Homeowners should be made aware of the potential benefits and risks of taking on additional debt to finance the construction of an ADU on their property. In many cases, monthly payments for their mortgage will increase as part of developing an ADU, and homeowners must be notified of these increases and changes to their mortgage terms and conditions. There may also be other costs associated with owning and renting an ADU that a homeowner should be made aware of, including their role as a landlord, property management, and maintenance needs. This information may be easily provided by a local community organization, such as a Habitat for Humanity or possibly a local Housing Authority. Regardless of who provides the financing or what organization creates a pilot program, homeowner education must be incorporated to empower homeowners to make the best decisions for them and their family.

Knowledge of the cost of the ADU up-front is key to helping homeowners discern if building an ADU is the right decision. Providing examples of potential monthly costs based the type of loan may be a useful tool. A tool similar to this may be created to help homeowners estimate the potential cost of construction as well as their monthly costs and projected revenue from renting out the unit.

EXISTING PROGRAMS TO SUPPORT ADU DEVELOPMENT

In an effort to identify existing programs that support ADU development, including financing products, pilot projects, and other financial incentives, research was completed on four "best practices" from around the country. Each best practice is outlined below and includes information about program partners, costs, challenges to implementation, and lessons learned. Complete summaries of each program are located within the Appendix of this report.

While these examples of provide insight on lessons learned from program development to implementation, all of them are still relatively new. Few of programs have completed more than a couple of ADUs with low- and moderate-income homeowners and have run into unintended challenges with implementation. Additionally, due to the COVID-19 pandemic, much of the progress made on these programs has been further limited. While these examples provide an outline for ways to structure a pilot program, they have not produced enough units to significantly change the ADU markets within their communities,

The four best practices researched in this report include:

1. West Denver Single Family+ ADU Pilot Program, Denver, CO
2. My House My Home Program, Santa Cruz, CA
3. LA Más Backyard Homes Program, Los Angeles, CA
4. Second Dwelling Unit Pilot Program, Los Angeles, CA

Summary of Best Practices of Existing Programs

Name of Program	West Denver Single Family+ Pilot Program	My House My Home Program	Backyard Homes Project	Second Dwelling Unit Pilot Program
Location	Denver, Colorado	Santa Cruz, California	Los Angeles, California	Los Angeles, California
Purpose of Program	Minimize displacement due to gentrification.	Assist low-income seniors to age in place.	Provide affordable units, create alternative financing product, demonstrate ability to scale program model.	Focus is on providing units for those transitioning out of homelessness –created by county leadership as homelessness strategy.
Year Program Started	April 2019	2018	Late 2018	April 2017
Number of Homes or Homeowners (Units Generated)	200 units by 2023. 5 homeowners are committed to creating units since April 2019.There is a pool of 60 serious applicants, over 900 inquiries from homeowners.	Habitat completes one project/year, though 3 units have been completed since 2018.	The program had not built fully constructed units as of early-2020; however, the pilot phase of the program will work with up to 10 homeowners.	6 units (3 for new construction, 3 rehabilitation of existing unpermitted ADUs) since 2017.
Homeowner Selection	<120% AMI, live in West Denver neighborhood, preference for long-term residents (5+ years)	Homeowner must be 62+ years old, qualify as low-income	Any homeowner – financing only available to 5 of 10 homeowners who participate in program	Any homeowner – preference on homeowners with knowledge of the construction process, since there is no construction management aspect
Tenant Selection	<80% AMI	<60% AMI (County), can be caregiver, family, or lower-income tenant (City)	Section 8 voucher recipients	Eligible individuals are those transitioning out of homelessness and are eligible to receive either a Section 8 voucher or Housing for Health voucher
Financing Product	Refinance first mortgage using renovation loan. Additional forgivable second mortgage up to $25,000.	Depending on where home is located, either a second mortgage loan or a grant.	Refinance existing loan to provide a construction to permanent mortgage loan.	Provides forgivable second mortgage loans.
Financing Details	Must have $10K-$25K in home equity for down payment on first mortgage loan.	Loan up to $80,000 at 3% interest, payable on sale or transfer. .	Uses qualifying income up to 75% of projected rents from ADU. Max loan-to-value is 90%. Genesis LA provides	Homeowners required to have $125,000 in either cash, home equity, or a line of credit to be eligible for the $75,000 forgivable loan.

	Second mortgage up to $25,000 is forgivable from the City of Denver. [15]		guarantee for Self Help loans, which are repaid upon SH loan closing. Required down payment is $3,500 if receiving funding.	Forgivable loan only up to $50,000 for rehabilitation of existing unpermitted ADUs.
Deed Restrictions	Yes, requiring occupant <80% (either ADU or primary dwelling), in place for 25 years.	Yes, deed restricted for 20 years. Payable upon sale or transfer. Restrictions lifted earlier if loan is paid off.	Must rent to Section 8 voucher recipient for 5 years.	Must rent to person experiencing homelessness for 10 years. Payable upon sale or transfer. Restrictions lifted earlier if loan is paid off.
Construction Management?	Habitat for Humanity provides construction management services.	Habitat for Humanity provides construction management services.	Yes, through non-profit affordable construction management organization, Restore Neighborhoods LA	Not included as part of the project.
Design Consultation?	Pre-approved WDSF+ designs	Not included as part of the project.	Receive consultation with LA Mas to review site plan. Design costs include permits, labor, materials. Plans not pre-approved by the City.	No design management services; however, program did host a design competition, Yes to ADU.[16]
Training for Homeowners/ Property Management?	Property Management Education by Denver Housing Authority and other service organizations	Habitat assists in tenant selection and income certification. Local senior-focused non-profit provides case management.	Landlord training provided by Housing Authority of the City of Los Angeles and the Housing Rights Center.	Not included as part of the project.
Other Notes		The biggest challenge has been financing, cost to build an ADU is about $140,000. Homeowner does have to take on additional debt. Additionally, a lot of work has to be done to the primary structure to bring it up to code, which increases the overall cost for the project.		

[15] Fannie Mae HomeStyle Renovation Loan. Construction to permanent loan or can arrange to pay the construction loan down more quickly.
[16] https://bustler.net/competitions/5555/part-of-the-solution-yes-to-adu

RECOMMENDATIONS

This research has been compiled into a set of recommendations for the consideration of the Community Development Department to assist the City in determining next steps to support development of ADUs for the purpose of increasing homeowner equity, supporting affordable housing, and encouraging density and increased housing options while maintaining neighborhood scale.

Each recommendation will include information on:

- How to support or create financing options;
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- Identification of any additional barriers that may need to be addressed to see the construction of more ADUs in Durham.

Goal 1: Decrease Barriers for All Property Owners Developing ADUs

Recommendations are primarily focused on decreasing regulatory, design, and construction barriers for property owners in Durham who want to build ADUs to increase density in housing options across the City. Many property owners interested in building an ADU may use existing avenues to finance the cost of construction, such as personal savings, a conventional Home Equity Line of Credit (HELOC), refinancing their first mortgage (cash-out refinance), or credit cards. Therefore, no additional financing product is recommended at this time. However, there are other ways that the City can support property owners in developing ADUs, such as by improving information sharing and reducing development costs.

1. **Right-Size the City's Impact Fee Schedules for Newly Constructed ADUs**
   Request that the City of Durham's Transportation Department consider conducting an updated study to review the required assessible fees per development of new ADU. This study should consider the difference of impacts on streets by ADUs as compared to single-family units based on the size of the unit. Communities where ADUs are more prevalent often have examples of street impact fee studies that consider ADUs, such as the City of Cloverdale.[17] Other communities may choose to waive impact fees completely for ADUs.

2. **Create Clear Instructions to Navigate the City's ADU Process**
   Information relating to the development of ADUs and the permitting and construction processes and requirements of the City can be made available early on, at the pre-application meeting with City-County Planning staff. This information could also be integrated into an ADU Manual, if one is created, providing a step by step guide for the process from the pre-application meeting with planning staff to the final inspection and issuance of the certificate of occupancy. Examples of successful ADU manuals include those created for Santa Cruz County or Los Angeles, California.[18,19]

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[17] http://www.cloverdale.net/DocumentCenter/View/2350/City-Council-Resolution-009-2018?bidId=
[18] http://www.cityofsantacruz.com/home/showdocument?id=8875
[19] https://citylab.ucla.edu/adu-guidebook

3. **Educate Appraisers and Advocate for Local Knowledge Sharing**
   Advocacy for those involved in the lending process, including appraisers, banks, credit unions, and builders, about the existing laws, regulations, and opportunities for flexibility is a key first step in improving the valuation process for ADUs. Other communities where more ADUs have been built, including Portland and throughout California have experience with appraisers who specialize in valuation of ADUs. A third party organization, such as Triangle Community Coalition or the Home Builders' Association of Durham, Orange, and Chatham Counties may be interested in hosting or partnering in a similar training.

Goal 2: Help Create Affordable Housing Opportunities Through ADU Construction

1. **Support a Lender Pool to Provide Below-Market Financing**
   Similar to the Durham Affordable Housing Loan Fund, a pool of funds that can be accessed outside of the traditional lending avenues may be the right place to start for homeowners wanting to access financing in order to rent out their units to low-income households. Currently, Haven Developers is working to identify a group of potential investors to create a lending pool that provides gap financing. The City may want to engage the firm to identify if they can participate in the pool by providing a level of support that could bring down the interest rate for homeowners that participate in the program.

   By partnering with another organization that is already providing this type of funding, the City would not need to take the lead on the project. They could work with other funders to take a higher-risk position in the loan pool, which may help in attracting private and philanthropic funders. The loan pool could provide gap financing to homeowners that are unable to access the full cost of construction through a traditional lending institution. This is likely the preferable option compared to utilizing the loan pool to provide full financing for homeowners, as that would severely limit the number of loans that could be made using the loan pool funding.

2. **Identify Project Management and Design + Build Firms That Specialize in ADUs**
   For homeowners that plan to rent out their ADU at a reduced rental rate should also work to keep costs down on the construction side. This will help attract homeowners to participating in a program with the goal of creating more affordable housing. The lending institution should consider identifying several development, design, or Design-Build firms in the Triangle that have expertise in designing and building ADUs. If a homeowner pursues financing through the lender pool discussed above, one requirement may be for them to work with one of the Design-Build firms identified. These firms may be able to offer preferential pricing to customers who are referred to them through the lending pool.

   As a way to begin to move in this direction, the City or a third-party organization, such as Triangle J Council of Governments, may be able to identify a list of various construction and design professionals with experience in ADUs and the cost for their services and make it available to the public or lenders who want to provide financing to ADUs. Through this research, several firms have already been identified and there are currently plans by local designers to create some basic floor plans for ADUs that may be available at low cost to community members in the future.

3. **Work with Durham Housing Authority or Other Community Organization to Create Affordable ADUs for Specific Populations**
   Some communities where financing or other pilot programs have been created for ADUs have required homeowners that participate in the program to rent out the ADU to a specified population, including the recipient of the local housing authority's Housing Choice Voucher program, a formerly incarcerated individual or family, or someone who has experienced housing instability or homelessness. Identifying tenants that receive a monthly rental subsidy from the housing authority or other program can provide the financial security needed for a homeowner to rent to a low-income household.

   In addition, for homeowners who are new to landlord responsibilities, the local housing authority or other partner organization may be able to provide landlord training and other resources for homeowners who participate in the program. In addition to helping homeowners find low-income tenants and securing a monthly subsidy to help pay for the rent, homeowners will likely need to receive some other kind of financial incentive in order to agree to a reduced rental rate or deed restriction for how they rent out their ADU. Many other programs have paired this concept when they provided subsidy or access to financing through a pilot program. More information about a similar program can be found the Appendix of this report within both the Backyard Homes Project by LA Más and the Second Dwelling Unit Pilot Program.

Goal 3: Support Low- and Moderate-Income Homeowners in Building ADUs for Wealth Creation

1. **Provide Gap Financing for Low- and Moderate-Income Homeowners**
   Few lending institutions provide adequate financing options for low- and moderate-income homeowners to finance the cost of construction to build an ADU. At this time, it is virtually impossible for a homeowner without sufficient home equity or personal savings to acquire funds to construct an ADU on their property. The City may consider stepping into the role of the lender by providing gap financing to homeowners who meet income-restrictions. This option is not dissimilar to Recommendation 1 identified under Goal 2: Support a Lender Pool to Provide Below-Market Financing; however, several additional considerations exist if the goal is to exclusively provide financing to low- and moderate-income homeowners.

   It is extremely important that low- and moderate-income homeowners are not at risk for overleveraging their properties to build an ADU, as often a home is a family's only asset. The City is not interested in putting homeowners at risk of owing more than their property is worth, particularly in a volatile market. If the City is interested in pursuing this option, they can create some security for the homeowner by setting up a shared equity and shared risk financing model. In this model, if the homeowner chooses to sell their home, and the home is overleveraged and they will lose money on the sale, the City must be willing to take that loss. However, if the homeowner sells the home, and the value has increased, both the homeowner and the City would be eligible for a share of the equity in the value that increased through the addition of the ADU.

Regardless of the financing mechanism, low- and moderate-income homeowners must receive adequate information and education on the benefits and risks to taking on additional debt to finance the construction of the ADU. LA Más' Backyard Homes Project has great examples of how to communicate with homeowners regarding increased monthly payments and the risks associated with financing.

2. **Create a Waiver or Reimbursement Program for Impact Fees**
   Despite whether the City is able to amend the impact fee schedule for newly constructed units, it might consider creating a fee reimbursement program for low- and moderate-income homeowners who are building an ADU on their property. The cost of construction for an ADU can be prohibitive for homeowners and this fee reimbursement grant could assist in containing soft costs.

   The State of North Carolina has some regulations related to whether a local government can waive fees; therefore, rather than waiving fees, the City would do better to create a grant program that reimburses homeowners for the fees, which is currently allowable. A similar program for units that providing affordable housing is currently provided by Chatham County, NC.[20]

3. **Identify a Suite of Support Services for Participating Homeowners**
   It is important that homeowners that participate in a program are surrounded with resources to help them succeed as ADU owners and possibly landlords. Staff who participated in the LA Más Backyard Homes Program noted the importance of having a "homeowner concierge" where homeowners were able to connect with a point person or project manager to answer any questions they had about the process and make sure they received financial literacy training and other information as appropriate.

[20] Established in 2018, the County's Impact Fee Reimbursement Policy provides 100% reimbursement for both single- and multi-family units developed that are affordable to households earning at or below 80% of Area Median Income for a period of at least 10 years.

APPENDIX: CASE STUDIES OF ADU PILOT PROGRAMS

West Denver Single Family Plus (WDSF+) ADU Pilot Program

Regulatory Background

Zoning changes in 2010 allowed ADUs to be constructed in certain neighborhoods (about a quarter of single-family zoned areas). To expand the neighborhoods where these units are allowed, the planning process requires a year-long community outreach effort. Currently, the city council does not have plans to increase the neighborhoods where ADUs can be constructed by right. In an effort to circumvent this process, individual homeowners are taking it upon themselves to have their individual properties rezoned.

Blueprint Denver, the City's planning document, identifies ADUs as a way to add density and build wealth for low-income Denver homeowners. Recent ADU regulations have passed in the city, however, these have been criticized for being restrictive. For instance, the main home must be brought up to code before an ADU can be built. Recently, there has been a push for ADUs in West Denver through the West Denver Single Family Plus Pilot Program, discussed below.

Program Practice

The West Denver Single Family Plus (WDSF+) ADU Pilot Program aims to help homeowners build equity in their homes, offset monthly expenses through rental income, and minimize displacement in nine gentrifying West Denver neighborhoods. Launched in 2019, the program offers ADU design, finance, and construction services through a team of in-house and partner professionals. By 2023, WDSF+ plans to build 200 total ADUs. Participating homeowners have the option of renting either the primary house or the ADU; however, participants must agree to deed restrictions that ensure that tenants have an income of 80% AMI or below for 25 years. Through carefully selected and bundled services, WDSF+ saves homeowner participants approximately $100,000 in the construction process.

In addition to participation in WDSF+'s ADU pilot program, participants are encouraged to participate in West Denver Renaissance Collaborative's (WDRC) Homeowner Forums. As part of the forums, homeowners build connections with businesses that specialize in home finance, home repair, and energy efficiency. Further, homeowners attend neighborhood leader presentations on topics such as high-risk mortgages, refinancing, zoning, and housing market trends and participate in breakout discussions with local service providers. In addition to topics concerning loans and refinancing, down payment assistance, home rehab, weatherization, and home ownership counseling, homeowners learn about the financial benefits of ADUs.

As part of the program, homeowner participants can receive a forgivable second mortgage loan product in addition to a traditional loan product to cover ADU costs. The financial product specific to WDSF+ is a forgivable soft second mortgage loan of up to $25,000 that can go towards initial costs. Before loan issuance, participants meet with a WDRC financial counselor to review current finances, existing home equity, financing options, and deed restriction requirements. The more traditional loan options offered through the program include Fannie Mae HomeStyle loans (a refinanced mortgage that include ADU construction costs) or home renovation loans (a separate loan to be paid down more quickly). In future stages of the program, WDRC hopes to provide a new product that attracts impact investors that will serve as a guarantor on home equity construction loans for the ADUs.

In addition to loan products, WDRC also offers zoning assistance to help homeowners determine whether their property is located in ADU-eligible zoning district or whether the site has specific requirements (including height and setbacks). As part of the city's ADU regulations, all primary homes must be in good physical condition to qualify for the program. As a result, many of the private and nonprofit service providers that participate in the Housing Forum offer affordable services for both the primary home and future ADU. During the financial approval process, WDRC appraises the primary home to ensure the quality. Habitat for Humanity serves as the program's construction partner, and offers pre-construction, design planning, and construction services. Homeowner participants select one of WDRC's six pre-approved ADU designs submitted by Habitat for Humanity and the American Institute of Architects, and through this selection, can reduce their overall design costs and permitting timeline. Participants are eligible for City of Denver fee reductions of $6,000-12,000 through a waiver from the Affordable Housing Linkage Fee.

Program Partners

The West Denver Renaissance Collaborative (WDRC), the agency leading WDSF+, is a collective impact organization that convenes multiple sectors and agencies in planning related matters for equitable development. While WDRC is housed within the Denver Housing Authority, the organization functions as a fully separate district. WDRC collaborates with multiple public, nonprofit, and private partners to offer the program's array of direct and supportive services. The Denver Community Planning and Development Department offers a streamlined permitting process for program participants who select pre-approved WDSF+ designs. Habitat for Humanity of Metro Denver acts as the program's construction partner and will build 40 projected units over two years. Denver Economic Development and Opportunity has provided $500,000 of public funds to finance the program's forgivable loans. The Denver Housing Authority offers homeownership counseling and financial coaching for all participants. Additionally, local service organizations offer homeownership education and counseling, down payment assistance, weatherization assistance, home rehab services, and financial coaching.

Participant Selection

Participating homeowners must live in one of nine West Denver neighborhoods with zoning that allows for ADUs. Additionally, homeowners are prioritized if they have lived in the neighborhood for at least five years. Homeowner participants must meet income requirements to both participate and receive financial assistance, with those at or below 120% AMI eligible to participate in WDSF+ and those at or below 80% AMI eligible to receive a forgivable loan. In addition to income restrictions, participants must meet financial requirements including having between $10,000 to $25,000 in home equity and/or savings for a down payment and meeting credit score requirements. All tenants in the WDSF+ ADUs must have an income at or below 80% AMI.

Program Finances

On average, ADUs built through WDSF+ cost $260,000. This total cost includes the construction of the unit (ranging from $94,700 - $155,400), utility requirements (ranging from $5,000 - $46,000), and pre-construction elements (site planning, entitlements, financial counseling, loan administration, property management education, and financing). Loan recipient participants have their forgivable loan amount of $10,000 to 25,000 held in a note and forgiven over the course of years 6 to 25 of participation. If participants breach the terms of the program or sell the property, the note amount is not forgiven. Depending on the ultimate size of the unit built, monthly rental amounts (based on 2019 voucher standards) are in the $1,850 range.

A sizable source of program funding came from the City of Denver's Affordable Housing Fund, a fund that receives money from the City's general fund (via tax revenue) and linkage fees on commercial and residential developments. This funding covers the $500,000 for 20 forgivable loans during the two years of the pilot program. Additional funding sources include FirstBank's provision of a $3 million pilot loan fund; Fannie Mae's Sustainable Communities Innovation Challenge award to fund affordable housing; a SPRACC grant of $200,000 to create the program; and a second SPARCC capital grant of $250,000 utilized for revolving funds. The Denver Foundation and Enterprise Community Partners have also been funding partners for WDSF+.

Challenges for Participation and Implementation

In a media interview, WDRC's Executive Director noted that the project and ADUs generally faced high obstacles, particularly as neighborhood residents feared significant increases in density. These fears, she explains, are unfounded as the current state of the lending and building markets will not allow for triple the amount of current density. In addition to neighborhood perceptions of ADUs, zoning and regulatory restrictions have limited the pool of qualified participants and properties. Under current regulations, homeowners must have primary homes without their own construction needs or must first improve the quality of existing homes. For homeowners with limited incomes and budgets, this requirement could wipe out ADU construction budgets. As a further challenge, interested homeowners may be in strong financial standing and have a primary home without construction needs, but if they are not located in the proper zoning that allows for ADU construction, they cannot participate.

Program Lessons

As of April 2019, WDSF+ had five households moving forward out of a pool of 60 serious inquiries. Beginning in 2019, WDRC began community outreach efforts, including door-to-door contact, mailers, and community meetings, and came into contact with over 900 individuals within the first few months. As a program in its early stages, WDSF+ is working with the limited tools at hand. In a media interview, WDRC's Executive Director noted that the program is trying to figure out how to build affordable and efficient units through more predictable systems in the absence of full neighborhood, bank, and builder participation. In an effort to build and scale the program, the hope is that the numbers will become relevant and, ultimately, ADU construction costs will be lowered. Ultimately, WDRC's Executive Director views the program as a neighborhood stabilization strategy beyond the 200 units expected to be built by 2023 with the potential to positively impact 1,000 households. Not only do the WDSF+ ADUs stabilize the participating homeowner's household through additional income, but they also provide an affordable home to qualifying renters. Over the course of 25 years, these ADUs could see an average of three different positively impacted households. Ultimately, because the homeowner household has a stronger likelihood of staying in the neighborhood with rising property taxes, the property can then be passed to the next generation.

My House My Home Program: Habitat for Humanity Monterey Bay

Community Background and Regulations

Santa Cruz County is abiding by the updated state ADU last, which went into effect January 1, 2020. Regulations for ADUs within the county depend on whether a property is located outside or inside the coastal zone. The County Code has been updated to reflect the new state laws for properties outside of the coastal zone. Within the coastal zone, ADUs are allowed in residential and mixed-use zones. For multi-family developments, ADUs can be built for up to 25% of the multi-family units on the property. Streamlined approval timelines are required for ADUs, within 60-days for ADUs built with primary dwellings. Additionally, no impact fees are required for ADUs less than 750 square feet. For larger ADUs, the impact fee is proportional to the ADU size. Additionally, utility connection fees are only for new construction ADUs and the fees are to be proportional to the ADU size.

The County's website makes resources available to homeowners, such as a GIS tool that helps individuals identify if their parcel is eligible to add an ADU. Additionally, there is a fee and construction cost estimator available on the website for homeowner use. These tools help make clear some of the costs and processes associated with building an ADU.

Program Practice

My House My Home is a collaborative program with the three goals of assisting senior homeowners age in place, building ADUs to provide seniors with additional income, and adding to the supply of affordable housing for lower income families. The units built through the program are all ADA-compliant and meant to give senior homeowners the option to move into the new ADU (and rent out their primary home) or rent the ADU to another family. In either method, the additional unit on the property provides rental income for seniors already living on a limited income.

Led by Habitat for Humanity Monterey Bay, My House My Home began in 2018 and has been implemented as separate programs by both the City and County of Santa Cruz. Both public entities' programs offer participants a loan of $80,000 at 3% simple interest, deferred for up to 30 years, or payable upon sale or transfer. For both the City and County, the $80,000 represents roughly half of the cost of an ADU. In receiving the loan, the homeowner must agree to place deed restrictions on the rental unit (either ADU or primary home) at 60% AMI for 20 years. If the loan is fully paid off before the 20 years, the deed restrictions can be lifted from the property. The loan can only be issued once the project's budget has been approved, and funding is available to cover costs at any stage of development, including permit fees, design, or construction. Funding for My House My Home has been available for the first 3 projects of the pilot.

Program Partners

Habitat for Humanity leads the project with the support of public and nonprofit partners. In addition to managing the construction process, Habitat for Humanity also assists in the tenant selection portion of the program. Both the City and County of Santa Cruz are program partners with their own funding available to program participants, depending on the homeowner's location. For the County program, the Santa Cruz County Housing Program certifies eligibility of tenant households and conducts annual compliance monitoring. For both programs, Senior Network Services provides outreach to eligible seniors, case management to homeowners, and rental property management.

Participant Selection

For the County program, homes must be located in unincorporated Santa Cruz County. For the City program, homes must be within the Santa Cruz city limits. My House My Home is open to low income senior homeowners (age 62 or older) who are at risk of losing their homes. All homeowners are expected to help Habitat for Humanity in the home building process, community outreach, or participate in Senior Network Services' media opportunities for increased program awareness. Each program has its own tenant requirements. For the County program, tenants must earn 60% AMI or lower. For the City program, tenants could be caregivers, family members, or tenants renting at an affordable rate.

Program Finances

Program funding is provided by both public entities participating in their respective My House My Home programs (equating roughly half the cost of a $140,000 ADU). The City and County of Santa Cruz provide $80,000 in loan money that can be reinvested in the program as the loans are repaid or if the home changes ownership. For homeowners needing additional funding, Habitat for Humanity may offer additional funding opportunities. To cover the costs not covered by the public entity loans or Habitat for Humanity funding, homeowners must use their own savings or take out another loan. Habitat for Humanity is in discussions with the City of Santa Cruz to increase the loan amount, however, as of Spring 2020, no funding increases have been approved. Habitat for Humanity is seeking CalHOME[1] funds for the project, particularly after ADU-specific funds were set aside at the state level.

Challenges for Participation and Implementation

The program's largest challenge has been funding. The cost to build an ADU in the Santa Cruz area is between $120,000 – 140,000. While the public entities' loans cover roughly half of these costs, some potential participants are reluctant to take out any loans, programmatic or additional, to help cover the cost.

Habitat for Humanity's staff capacity is another challenge. With two construction managers on staff, Habitat for Humanity would need to allocate resources to hire a third manager to successfully scale the program. A third manager would oversee ADU construction, as well as inspect existing primary homes to certify their condition. As a condition of ADU construction, Habitat for Humanity assesses any construction needs for the primary home. In one of the first ADU projects, the primary home required major updates that drove the project costs overbudget, including a new electrical panel, water mains, and the associated permits.

Program Lessons

After the first My House My Home ADU was built, the former Executive Director of Habitat for Humanity Monterey Bay noted how important it was to allow flexibility for seniors to choose to live in the ADU or remain in their primary home. Further, the success of the program has been the ability to not only assist seniors age in the familiarity of their homes, but also to increase the number of affordable rental properties in an area experiencing rising housing costs. As of 2020, the program has completed three total ADU's. Habitat for Humanity leadership is interested in expanding the program's reach, however there is an acknowledgment that the program needs to increase its publicity efforts. In addition to funding and staff capacity, the program's project volume is driven by community demand. Without robust advertising efforts, many within Santa Cruz's senior population do not know about the options offered by the program.

Backyard Homes Project: LA Más

Regulatory Background

In 2017, the state of California reduced regulatory barriers for ADU construction. Significantly, State Bill 1069 allowed ADU construction in single-family and multi-family residential zoning by right. Municipalities are allowed to create specific ADU ordinances to guide construction, but not limit or lessen what is allowed at the state level.

A city-level ordinance was passed in 2019 to eliminate parking requirements for ADUs. Additionally, all ADU applications must be acted upon within 60 days of application (if existing home(s) on the proposed lot). The ordinance further specifies regulations regarding sprinklers (only required if required in the primary residence), and parking (one space per ADU unless located within one-half mile of transit, within block of ride-share, within a historic designated area, or is attached to primary residence).

At this time, the City does not provide additional incentives to ADUs, such as reduced permitting fees. The City of Los Angeles is not a partner with the Backyard Homes Project; however, in developing an ADU prototype pilot, the City worked closely with LA Más as the design partner. Through the LA ADU Accelerator Program, the City of Los Angeles is offering financial incentives to homeowners who are in the process of building ADUs or who have existing ADUs on their property and are willing to rent them to a housing insecure Angeleno for an agreed upon period of time. This program is run through the Mayor's Office of Innovation.

Program Practice

The Backyard Homes Project was designed in response to interrelated problems of limited affordable housing in Los Angeles, rising neighborhood displacement, and zoning changes within the single-family neighborhoods. After receiving grant funding to conduct in-depth research, the program launched its application portal in late 2018. Researched, designed, and implemented by Los Angeles-based nonprofit LA Más, the Backyard Homes Project is a full suite program that offers design, construction, financial, and rental services for a new or converted ADU. ADUs built through the program must be rented out to Section 8 voucher holders for a period of 5 years. Additionally, some homeowner participants receive financial assistance in the form of a first permanent mortgage loan specifically designed for this program. In its early stages, the program aims to build 4-10 units to demonstrate the feasibility of scaling the program model.

Created by Los Angeles-based CDFI Genesis LA and Self Help Federal Credit Union (SHFCU), the Backyard Home Project's loan is uniquely tailored to ADU construction in that it calculates homeowners' qualifying income with up to 75% of the projected ADU rent and looks to the future value of the property. Loan recipients refinance their existing mortgage to repay the original mortgage and take out additional funds for ADU construction. As a result, the total loan amounts are high, ranging from $400,000 - $700,000. Loan funding does not cover the cost of the down payment, requiring participants to have $3,500 in cash savings (for participants not receiving the loan, the down payment amount is 10% of total development costs). Participants have the option of choosing mortgage terms of 10, 15, 20 or 30 years.

In addition to financial assistance, the Backyard Homes Project offers direct design and construction management. With LA Más as the project manager, the organization oversees the development process to ensure that progress continues. For participants less familiar with the construction process, this free project management has been particularly helpful. Construction services are all provided by a single program partner, ensuring that the new unit is efficiently built, contextually appropriate, and of high quality. All participants work with LA Más on a site plan and design consultation. Participants select one of LA Más' ADU designs of varying sizes and architectural styles. Although the designs are not pre-approved by the City of Los Angeles, the designs include all elements necessary to obtain a certificate of occupancy. In some instances, site specific needs are additional considerations and costs for ADUs (such as utility connection and relocation, demolition, and landscaping). The design process has been created to amount to four months, with design and construction processes taking a total of 15 months to complete. This expedited timeline is an intentional feature to reduce the amount of time between homeowner investment and receipt of first rental payment.

Program Partners

The Backyard Homes Project brings together the strengths and services of several agencies and organizations across Los Angeles. The program is led by LA Más, an urban design nonprofit that works with lower-income and underserved communities and specializes in policy and architecture. Handling the financial aspects of the program, Genesis LA Economic Growth Corporation offers participating homeowners financial assistance for permitting and planning costs, prior to the loan closing. Additionally, Genesis LA provides the guarantee for the program's loans. The loans are provided directly by Self Help Federal Credit Union. Acting as the general contractor for the projects, Restore Neighborhoods LA (RNLA) is a nonprofit organization that offers affordable construction work to participants. The Housing Authority of the City of Los Angeles (HACLA) is the program's only public agency partner and offers support around Section 8, including streamlined landlord registration and (potentially) a new Section 8 signing bonus.

The Housing Rights Center provides direct landlord training around fair housing regulations and landlord responsibilities. Two nonprofits, St. Joseph's LA Family Center and LA Family Housing, will provide landlord-tenant matching services as well as direct supportive services to tenants. These supportive services can include mental health care, education and vocational programming, and engagement. For many homeowners who are first-time landlords, landlord training offers homeowners with an opportunity to learn more about the intricacies of the Section 8 processes, including registration, document submission, and property approval, as well as best practices associated with landlord responsibilities.

Participant Selection

Eligible participants must live within Los Angeles city limits in a single-family zoned neighborhood. Targeted homeowner participants are low- to moderate-income with equity in their home and a stable income to cover the loan payments. All homeowners go through a rigorous financial application to ensure they meet the minimum equity, income, and credit score qualifications. In addition to a financial analysis, homeowners receive a comparison of mortgage calculations with existing payments and future rental income, mortgage payments, property taxes, and home insurance. Homeowners are responsible for opening a savings account with SHFCU prior to participating in the project. Additionally, homeowners must agree to rent the ADUs to Section 8 voucher holders. Future tenants are must be Section 8 voucher holders, but do not have additional requirements.

Program Finances

Depending on the site requirements and size of the ADU, newly constructed unit costs range from $160,000 – 250,000. For converted garage units, costs range between $75,000 – 140,000. Prior to receiving the loan, homeowners are responsible for covering the initial mortgage set up costs ($700) and the 4% closing costs associated with title, escrow, recording fees, and one year of property tax and insurance payments. Homeowners are responsible for beginning loan payments 30 days after the loan closes. Monthly payments range from $2,000-3,000, and rental amounts (based on 2019 voucher standards) range from $1,273 – $1,970. In consideration of loan payments and incoming rental income, homeowners stand to earn an additional $400-1,000 each month.

Participants may receive pre-loan funds through Genesis LA which are subsequently repaid with loan funds. Genesis LA provides the guarantee for the loans issued by Self Help Federal Credit Union, and after construction ends, Genesis LA revolves the guarantee amount back into the project. To mitigate the high risk associated with these loans, Genesis LA utilized $650,000 of grant funding from a JP Morgan Chase PRO Neighborhoods Initiative award. To help fund the design and implementation of the grant, LA Más received a HUD Section 4 Capacity Building grant. Additional grant funding from Wells Fargo and LISC LA has helped fund the project management aspect of the program. In total, the multi-year program budget for Backyard Homes Project is $275,000.

Challenges for Participation and Implementation

Loan eligibility has been an initial challenge for the Backyard Homes Project. Despite strong interest levels, the pool of loan-eligible homeowners was smaller than anticipated. Loan recipients must have equity in their homes, yet low and stable incomes. If applicants cannot support the loan payments, they cannot participate in the program. While changes in regulations at both the state and city level have made ADUs more feasible to construct, the number of homeowners able to build is still restricted by high construction costs.

Program Lessons

Success for the Backyard Homes Project is measured against the program's four overarching goals, including supporting homeowners to become affordable housing providers and advocates, increasing opportunities for stability for individuals experiencing housing insecurity, maintaining and strengthening the fabric of neighborhoods through ADUs, and enhancing the role of ADUs as a crucial form of affordable housing. LA Más is intentional about connecting each of these goals to specific programmatic elements, whether provided directly or through carefully selected partners. While affordable ADU construction is central to the program, LA Más has made deliberate programmatic decisions to support mixed-income neighborhoods and ensure that new tenants feel comfortable and welcome. Further, the program is intentional about raising awareness around Section 8 and reducing the stigma associated with the program.

In its early stages, the Backyard Homes Project offers an example of a scalable program that public agencies can study, modify to their local contexts, and implement. The program had not built fully constructed units as of early-2020; however, the pilot phase of the program will work with up to 10 homeowners. Because construction costs remain a high barrier for many homeowners, LA Más hopes that public agencies and organizations implementing similar programs will establish incentives, such as cash awards, subsidies, or permit fee waivers, that make affordable rental rates feasible for homeowners.

Second Dwelling Unit (ADU) Pilot Program: Los Angeles County Development Authority

Regulatory Background

Los Angeles County had an ADU ordinance in place prior to the passage of the state bill, which went into effect January 1, 2020. Staff proposed an updated ordinance on April 16, 2020, which recommends including the updated ADU recommendations from the state bill into the County's ADU ordinance.[21] Some items included in the updated state bill and proposed County ordinance include limiting ADU development within prohibit areas, such as fire hazard zones. It also recommends prohibition of ADUs to be used as short-term rentals and usage of ADUs for home-based occupations.

Program Practice

The Second Dwelling Unit (ADU) Pilot Program strives to create housing solutions for homeless families and individuals by facilitating ADU construction with homeowners. Administered by the Los Angeles County Development Authority (LACDA), the pilot program provides forgivable loans to homeowners for ADU construction in exchange for deed restrictions on the new units. ADUs built through the pilot must be rented to individuals transitioning out of homelessness for a period of 10 years. The pilot offers loans of up to $75,000 for new ADU construction, and up to $50,000 for ADU rehabilitation. The program received the initial motion to launch from the Los Angeles County Board of Supervisors in April 2017. As of March 2020, the program was providing four new construction loans and one rehabilitation loan.

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[21] http://planning.lacounty.gov/assets/upl/project/adu_staff-report-20200416.pdf

Designed to ensure full participation through the program's full 10-year period, the loan is structured so that 1/10 of the amount is forgiven every year that a participating homeowner is within full compliance. Each has a pay-out schedule, and for any homeowner participant who leaves the program before the end of 10 years, the balance of the loan must be repaid to the County. Any homeowners who leave the program prior to the sixth year of participation are required to pay an additional pre-payment penalty.

In addition to ADU financing, the pilot program offers a streamlined permitting process. The program offered initial design and construction guidance for homeowners constructing new ADUs; however, all participating homeowners are responsible for managing the ongoing design and construction processes. Given participants' independence throughout the process, homeowners with more construction experience have a slight advantage in navigating the development stages of the pilot program.

Program Partners

Acting as both the County's housing authority and community development agency, LACDA administers all stages of the pilot program. Established as one of 47 County-wide strategies to mitigate homelessness, the pilot was designed with input from several other County agencies and a local nonprofit partner. These partners included the Department of Regional Planning, Department of Public Works, Arts Commission, and the nonprofit, LA Más. In the initial stages of the pilot, LA Más assisted in the homeowner application review and provided technical assistance for new ADU design and construction.

Participant Selection

Properties located in unincorporated Los Angeles County were eligible to apply for the program. In addition to location requirements, participating homeowners had to agree to record a deed of trust on their property for 10 years and rent the future ADUs to voucher-holding tenants with a history of homelessness. Prior to homeowner selection, pilot program staff conducted a financial review of participants' assets, income, and budget to ensure that participants were in solid financial standing with enough resources to complete the construction process.

As of March 2020, no ADU tenants had been selected. With the first ADU expected to be complete later in 2020, future tenants must be transitioning out of homelessness and be eligible for one of two County voucher programs – Section 8 or Housing for Health22. Tenants are not obligated to remain in the ADUs for the entirety of the program; however, all new tenants must also meet the criteria of transitioning out of homelessness and voucher eligibility.

Program Finances

The forgivable loan at the center of the Second Dwelling Unit Pilot Program is a significant draw of the program. Similar to other loans on the market, this pilot loan does not account for future ADU rental income in homeowners' income. Homeowner participants can access the first installment of loan funding once they have pulled building permits for the new unit. This provision, however, requires homeowners to have cash funds of $10,000 - $20,000 in order to pay for design and permitting

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[22] Housing for Health is a Department of Mental Health-run program

process. In total, participating homeowners need an approximate total of $125,000 through cash, home equity, a home equity mortgage, or a line of credit on the home to get through the entire construction process. Program staff have found that ADU costs extend up to $200,000 for new construction. This final cost is inclusive of both soft costs (associated with inspections and permitting) and hard construction costs. Due to economies of scale, the larger units tend to be cheaper to construct at $166 per square foot as opposed to the smallest unit at $200 per square foot.

Overall funding for the loans and program has been set aside by the County Board of Supervisors from Measure H funds. Approved by voters in 2017, Measure H is a 10-year, quarter-cent sales tax to fund housing, supportive services, prevention, and outreach for individuals experiencing homelessness. Total funding for the program was established at $550,000; however, a portion of this amount was allocated towards a separate ADU design competition. The results from this pilot program will help public officials decide whether future funding will continue for this or similar programs.

Challenges for Participation and Implementation

Over the course of pilot program, staff and participants have navigated unforeseen challenges. Program staff noted that despite the rigorous financial review, some homeowners faced financial challenges prior to accessing the loan funding. With site-specific requirements emerging during the entitlement process, homeowners had to find the funding to pay for additional requirements (such as fire sprinklers) and inspections (such as soil tests in a fault zone). These site-specific requirements add to the already lengthy construction timelines and offset the time savings of the streamlined permitting process.

Program staff noted that the expedited permitting process has been helpful in reducing timelines, particularly when leadership and senior staff see the value in the pilot program. Additional challenges that program staff have worked through include managing the role as both the lender and homeowner representative, specifically when paying contractors whose payment schedules do not match those of the incremental loan installments; building collaborative solutions where structures for cross-agency collaboration do not exist; managing the participant-specific situations, including financial standing and quality variations across contractors; and mitigating poor data integration.

Program Lessons

As a program still in progress, the Second Dwelling Unit Pilot Program staff view the success of the program as having tenants placed in safe and comfortable ADUs. Since program inception, staff have been pleased by the high level of interest from the general public and view the high volume of applications as a sign that the loan amount and program requirements were properly set. In terms of best practices moving forward, program staff believe this type of loan program is best suited for public agencies' existing home rehabilitation programs. By building on established procedures, future ADU loan programs can become part of the agency's existing portfolio for financing and compliance purposes. Program staff view additional strengths of the program to be its location within the County's housing authority, the successful outreach and vetting process, and the spread of community knowledge around existing voucher programs.