

A TURNER CENTER POLICY BRIEF - JULY 2020

# Revisiting California's Density Bonus Law: Analysis of SB 1085 and AB 2345

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In May 2020, California State Senate President Pro Tem Toni Atkins unveiled a series of legislative proposals to facilitate the production of more housing. This Senate Housing Production Package includes several ideas to bolster new home construction and remove barriers by streamlining the development process. Given the severe shortage of housing statewide and the likelihood of a prolonged recession due to the COVID-19 pandemic, the prioritization of new legislation to encourage construction is welcome. One of the proposed ideas—Senate Bill 1085 introduced by State Senator Nancy Skinner—would reform California’s existing density bonus law to increase the incentive for projects to incorporate units affordable to Very Low Income (VLI) households, as well as create a new Middle Income bonus category. In the Assembly, Assembly Bill 2345 introduced by Assemblymember Lorena Gonzalez proposes to increase the bonus density permitted by state law based on a variation of the law currently used in the city of San Diego.

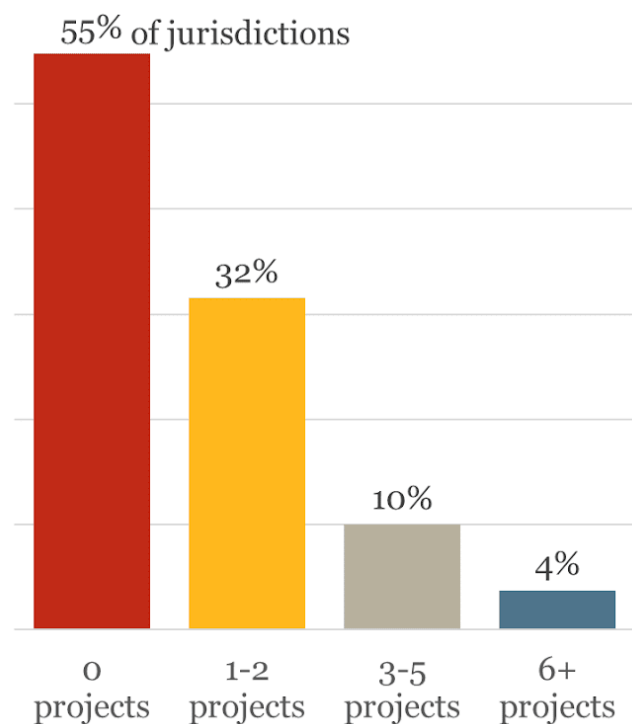
This analysis examines the potential impact that each of these legislative proposals could have on the development of new housing. We consider both the implications of the legislation for the financial feasibility of housing development—using a pro forma model that allows us to compare the expected return on cost (ROC) under the different legislative scenarios—as well as the extent to which the proposed reforms may promote the inclusion of more affordable units on-site by offering greater flexibility to developers, and concludes with recommended policy actions that could help religious institutions overcome those barriers.

## The Need for Density Bonus Reform

California’s density bonus law merits improvement. Our [2018 California Residential Land Use Survey](#) revealed that most cities see little to no use of the law.<sup>1</sup> While more than three-quarters of survey respondents have adopted local density bonus ordinances, less than half of jurisdictions reported any developments making use of the ordinance from 2015 through 2017 (Figure 1). Most of these only had one or two density bonus projects, and only 14 percent of respondents had three or more density bonus projects. Over the three-year period, 449 density bonus projects were reported by survey respondents. Of those projects, 175 were built in the City of Los Angeles.

Figure 1. Density Bonus Implementation in California Jurisdictions (2015-2017): Number of Projects

### How many projects received density bonus concessions from 2015-17?



Source: Turner California Residential Land Use Survey



While reform is warranted, care must be taken to ensure that any changes in density bonus law are considered in the context of the economic feasibility of new construction. In other words, the incentives and requirements in the law must be balanced to ensure the program succeeds in its goal: increased housing production, particularly affordable housing. If a program is designed too narrowly, or with requirements that restrict a project's financial feasibility, developers may choose not to participate. As our 2019 brief "[Making It Pencil: the Math Behind Housing Development](#)," illustrates, policy and market variables have a significant impact on whether or not housing gets built.<sup>2</sup> The same principles apply to potential density bonus law changes: if reforms are not calibrated for feasibility, they will not be used.

## Proposed Changes

Current density bonus law allows developers to build more densely in exchange for making a certain percentage of the project's units affordable to certain income levels. The maximum increase in affordability for any mixed-income project that uses the density bonus is 35 percent above what is allowed by a locality, depending on the level of affordability provided on-site (Table 1). In addition

to increased density, the law also allows projects to claim other incentives to facilitate housing development, such as lowered parking requirements, as further described below.

As currently drafted, SB 1085 and AB 2345 take different approaches to reforming density bonus law. SB 1085 would increase the density bonus from 35 percent to 40 percent for projects that include 11 percent of units affordable to people with Very Low Incomes<sup>3</sup> (VLI), and would also create a new 35 percent density bonus incentive for rental projects that include 20 percent of units affordable to people with Low Incomes (LI) or Moderate Incomes (MI), provided that the rent for the unit is 30 percent below the market rate for the city or county in which the housing is located. This is a notable change from current law as MI units are not currently eligible for density bonus incentives in rental projects.

AB 2345 recalibrates the density incentive by extending bonus density for VLI units up to 50 percent where 15 percent of the units are affordable to VLI households. The same increases in density are proposed for LI units (provided at least 24 percent of units are LI) and for MI for-sale units (if at least 44 percent of units are MI). Unlike SB 1085, AB 2345 does not create a new category for MI rentals.

Table 1. Current Density Bonus Law Maximum Density Incentives by Income Category Compared to Proposed Changes in SB 1085 and AB 2345

	Current Density Bonus Law	SB 1085	AB 2345
Very Low Income (VLI)	35% bonus for 11% VLI units	40% bonus for 11% VLI units	50% bonus for 15% VLI units
Low Income (LI)	35% bonus for 20% LI units	No change	50% bonus for 24% LI units
Moderate Income (MI)	35% bonus for 44% MI units (for-sale only)	35% bonus for 20% MI units (rental and for-sale)*	50% bonus for 44% MI units (for-sale only)

\*Applies only when rent for the unit is 30 percent below the market rate for the city, county, or city and county in which the housing development is located.

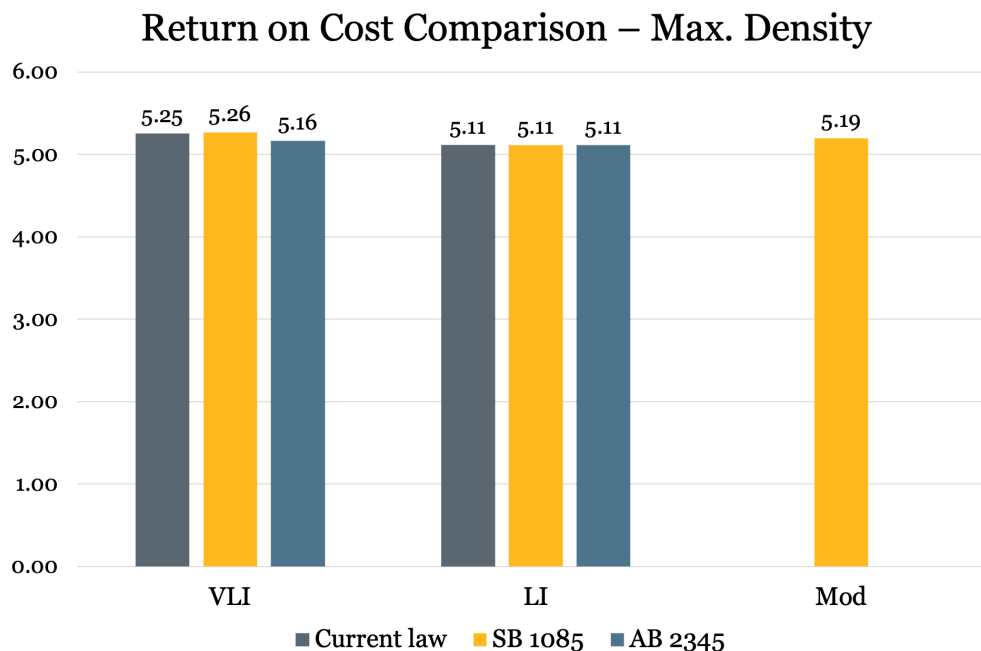
## Pro Forma Scenarios

To compare the potential impacts of SB 1085 and AB 2345 on new market-rate development, we used the Oakland-area pro forma model we developed for our “Making It Pencil” analysis, after updating the inputs for construction costs and asking rents in new projects. Our model is for a 100 unit for-rent project, with a mixture of studios, 1 and 2 bedrooms. We also assume a .75 to 1 parking space to unit ratio. Adapting the pro forma to reflect key features of the reform bills allows us to compare the results to a baseline model that includes the most commonly used incentive allowed by current density bonus law: a 35 percent increase in density in exchange for 11 percent of units affordable to VLI households. Developers typically consider a project to be financially feasible if a pro forma analysis predicts a Return on Cost (ROC) of at least 1 to 1.5 percentage points above capitalization rates. Using current density incentives for a

project incorporating VLI units, our model projects a 5.25 percent ROC. When compared to area capitalization rates for multifamily buildings (4.30 percent), our baseline model is on the margin of feasibility.

Our pro forma results indicate that proposed density increases to the density bonus law would not improve financial feasibility compared to what is currently allowed in existing law. While the increase in density proposed in SB 1085 for VLI units offers a similar ROC to current law (5.26 percent), the newly proposed Moderate Income rental incentive produces a slightly lower ROC (5.19 percent). This difference in value is primarily due to the bill language requiring MI units to be 30 percent below market rate for the city or county which in practice may not be significantly higher than regulated low-income rents. In addition, in certain circumstances, land sales prices could reflect the higher revenue potential of MI units.

Figure 2. Comparison of Return on Cost for Pro Forma Model Using Maximum Density Allowed Under Current Density Bonus Law and Proposed Legislation, By Income Category\*



\*Current Density Bonus law and AB 2345 do not allow for moderate income rental projects.

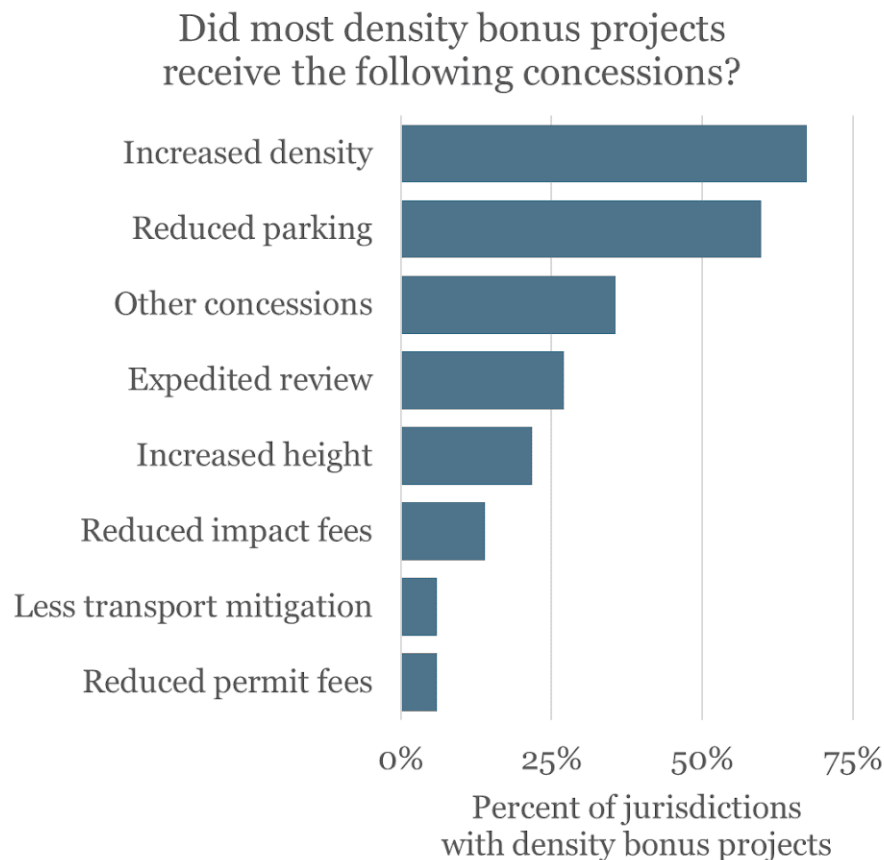
Similarly, the proposed changes in AB 2345 are slightly less attractive than the existing law. Despite a significant increase in bonus density, our model shows that AB 2345’s incentives offer less value across the board than our baseline model, as measured by ROC.

While the pro forma results suggest the changes proposed in SB 1085 and AB 2345 would not significantly change financial feasibility in the Oakland market, the reforms may still provide important support for the inclusion of more affordable units overall. For example, many cities that employ inclusionary zoning policies—requiring that a developer reserve a percentage of units as deed-restricted affordable units in a new project—do not align these requirements with current density bonus law. For example, while a city may require a 15 percent inclusionary zoning requirement, bonus density per the existing density bonus law stops at 11 percent for VLI units, and LI

bonus density (just a 10 percent increase for 15 percent of units at LI) does not provide enough value to offset increased affordability. Both SB 1085 and AB 2345 provide more flexibility for developers to meet more robust inclusionary requirements by expanding bonus density for higher percentages of affordability.

There is some evidence to suggest that this increased flexibility may be valuable in achieving more affordable units. For instance, after the implementation of San Diego’s 2016 density bonus ordinance—which AB 2345 is modeled after—more projects utilized the program than before the reforms, with the majority of projects using a density bonus higher than 35 percent, and by extension, including more affordability onsite than would have been required under standard density bonus law.<sup>4</sup> Moreover, each market-rate project chose to use the VLI bonus category.

Figure 3. Density Bonus Implementation in California Jurisdictions (2015-2017): Number of Projects: Types of Concessions



Source: Turner California Residential Land Use Survey



In addition to added density, developers may also take advantage of other incentives allowed under density bonus law that can sometimes prove just as valuable—or even more valuable—than additional units. As part of this law, developers may request up to three regulatory concessions such as relaxed design standards (e.g., setbacks) or reduced parking requirements, among others. Our California Residential Land Use Survey found that developers do not always choose to utilize the added density afforded by density bonus law, but other concessions are frequently received (Figure 3).

Both SB 1085 and AB 2345 propose to increase available developer concessions above the current density bonus law. However, the value of these concessions is not factored into our model as it is difficult to measure their impact in a pro forma given that not all projects will request the same concessions or use all concessions available to them. It should also be noted that SB 1085 would prohibit cities from imposing affordable housing fees on a project's bonus units, a potentially important reform as well. However, our model does not capture the impact of this reform as the city of Oakland does not impose affordable housing fees on density bonus projects.<sup>5</sup>

## Conclusion

California's density bonus law is overdue for reform given how infrequently it is used across the state. And while more sweeping housing legislation such as upzoning near transit or reducing high impact fees have not moved forward this legislative session, density bonus reform offers a chance for meaningful change this year.

The changes proposed in SB 1085 and AB 2345 are modest in scope, but address key provisions of the current law that could be strengthened or improved. In SB 1085, the creation of a Moderate Income rental category provides an option to create housing that is affordable to middle-income households where no subsidy source exists today. This is a key change in the density bonus law, and should be considered for AB 2345 as well. The added density provisions in SB 1085 and AB 2345 offer more options for developers to meet local inclusionary housing requirements. To be sure, these are incremental improvements, but when coupled with other bills introduced this year, SB 1085 and AB 2345 represent a step in the right direction for legislation that prioritizes affordability while recognizing the need for offsets to achieve financial feasibility. However, further reform of the state's density bonus law is still necessary to significantly increase its utilization across the state.



## ENDNOTES

1. Mawhorter, S. and Reid, C. (2018). “Local Housing Policies Across California.” Turner Center for Housing Innovation, UC Berkeley. Retrieved from: [http://californialanduse.org/download/Terner\\_California\\_Residential\\_Land\\_Use\\_Survey\\_Report.pdf](http://californialanduse.org/download/Terner_California_Residential_Land_Use_Survey_Report.pdf).
2. Garcia, D. (2019). “Making It Pencil: The Math Behind Housing Development.” Turner Center for Housing Innovation at UC Berkeley. Retrieved from: <https://turnercenter.berkeley.edu/making-it-pencil>.
3. Very Low Income is defined as a household making less than or equal to 50 percent of Area Median Income (AMI). Low Income is defined as a household making less or equal to than 80 percent of Area Median Income. Moderate Income is defined as making less than or equal to 120 percent of Area Median Income. The affordable housing cost for these income levels is calculated based on what is affordable to a VLI household at 50 percent of AMI, a LI household at 60 percent AMI, and a MI household at 110 percent of AMI.
4. Circulate San Diego. (2020). “A Good Bargain: An Updated Evaluation of the City of San Diego’s Affordable Housing Bonus Program.” Retrieved from: [https://d3n8a8pro7vhm.cloudfront.net/circulatesd/pages/1316/attachments/original/1591816951/AHBP\\_status\\_report\\_2020\\_newlogos.pdf?1591816951](https://d3n8a8pro7vhm.cloudfront.net/circulatesd/pages/1316/attachments/original/1591816951/AHBP_status_report_2020_newlogos.pdf?1591816951)
5. Update July 20th, 2020: This section includes details added to the original version of this brief (published July 17th).