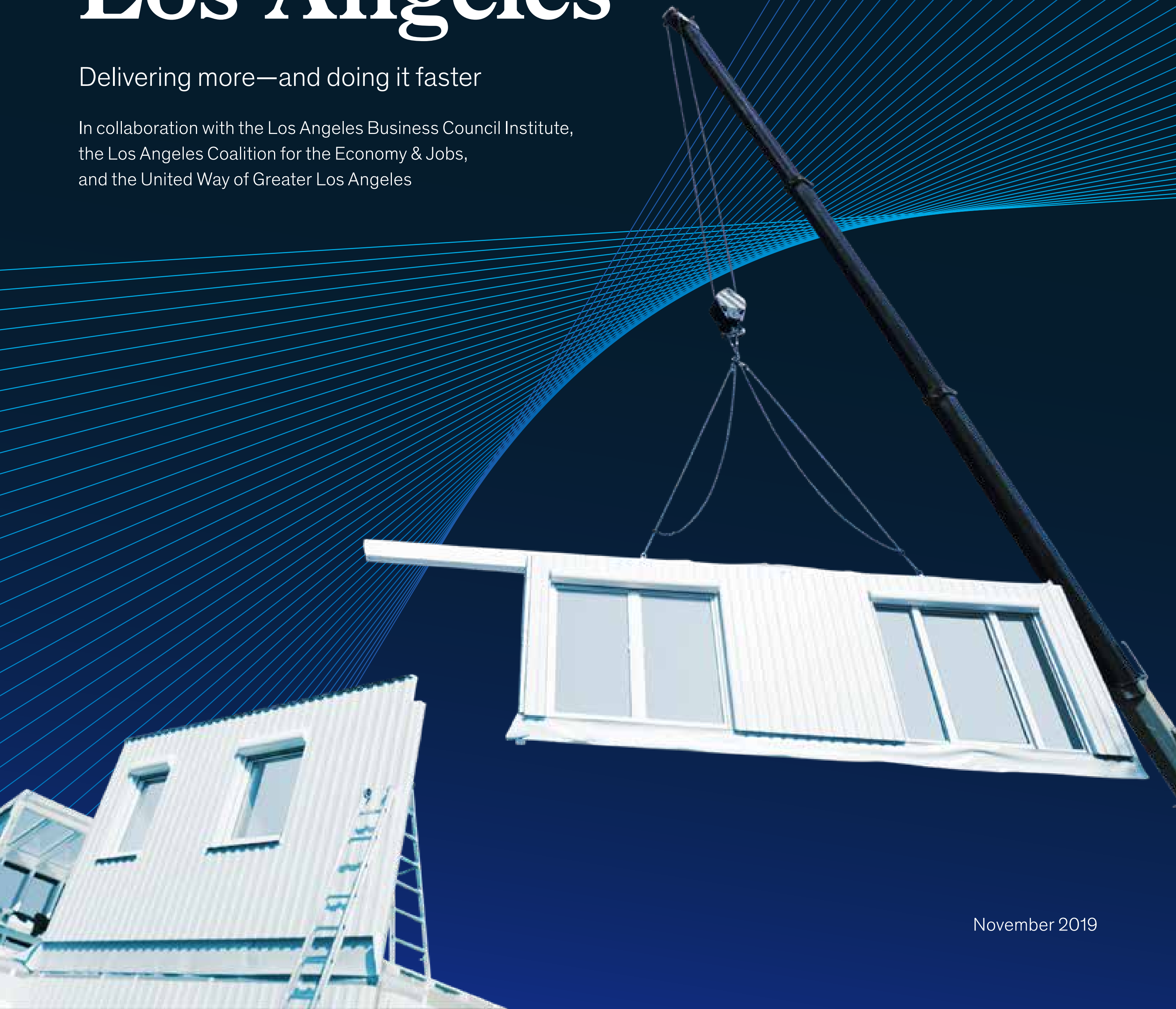
McKinsey Global Institute

Affordable housing in Los Angeles

Delivering more—and doing it faster

In collaboration with the Los Angeles Business Council Institute, the Los Angeles Coalition for the Economy & Jobs, and the United Way of Greater Los Angeles



November 2019

McKinsey Global Institute

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MGI is led by four McKinsey & Company senior partners: James Manyika and Sven Smit (co-chairs), Jacques Bughin, and Jonathan Woetzel. Michael Chui, Susan Lund, Anu Madgavkar, Jan Mischke, Sree Ramaswamy, Jaana Remes, and Tilman Tacke are MGI partners, and Mekala Krishnan and Jeongmin Seong are MGI senior fellows.

Project teams are led by the MGI partners and a group of senior fellows and include consultants from McKinsey offices around the world. These teams draw on McKinsey’s global network of partners and industry and management experts. The MGI Council, which includes leaders from McKinsey offices around the world and the firm’s sector practices, includes Michael Birshan, Andrés Cadena, Sandrine Devillard, André Dua, Kweilin Ellingrud, Tarek Elmasry, Katy George, Rajat Gupta, Eric Hazan, Acha Leke, Gary Pinkus, Oliver Tonby, and Eckart Windhagen. In addition, leading economists, including Nobel laureates, advise MGI research.

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Affordable housing in Los Angeles: Delivering more—and doing it faster

November 2019

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Preface

Growth sometimes sets off unintended consequences. In the heart of some of the world's most affluent cities, one of the most basic human needs—a decent place to call home—is slipping beyond the reach of many residents.

Housing resides at the intersection of several MGI themes, including urbanization, inequality, infrastructure, and construction and government productivity. After our initial work on global affordable housing five years ago, we followed up with a 2016 report on California's statewide housing shortage. Yet housing is ultimately an issue that comes down to many individual and highly local choices. With that in mind, this document zooms in again on Los Angeles, where housing affordability is squeezing low-income residents and the middle class alike.

Produced in conjunction with McKinsey & Company's West Coast Office, this report marks the launch of MGI in Society, an initiative aimed at translating MGI's ideas into action. It suggests concrete steps that could yield clear wins and outlines some of the choices and trade-offs that will need to be made. Above all, it highlights the need for stakeholders from across the region and from every part of its housing ecosystem to work collaboratively and move quickly. Soaring rents and home prices have been shutting people out, but LA can reinvent itself as a more inclusive place to live and a more productive place to do business.

This research was led by Jonathan Woetzel, a director of MGI based in Los Angeles and Shanghai; Shannon Peloquin, a McKinsey partner based in San Francisco; Steve Kling, an associate partner based in Los Angeles; and Tim Ward, managing partner of McKinsey's Southern California office. Sucheta Arora led the project team, which included Andrew Margrave, Matthew Rock, Anneke Maxi Pethö-Schramm, Luis Carlos Piedra, and Justin Portela.

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In the course of this research, we interviewed dozens of people representing every part of the Los Angeles housing ecosystem. Many thanks go to Kome Ajise (Southern California Association of Governments), Ashley Atkinson (LA Department of City Planning), Caitlin Barrow (Highridge Costa Housing Partners), Alison Becker (Los Angeles City Council District 15), Kasey Burke (Meta Housing), Rushmore Cervantes (LA Housing + Community Investment Department), Darin Chidsey (Southern California Association of Governments), Andrew Clare (Loeb & Loeb LLP), Rick Cole (City of Santa Monica), Michael Costa (Highridge Costa Housing Partners), Brian D'Andrea (Century Housing), Kevin Demoff (LA Rams), Steven Dietz (United Dwelling), Chris Dombrowski (State of California), Sean Doss (LA Housing + Community Investment Department), Guadalupe Duran-Medina (Los Angeles County First District), Sarah Dusseault (Los Angeles Homeless Services Authority), Hilary Firestone (Natural Resources Defense Council), Mark Forbes, Gary Freedman (Ervin Cohen & Jessup LLP), James Frost (Frost/Chaddock Developers), Ron Galperin (LA City Controller), Art Gastelum (Gateway Science and Engineering), Tom Gilmore (Gilmore Associates), Matthew Glesne (LA Department of City Planning), Nicholas Greif (Los Angeles City Council District 4), Andrew Gross (Thomas Safran & Associates), David Grunwald (National Community Renaissance), Nicholas Halaris (AH Capital and Proposition HHH Citizen Oversight Committee), Dianne Harrison (California State University, Northridge), Michele Knab Hasson (Natural Resources Defense Council), Marchell Hilliard (Bank of America Merrill Lynch), Rob Jernigan (Gensler), Karly Katona (Los Angeles County Second District), Richard Katz (Richard Katz Consulting), Kevin Keller (LA Department of City Planning), David Kersh (Carpenters/Contractors Cooperation Committee), Monique King-Viehland (LA County Development Authority), Krista

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This work benefited from the support and contributions of McKinsey colleagues, including Kate Anthony, Avery Cambridge, Josh Davis, Isabelle Fisher, Vasudha Gupta, Tom Hellstern, Garo Hovnanian, Jared Katseff, Jonathan Law, John Means, Jan Mischke, Kunal Modi, Remona Moodley, Seema Parmar, Sangeeth Ram, Sarah-Tucker Ray, Ben Safran, Ben Silverstein, and Jonah Wagner.

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This report contributes to MGI's mission to help business and policy leaders understand the forces transforming the global economy and prepare for the next wave of growth. As with all MGI research, this work is independent, reflects our own views, and has not been commissioned by any business, government, or other institution. We welcome your comments on the research at MGI@mckinsey.com.

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Reimagining Los Angeles

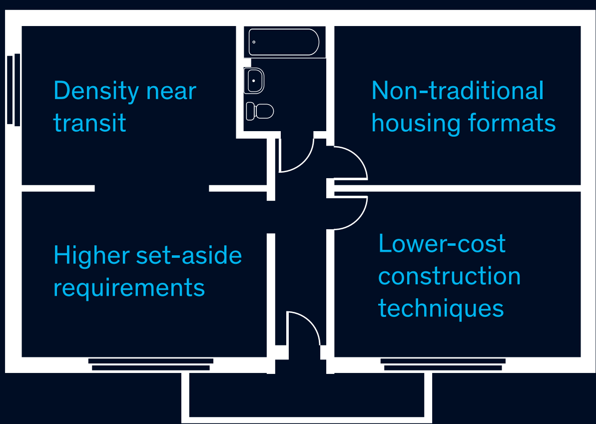
Unlocking affordable

Housing production in LA County

~100,000
housing units permitted from 2014 to 2018....

12%
...of which were affordable

A combination of...



...could deliver more affordable housing—more affordably

The keys that can help Los Angeles provide safe, decent housing for residents in all income brackets

Transit
Capitalizing on Metro expansion to add more affordable units through set-asides

Innovation
Incentivizing new lower-cost construction techniques and non-traditional housing formats

Efficiency and scale
Streamlining approvals and financing to reduce pre-construction time

Safety net
Supporting the most vulnerable tenants

A delivery coalition
Bringing together the public, private, and social sectors to get things done

McKinsey Global Institute

Executive summary

In 2016, the McKinsey Global Institute (MGI) published *A tool kit to close California's housing gap,* extending our earlier work on affordable housing worldwide and on productivity in the construction industry. The intervening years have seen California introduce a number of new housing incentives and legislative proposals, including measures to increase density near transit (Measure JJJ in Los Angeles) and to streamline approval processes in localities where construction is lagging (SB35). Yet housing remains one of the state's most urgent issues—one with profound consequences for millions of lives today and the course of California's future.

This report applies a more detailed lens to the Los Angeles region and to affordability. The City of LA is leading the state in housing production. With the addition of more than 88,000 units since 2010, it has produced more units relative to its population growth than almost any other city in California.[1] Despite this burst of residential construction, only about 9 percent of the new units added over the past five years have been affordable to households earning less than the area median income.[2] The comparable figure for the entire county is only slightly better, at 12 percent.

1.9M

households across LA County fall into the affordability gap

Increases in rents and home prices have far outpaced wage growth for most of the region's workers.[3] As a result, one million households, or 70 percent of all households in the City of Los Angeles, would have to stretch financially to obtain a standard-size unit in their current neighborhood.[4] This number rises to a little over 1.9 million households across LA County. The cost of housing has always weighed most heavily on people in the lowest income brackets, but it is now squeezing the middle class as well. While many homeowners are affected, the situation is inherently more precarious for renters.

We estimate that the shortage of affordable housing depresses GDP across the metro area by more than 2 percent. This translates into $18 billion to $22 billion in lost output every year for the City of LA, and almost double that amount for all of LA County.[5] Most of this occurs as households forgo other types of consumption to pay the rent or mortgage. Consumption is limited even further for Angelenos who face high transportation costs because they cannot afford to live near their place of employment—a situation that contributes to some of the nation's worst traffic congestion and related environmental consequences. The people who provide many of the services Los Angeles depends on every day are finding it harder to get by or to live anywhere near where they work.

Many young people are unable to gain a foothold to start their own households, and a significant number of them are considering moving out of the region.[6] One study from the

1. Based on California Department of Finance data. Since 2010, the City of LA has added 356 units for every increase of 1,000 in population. Among other California cities with populations above 250,000, only Irvine has a higher ratio (365 units added for every increase of 1,000 in population).
2. Based on the annual progress reports submitted to the California Department of Housing and Community Development from 2014 to 2018. Affordable housing is defined as housing units affordable to households earning less than 120 percent of the area median income.
3. From 2013 to 2017, median rent in LA County increased by 9.7 percent year over year (Zillow data), while median household income increased by only 2.4 percent year over year (American Community Survey data).
4. A standard unit is defined as 970 square feet. We assume that this is adequate space for an average household of three, in line with existing housing under programs such as the Mitchell-Lama affordable housing initiative. This standard also helps in normalizing for the variations in size across one-, two-, and three-bedroom units. Housing is considered affordable when the rent or payment is less than 30 percent of household income, a benchmark used by the World Bank and the US Department of Housing and Urban Development.
5. We estimate that housing costs depress GDP across all of LA County by up to 4 to 5 percent, costing it between $32 billion and $36 billion per year.
6. Berkeley Institute of Governmental Studies poll, September 2019.

LA County Department of Public Health found that more than one-third of adults who had difficulty paying their rent or mortgage could not afford medical care for health problems. Some residents accept whatever kind of substandard housing they can get, from uninsulated garages to tiny apartments where their children have no space to play or do homework. The affordable housing shortage is also one of the factors contributing to homelessness in Los Angeles and increasing the challenge of getting people back on their feet and into permanent housing.[7]

Los Angeles, a city of four million people, added fewer than 7,300 units of affordable housing over the most recent five-year period.[8] The rest of LA County added approximately 6,200 affordable units in the same period. Production is rising year over year. But both the city and the county are far short of where they need to be to meet the 2021 Regional Housing Needs Assessment (RHNA) goals for affordable units—targets that are modest when placed against the scale of the affordability gap.[9]

In addition, the clock is ticking on 10,000 units throughout the City of Los Angeles with affordability covenants that are due to expire before the end of 2023. If no action is taken, the stock of affordable housing will shrink even further.

Los Angeles is taking action. Voters approved $1.2 billion under Proposition HHH to accelerate development of affordable housing and permanent supportive housing for the homeless; more than 9,000 PSH units have been approved for funding since 2016.[10] Incentives built into Measure JJJ have helped create more than 3,800 affordable units near mass transit since its adoption in November 2017.[11] In addition, the city is moving to simplify the zoning code, digitize the permitting process, and provide case-management services to speed through high-priority projects. LA County has significantly increased funding through the Affordable Housing Trust Fund, Measure H, and the No Place Like Home program. Almost all Proposition HHH projects in the City of LA have also received funding from the county.

Despite this progress, a huge share of the population remains underserved. The initiatives currently under way need to be expanded and accelerated even as Los Angeles continues to look for new solutions. It will take not only public agencies but developers, nonprofits, investors, and community groups working together to address a challenge of this magnitude.

It's time to turn the region's housing crunch into an opportunity to reimagine Los Angeles. The region is already undertaking the biggest package of public works in the country, including transit expansion, revitalization of the LA River, the Complete Streets program, and modernization of the city's major port and airport. Now that same kind of ambition and investment has to extend to housing—and particularly to transit-oriented development.

This does not have to involve placing high-rises on every open space. Higher density is a given, but much of the gap could be bridged with low- and mid-rise redevelopment that capitalizes on the ongoing expansion of public transit and is within current zoning. Prioritizing select sites near major transit hubs and primary transit corridors for medium- and some high-rise development early in this effort could accelerate progress.

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7 See, for example, Los Angeles Homeless Services Authority, "Even as housing placement reach new heights, 2019 Greater Los Angeles homeless count shows 12 percent rise in homelessness," press release, June 4, 2019; Chris Glynn, Thomas Byrne, and Dennis P. Culhane, "Priced out: Homelessness rises faster where rent exceeds a third of income," Zillow Research, December 11, 2018; and Maggie Stringfellow and Dilip Wagle, "The economics of homelessness in Seattle," McKinsey.com, May 2018.

8 Based on annual progress reports submitted to the California Department of Housing and Community Development, 2014 to 2018.

9 The current Regional Housing Needs Assessment calls for adding 46,590 affordable units in the City of Los Angeles, and 103,184 affordable units overall in LA County, by 2021.

10 LA Mayor's Office, "Confronting the crisis: Helping our homeless neighbors," October 16, 2019, lamayor.org/CTC-Helping_our_Homeless_Neighbors.

11 Los Angeles Department of City Planning, Quarterly housing progress report, April–June 2019.

Los Angeles must ramp up construction of affordable units, with a specific focus on serving households earning less than 120 percent of the area median income. Central to our vision is the underlying principle that development should be undertaken in a way that supports low-income tenants through any disruption and helps them remain in their current neighborhood if they wish. It should also create a positive environmental impact by reducing commutes and adding more energy-efficient buildings. This would further ease the financial burden on residents by lowering what they spend on transportation and utilities.

Barriers of both land scarcity and high cost structures can be overcome. Very little land sits vacant in Los Angeles, but the parcels that are available can be prioritized for development. The region's biggest capacity gains could come from redeveloping residential parcels that are currently not taking full advantage of their zoning allowances, as well as underutilized commercial land. In the City of Los Angeles, current zoning allows for 1.5 million to 1.9 million additional housing units on highly underutilized residential parcels.[12] This theoretical potential, which does not include redevelopment of underutilized commercial land, is far beyond what Los Angeles would realistically build in the near future. But the existence of this much capacity indicates that communities have a wide range of choices available to add new housing while maintaining their existing character.

Los Angeles has a window of opportunity to add more affordable housing as it expands public transit networks across the broader region.

LA's ongoing transit expansion is creating an important window of opportunity. Building housing near transit can reduce traffic congestion and create a better work-housing balance. In the City of LA itself, much of the potential we identify for new affordable development comes from the higher density already allowed near transit stations. These allowances are set out in the Transit Oriented Communities (TOC) incentives that are part of Measure JJJ.[13]

Other cities throughout LA County can adopt similar incentive programs. In fact, almost half of Metro rail stations are outside the boundaries of the City of LA—and as its transit networks continue to expand, the broader region will gain even more capacity for affordable housing. This is a crucial point, since the City of LA produced more than 70 percent of the new housing units added across the county from 2014 to 2018 despite accounting for only 40 percent of the county's population.[14] Meeting this challenge will require all cities within LA County and in the surrounding region to do their part and work collaboratively. The current shortage is a regional problem that needs regional solutions.

Public funding resources are limited. Since 2008, cuts in federal and state funding have reduced investment in affordable housing in LA County by more than $496 million annually, a

[12] We define "highly underutilized" parcels as those utilizing less than 25 percent of the density allowed by current zoning.
[13] Measure JJJ is time limited and will expire in 2027. It can likely be renewed for an additional five years but will expire after that. The city can consider making the program permanent by folding it into another formal density bonus program or into other local plans.
[14] Based on annual progress reports submitted to the California Department of Housing and Community Development, 2014 to 2018.

drop of 70 percent. Most of this drop occurred after California dissolved local redevelopment agencies.[15] More public funding is urgently needed, but realistically, Los Angeles will have to mobilize private capital to meet the scale of this challenge. The region has ample capital available; now it needs to create a pipeline of projects with sufficient returns to put it to work. If private development can provide units affordable to most income cohorts through deed restriction or other methods, the available public dollars could be directed toward the most vulnerable, whose needs are least likely to be met by market solutions.

Under current market conditions, the economics do not work for developers to build standard units that are affordable for households earning less than 120 percent of the area median income. As a result, most affordable units have historically been produced through public subsidies to compensate the developer for lower rents. More recently, the city has experimented with replacing subsidies with incentives—that is, "density bonuses" that allow developers to build bigger projects near transit in exchange for defined affordable housing commitments.[16] This approach has proven successful and could be scaled up even further if combined with new housing formats, innovative construction techniques, and the opportunity to capitalize on public transit expansion.

Unit costs can be reduced by up to

50%

for prefab projects with nontraditional formats

Micro-units, co-living developments, and single-family home conversions are cheaper to build per unit than standard size housing units (assuming appropriate streamlining of the approval process and policy accommodations regarding issues such as open space and parking). These types of homes are not for everyone, but they have enough appeal and utility to account for a sizable subset of the housing the region needs to add. Their reduced construction costs can allow market-driven development of housing that is affordable for moderate-income households without the need for additional subsidies or incentives; they can also support higher set-asides for lower income brackets under the right conditions. Modular and prefab construction can further bring down costs without sacrificing good design and quality, although these methods need to be adopted on a large scale to realize the full potential savings and efficiencies. Utilizing both nontraditional housing formats and prefab construction has the potential to reduce per-unit costs by some 50 percent—while minimizing the number of buildings that must go up and bringing more new housing online faster.

This report provides an in-depth assessment of what it will take to accelerate progress. The six recommendations below have been developed in the context of the City of Los Angeles, but they apply equally to the broader region:

1. **Turbo-charge the process of creating a fully integrated plan with shared accountability for all of Los Angeles.** Every part of LA—including affluent areas and major employment centers—will have to plan and deliver more affordable housing. But instead of piecemeal projects, the region needs a cohesive and integrated approach, with strengthened planning capabilities at the core. In the City of LA, each council district can commit to delivering a share of the overall affordable housing goal and identify the right types of land, following the precedent of the Bridge Program for emergency shelter and supportive housing.[17] The City Planning Department, in collaboration with the City Council, can create an overarching policy document that provides a framework for achieving affordable housing goals. Clear, consistent principles on transit-adjacent housing, density, and housing formats (especially nontraditional alternatives) can be applied across all neighborhoods. The next level of detailed community-level planning should incorporate these principles and respond to potential city- and state-level actions. Among the priorities are expanding the conditions under which desired housing types (such as affordable micro-units and prefab affordable projects) can be considered by

[15] *Los Angeles County annual affordable housing outcomes report,* California Housing Partnership, April 2019.
[16] A density bonus incentive allows the developer to build more than the allowed number of units under current zoning if it sets aside a specific number of units for households below a certain income level. TOC incentives provided under Measure JJJ are a kind of density bonus.
[17] Everyone In, "Supportive housing tracker," United Way of Greater Los Angeles, everyoneinla.org/supportive-housing-tracker.

right; standardizing select building code requirements and approval processes across municipalities; and reconsidering limits on housing development on commercially zoned parcels, especially near transit. The most recent community plan updates have designated certain projects for staff-level decisions or administrative clearances rather than discretionary approvals—a positive trend that should continue. All community plan updates need to be accelerated, which will require more resources.

2. **Adopt new construction techniques and technologies at scale to decrease costs and accelerate development.** Prefab construction involves producing standardized components of a structure in an off-site factory, then assembling them on-site. It can reduce the development cost of multifamily housing by 5 to 15 percent, if adopted at scale (with even greater benefits over the longer term). This approach promotes standardization within and across projects, which can speed approvals. The city has funded a number of prefab projects as pilots and set up a peer review process to accelerate approvals. But there is room to do more: establishing new standards and regulations that account for these techniques; mandating accelerated approval of these projects; seamlessly integrating permitting and inspections at both factory and assembly sites; and offering favorable financing terms. The city or the county can also partner with select prefab companies to help them build a pipeline of demand. A thriving prefab construction industry will need a workforce with the right skills, which will require investment in training. In addition to building housing faster, this initiative can bring high-quality jobs to the region. Developers and builders can also boost productivity and improve communications and turnaround times by adopting 5D Building Information Modeling (5D BIM) software and other next-generation digital tools more universally.

3. **Gradually increase set-aside requirements to reflect the savings from new housing types and lower-cost construction methods.** California's density bonus program and the city's own Transit Oriented Communities incentive program grant developers the right to build larger projects in exchange for designating a portion of the units as affordable housing. But these set-aside requirements were established with standard property types and traditional construction techniques and cost structures in mind. With the appropriate policy accommodations in place, micro-unit and co-living properties can support a greater proportion of affordable units while maintaining sufficient returns to secure financing.[18] A co-living property can support set-asides of up to 35 percent of units for extremely-low-income tenants, while a micro-unit development could economically set aside up to 33 percent—a significant increase from the 11 percent set-aside that can be supported by standard properties with the same level of density bonus.[19] Prefab construction, when adopted at scale, can bring costs down even further. Los Angeles can consider raising set-aside requirements over time as these formats and technologies are more widely embraced. Without higher requirements, it is unlikely that developers would voluntarily add affordable housing to market-driven projects.

4. **Reduce the time, uncertainty, and complexity of approval and permitting processes.** Building a project in Los Angeles can take three to five years. Developers often cite long and unpredictable processes for obtaining land use and building permits as a major challenge. The city has several initiatives under way to improve the entitlement and permitting process, including online permit submissions and review, plan-level exemptions to California Environmental Quality Act (CEQA) review, and simplification of the zoning code. High-priority affordable housing developments can take advantage of case-management services as well as parallel processing of entitlements and building permits. These initiatives are all positive steps. The city can now accelerate implementation, track data on their effectiveness, and expand the scope of successful programs. The re:code

[18] Depending on the specific land parcel, the new housing formats will need accommodations. For example, micro-units may require waivers regarding open space and parking requirements per unit, density limits, and minimum size specifications to ensure lower costs than standard-size units.

[19] Extremely-low-income households are defined as those earning less than 30 percent of area median income.

LA zoning revamp, for example, can be completed hand-in-hand with community plan updates over the next two to three years to incorporate design requirements of new housing formats, eliminating the need for discretionary review. The city recently launched BuildLA, a multi-year effort to digitally streamline development services and improve collaboration and communication between developers and city offices. This platform can be used to provide a comprehensive view of citywide development with a consolidated live performance dashboard tracking projects in the pipeline and the time taken at each stage. Similar initiatives can be adopted by other cities in the region. We estimate that fully digitizing and integrating processes and making targeted operational changes could trim total development time by 30 to 35 percent. Time savings reduce the carrying costs of capital between the start of development and the point at which occupancy starts to generate income—and most important, it gets more Angelenos into new homes faster.

5. **Stabilize and consolidate public financing for affordable developments.** Lining up financing for an affordable housing project can involve applying for multiple types of government funding, philanthropic grants, and loans, with significant administrative burden and uncertain results. Affordable housing developers in the region report that their projects may require up to 15 different sources of funding, each with its own application requirements, restrictions, and timeline for approval. Los Angeles should aim to bring greater coordination, predictability, and transparency to the financing of affordable projects. The city and county are already implementing a single digital application portal where developers can access all public funding sources. It should coordinate the various approval processes and surface ways to create more consistency, just as a university's financial aid office does. The city can also work with smaller affordable developers to help them navigate these highly complex processes and consider consolidating philanthropic and other private funding sources as well. In addition, establishing professional management of city-owned land and other real estate assets, as New York City, London, Copenhagen, and Stockholm have done, can generate additional revenue for affordable housing. There are 14,000 publicly owned parcels in the City of LA, and slightly more than half are owned by the city itself.[20] Professional management of this real estate can identify suitable city-owned sites for affordable developments; other sites can be developed commercially, with the returns channeled back into affordable housing.

6. **Strengthen the safety net for the most vulnerable tenants.** Los Angeles will need to redevelop many existing properties to add more affordable housing. But that raises the issue of what happens to current low-income residents during construction. We take it as an underlying principle that redevelopment should not ultimately force them out of their neighborhood. While affected tenants are entitled to compensation from developers if they have to move out due to construction, they may need additional assistance in finding a new unit. The LA Homeless Services Authority has developed a "coordinated entry system" to match homeless individuals with affordable housing units funded by the city. Now the city may need to establish a similar program for a wider population of at-risk tenants. LA's Housing + Community Investment Department is currently building an online inventory of all non-subsidized affordable units to provide a single platform for tenants to apply; this effort could be scaled up and accelerated. Los Angeles also needs to monitor two additional issues: expiring affordability covenants and tenant eviction. Between 2019 and 2023, more than 10,000 affordable units across the city will convert to market rates as their 30-year affordability covenants expire, threatening to displace more tenants and set back progress. A citywide strategy and program can work with neighborhoods to extend those covenants or place affected tenants in new affordable units nearby, making case-by-case assessments. HCIDLA's 2018-21 strategic plan provides a foundation for what could be an effective citywide initiative. Los Angeles can also consider providing free legal assistance to low-income tenants facing unnecessary evictions, similar to programs

[20] See Property Panel, City of Los Angeles Controller's Office, lacontroller.org/propertypanel.

in New York, San Francisco, and Newark.[21] LA County has instituted landlord incentives such as deposit payments, an emergency fund for any potential damage in the units, and one-time rent payments to curb evictions. These programs can be replicated regionwide.

The Southern California region is currently undergoing the sixth Regional Housing Needs Assessment (RHNA) process for the eight-year cycle that will run from 2021 to 2029. In November 2019, the Southern California Association of Governments finalized its allocation methodology for this cycle, giving LA County an overall housing production goal of 818,943 units. Out of this total, 475,694 units should be affordable to households earning less than 120 percent of the area median income.[22] These targets are more than four times higher than the previous cycle's goals. At the current pace, it would take LA County more than 35 years to hit an overall housing production goal it is meant to achieve in an eight-year period.[23]

Meeting higher RHNA goals in the decade ahead will require a significant increase in construction and investment. In general, building more, increasing density, and capitalizing on set-asides in private-sector developments will improve the region's chances of meeting its goals in a timely manner—with fewer public- and social-sector dollars.

4.5x

increase in the county's build rate required to achieve its sixth-cycle RHNA goals

LA County would have to increase its build rate by a minimum of 4.5 times, adding almost 102,000 units per year, to achieve its overall housing production goal for the upcoming cycle. It can meet the affordable housing component of this total in two ways: through public financing and through market-driven developments with set-asides for affordable units.[24]

Meeting 100 percent of the county's affordable housing goal through public financing of standard units alone would require more than $130 billion over the eight-year cycle. The alternative is taking steps to achieve a portion of this goal through the private market. LA County could adopt an incentive program similar to the Transit Oriented Communities provision in Measure JJJ, which has already had success in the City of LA. If the county fully meets its goals for adding new housing geared to above-moderate-income households, it would gain enough set-asides to meet almost 9 percent of its affordable housing goal.[25] If the region adopts new housing formats and lower-cost construction techniques as described above, it could achieve up to 17 percent of its affordable housing goals through set-asides.[26] This shift would also help to produce housing that is affordable to moderate-income households, approximately 28 percent of the affordable housing goal, without the need for public subsidies.[27]

If these approaches are combined, Los Angeles could potentially achieve almost 45 percent of the next cycle's affordable housing target through market-driven development alone. Covering the remaining 55 percent of the RHNA target for new affordable units would require

21 The Los Angeles City Council is considering a proposal to create a "right to counsel" program offering legal advice and emergency payments to keep struggling renters in their homes. The Los Angeles County Board of Supervisors is exploring a similar proposal.

22 "SCAG approves modified plan for allocating 1.34 million units as part of the 6th cycle RHNA process," Southern California Association of Governments press release, November 7, 2019.

23 In the 5th cycle RHNA, covering 2014 to 2021, LA County was given the goal of producing 179,881 total housing units, of which 103,184 were meant to be affordable to households earning less than 120 percent of the area median income. Based on the data from the California Department of Housing and Community Development, LA County's averages during this period were 22,500 units permitted annually, of which 2,700 were affordable.

24 The affordable housing goal is defined as the number of units that should be affordable to households earning less than 120 percent of area median income.

25 This estimate assumes that LA County builds all of the above-moderate-income units allocated in the 6th cycle (343,249 units), with 80 percent of these units added in multifamily developments near transit that follow set-aside requirements similar to those set in the Measure JJJ's Transit Oriented Communities incentive program.

26 This estimate assumes that LA County builds all of the above-moderate-income units allocated in the 6th cycle (343,249 units), with 80 percent of these units added in multifamily developments near transit but follow a higher 30 percent set-aside requirement.

27 Our analysis shows that accessory dwelling units, bungalow-style housing, conversions of single-family homes into multiplexes, and micro-units in multifamily developments can be affordable to moderate-income households (those earning 80 to 120 percent of area median income).

$41 billion to $81 billion in subsidies over the eight-year period.[28] The size of this range reflects variations in housing formats, whether lower-cost construction techniques are used, and the level of affordability desired.

The combination of density around transit, innovative construction techniques and housing formats, and higher set-aside requirements could be a powerful one to attract private investment in both moderate-income housing and deed-restricted low-income housing. Policy makers can consider giving projects that follow this model by-right approvals and incentives. When the state and city took broad action to allow accessory dwelling units, permit applications shot up citywide, a positive trend that could be replicated on a bigger scale with micro-units and prefab construction. Public dollars could then be directed toward efforts to support households with more acute needs such as supportive services, rental assistance, preservation, and eviction support.

Los Angeles also needs to change the way the community engages. Public meetings are often dominated by the loudest anti-growth voices. But everyone needs to be heard, including local employers and workers who are priced out. In a more technology-driven age, the city can conduct digital surveys and create apps to keep the public informed and invite comments while reducing design iterations. While some communities have fought against adding shelters to get homeless people off the streets, things have gone more smoothly in Glendale and other communities where innovative programs have built goodwill. It may take similar creativity, communication, and community education to build consensus on what Los Angeles needs to build and why.

The combination of density around transit, innovation in housing formats and construction techniques, and higher set-aside requirements could deliver more affordable housing through private development.

Los Angeles needs to speed up its metabolism and take an "all of the above" approach to meeting its housing challenge. Increasing the build rate is a must. Since dramatically ramping up construction will affect labor demand, the region should take steps to bolster the local workforce in the construction industry to mitigate the risk of shortages.

The region's fragmented housing ecosystem needs to become more cohesive and easier to navigate. A public-private-social delivery coalition could be the catalyst needed to bring about this change. It should bring together for-profit and nonprofit developers, builders,

[28] The higher end of this range assumes all units are standard-size (970-square-foot) units. The lower end assumes that 60 percent of the units are standard size, 20 percent are micro-units, and 20 percent are co-living units. The funding estimate changes if these ratios shift.

relevant city agencies, and neighborhood representatives—plus the region's major employers, its architecture community, digital innovators, investors, and philanthropists—to create consensus and drive progress. This kind of entity, perhaps united in one space, can provide technical assistance and serve as a forum for difficult conversations regarding trade-offs. More broadly, it could serve as an incubator of ideas and a vehicle for ensuring accountability. All stakeholders in the coalition must commit to the overarching public good of meeting LA's affordable housing needs, recognizing that it will take collaboration and compromise.

Our initiative provides a fact base that can inform the region's road map forward. We measure the size and economic impact of the problem, propose a set of options for boosting the production of affordable housing, and explore how to bring that vision to reality. Los Angeles needs decisive action to ensure that residents of all income levels can count on finding a decent place to call home.

1. Measuring LA's affordability gap and its impact

Imagine an ambulance driver and a retail worker with full-time jobs, living in a one-bedroom apartment in East LA. With a toddler and a second child on the way, they want a bigger place. To keep their housing costs at a level considered affordable on their combined income of $55,000 a year, they need to find a place that rents for less than $1,375 a month. But in August 2019, the typical two-bedroom in Los Angeles was going for $3,050—and for far more in the Westside neighborhoods where the couple work. Their choices come down to squeezing a growing family into a small space, resigning themselves to a long daily commute, or allocating a dangerously large share of their take-home pay to rent every month. With the median single-family home in Los Angeles County going for more than $690,000, the couple does not even entertain the American Dream of homeownership.[29]

Or consider the dilemma faced by a 73-year-old widower who has been in his rent-controlled Silver Lake apartment for decades. Now the building has been sold to a new owner with plans to redevelop the property, and he has been given notice to vacate. Although he is entitled to relocation assistance, rent for a small market-rate unit in his longtime neighborhood runs higher than his entire monthly Social Security check.[30]

>90%

of new units permitted in the city from 2014-18 were not affordable

A construction boom has steadily added new residential buildings. From 2014 to 2018, the City of Los Angeles produced more than 70 percent of all new units in LA County, despite accounting for only 40 percent of the its population.[31] But more than 90 percent of the units permitted in the city during this five-year period were geared to more affluent renters and buyers.[32] Construction of affordable homes, by contrast, has not kept up with demand. Fewer than 7,300 units permitted during that same period are affordable for households making less than 120 percent of the area median income.

High housing costs are causing real economic losses and daily trade-offs for individual residents and for the region as a whole. From 2013 to 2017, median rent in LA County increased by 9.7 percent annually, while median household income increased by only 2.4 percent.

We estimate that one million households in the City of Los Angeles (and 1.9 million across LA County) face an affordability gap—that is, they would have to stretch beyond 30 percent of their income to secure a standard-size market-rate unit in their current neighborhood. Soaring housing costs are limiting other types of household consumption, hampering the local economy. They also force many people into accepting long commutes, which produce emissions and air pollution. Angelenos lose precious time every day fighting through some of the nation's worst traffic.

29 Rental prices and home values based on 2019 Zillow data.
30 See Andrew Khouri and Colleen Shalby, "Seniors facing eviction fear homelessness and isolation as California's housing crisis rolls on," *Los Angeles Times,* August 29, 2019.
31 Based on annual progress reports submitted to the California Department of Housing and Community Development, 2014 to 2018.
32 Los Angeles Department of City Planning, annual housing progress report to California Department of Housing and Community Development, 2018.

Stakeholders across the region agree that the current path is unsustainable. Consensus is growing that LA's approach to housing needs rapid and radical change. Today, the state is setting much higher housing production targets, and the Department of City Planning is in the process of updating dozens of community plans. The time is right to think creatively, clear away impediments, and assemble coalitions to ensure that Angelenos in every income bracket have sustainable housing options.

Box 1.

About this research

This report analyzes the scope of LA's affordable housing shortage and provides a set of options for debate. We assess the region's land availability and analyze developer economics to lay out a vision for what is possible. We also offer a set of potential solutions that could help the city produce more affordable housing units and do it faster, providing much-needed relief to financially burdened residents and stabilizing the city's economic future. Our aim is to highlight opportunities for greater efficiency—and to start a constructive civic dialogue that can get all stakeholders working together toward a common goal.

This report should not be read as a critique of city and county agencies or processes. It does not propose another housing production target, nor does it address the full range of issues connected with homelessness. Instead, it suggests a path for Los Angeles to accelerate affordable housing production in line with goals set by the state's Regional Housing Needs Assessment process while minimizing the need for taxpayer dollars.

More than one million households citywide cannot afford market-rate units in their own neighborhood

~70%

of households in the city fall into the affordability gap

The affordability gap has grown to such proportions that it now affects roughly 70 percent of the 1.4 million households in the City of Los Angeles (Exhibit 1). We find that almost one million of those households could not obtain a standard-size market-rate unit in their current neighborhood without a financial stretch.[33]

The mismatch grows even bigger when we consider the entirety of LA County, which includes a number of separately incorporated cities where housing costs soar even higher. Roughly 1.9 million households across the county (out of 3.4 million in total) fall into the affordability gap. Among them, 1.4 million are renters.

Our estimate of the affordability gap is 46 percent higher than the 685,000 households in the City of Los Angeles classified as "cost burdened" by the US Department of Housing and Urban Development (HUD). The cost-burden measure looks at whether households are actually spending more than 30 percent of income on housing costs today. It captures the extent to which those higher costs are currently causing financial strain. Using a methodology similar to the one used by HUD, the California Housing Partnership took a countywide view and categorized one million renter households as cost burdened.[34]

Our analysis of the affordability gap complements the cost-burden view. It accounts for the fact that many Angelenos have already adapted to high prices over the years by accepting

[33] A standard unit is defined as 970 square feet. We assume that this is adequate space for an average household of three, in line with existing housing under programs such as the Mitchell-Lama affordable housing initiative. This standard also helps in normalizing for the variations in size across one-, two-, and three-bedroom units. A unit is considered unaffordable when the rent or mortgage payment exceeds 30 percent of household income, a benchmark used by the World Bank and the US Department of Housing and Urban Development.

[34] *Los Angeles County annual affordable housing outcomes report,* California Housing Partnership, April 2019.

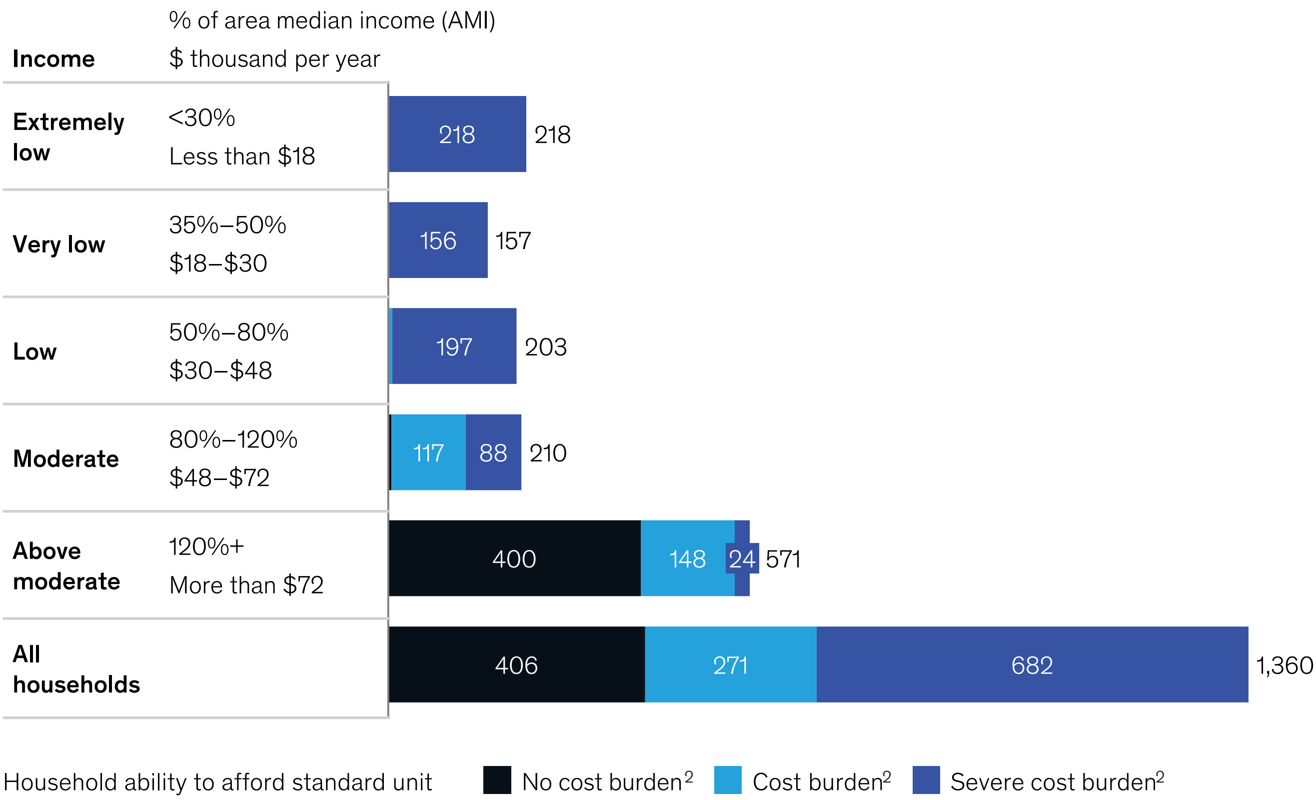
substandard housing or moving far from where they work. Residents who keep their housing costs within affordability guidelines by resorting to these strategies do not show up as cost burdened, but the affordability gap captures their inability to obtain standard-size units in today's real estate market. Many Angelenos who can manage their housing costs today would not be able to replicate that situation if they had to move into a standard market-rate unit. The affordability gap therefore reflects growing precariousness among LA residents.

Exhibit 1

Almost one million households in the City of Los Angeles are unable to afford standard market-rate housing in their current neighborhood.

LA households by ability to afford a standard housing unit[1]

Thousand



1. A "standard" unit is defined as 970 sq ft, a benchmark used by New York's Mitchell-Lama Housing Program. Our calculations are based on prevailing market rents and mortgage payments per square foot in each neighborhood.
2. Per benchmarks used by the US Department of Housing and Urban Development, a household is "cost burdened" when housing costs exceed 30% of gross household income. A household is considered "severely cost burdened" when housing costs exceed 50% of gross household income.

Note: Data labels ≤5 not shown. Figures may not sum to 100% because of rounding.
Source: US Census Bureau; Zillow; McKinsey Global Institute analysis

The one million households facing the affordability gap do not include those who want to move to other neighborhoods for a better quality of life. Many Angelenos have highly constrained options for moving to other parts of the city if they want to enroll their children in different schools, shorten their commutes, or enjoy nicer surroundings. The need to hold on tightly to a good deal can crowd out other goals.

Furthermore, the affordability gap may grow in the years ahead as new households come into the picture. Newcomers to Los Angeles often face sticker shock and have to make compromises in their living situations to gain a foothold. The artists, actors, writers, musicians, and other creative types who have always flocked to Southern California to pursue their dreams in the entertainment industry face greater barriers than ever before.

Housing costs have also become a significant hurdle for young adults who want to start their own households. Many of them are scaling back their aspirations and delaying life plans as a result. Outmigration is increasing. According to data from Apartment List, more than 10 percent of LA residents interested in moving out of the city searched for rentals in Seattle, Dallas, and Phoenix. If young people give up and leave altogether, the region will find itself with an aging population and diminished cultural and economic vitality. Los Angeles needs to ensure that the next generation has more viable options to avoid a situation in which employers cannot attract and retain young talent.

Most of those facing the affordability gap are low-income renters

A closer look at who exactly falls into the affordability gap reveals that almost all LA households earning the area median income or less would face financial strain if they had to obtain a standard market-rate unit in their current neighborhood. This is in line with findings from the California Housing Partnership, which found that renters would need to earn 3.6 times the local minimum wage to afford the median asking rent in LA County without stretching.[35] The Federal Home Loan Mortgage Corporation (Freddie Mac) found Los Angeles to be one of the most unaffordable places to live in the United States relative to typical incomes.[36] The people who provide many of the services Los Angeles depends on every day are finding it hard to get by or to live anywhere near where they work.[37]

More than three-quarters of the city's renting households fall into the affordability gap. While many homeowners are burdened, renters are subject to rent increases, changes in building ownership, and redevelopment plans. A sharply rising real estate market has created incentives for many property owners to sell and convert older affordable housing stock.[38]

While all LA households in the low-income category and below would encounter difficulty in their local housing market, the affordability gap extends beyond those brackets. It affects almost 210,000 LA households making 80 to 120 percent of the area median income. Almost 140,000 of them are renters. While numerous policies and programs are geared to assisting residents in the lowest income brackets, affordable options for the "missing middle" are an important part of the city's future planning.

We recognize that encouraging home ownership is an important goal to help more people build wealth over the long term and realize the American Dream. We believe the solutions proposed in this report will create new opportunities to further that goal as the supply of housing increases. However, many factors beyond housing supply affect the rate of home ownership, making this issue beyond the scope of this report.

The affordability gap is highest in neighborhoods close to Downtown

The affordability gap exists across the entire City of Los Angeles. But the issue is highly pronounced in certain neighborhoods—most notably those in proximity to Downtown (Exhibit 2).

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35 Ibid. The area median household income roughly equates to both members of a couple working full-time minimum-wage jobs. Note, however, that the City of Los Angeles recently raised its minimum wage to $13.25 an hour for employers with 25 or fewer employees and $14.25 for larger employers, with an additional increase scheduled for 2020.

36 Freddie Mac Multifamily, "Rental burden by metro," April 2019.

37 See, for example, *How permanent tenant protection can help communities prevent homelessness and resist displacement in Los Angeles County,* Public Counsel and the UCLA School of Law Community Economic Development Clinic, June 2019.

38 See, for example, Zole Matthew, "Amid LA's housing crisis, developers are demolishing affordable homes to build upscale hotels," *Los Angeles Magazine,* September 3, 2019.

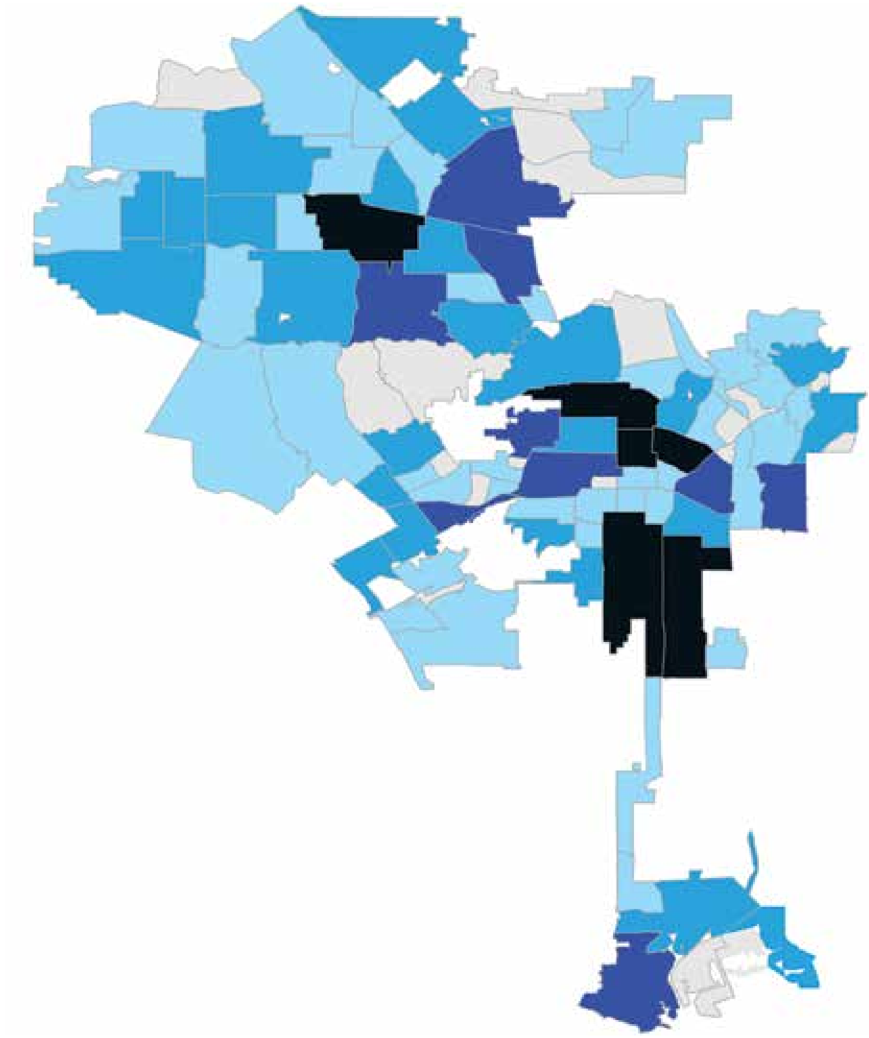
Exhibit 2

The affordability gap exists throughout Los Angeles but is most acute in neighborhoods near Downtown.

Households unable to afford a standard housing unit

Thousand

- 0–2.5
- 2.6–10.0
- 10.1–15.0
- 15.1–25.0
- >25.0



Top 10 LA neighborhoods with the highest affordability gap

	Households: Total	Unable to afford standard unit without cost burden[1]	Unable to afford standard unit without severe cost burden[2]
Hollywood	64,600	55,900	42,600
South Los Angeles	59,200	46,900	36,200
Southeast Los Angeles	44,800	37,600	30,600
Koreatown	37,200	31,100	24,500
Westlake	34,800	29,400	24,200
Van Nuys	34,300	26,900	19,300
Mid-City	32,500	23,100	17,000
North Hollywood	30,000	22,500	16,200
Sherman Oaks	36,700	20,300	13,300
San Pedro	30,900	19,500	13,600

1. Number of households that would have to expend more than 30% of their income to afford a market-rate standard unit (970 sq ft) in the current neighborhood.
2. Number of households that would have to expend more than 50% of their income to afford a market-rate standard unit (970 sq ft) in the current neighborhood.

Note: Neighborhood boundaries based on the *Los Angeles Times*' "Mapping LA" project.
Source: American Community Survey; Experian Q3; *Los Angeles Times*; Zillow; McKinsey Global Institute analysis

Hollywood tops that list. One of LA's most iconic neighborhoods, it is gentrifying. Eighty-six percent of Hollywood's 64,600 households would have to stretch beyond their means to move to a standard unit within the neighborhood, and two-thirds of them would have to allocate more than half of their income for a standard-size unit. In a story that is emblematic of the citywide crunch, the Hollywood Community Housing Corporation recently redeveloped a historic hotel into 54 affordable apartments geared to households making well below the area median income; the project was immediately deluged with 800 applications and will select occupants by lottery.[39] (See Chapter 4 for more in-depth discussion of how solutions might play out in Hollywood.)

Other neighborhoods in proximity to Downtown with notably large affordability gaps include South LA, Koreatown, and Westlake. The neighborhoods of Southeast LA also stand out as problem areas. In the San Fernando Valley, some of the most stressed neighborhoods include Sherman Oaks and Van Nuys.

The affordability gap has major repercussions for households and drains $18 billion to $22 billion from LA's economy each year

Angelenos are paying

$6B

more for housing each year than their incomes can sustain

Based on an analysis of household incomes and rents within each neighborhood in Los Angeles, we estimate that households across the city are paying an additional $6 billion toward housing over the level that would be sustainable (defined as 30 percent of their household income).

Many Angelenos who cannot find decent places to live within their budget in central parts of the city move to more affordable periphery neighborhoods. But in a city with limited public transit and some of the nation's worst traffic congestion and highest gasoline prices, moving farther afield can drive up commuting costs in a significant way. The Center for Neighborhood Technology finds 91 percent of LA households are spending more than the recommended 15 percent of their income on transportation.[40] Longer commutes also take a toll on the environment and personal health.

When a large share of a household's income is earmarked for housing and the daily commute, other basic necessities can get crowded out. One study from the LA County Department of Public Health found that more than one-third of adults who had difficulty paying their rent or mortgage could not afford medical care for health problems. Furthermore, people in the lowest income cohort who struggled to afford their housing costs were two and a half times more likely to be food insecure than those with more affordable housing.[41]

We estimate that curtailed consumption costs the City of Los Angeles between $18 billion and $22 billion per year in lost economic output. This figure almost doubles for all of LA County.[42] People in lower income cohorts typically spend any money left over after paying their rent or mortgage on essential goods and services such as food, healthcare, household goods, and clothing.[43] When they are housing cost burdened, they must forgo some of that highly localized spending. Not only is their direct spending lost; its multiplier effect on the economy is lost as well.

39 Pauline O'Connor, "Handsome new affordable housing complex the Coronel makes its Hollywood debut," Curbed, August 26, 2019.
40 See the Center for Neighborhood Technology's Housing and Transportation Affordability Index at htaindex.cnt.org.
41 *Social determinants of health: Housing and health in Los Angeles County,* LA County Department of Public Health, February 2015.
42 We estimate that housing costs depress the entire county's GDP by up to 4 to 5 percent, costing it between $32 billion and $36 billion per year in lost output. Almost 60 percent of this occurs in the City of LA, which represents around 40 percent of the county's population. The loss to county-level GDP was calculated assuming a countywide GDP of $700 billion and $800 billion, based on US Bureau of Economic Analysis data for 2015. See the technical appendix for methodology.
43 Lower-income households have a higher marginal propensity to consume than the income cohorts receiving rental income. The latter tend to have higher savings rates.

Our estimate of lost economic output is a conservative one since it factors in only reduced consumption. But the affordable housing shortage creates two other significant costs: it makes it harder for employers to retain talent, and it feeds into the spiral of homelessness (see Box 2, "The rising cost of housing and the crisis on LA's streets").

Over the past five years, the LA metro area added four times as many net jobs as housing units.[44] Limited housing options and high costs near the city's major employment centers mean that fewer workers have easy access to the opportunities concentrated in these areas. Because many are forced to live farther from their jobs, they lose hours of potentially

Box 2.

The rising cost of housing and the crisis on LA's streets

Homelessness in Los Angeles has reached epidemic proportions. It has become commonplace to see tents pitched on sidewalks, often just a stone's throw from luxury buildings and upscale boutiques. Along major thoroughfares, people are living out of cars and RVs. Meanwhile, residents and local business owners are increasingly frustrated as encampments mushroom around them, affecting their own quality of life.

Despite the best efforts of local officials and nonprofits, as well as the passage of a $1.2 billion homeless housing bond measure in 2016, the problem continues to spiral. Although more than 21,000 formerly homeless people were placed into permanent housing in the past year, the latest count conducted by the Los Angeles Homeless Services Authority found more than 36,000 homeless people across the city, a jump of 16 percent from the previous year's count. Homelessness across the entirety of LA County rose by 12 percent, to almost 59,000 people.[1] The city has fewer than 10,000 emergency shelter and transitional housing beds, which leaves thousands of people sleeping unsheltered on any given night. More than 1,000 of them have died on the county's streets so far this year.[2]

Homelessness is the product of multiple intertwined issues. Many homeless individuals struggle with mental illness and addiction. But others have been pushed out of their homes by economics, and the high cost of housing is a contributing factor. The loss of a job or an unexpected major expense can topple people living near the poverty line into homelessness—and once that occurs, the lack of affordable local housing options makes getting back on their feet and into a stable situation that much harder.

A recent study by Zillow found that homelessness rises faster in cities where people spend more than 32 percent of their income on rent.[3] McKinsey's own recent work on this issue in Seattle shows that homelessness in that city has increased in line with rising fair-market rents.[4] As in Los Angeles, the city has been booming, but economic growth has not lifted all boats.

Los Angeles is chipping away at the problem from multiple angles. The county, for instance, established the Flexible Housing Subsidy Pool (Flex Pool), one of the few locally funded permanent rental-subsidy programs in the country; it has served more than 7,000 people who have experienced homelessness.[5] All levels of state and local government have devoted more resources to building supportive housing. Since Proposition HHH was passed in 2017, the city has been putting that funding to work in building emergency shelters and permanent supportive housing in multiple locations.

Despite this progress, community resistance has slowed some projects, and development costs have escalated to almost $500,000 per unit in others.[6] Finding ways to accelerate the pace of construction at a lower cost—and to prevent households on the edge from falling into homelessness in the first place—will be critical to ending the humanitarian crisis unfolding on LA's sidewalks.

1 Los Angeles Homeless Services Authority, "Even as housing placements reach new heights, 2019 Greater Los Angeles homeless count shows 12 percent rise in homelessness," press release, June 4, 2019.
2 Steve Lopez, "He died Sunday on a West LA street. He was homeless. He is part of an epidemic," *Los Angeles Times*, September 4, 2019.
3 Chris Glynn, Thomas Byrne, and Dennis P. Culhane, "Priced out: Homelessness rises faster where rent exceeds a third of income," Zillow Research, December 11, 2018.
4 Maggie Stringfellow and Dilip Wagle, "The economics of homelessness in Seattle," McKinsey.com, May 2018.
5 *Los Angeles County annual affordable housing outcomes report,* California Housing Partnership, April 2019.
6 Doug Smith, "Rising costs threaten LA's homeless housing goal," *Los Angeles Times,* May 11, 2018.

44 US Census Bureau, Building permits survey (2010–18); US Bureau of Labor Statistics, State and area seasonally adjusted employment, hours, and earnings (2009–18).

productive time each week to commuting. A survey of major local employers conducted by Los Angeles Business Council revealed that three-quarters of respondents believe that the high cost of housing has become an important challenge for retaining employees.[45] Several years ago, Toyota left LA County for Texas, with some reports speculating that the top reasons included lower housing costs for employees.[46] A recent UC Berkeley poll found that more than half of registered voters in California are contemplating leaving the state—and more than 80 percent of those young adults cite the high cost of housing as a major factor.[47]

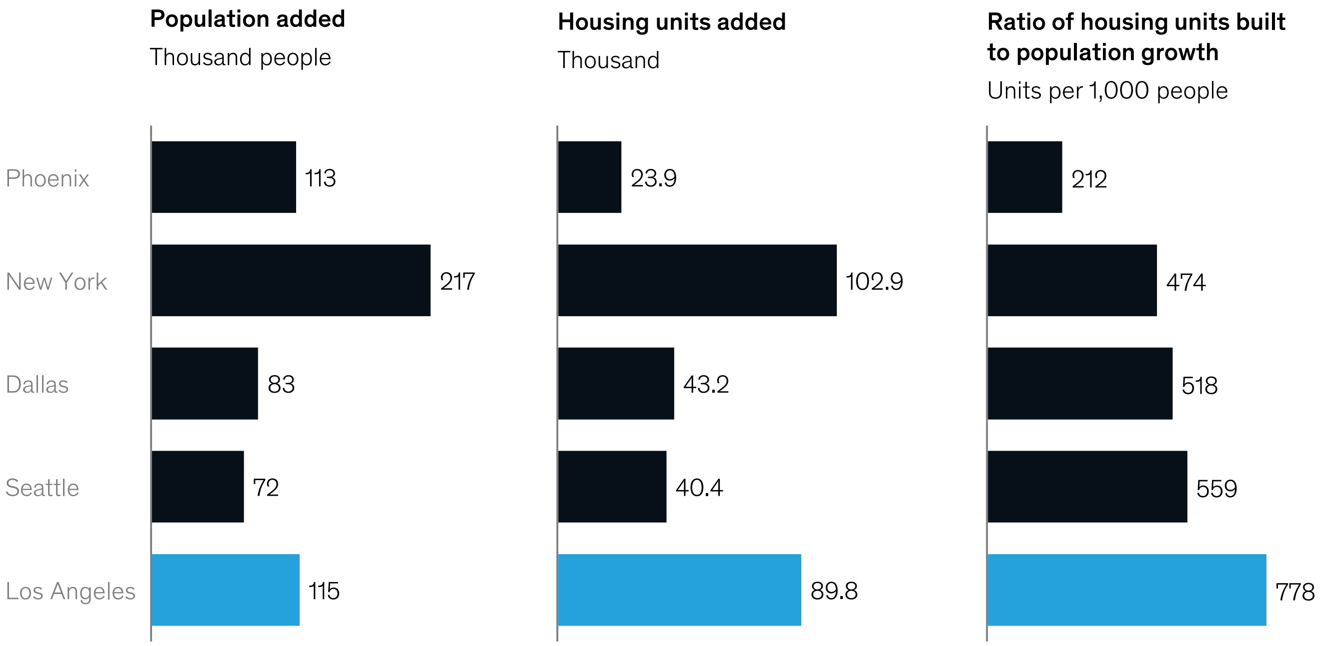
Los Angeles is denting the problem, but it needs bigger and bolder action

LA has been ramping up residential construction in recent years. In fact, from 2013 to 2017, it added more units than peer cities, with the exception of New York (Exhibit 3).

Exhibit 3

Los Angeles has added more housing to accommodate population growth than many peer cities.

Housing units added relative to population growth, 2013–17



Note: Peer cities have similar populations to Los Angeles and were top destinations for households emigrating from Los Angeles to other cities (outside of California).
Source: Experian; US Census, 2013–17; McKinsey Global Institute analysis

But most of the new units being added are not targeted at the income brackets where the need is greatest (Exhibit 4). A city of four million people added fewer than 7,300 units of affordable housing over the most recent five-year period. This falls far short of the current Regional Housing Needs Assessment (RHNA) goals for Los Angeles set by the state, which were modest relative to the number of cost-burdened households (see Box 3, "Understanding the Regional Housing Needs Assessment allocation").

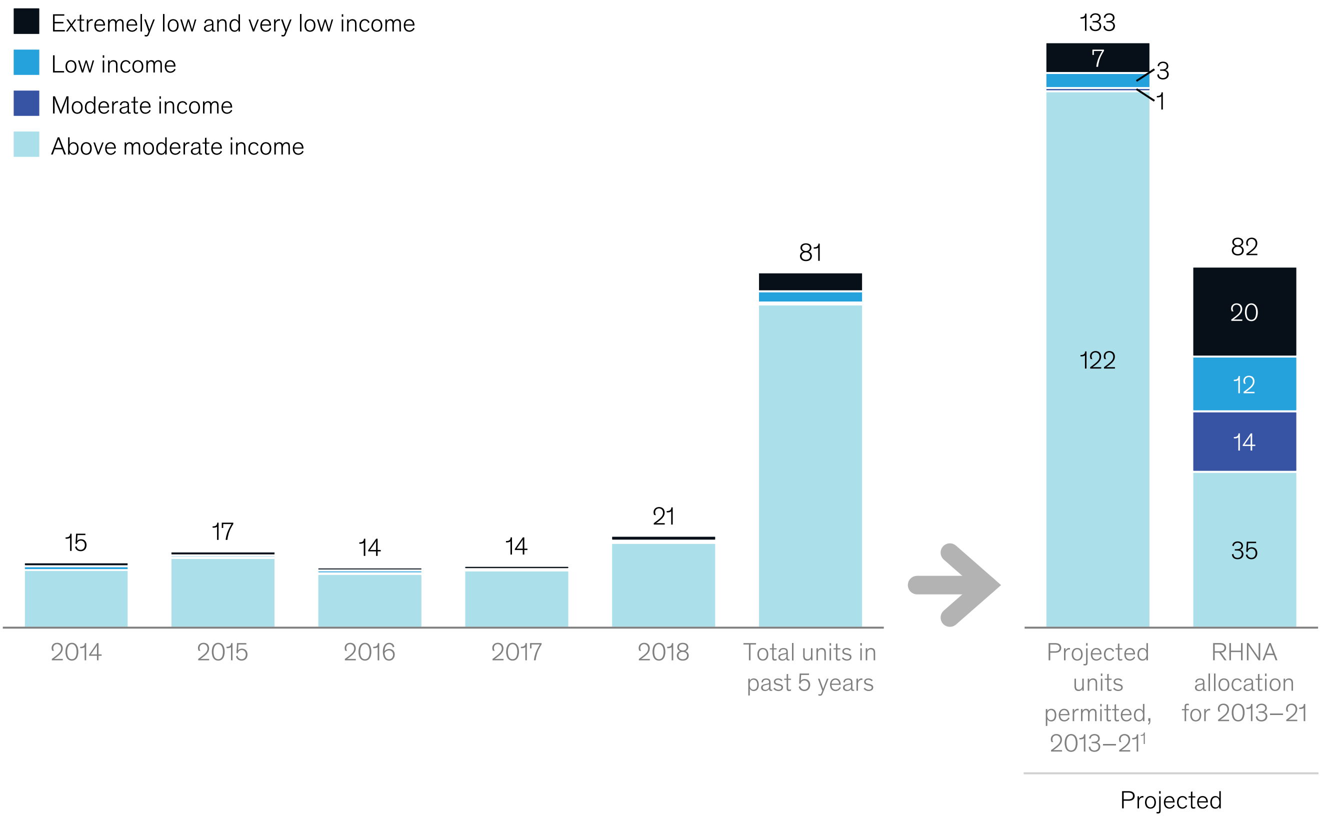
[45] *The affordable housing crisis in Los Angeles: An employer perspective,* Los Angeles Business Council Institute, 2017.
[46] Bill Hethcock, "Here's the main reason Toyota is leaving Torrance," *Los Angeles Business Journal,* December 14, 2015.
[47] Berkeley Institute of Governmental Studies poll, September 2019.

Exhibit 4

More than 90 percent of housing units added in the City of Los Angeles over the most recent five-year period are affordable only to households making above the area median income.

Units permitted in the City of LA by affordability to income cohort

Thousand units



1. Projection assumes current rate of permitting continues at an average annual rate based on 2017 and 2018.
Note: Figures may not sum to 100% because of rounding.

Source: Regional Housing Needs Assessment annual progress reports submitted by the City of Los Angeles to the California Department of Housing and Community Development; McKinsey Global Institute analysis

Housing construction has been picking up. The Transit Oriented Communities (TOC) incentives in Measure JJJ have added momentum since their adoption in 2017 by allowing developers to build larger projects near transit stops if they set aside a greater number of affordable units.[48]

However, given the size of today's gap plus expected population growth, the current pace of construction will not be enough to ease the strain, nor to achieve the goals set through the RHNA process.

[48] Andrew Khouri, "A little-noticed zoning twist is set to spark a home-building boom in LA," *Los Angeles Times*, May 26, 2019. Note that Measure JJJ is time limited and will expire in 2027. It can likely be renewed for another five years but will expire after that. The city can consider making the program permanent by folding it into another formal density bonus program or into other local plans. Other cities throughout the county can also adopt similar incentive programs to capitalize on Metro expansions in their areas.

Box 3.

Understanding the Regional Housing Needs Assessment allocation

Since 1969, California has required all city and county governments to make adequate plans to meet the housing needs of everyone in the community. In order to create a housing plan (also known as a housing element), a jurisdiction needs to know how many housing units should be added at a variety of affordability levels. This is determined by a process called the Regional Housing Needs Assessment (RHNA).

RHNA is based on the existing housing gap in a given region plus an estimate of its future needs based on anticipated population and income growth. Jurisdictions use RHNA in land use planning, prioritizing local resource allocation, and deciding how to grow in the future.

The California Department of Housing and Community Development is responsible for conducting the housing needs assessment for each region's planning body (known as a "council of governments," or COG). Once the department and the COG have agreed on the region's housing target, the COG takes over and divides the regional goal into more detailed targets for each city and county in the region it governs. The Southern California Association of Governments (SCAG) is responsible for allocating RHNA goals to various jurisdictions across the LA region. Each local city council or board of supervisors must prepare an annual RHNA progress report.

Today, California is in the fifth cycle RHNA allocation plan, which covers 2013 to 2021. The sixth cycle plan, which is currently under development, will cover October 2021 through October 2029. In November 2019, SCAG finalized its allocation methodology for this upcoming cycle, giving LA County an overall housing production goal of 818,943 units. Out of this total, 475,694 units should be affordable to households earning less than 120 percent of the area median income.[1] These targets are more than four times higher than the previous cycle's goals.[2]

Recently passed legislation (SB35) holds local governments more accountable for meeting their RHNA goals. If they fall short, the state can impose a streamlined project approval process. Most cities and counties across the state are running behind: 511 out of 539 California jurisdictions would be subject to at least some form of SB35 streamlining, per the most recent statewide determination of progress against the RHNA goals.[3]

1 "SCAG approved modified plan for allocating 1.34 million units as part of the 6th cycle RHNA process," Southern California Association of Governments press release, November 7, 2019.

2 In the 5th cycle RHNA, covering 2013 to 2021, LA County was given the goal of producing 179,881 total housing units, of which 103,184 were meant to be affordable to households earning less than 120 percent of the area median income.

3 SB35 Statewide Determination Summary, California Department of Housing and Community Development, as of June 25, 2019.

Furthermore, the clock is ticking for many existing affordable units. By 2023, 10,673 units across the city are set to convert to market rates as the affordability covenants issued at the time of their development expire.[49] These covenants were produced through a variety of federal, state, and local subsidies, with more than half of them coming through the federal Section 8 program. Both Hollywood and Downtown stand to lose more than 900 units each over the next four years. Across the city, more than 10,000 households could lose a measure of financial stability and find themselves navigating a housing market in which rents have been soaring. Unless these units can be preserved, these expirations could set back the city's progress.

LA's housing market has grown distorted. The most visible and urgent symptom is the rising number of homeless people on the city's streets. But the invisible burden is growing, too, including household stress, lost economic output, and increased costs of doing business. High housing costs have been holding the region and its residents back. Stakeholders—including developers, builders, government, nonprofits, local businesses, and neighborhood groups—will have work together, compromise, and apply more creative solutions to ensure that Angelenos of all income brackets can have a decent place to call home.

[49] At-Risk Affordable Housing Database, Los Angeles Housing + Community Investment Department (HCIDLA), May 2019.

2. Reimagining Los Angeles: Where and what it's possible to build

In every crisis, opportunity is lurking. The affordable housing crunch is a major pain point for residents. But it can also spur positive change as the region attempts to address it. This is the moment to reimagine Los Angeles—and to build a region that is more inclusive, more mobile, and more accessible to newcomers.

That vision does not have to involve erecting high-rises on every open space. Much of the housing gap can be met with low- and mid-rise redevelopment that capitalizes on the ongoing expansion of public transit, perhaps supplemented with high-rises on select sites. LA can increase density without losing its essential character.

Los Angeles has ample capital available, but it needs to create a pipeline of development projects with sufficient returns to mobilize it. Greater density, particularly around transit, will be a critical element. But since the business case for building standard-size affordable units is unattractive for private developers and investors, the region must think outside that box, regardless of location. It can shift to nontraditional types of housing (such as micro-units and co-living developments), which can accommodate 2 to 3 times as many households in the same total square footage as standard properties. The combination of nontraditional units and prefabricated construction can reduce per-unit costs up to 50 percent—and bring more new housing online at a faster rate. At a time when public funding is scarce, these strategies can unlock additional development of affordable housing by the market.

Los Angeles has room to build

Increasing the number of affordable housing units starts with a fundamental question: Where will it all go? Fortunately, Los Angeles does have room to build under its existing zoning framework. The key will be matching available sites to the solution that is appropriate for its setting. In this report, we identify land potential in the City of Los Angeles. A similar analysis can be done at the county level and for other separately incorporated cities within it.

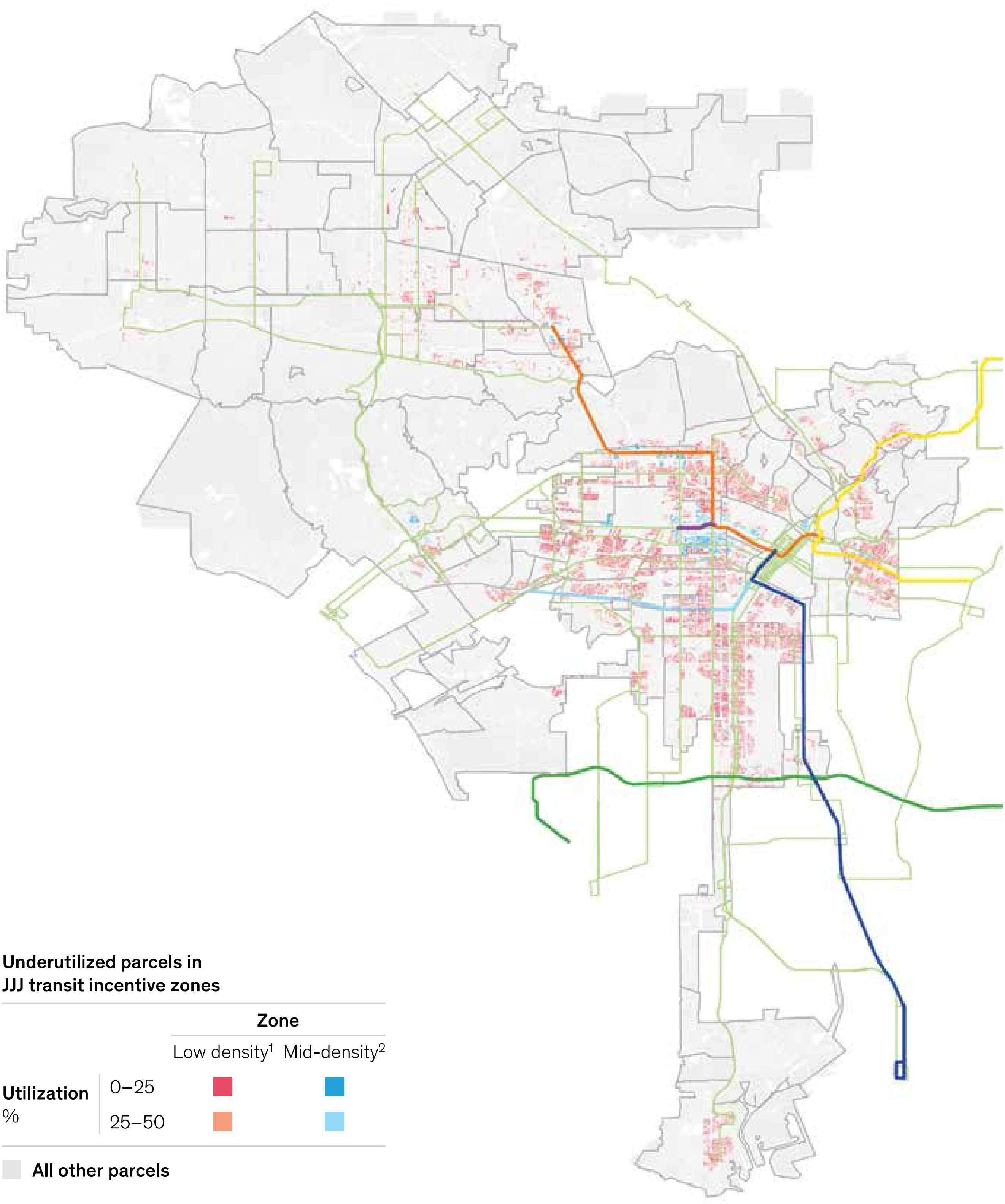
40,000

parcels near transit are highly underutilized under current zoning

Focusing on transit-oriented development is a top priority, capitalizing on the fact that the region is engaged in the largest infrastructure expansion in the nation. Building affordable housing in locations where residents have options for getting around without relying exclusively on their cars is critical for mitigating congestion. Across the city, more than 40,000 parcels of land near transit (as defined by Measure JJJ's Transit Oriented Communities incentives) are utilizing less than 25 percent of their maximum zoning allowance and could be candidates for redevelopment (Exhibit 5). Another 14,800 parcels utilize less than 50 percent of their allowance and could also be considered.

Exhibit 5

Across Los Angeles, some 40,000 parcels near transit utilize less than 25 percent of their zoning potential.



Underutilized parcels in JJJ transit incentive zones

		Zone	
		Low density[1]	Mid-density[2]
Utilization %	0–25		
	25–50		

All other parcels

Note: A parcel qualifies as "near transit" if it falls within Tier 1, Tier 2, Tier 3, or Tier 4 as defined in Measure JJJ Transit Oriented Community incentives. Utilization was estimated using the total number of current units on a given parcel divided by the maximum number of allowable units on the parcel (based on SCAG estimates).

1. Residential zones R2, R3, RD2, and RD3.
2. Residential zones R5, R6, RD4, RD5, and RD6.

Source: City Assessor's Parcel Data; Los Angeles County Metropolitan Transportation Authority; Measure JJJ legislation; McKinsey Geospatial Analytics; McKinsey Global Institute analysis

The 40,000 highly underutilized parcels identified above have the combined capacity for more than one million housing units through addition of low-rise and mid-rise buildings. In addition, building 20-story high-rises on just a quarter of the roughly 750 highly underutilized mid-rise parcels in TOC Tier 3 and Tier 4 zones would yield an additional 140,000 units.

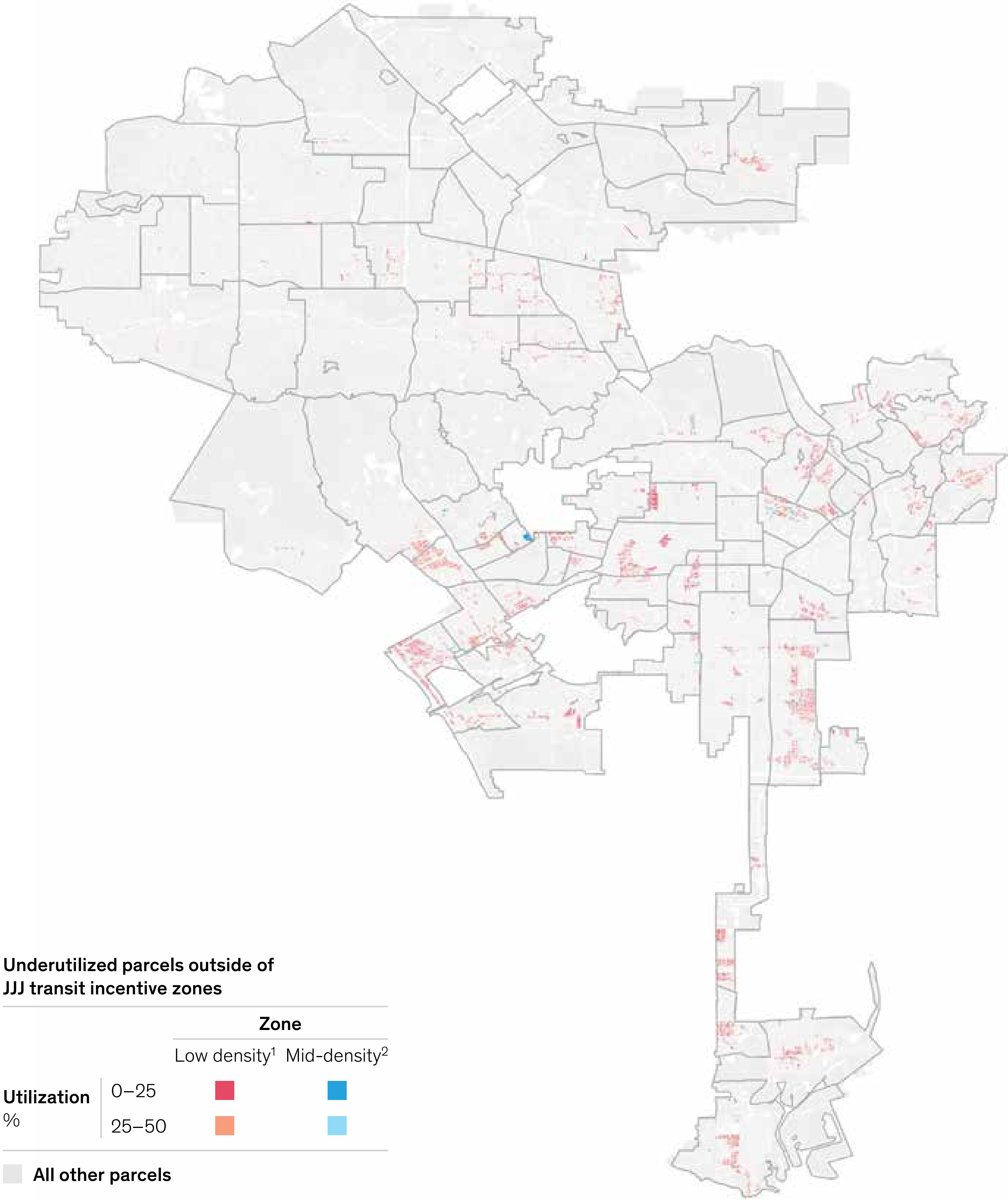
However, in a city where sprawl has spread faster than public transit, there are more opportunities to consider on land that is not in the immediate vicinity of a Metro rail or bus stop. Some 18,000 non-transit-adjacent parcels today utilize less than 25 percent of the maximum residential capacity allowed under current zoning (Exhibit 6). An additional 6,500 parcels are utilizing only 50 percent of the maximum zoning allowance.

Since single-family homes are the dominant housing type in many LA neighborhoods, more capacity can be unlocked by allowing homeowners to add accessory dwelling units (ADUs). Some large single-family homes can even be converted into multiplexes. More than 315,500 single-family homes in the City of Los Angeles could potentially add ADUs (Exhibit 7). Some 57,000 of them are on multifamily zoned parcels, meaning that they could potentially be converted into multiplexes. Obviously only a small fraction of these property owners will want to have a tenant on their property or will be able to invest in the necessary construction or renovation. But local officials can encourage the homeowners who are interested in undertaking these projects in a variety of ways, such as making preapproved designs publicly available and connecting homeowners with financing.

Much of the housing gap can be met with low- and mid-rise redevelopment that capitalizes on the ongoing expansion of public transit, potentially supplemented with high-rises on select sites.

Exhibit 6

Across Los Angeles, some 18,000 parcels in non-transit zones utilize less than 25 percent of their zoning potential.



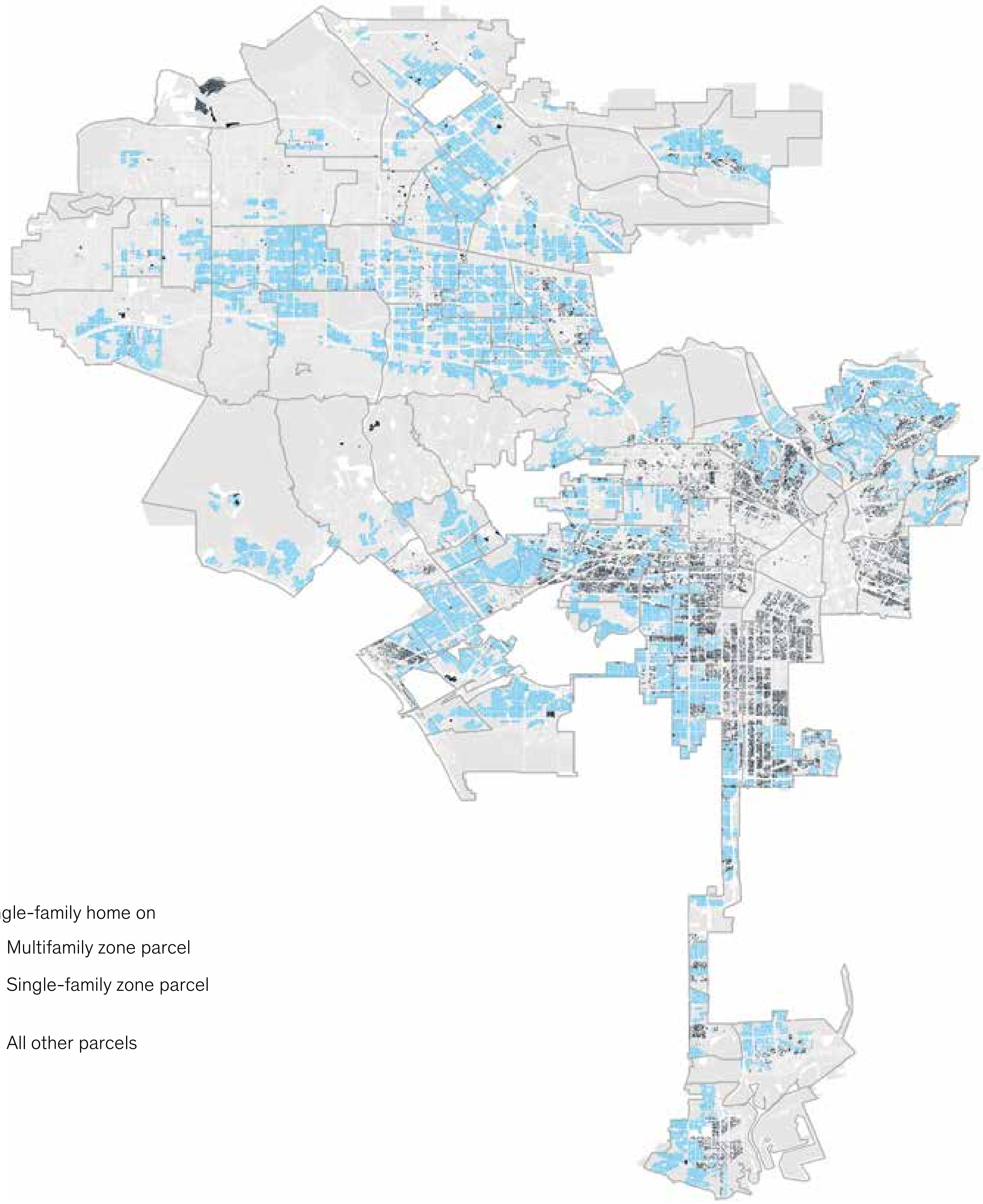
Note: A parcel qualifies as “near transit” if it falls within Tier 1, Tier 2, Tier 3, or Tier 4 as defined in Measure JJJ Transit Oriented Community incentives. Utilization was estimated using the total number of current units on a given parcel divided by the maximum number of allowable units on the parcel (based on SCAG estimates).

1. Residential zones R2, R3, RD2, and RD3.
2. Residential zones R5, R6, RD4, RD5, and RD6.

Source: City Assessor’s Parcel Data; Los Angeles County Metropolitan Transportation Authority; Measure JJJ legislation; McKinsey Geospatial Analytics; McKinsey Global Institute analysis

Exhibit 7

More than 57,000 single-family homes in the City of Los Angeles are on multifamily parcels.



Single-family home on

- Multifamily zone parcel
- Single-family zone parcel

- All other parcels

Note: Multifamily zone parcels include parcels in zones categorized as R2, R3, R4, R5, and R6, and the corresponding "D" zone codes.
Source: City Assessor's Parcel Data; Measure JJJ legislation; McKinsey Geospatial Analytics; McKinsey Global Institute analysis

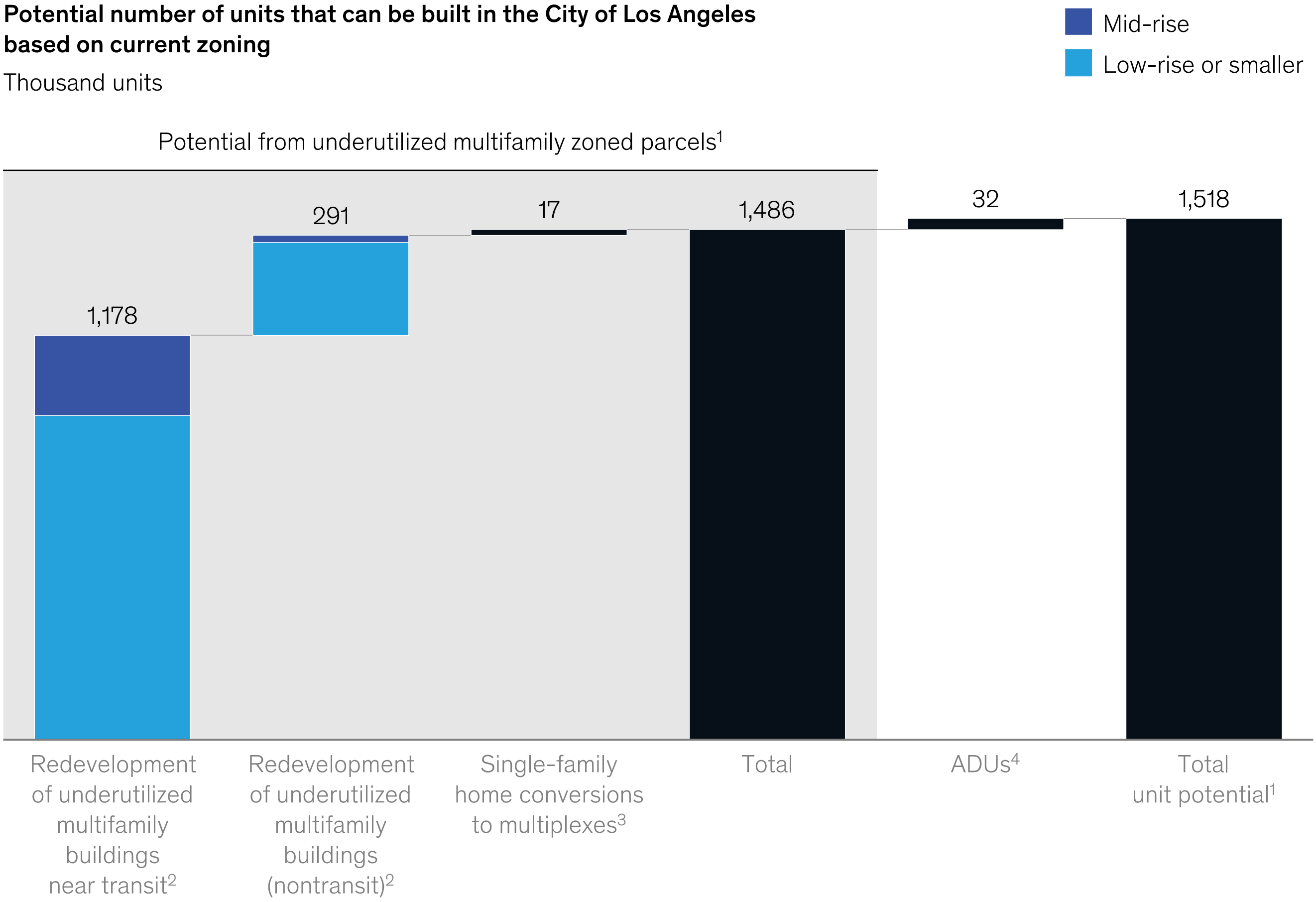
In theory, the city has the potential to add 1.5 million to 1.9 million housing units under current zoning in residential areas (Exhibit 8). Clearly that is far more than the actual development that will be undertaken. But quantifying the potential serves an important purpose. It shows that Los Angeles has many options that could be pursued—and many choices to make (see Box 4, "Redevelopment and temporary tenant displacement").

Exhibit 8

The City of Los Angeles has the theoretical capacity to add at least 1.5 million housing units, not including underutilized commercial land.

Potential number of units that can be built in the City of Los Angeles based on current zoning

Thousand units



1. If parcels containing fewer than 50% of units allowed by zoning are also redeveloped, an additional 470,000 units could be added.
2. A parcel is considered underutilized if it contains fewer than 25% of the units allowed by zoning. Low-rise multifamily parcels have a zone code of RD1.5, RD2, or RD3. Mid-rise multifamily parcels have a zone code of RD4, RD5, and RD6. Single-family homes are excluded from this analysis.
3. Assumes 10% of single-family homes in multifamily zones convert to quadplexes, adding three new units per conversion.
4. Assumes 10% of single-family homes (in non-multifamily zones) add accessory dwelling units.

Source: City Assessor's Parcel Data; Measure JJJ legislation; McKinsey Global Institute analysis

In addition to available residentially zoned land, Los Angeles can place housing on unused commercially zoned land, further expanding the range of options. The City of LA has almost 15 square miles of land zoned for commercial purposes.[50] Data limitations make it hard to quantify how much of this land is unused and could accommodate housing. Proposition U also limits the ability to redevelop commercial land for housing. But the city could revisit that restriction, especially for viable sites near transit. The city can also consider raising its parking tax to discourage underutilization of commercial land, especially near transit corridors.[51]

[50] C1, C1.5, C2, C4, and C5 zoning codes.

[51] The City of Los Angeles currently levies a 10 percent tax on parking fees collected at all pay-parking facilities. By comparison, the parking tax is 25 percent in San Francisco and 12.5 percent in Seattle.

Box 4.

Redevelopment and temporary tenant displacement

As discussed above, Los Angeles has many residential structures with fewer units than zoning allows. Expanding those properties to add more affordable units is a key strategy for the city. But what happens to current tenants during construction?

Current regulations have various ways to incentivize housing development on sites that are vacant, commercial, or underbuilt, minimizing the displacement of tenants. The vast majority of projects utilizing Transit Oriented Communities incentives, for example, have been developed on vacant land or on properties with single-family homes. But sharply higher RHNA goals call for a major increase in the build rate. The city, working with developers and community organizations, should be prepared to coordinate the temporary or permanent relocation of a meaningful number of tenants.

We start with the principle that redevelopment should not force low-income tenants out of their neighborhoods. The creation of new affordable housing should not happen at the expense of these households, many of which are low income.

Right now, developers are required to pay relocation assistance (typically 12 months of rent). But tenants may need additional logistical help to find suitable alternative housing as well as financial help to manage moving costs. In the City of LA, the LA Homeless Services Authority has developed a "coordinated entry system" to match homeless individuals with affordable housing units funded by the city. Now the region may need to establish a similar program for a wider population of at-risk tenants. LA's Housing + Community Investment Department is currently building an online inventory of all non-subsidized affordable units to provide a single platform for tenants to apply; this effort could be scaled up and accelerated. This is an area where social-sector organizations can support the region's efforts.

The region may need to coordinate a large number of relocations. It will need an integrated master view of all projects throughout the region to understand when and where new units will come online. Focusing first on underutilized commercial land, which does not involve displacing tenants, could be an important safety valve.

Oakland and Washington, DC, for example, impose higher taxes on vacant properties to spur owners into developing them.[52]

The majority of the identified capacity comes from increasing density near transit, and 80 percent involves low-rise or smaller buildings. The path forward involves building bigger multifamily developments near transit stops; redeveloping non-transit parcels that are zoned for multifamily housing but are currently underutilized; adding more ADUs to single-family homes; and converting some single-family homes on multifamily zoned parcels to duplexes and triplexes. The common thread across all these projects is increased density, an inevitable shift that is already starting to occur.[53]

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52 Kathleen Pender, "Oakland's vacant property tax takes effect, sparking hope—and alarm," *San Francisco Chronicle,* January 26, 2019. Washington imposes a further tax on properties it deems to be blighted. See J. Brian Charles, "Cities now use taxes to fight blight. Is it working?," *Governing* magazine, May 14, 2018.

53 According to the Department of City Planning's quarterly report for Q2 2019, more than 11,800 ADU permits have been submitted since January 2017, and applications for almost 20,000 units have been submitted through the TOC incentive program since October 2017. City Council member Gil Cedillo recently introduced a motion to pilot the development of micro-units near transit.

New housing types can transform the economics of affordable housing

Today in the City of Los Angeles, for-profit developers must charge average rent of about $3,000 for a standard (970-square-foot) unit to achieve sufficient returns to secure financing. This analysis assumes that a 10 percent internal rate of return is the minimum required for a development to proceed.[54] These rents would be affordable only to households making 175 percent or more of the area median income. Units with lower rents that are affordable to lower income brackets do not "pencil out" without meaningful density bonuses, public subsidies, and/or other incentives. (See the technical appendix for details on the methodology behind this analysis.)

One way to improve the economics and encourage more developers to build for the lower end of the market is to bring down their development costs. A number of nontraditional formats—including some older, proven ideas making a comeback—can be built for significantly less than standard apartments, assuming that the approval process is streamlined and appropriate policy accommodations are made regarding requirements such as open space and parking (Exhibit 9). Micro-units can be developed for more than 50 percent less than standard units, enabling sufficient returns even with rents as low as $1,480 per household. Similarly, co-living layouts can be built for about 28 percent less than standard units, enabling rents as low as $2,310 per household. These formats are described in greater detail below. These housing types are not for everyone, but they could represent a meaningful share of the new housing the city needs to add, providing viable options for many households that lack them today.

Micro-units

The "tiny house" concept translates well into an urban setting. Small apartments of 350 square feet or less, suitable for a single tenant or a two-person household, are a highly scalable model. Living in very small quarters will not appeal to everyone.[55] But in addition to making up much of the gap for LA's lowest-income and most vulnerable residents, these units, if centrally located near commerce and transit, could appeal to students and to workers who do not spend much time at home.

If the right policy accommodations are made, these developments can support 2 to 3 times more units on the same total square footage and floor-area ratio as standard properties, reducing per-unit costs by more than 50 percent.[56] Micro-units sit in a sweet spot: they actually command higher rents per square foot, which is appealing to developers, but low square footage keeps them within reach for lower-income households.

But the economics work for developers only if they are granted permission to build a greater number of micro-units than standard units on a given parcel of land. Because they can accommodate approximately three times more households in the same square footage than a standard building, these projects might require exemptions and special approval processes. Depending on their location, they may need accommodations regarding their extra public infrastructure usage, the amount of open space required per unit, parking requirements, any special density restrictions, and minimum unit sizes.[57] Because of their higher density, these properties should ideally be built near transit to reduce parking requirements and allay traffic concerns.

54 Based on our research, a project return of 10 percent is the minimum required for private investors (some of which are pension funds) to consider financing a development project. We therefore use 10 percent returns as a benchmark in this report's analysis. Note that this rate can increase or decrease in the future, based on market dynamics.
55 See, for example, Gene Tempest, "What no one ever tells you about tiny homes," *New York Times,* June 2, 2017.
56 Assumes property is a redevelopment and constructed in a Tier 3 transit-oriented corridor area. We see similar relative costs and increase in affordable units if the property is in other TOC tiers.
57 For example, LA's municipal code specifies a minimum average unit size of 750 square feet and a minimum dwelling unit size of 450 square feet in adaptive reuse projects.

Exhibit 9

With appropriate enablers in place, alternative housing types can meaningfully reduce the cost of construction, enabling rents that are affordable to lower-income households.

Housing type		Minimum achievable rent per month per housing unit[1] ($)	Cost of construction per housing unit ($ thousand)
Standard unit low-rise	3-story building made up of 970-sq-ft units	3,000	513
Micro-unit low-rise	3-story building made up of 350-sq-ft units	1,480	241
3-bedroom co-living, low-rise	3-story building made up of 3-bedroom, 2,000-sq-ft units	2,310	369
Detached accessory dwelling unit	1,000-sq-ft standalone new construction	1,030	192
Single-family home converted to 4-plex	Conversion of an existing single-family home to 4 housing units	1,500	84[2]
Bungalow-style 4-unit development	5,000-sq-ft property, subdivided into 4 units	1,000	175

Rent affordable to households, by income
$

426	710	851	1,561
Extremely low income	Very low income	Low income	Moderate income

1. Minimum achievable rent is estimated as the rent required to provide a 10 percent return on the development project.
2. Conversion of an existing single-family home to 4 housing units by the homeowner. Assumes no land cost and no dedicated parking required or street parking is available. The analysis assumes that rent payments will support both the development cost and mortgage payment for the original home. Thus, the relatively low cost of construction for these units does not result in proportionately lower rents.

Source: McKinsey Global Institute analysis

Co-living

Co-living is a new term for an old concept: communal housing. Large apartments or homes accommodate multiple tenants, each of whom gets a private bedroom while sharing common living, dining, and kitchen spaces. Co-living is not far removed from living with roommates, as many people already do. But unlike makeshift roommate arrangements, co-living developments can be thoughtfully designed for sharing from the start. One unit could house multiple singles or couples, two or three small families, or one large multigenerational family.

By opting for a co-living design over standard apartments, builders can create up to 1.5 times more bedroom units in the same total square footage and floor-area ratio, reducing the per-unit cost by close to 30 percent.

Co-living complexes are already an accepted part of the housing mix in major European capitals. Now developers are following suit in the most expensive US cities, creating a new property category that is attracting significant capital.[58] Starcity, for example, renovates

[58] *Survey of the co-living landscape,* Cushman & Wakefield, May 2019.

the interiors of existing buildings in San Francisco and Los Angeles to create smaller, more affordable co-living units geared to middle-income residents.[59] Other companies are building co-living complexes from the ground up, hoping to strike the right balance between shared and private spaces in the initial design, and contracting with dedicated operators to provide services and tend to the community aspects.

Young singles are a natural market, but some developments are targeting other demographic groups. Tishman-Speyer and co-living operator Common recently unveiled Kin, a family-oriented co-living complex in Long Island City, New York, complete with shared play spaces, stroller parking, extra soundproofing, cleaning services, and an app for booking babysitters.[60] Community is also a key part of the appeal for the seniors who opt for co-living over aging alone. In Oakland, Phoenix Commons is a self-managed co-living community for residents over age 55, where a rotating group of volunteers cooks for everyone in the evenings.[61]

In Los Angeles, UP(st)ART offers cheap co-living for artists, with shared amenities such as computers, recording studios, musical instruments, big-screen TVs, and regular group activities.[62] Common has partnered with LA-based Proper Development to build $100 million worth of pre-furnished shared living spaces in neighborhoods across LA geared to residents making $40,000 to $80,000 per year. A total of 600 beds should be available in the next few years—and the first completed project attracted 9,000 applications from prospective renters, a sign of the scale of unmet demand.[63]

Flyaway Homes is applying the co-living concept to supportive housing for the homeless, using prefab construction techniques to speed the conversion of recycled shipping containers into modern residential structures. The company partners with a social services agency to deliver the services residents need on-site.[64]

To encourage market-driven co-living developments that set aside affordable units, Los Angeles can tie incentives to affordability covenants. These covenants can apply to each bedroom within shared units, as opposed to one covenant for each standard unit. This would give a greater number of tenants long-term stability. New York recently launched a pilot program that makes public financing available to developers planning to build more affordable dorm-style projects.[65]

Accessory dwelling units (ADUs)

Single-family homeowners can add ADUs (small, self-contained units with their own kitchens, baths, and entries) to their properties to generate rental income or accommodate extended family. They come in many flavors, such as freestanding backyard cottages, “granny flats” attached to the main residence, and converted garages.[66] State law allows these additions provided there is room on a given lot, and localities across LA County have been issuing their own guidelines governing rules such as setback requirements and size limitations. While it is difficult for homeowners to invest in building these structures and then charge rents that are affordable to low-income tenants, they can be good options for moderate-income tenants—a cohort that struggles in the LA market but is rarely the focus of housing policy.[67] Rents can be further reduced to make ADUs affordable for low- and extremely-low-income households

59 Andrew Khouri, “California’s housing shortage has companies carving up apartments to lower the rent,” *Los Angeles Times,* November 25, 2018; and Nellie Bowles, “Dorm living for professionals comes to San Francisco,” *New York Times,* March 4, 2018.
60 Patrick Sisson, “New co-living concept for families launches in NYC,” Curbed, March 19, 2019.
61 Anna Leach, “Happy together: Lonely baby boomers turn to co-housing,” *Guardian,* August 15, 2018.
62 See liveupstart.com.
63 Roger Vincent, “New York co-living company plans $100 million expansion with Los Angeles apartment developer,” *Los Angeles Times,* March 8, 2019.
64 See flyawayhomes.org.
65 Stefanos Chen, “Co-living goes affordable,” *New York Times,* November 1, 2018.
66 See, for example, Bonnie Tsui, “Empty garages: The answer to California’s housing shortage?,” *New York Times,* October 15, 2019.
67 This is based on ensuring the homeowner a 10 percent return on the initial investment, in line with our assumptions for private developers of multifamily projects.

Box 5.

Where micro-units and co-living meet

Combining tiny individual units with shared living spaces is a natural fit—and a cost-effective format. A micro-unit co-living development could include some 100 dwelling units, with 34 percent reserved for extremely-low-income households, at a development cost of $251,500 per household. In comparison, a building of similar size with standard (970-square-foot) units would produce only 50 units, with 10 percent reserved for extremely-low-income households.

The combination of micro-units and co-living could be a particularly effective way to provide transitional housing for the homeless population, as it provides much higher capacity in the same space. This concept can be built ground-up or can be implemented rapidly through motel conversions. The City of Los Angeles jump-started motel conversions in 2018 with an ordinance that allowed owners of local motels to turn their properties into low-income housing. These projects are quicker and cheaper than building from the ground up, and they offer a way to combine housing with the delivery of supportive services. The city's planning department recently identified 328 motels with more than 10,000 rooms that are old or in disrepair, all of which could be candidates for this approach.[1] Local authorities and nonprofits can either make offers to purchase these properties or master lease them. The National Health Foundation's Pathway Recuperative Care program has taken the master-lease approach at the Reno Motel, serving more than 3,000 people since 2010.[2] In a more recent pilot project, the Jewish Foundation of LA issued a grant to the nonprofit Brilliant Corners to renovate a mid-city motel into supportive housing for dozens of homeless individuals.[3]

1 Elijah Chiland, "City council approves new rules to speed up delivery of new homeless housing," Curbed LA, April 11, 2018; and Madeleine Parker, "LA County motel rooms could be turned into homeless housing," *Santa Monica Daily Press,* June 21, 2019.

2 Kelly Bruno, "Converting motels to homeless housing is good business," California Health Report, March 16, 2018, calhealthreport.org/2018/03/16/converting-motels-homeless-housing-good-business.

3 Jewish Foundation of Los Angeles, jewishfoundationla.org/grant/brilliant-corners.

through additional subsidies or grants to the homeowners, but it would take public or philanthropic intervention to make this a viable strategy to serve those cohorts.

>11,800

property owners have applied to add accessory dwelling units since January 2017

Since new state rules went into effect in January 2017, the pace of ADU construction in Los Angeles has accelerated rapidly.[68] From January 2017 to September 2019, more than 11,800 property owners filled applications with the Department of City Planning to add ADUs. By way of comparison, the city received just 536 permit applications in the two years prior to 2017. Despite this increase, it should be noted that the Department of Water & Power has denied hundreds of applications in Los Angeles due to power line safety concerns. Finding a way to safely enable homeowners willing to add density should be a cross-department priority for the city.

Local policies can encourage homeowners to add rental units. LA County's pilot involves streamlining the permit approvals process, providing technical assistance to homeowners, providing some financing options, and promoting ADUs through an architectural design competition. The urban design nonprofit LA-Mas finances and builds ADUs for homeowners who agree to rent to Section 8 voucher holders for a minimum of five years. A ready ecosystem of nonprofits can broadly distribute ADU construction know-how and property management

68 This reform package requires the city offices to streamline ADU permitting, waive parking requirements for units located within half a mile of a high-frequency transit stop, and cap floor space at 1,200 square feet for detached units and 1,200 square feet or 50 percent of house size, whichever is less, for attached units. Some cities and counties have added further regulations. Santa Monica, for instance, limits ADUs to 650 square feet and forbids their use as short-term hospitality rentals.

expertise. South of Los Angeles, the city of Encinitas has released free permit-ready plans for ADUs that can be downloaded online; Seattle's mayor has announced similar plans.[69]

Single-family home conversions and bungalow courts

As mentioned above, select homeowners can convert their large single-family homes into duplexes, triplexes, or four-plexes. These renovations can be completed more quickly and at a significantly lower cost than building from the ground up. This approach could support rents as low as $1,500 per month, which is affordable to moderate-income households. (This assumes that no dedicated parking is required.) These types of conversions represent a promising idea, but they are still relatively uncommon in Los Angeles.

Another option is building bungalow courts on parcels currently zoned for single-family homes. This type of development was once common in Southern California, although it fell out of favor as cities began to institute parking requirements for residential construction. But with older bungalow courts still dotted across the region today, this model fits in nicely with the existing aesthetic in many neighborhoods. A four-unit development could support rents of $1,000 per month, which would be affordable to a low-income household. Further, if one of the four units is occupied by a market-rate tenant, the other three can be made affordable to extremely-low-income households. (This assumes development on a parcel zoned for a single-family home, with a lower land cost than a parcel zoned for multifamily.) A recent pilot project, undertaken by a nonprofit called Restore Neighborhoods LA, is using a grant from the county to build an eight-unit bungalow court in South LA.[70]

Both of these housing formats may require appropriate zoning exemptions and parking requirement waivers to encourage their construction in neighborhoods where single-family homes are the norm. They can already be built on multifamily-zoned parcels, but R1 parcels would require rezoning (or exemptions) to allow for a higher number of units.

Cities across LA County can streamline the approval process for these housing types, since they are more likely to be undertaken by small developers or individual homeowners with minimal capital and risk appetite. Cities can further reduce risk by releasing permit-ready plans.

Modular and prefabricated construction

Modular and prefab construction—that is, producing standardized components of a structure in an off-site factory, then assembling them on-site—can yield major efficiencies and economies of scale. Already accepted globally, prefab construction is relevant in any market with strong housing demand and a shortage of construction labor.[71] In places like Japan, developers have positioned prefab homes as a premium product with a strong focus on design and quality, particularly with respect to earthquake resistance.[72] Singapore requires all government housing projects to use prefab methods and provides tax incentives to support the development of advanced manufacturing facilities producing components. The industry is small but growing in the United States. In Vallejo, California, a company called Factory OS is producing about 1,000 prefabricated units per year for use as permanent supportive housing.

In broad terms, prefab construction involves producing standardized components of a structure in an offsite factory, then assembling them onsite. Terms such as off-site construction, prefabrication, and modular construction are used interchangeably and cover a range of approaches and systems. The simplest are elements that are clipped together using

69 Sarah Anne Lloyd, "With new ADU rules in effect, Seattle hopes to drop more barriers to building," Curbed Seattle, October 1, 2019.

70 Elijah Chiland, "Homeless housing developer aims to bring back the bungalow court," Curbed LA, July 23, 2019.

71 Japan has created a healthy prefabrication construction industry that benefits from economies of scale (high volume and synergies with its manufacturing industries). Sweden's prefabrication industry helps construction continue even with short daylight hours and cold workdays; 85 percent of current construction uses some form of industrial construction.

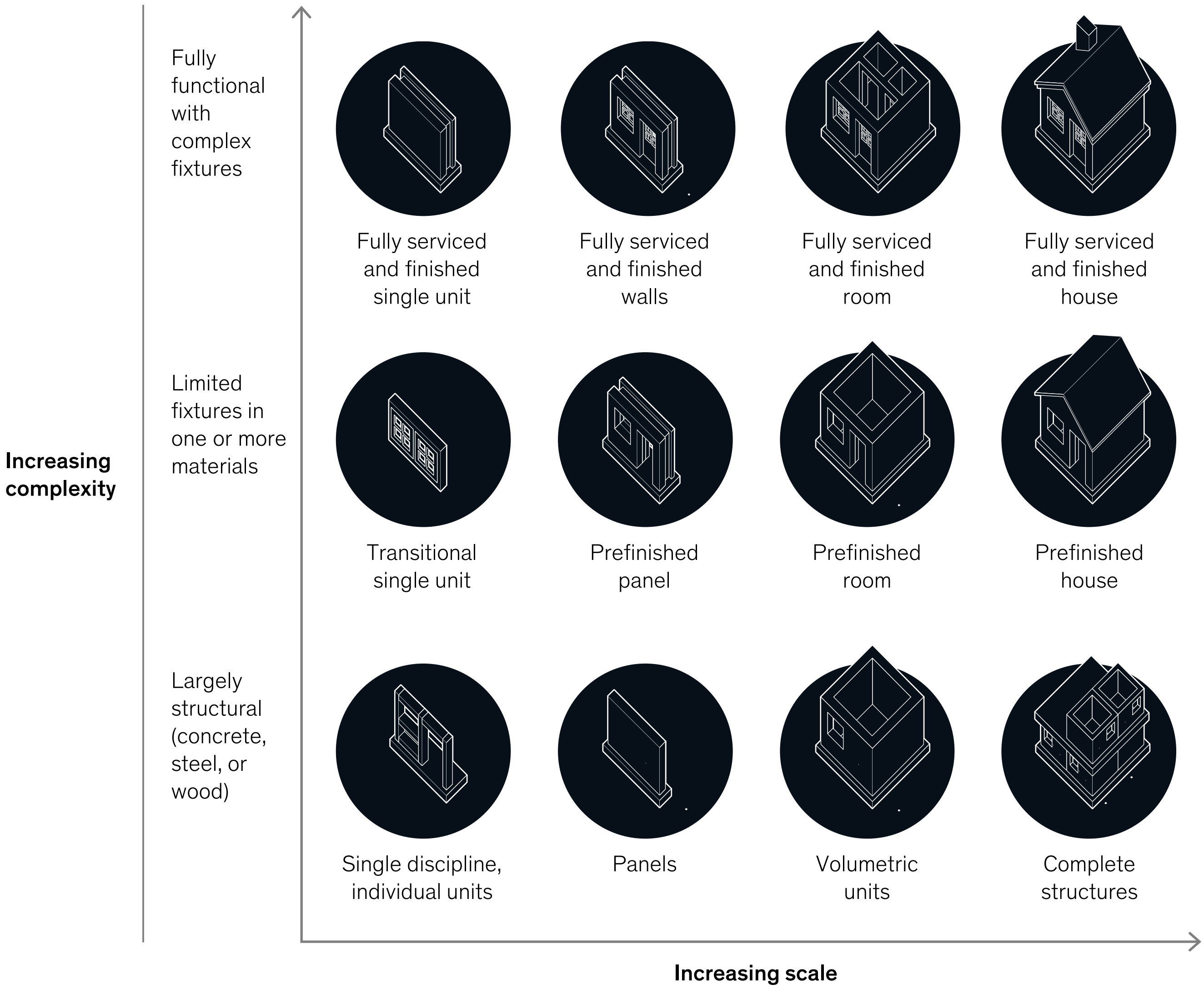
72 For more details, see *Modular construction: From projects to products,* McKinsey & Company Capital Projects & Infrastructure Practice, June 2019.

standard connections and interfaces. Further along the spectrum are two-dimensional panels and three-dimensional volumetric units with full fixtures (Exhibit 10).

Exhibit 10

Modular and prefabricated construction cover a broad set of approaches.

Complexity and scale of modular and prefab construction—comparison of approaches



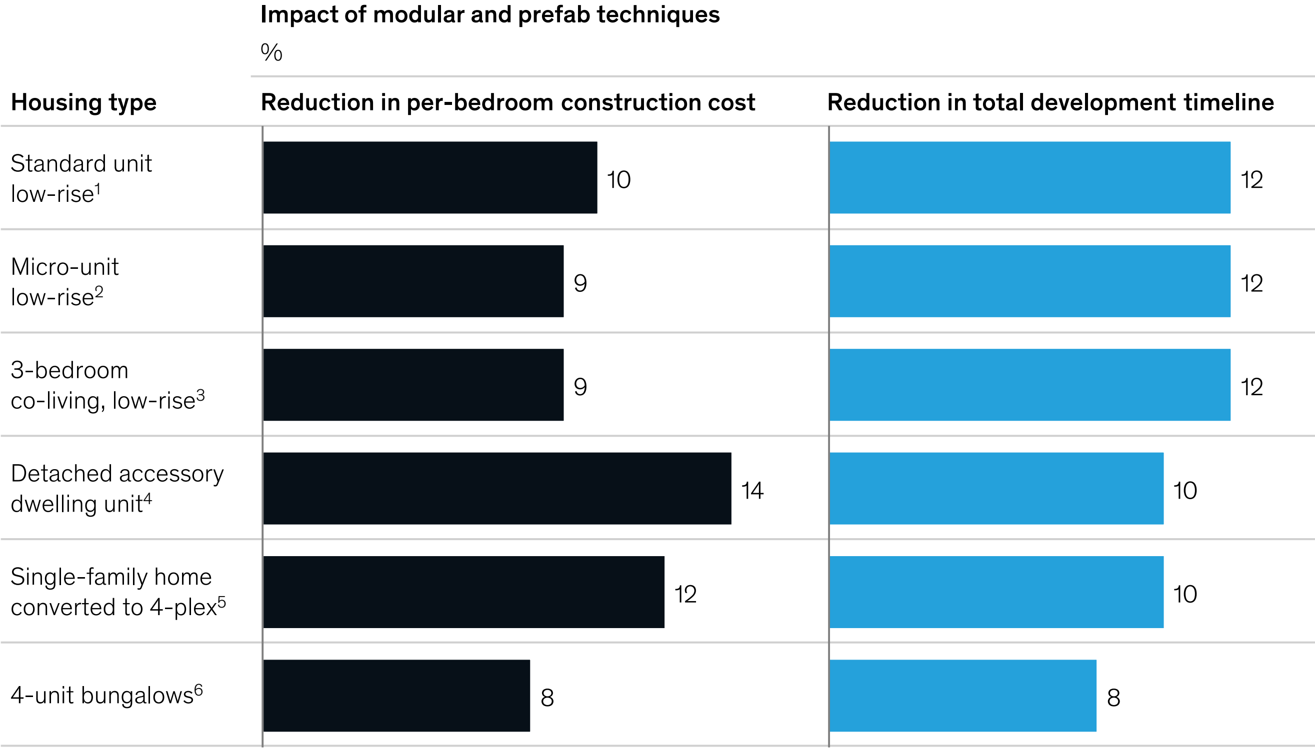
Source: McKinsey Global Institute analysis

A prefab approach can reduce the cost of construction by 5 to 15 percent, depending on the project type (Exhibit 11).[73] Beyond the cost savings, this model increases standardization within and across projects, which can speed approvals. It can also minimize building time, noise, and disruption for the surrounding neighborhood.

[73] To calculate this, we focus on "hard" building costs undertaken during construction only and on the site preparation and construction phases of development. We ranged maximum achievable cost savings for construction based on the type of construction. Single-family homes realized the smallest benefits in both costs and time savings, but accessory dwelling units realized up to twice the savings in percentage terms. See *Reinventing construction: A route to higher productivity,* McKinsey Global Institute, February 2017; and *Modular construction: From projects to products,* McKinsey & Company, June 2019.

Exhibit 11

New building techniques such as modular and prefab construction can deliver significant cost and time savings when adopted at scale.



1. A 3-story building in a multifamily residential zoned parcel made up of 30 units of 970 square feet each.
2. A 3-story building in a multifamily residential zoned parcel made up of 83 units of 350 square feet each. The overall building size is same as the standard unit low-rise building.
3. A 3-story building in a multifamily residential zoned parcel made up of 14 3-bedroom, 2,000-square foot units. Each unit is shared by 3 households. The overall building size is the same as the standard unit low-rise building.
4. A 970-square-foot stand-alone unit added to an existing single-family home by the homeowner. Assumes no land cost and no dedicated parking required or street parking is available.
5. Conversion of an existing single-family home to 4 housing units by the homeowner. Assumes no land cost and no dedicated parking required or street parking is available. The analysis assumes that rent payments will support both the development cost and mortgage payment for the original home. Thus, the relatively low cost of construction for these units does not result in proportionately lower rents.
6. A set of 4 small single-family units of 700 square feet each, built on a single-family residential zoned parcel. Assumes 1 dedicated parking per unit required.

Source: McKinsey Capital Projects & Infrastructure Practice; McKinsey Global Institute analysis

In the LA Arts District, the Sustainable Building Council installed an elegant modular home known as ARCspace to demonstrate how quickly homes can be built; it was assembled by a four-person team in less than two days.[74] Hope on Alvarado, an 84-unit apartment complex rising in Westlake, will be the first of three projects for formerly homeless residents developed by Aedis Real Estate Group. Using modular steel components, it is expected to be completed in one year—about half the time conventional construction would take.[75] But Los Angeles would need to adopt prefab on a large scale to capture the full potential efficiencies and cost savings. It will take a robust pipeline of demand to support manufacturing output.

74 Arielle Paul, "The beauty and affordability of modular living," *Los Angeles Times*, June 21, 2019.
75 Jenna Chandler, "Modular homeless housing rising in Westlake," Curbed LA, October 1, 2019; "Hope Street Initiative," Aedis Real Estate Group, aedis-re.com/hope-street-initiative.

Los Angeles can build a more affordable future—and even a more livable one. It will inevitably add density along the way, but it can rely on development that fits within each neighborhood's context. New housing formats open the possibility of not only accommodating low-income tenants but creating a sense of community and stability that is often lacking in a sprawling metropolis. Focusing on transit-oriented development can alleviate congestion, which has become one of the biggest pain points for residents. After considering what is possible, the big question is how to turn some of these concepts into reality. The next chapter outlines some concrete actions that could unlock progress.


LULL

3. Six strategies to accelerate progress

To dig out from a housing shortage that has been building for years, Los Angeles needs to speed up the metabolism of its response. Delivering more affordable housing will require the city to ramp up how much it builds—and to get projects completed much faster. Time is of the essence for residents under personal and financial stress.

A great deal of complexity can be eliminated in both approvals and financing. Instead of putting each project through a series of hurdles, agencies need to usher high-priority proposals through the system, perhaps with a dedicated liaison who can coordinate across agencies, funders, social-sector partners, and community groups. As Los Angeles undertakes large-scale redevelopment, cities need to play a role in coordinating across agencies, funders, social-sector partners, and community groups as well as arranging tenant relocation during construction. Above all, Los Angeles needs to shape its fragmented housing landscape into a more cohesive and cooperative ecosystem. A development process with many discrete steps and information streams needs to be fully digitized and seamlessly linked for both speed and transparency.

LA's ongoing transit expansion is creating an important window of opportunity. Density linked to transit is critical to driving the delivery of affordable housing with private capital, building on the initial progress made by Measure JJJ's Transit Oriented Communities guidelines. Adding new housing types around transit will require a decisive new approach to permitting and approvals.

This chapter proposes six priorities for making the housing market work for Angelenos of all income levels. The development process can become not only faster but more productive. Together these actions could set Los Angeles on a new course—and within each one, stakeholders across the region have a great deal of work to do.

1. Turbo-charge the process of creating a fully integrated plan with shared accountability for all of Los Angeles

County- and city-level RHNA goals have to translate into more affordable housing going up in every neighborhood. In the City of Los Angeles itself, doing this effectively will require updating the General Plan and 35 community plans, some of which have not been revised in more than 20 years. Without updated community plans across the entire city, any proposed development that does not meet today's requirements will be subject to lengthy discretionary approval processes, adding risk and delay.

Every Council district (or separately incorporated city in LA County) will need to build more and get it done faster. A public, shared commitment to addressing the affordable housing crisis across all Council districts could be a powerful policy statement. This would build on the successful precedent set in the current Bridge Program, which is focused on emergency shelters and supportive housing.[76] Digital tools, building on the dashboards developed for supportive housing and the Proposition HHH pipeline, can create transparency and identify roadblocks quickly.

[76] Everyone In, "Supportive housing tracker," United Way of Greater Los Angeles, everyoneinla.org/supportive-housing-tracker.

For their part, neighborhoods will need to focus on adapting their communities for a higher-density future, planning for schools, infrastructure, and open space. Alleviating traffic congestion and environmental concerns requires making affordable housing available near employment centers and transit hubs, freeing more workers from long commutes. In deciding where to place housing, it is important to consider each area's current housing stock, its local workforce, the demands on public infrastructure (including schools), and anticipated job growth.

Los Angeles needs a cohesive and integrated planning approach to deliver affordable housing effectively. Many barriers can be addressed if the City Planning Department creates an overarching policy document with clear principles on transit, density, and housing formats (especially nontraditional alternatives) to ensure consistency across all neighborhoods. The City Council could endorse this high-level policy document to give the Planning Department more authority and momentum in the community planning process. Two years ago, the City Council agreed to refresh all 35 plans by 2024. But this process needs to be accelerated, which will require additional resources and new processes for input, revisions, and approvals.[77]

The next level of detailed community-level planning should incorporate the overarching principles set out by the City Planning Department. Among the priorities are expanding the conditions under which desired housing types (such as micro-units, bungalow-style housing on large R1 parcels, prefab affordable projects, or some combination) can be considered by right; standardizing select building code requirements and approval processes across municipalities; and reconsidering limits on housing development on commercially zoned parcels, especially near transit.[78] The most recent community plan updates have designated certain projects for staff-level decisions or administrative clearances rather than discretionary approvals—a positive trend that should continue. Any preferential zoning or incentives that enable higher density should be paired with higher required set-asides for units that are affordable to lower income cohorts, ensuring that the benefits provided to developers by local government produce more affordable housing.

All of this should be undertaken in the context of potential state-level action, which could classify desired classes of housing (such as micro-units or prefab affordable projects) as by right.[79] This could reduce the time required for permitting and approvals while mitigating the need to incorporate these changes into individual community or master plans.

The push to add affordable housing ultimately comes down to many project-by-project and block-by-block decisions. A logical starting place would be taking an inventory of all vacant and publicly owned land as well as parcels that are for sale or dramatically underutilized under current zoning. The city is already taking steps in this regard. The Controller's Office recently released PropertyPanel, an interactive map cataloguing publicly owned land, while the Mayor's Office is releasing numerous data sets through the city's Open Data Portal.

Planners must also find ways to gather input from all community stakeholders and mitigate concerns. Many stakeholders oppose new growth because they are worried about congestion or their own property values. But others, particularly neighborhood workers and employers, very much want to see more housing added. It is critical to ensure that all voices, not just the loudest, are heard. Los Angeles needs to find a way to enable all members of the community

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77 The state allocated almost half a billion dollars for planning-related efforts in the July 2019 budget and through SB2, passed in 2018. Long Beach recently received more than $500,000 for planning efforts from SB2. See http://www.hcd.ca.gov/grants-funding/active-funding/planning-grants.shtm and https://www.gov.ca.gov/2019/03/11/governor-newsom-announces-legislative-proposals-to-confront-the-housing-cost-crisis/.

78 These principles could go so far as to standardize building code requirements and approval processes. Minneapolis, for example, became the first major US city permitting duplexes or triplexes on all lots, with no additional parking requirements.

79 For example, when the state and city took broad action to allow and encourage accessory dwelling units, permit applications shot up citywide—a positive trend that could be replicated on a bigger scale with micro-units and prefab construction.

to provide input while reducing the number of revisions and iterations of project plans based on that input.

Holding open houses, or even creating one-on-one availability with officials, can be helpful in providing transparency on how development might affect property values, traffic patterns, and the fabric of the neighborhood. Visuals and testimonials from other areas can assuage concerns. At the same time, online portals, digital surveys, community apps, and even a local "complaint desk" could broaden the net for community input while speeding the process. All stakeholders need to commit to meeting the city's housing needs, recognizing that it will take collaboration and compromise.

2. Adopt new construction techniques and technologies at scale to decrease costs and accelerate development

New building techniques and technologies can help decrease both the time and the cost of construction. This would improve the economics of building projects with lower rents that are affordable to a much larger share of the population while allowing developers a sustainable rate of return—enabling Los Angeles to narrow its housing gap much faster.

Prefab can lower the cost of multifamily construction by

5–15%

As discussed in Chapter 2, modular and prefab construction can bring the benefits of industrial production and economies of scale to the housing sector. It can reduce the development cost of multifamily housing by 5 to 15 percent, if adopted at scale (with even greater benefits over the longer term). Los Angeles has funded a number of prefab projects as pilots and set up a peer review process to accelerate approvals.[80] But state and city agencies need to develop new standards for permitting and update regulations.[81] Seamlessly integrating permitting and inspections at both the factory and assembly sites will be essential. By-right approvals would create a powerful incentive, as would favorable financing terms from private, nonprofit, and government investors.

According to McKinsey research, prefab factories typically need to produce a minimum of 1,000 units per year (and likely much more) to be viable. A single developer is unlikely to achieve this scale on its own. Despite these hurdles, prefab construction can reach critical mass simply because developers see the advantage of shorter timelines and can give suppliers forward-looking certainty. Los Angeles could invest in getting this ecosystem off the ground through measures such as offering incentives for a prefab factory, ensuring the initial pipeline of demand, and developing and preapproving standardized designs to take advantage of the factory model. Singapore's Housing Development Board is building 20,000 to 30,000 units a year using off-site manufacturing, while the United Kingdom produced about 15,000 new prefab homes in 2018.

In the Western United States, the prefab ecosystem is generally fragmented and small scale, with about 200 low-capacity manufacturers. However, as a sustained construction boom outstrips capacity, the economics are improving. Major investors (including SoftBank, Alphabet, and Amazon) have backed prefab home developments and builders such as Katerra, RAD Urban, Plant Prefab, and Factory OS. RAD Urban, for example, aims to move 85 to 90 percent of on-site labor into the factory.[82]

Prefab construction is not the only route to boosting productivity. Developers, local agencies, and builders alike can digitize more of what they do to improve efficiency, turnaround times, and communication. Developers can use 5D BIM software (which layers scheduling and costs over physical and spatial dimensions) to lower costs, reduce rework, and streamline

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80 https://www.latimes.com/california/story/2019-08-23/homeless-housing-innovation-challenge-mayor-eric-garcetti-financing.

81 For modular and prefab units, the actual structure is reviewed and certified by the state. The city permits and inspects related foundation work, utility connections, and select safety standards.

82 For a more detailed discussion, see *Modular construction: From projects to products,* McKinsey Capital Projects & Infrastructure Practice, June 2019.

the approval and permitting process. Digital collaboration tools (such as construction-management apps on portable devices), higher-definition surveying and geolocation tools, and advanced analytics can decrease long-term costs and improve the coordination of subcontractors, deliveries, and inspections. Mandates from local agencies can spur this type of change across the industry. The city's BuildLA initiative, which seeks to digitize and streamline plan submissions, reviews, and inspections, is a step in this direction.

Builders can improve on-site execution through rigorous integrated planning that tracks milestones, the use of real-time dashboards to monitor performance, standardized processes, and lean construction techniques. They may also need to focus on workforce training, improving procurement and supply-chain management, rethinking design and engineering processes, and restructuring contracts.[83]

The industry will need to invest in training trade workers to develop new skills in design, manufacturing operations, and digital technologies. Not only are new processes needed in the off-site factories that produce prefab components, but the workers assembling the units on-site need to have proper knowledge and training.

Increasing the size of the construction workforce and building new types of skills will require an effective partnership between private industry, unions, education providers (such as community colleges and vocational schools), and public-sector stakeholders. The construction industry has a long legacy of training the next generation of talent through apprenticeship programs. Meeting higher housing goals and launching a large-scale prefab industry will require significantly increasing the scope and scale of training courses and apprenticeships, preferably with multiple programs distributed across the region (as opposed to one or two centralized programs). These programs can include career coaching and job matching, and they can take advantage of state resources. California recently allocated $165 million over five years to create 500,000 "learn and earn" apprenticeships by 2029.[84] The success of training programs will require creating a pathway to a good and secure livelihood, which is feasible given the continuous demand for housing in the coming years.

Los Angeles will need to find ways to encourage the industry to adopt new construction techniques—and to do so on a large scale, since they become more powerful with a network of users. LA has already funded an innovation challenge, using supportive housing as a testing ground. The city and county could go even further by partnering with prefab companies to ensure an initial pipeline of demand and grow the industry, perhaps enlisting major California employers to help seed the supply chain. The Los Angeles Community College District requires every design-build team bidding for part of its $6 billion modernization program to adhere to BIM standards, with strict rules on workflow, information sharing, and early design collaboration.

3. Gradually increase set-aside requirements to reflect the savings from new housing types and lower-cost construction methods

LA's two signature programs for developing mixed-income, multifamily properties are Measure JJJ (a transit-oriented development plan that came into effect in October 2017) and the California Density Bonus program (a long-standing statewide initiative).[85]

83 For a broader discussion, see *Reinventing construction: A route to higher productivity,* McKinsey Global Institute, February 2017.

84 https://californiaedgecoalition.org/governor-newsom-signs-2019-20-budget-bill/.

85 In 2005, the California State Legislature passed SB1818, requiring local governments to offer density bonuses for developers that set aside a percentage of the units they construct for very-low-, low-, or moderate-income housing. The City of LA's density bonus ordinance, approved in 2008 to implement SB1818, allows for density bonuses of up to 35 percent if developers set aside 11 percent of their units for very low-income tenants, 20 percent of the units for low-income tenants, or 40 percent of their units for moderate-income tenants. However, this measure does have the potential to expire and would need to be renewed.

Measure JJJ categorizes properties into tiers based on their proximity to transit. If a property is in a Tier 3 transit zone, for example, the developer will be allowed to build 70 percent more units than allowed by the current zoning as long as a specified share of the units are set aside as affordable. The current rules set those levels at 10 percent of units that are affordable to extremely-low-income tenants, 14 percent for very-low-income tenants, and 23 percent for low-income tenants. These set-aside requirements vary depending on the tier in which each property is categorized. The higher the tier, the higher the requirement to create affordable units.

The TOC incentives in Measure JJJ have led to the addition of about 3,800 new affordable units since their inception in September 2017.[86] This program has been instrumental in encouraging affordable housing production within market-driven developments—and without any public subsidies.

As Los Angeles moves toward new housing formats and innovative construction techniques, it can redesign the incentives in Measure JJJ and similar programs to reflect the savings they produce. The current set-aside requirements were created with standard property types in mind, but as described in Chapter 2, micro-unit and co-living properties have more attractive cost structures. They can accommodate a greater number of affordable units while maintaining sufficient returns for developers if the right processes and policy accommodations are in place.[87] A co-living property can support set-asides of up to 35 percent of units for extremely-low-income tenants, while a micro-unit development could economically set aside up to 33 percent—a significant increase from the 11 percent set-aside that can be supported by standard properties with the same level of density bonus.[88] If the prefab industry reaches critical mass, projects built with these techniques could also support higher set-aside requirements (Exhibit 12).

When local governments provide benefits, they have to do so in a way that gets the community closer to its goals. Any incentives given to developers (such as density bonuses or waived requirements) need to be paired with requirements for higher set-asides of affordable housing. Without them, it is unlikely that developers would voluntarily add affordable housing to market-driven projects. Increases would need to be carefully considered and tailored to projects featuring more innovative housing types and forward-looking construction methods. City planners and neighborhoods should work together to identify the right combinations of land and building types, then implement new requirements through the right channel. For example, altering the rules of Measure JJJ Transit Oriented Communities incentives to encourage more micro-units would require the city planning director to work with the City Planning Commission.

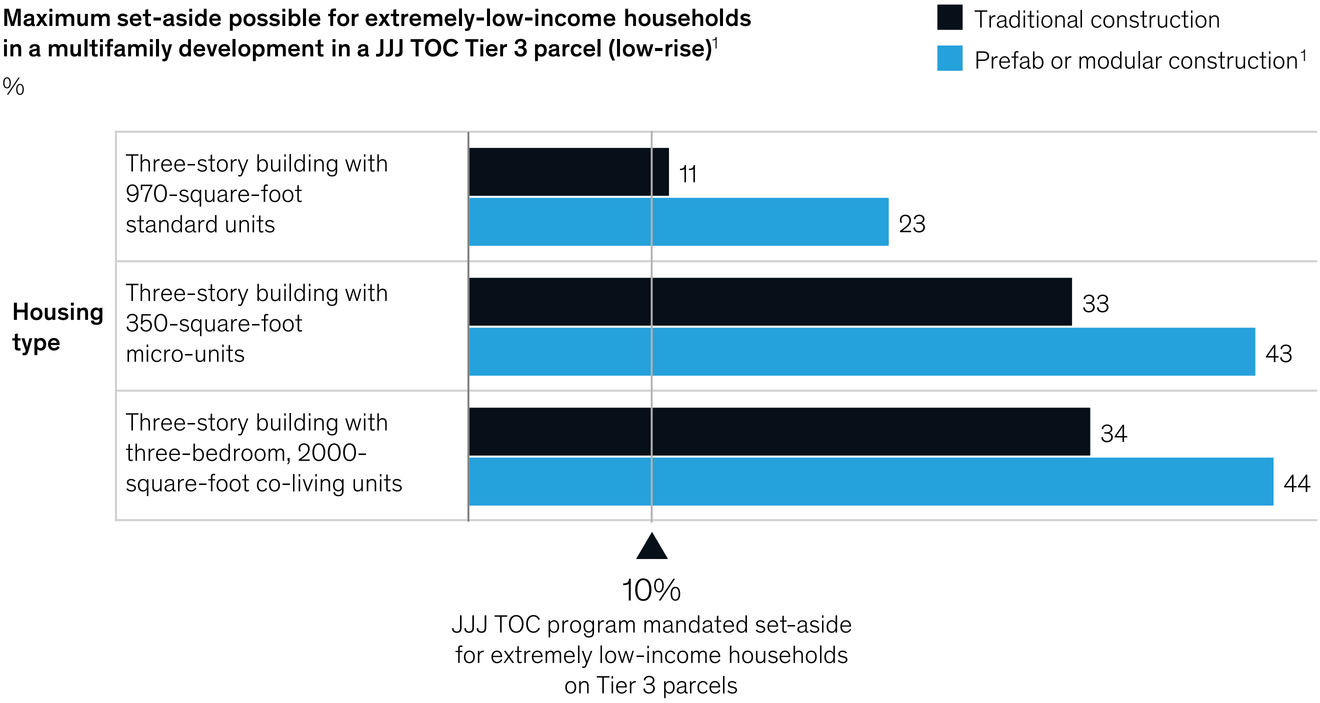
[86] Los Angeles Department of City Planning, Quarterly housing progress report, April–June 2019.

[87] Depending on the specific land parcel, the new housing formats will need accommodations. For example, micro-units will require waivers for per unit open space requirements, any density limits, and unit size minimums to be built at a lower per-unit cost of construction than standard units. Parking requirements can further increase the cost of a micro-unit development.

[88] Extremely-low-income households are defined as those earning less than 30 percent of area median income. Our analysis is based on a minimum return of 10 percent, which is generally required to secure financing. It also assumes the same square footage allowance as a standard property in both cases. It further assumes that micro-unit and co-living development receives appropriate policy accommodations regarding issues such as open space and parking.

Exhibit 12

The savings from alternative housing types and innovative construction techniques can allow increases in the set-aside requirements in density bonus programs.



1. The modular and prefab savings assume that these techniques are adopted at scale in the Los Angeles region.
Source: McKinsey Global Institute analysis

4. Reduce the time, uncertainty, and complexity of approval and permitting processes

The process of obtaining land use and building permits for any project, whether affordable or market-rate, can be a lengthy one in Los Angeles. It is common for more than 50 percent of development time to be eaten up in the preconstruction phases, including land acquisition, entitlements (approvals), and permitting. In some cases, these steps bog down developments to such an extent that they add years to timelines, which is extremely costly. This can keep some projects from ever getting off the ground and discourage developers from entering the LA market.

Preconstruction phases can take up to

5 years

From start to finish, the preconstruction phases in Los Angeles can take up to five years, sometimes with little predictability. The larger the project, the more likely it will be put through a discretionary review process. The complexity of the city's zoning and building codes often requires projects to seek variances. One study found that three-quarters of all projects with five or more units undergo discretionary review, which can add more than 12 months to the timeline for small projects and 16 to 22 months for projects of more than 100 units. It also found that environmental impact review under the California Environmental Quality Act can take roughly 13 months for small projects and 43 months for larger projects.[89]

Jurisdictions across the country have managed to overhaul their planning processes to bring new developments online faster. Lean process overhauls in Leesburg, Virginia, and in the state of Washington reduced approval times by 55 percent. One county in Washington

[89] Moira O'Neill, Giulia Gualco-Nelson, and Eric Biber, *Examining the local land use entitlement process in California to inform policy and process,* working paper number 2, Center for Law, Energy & the Environment at Berkeley Law, University of California, Berkeley Institute of Urban and Regional Development, and Columbia GSAPP Urban Planning, February 2019.

Box 6.
Considering the impact of CEQA

The California Environmental Quality Act (CEQA), which requires local governments to measure and report on the environmental impacts of projects before granting approval, poses a unique challenge to development. While it is important to evaluate environmental concerns and have a legal path for valid challenges, the current process is a bottleneck. One study found that it takes an average of 43 months to receive approvals on projects in Los Angeles that go through Environmental Impact Review, compared to 10 months for exempted projects. Ensuring a transparent, efficient, and promptly adjudicated process could unlock more housing that is environmentally appropriate and in line with CEQA. As cities across the region finalize their new community plans, it will be critical to ensure that their housing vision takes CEQA guidelines into account, potentially obtaining approval across desired project types or their plan as a whole instead of on a project-by-project basis. The city has obtained plan-level CEQA exemptions in certain cases (Warner Center 2035, the Cornfield Arroyo Seco Specific Plan, and the Exposition Corridor Transit Neighborhood Plan). The same approach can be considered for all community plan updates.

It should also be noted that state legislation enacted in September 2019 (AB1197) grants Los Angeles a CEQA exemption for supportive housing for the homeless. However, this exemption does not affect the mixed-income developments that will end up providing a large proportion of affordable units in the region.

was able to reduce permit application times by 40 percent by hiring additional planners to manage the backlog.[90] San Francisco implemented maximum time caps for review, adding predictability to the process and reducing timelines. Dallas created a "gold card" plan that reduced permit approval times for smaller projects to just 45 minutes by giving by-right approvals to developers that consistently submit quality requests.

While more work still needs to be done, LA has made efforts in recent years to improve the system. Its successful initiatives can be accelerated and adopted by other cities in the region as well.

Re:code LA is an initiative that aims to simplify and modernize the city's entire zoning code. This initiative is working to minimize site-specific conditions and incorporate specific design standards that will enable many more projects to be by-right. If completed hand-in-hand with the community plan updates over the next two to three years, it can lay the groundwork for accelerating the types of housing Los Angeles wants to prioritize. Zoning requirements will need to be clear and to account for the requirements of different housing formats. The new code will also need to be paired with education on what will and will not meet inspections.

Construction permits must currently be approved by ten or more offices and departments, which can take six to 18 months depending on complexity. The approval system has historically been largely paper-based, slowing the process and increasing instances of lost documents and miscommunication. A seamless digital interface that links different city departments and developers could accelerate steps, improve coordination and communication, and provide a comprehensive view of citywide development.

[90] *Development process efficiency: Cutting through the red tape,* National Association of Home Builders and Abt Associates, November 2015.

In 2019, the city launched BuildLA, a focused, multi-year effort to digitally streamline development services and improve collaboration and communication between developers and city offices. This effort has the potential to eliminate the current confusion developers face when trying to navigate various city agencies to obtain clearance approval. One BuildLA initiative is an electronic plan check program (ePlan), which allows developers to submit plans, receive comments, and obtain approval electronically from the Department of Building & Safety, the City Planning Department, the Bureau of Engineering, and the Fire Department. The BuildLA portal will also enable customer self-service capabilities such as knowledge management, online project applications, payment, plan upload, and status tracking. A new universal cashiering system will collect development-related fees on behalf of multiple agencies to expedite transaction times and allow uniform financial reporting.

The BuildLA platform could provide a comprehensive view of citywide development with a consolidated live performance dashboard tracking projects through the pipeline and the time taken at each stage (Exhibit 13). This could facilitate problem-solving among neighborhoods, developers, and city agencies. It could also pave the way to new efficiencies. Experimenting with video for certain types of inspections, for example, can eliminate lost time in scheduling appointments.

Exhibit 13

A performance dashboard could provide a transparent view of development in LA.

Development pipeline dashboard

Last 12 months, updated Month, Day, Year

Source: McKinsey Global Institute analysis

Box 7.
What role can the State of California play?

This report focuses primarily on actions that can be taken at the neighborhood, city, and county levels. But the housing shortage is a statewide issue. Many of the issues Los Angeles is grappling with are also playing out in the Bay Area, San Jose, San Diego, and other cities.

Over the past few years, the state has been actively passing legislation and implementing programs to try to address the housing crisis. SB35, which went into effect in 2018, creates the authority to waive local requirements and streamline approvals in cities that fall behind on their RHNA goals for affordable housing creation. The state passed an extensive package of bills in October 2019 to address affordable housing, including caps on rent hikes for certain property types, a ban on landlords discriminating against tenants with Section 8 vouchers, a requirement to provide tenants with relocation assistance if they are forced to move from affordable units, and more.[1] Another measure designed specifically to address LA's homeless crisis, AB1197, exempts homeless shelters and permanent supportive housing projects in the city from CEQA review.

The state has room to take further action. Among the options to consider:

– Providing targeted incentives for housing types that can be built at a lower per-unit cost and can accommodate higher set-asides. For example, the state could relax specific "per unit" requirements for micro-units (such as those governing open space, parking, and allowed density) to allow by-right construction near transit in exchange for specified set-asides. Another option would be providing density bonuses for prefabricated and modular housing in exchange for higher set-asides.

– Offering incentives to seed the supply chain needed for prefabricated and modular construction. Demand guarantees can help companies achieve the appropriate scale. The state can also set up clear and simple design and inspection standards.

– Accelerating CEQA reviews. Providing better project-specific data on CEQA-related reviews and the time required for completion in all jurisdictions could identify bottlenecks and give developers predictability.[2] It may be necessary to create a dedicated clearinghouse for reviews, with an increased number of judges to hear these cases.[3]

– Supporting statewide workforce training to ensure that a shortage of skilled labor does not hinder affordable housing production.

1 Jeff Collins, "Newsom signs SB 330, 'Housing Crisis Act of 2019' aimed at speeding up homebuilding," *Orange County Register,* October 9, 2019.
2 Moira O'Neill, Giulia Gualco-Nelson, and Eric Biber, *Examining the local land use entitlement process in California to inform policy and process,* working paper number 2, Center for Law, Energy & the Environment at Berkeley Law, University of California, Berkeley Institute of Urban and Regional Development, and Columbia GSAPP Urban Planning, February 2019.
3 CEQA and Housing Production, 2018 Survey of California Cities & Counties.

The city has taken targeted steps to streamline the approval process for affordable housing developments. The city's Development Services Case Management office has case managers from the departments of Building and Safety, City Planning, Transportation, Water & Power, and Public Works (including the Bureau of Engineering, Bureau of Street Lighting, and Bureau of Street Services Urban Forestry Division) who work together to move priority projects through the permitting process. Projects need to have at least 20 affordable units (or 30 overall units) to take advantage of this service.[91] Likewise, the Parallel Design Permitting Process allows design and permitting to run concurrently for major projects.[92] The Priority Housing Program at Department of City Planning aims to expedite approvals for developments with significant set-asides for affordable units.[93]

Similar initiatives can be adopted regionwide. Ideally these services can be made available to all housing development projects with an affordable component. A data-backed assessment of the project pipeline, time taken at each step of the process, and effectiveness of these programs can help in identifying roadblocks as well as successes and best practices that can be replicated.

Denver and a number of smaller cities have implemented successful "one-stop shop" programs that involve consolidating all departments into a single location.[94] Los Angeles has considered similar initiatives in the past. Combining the Development Services Case Management (DSCM) model and a common digital platform could produce a similar outcome with more information-sharing between departments.

Adding more preliminary review sessions with developers at the beginning of the process could catch potential issues in applications before they are submitted, preventing churn and resubmissions. Los Angeles could also consider the model of Dallas's "gold card" program, with quicker reviews for frequent developers and affordable developers with solid track records.

5. Stabilize and consolidate public financing for affordable developments

Lining up financing for an affordable housing project in Los Angeles can feel like navigating a maze. It can involve applying for multiple types of tax credits, government funding, philanthropic grants, and loans—all with uncertain results. Sources include the federal government, multiple state programs, the Los Angeles County Development Authority, various pools of capital available through the city, private lenders, and social-sector organizations. Developers can apply for "off-the-shelf" 4 percent tax credits, or they can attempt to qualify for 9 percent federal low-income housing tax credits that are awarded on a biannual basis. The latter process requires showing commitments from multiple financial backers. Affordable housing developers must always be on the lookout for notices of funding availability from the City or County of Los Angeles. These infusions are often critical to getting a project off the ground, but their timing is unpredictable, and their requirements sometimes change.

Developers often hit roadblocks as they seek funding from different agencies and organizations. Each of these entities may have its own priorities and requirements. One funding source may be focused on building units for seniors, while another may be interested in housing for homeless veterans. In extreme cases, developers may be forced to change their designs for a project because they cannot fund their original plan. The application processes themselves represent a significant administrative burden. Developers are typically asked

91 For details on additional project requirements, see https://www.ladbs.org/services/special-assistance/dscm.

92 For details on project requirements, see https://www.ladbs.org/services/core-services/plan-check-permit/plan-check-permit-special-assistance/parallel-design-permitting-process.

93 According to LA City Planning, qualifying development must have ten or more dwelling units with either 20 percent of rental units affordable to and occupied by low-income households, or at least 30 percent of units for sale at restricted prices that are affordable to and offered to low- or moderate-income households.

94 These cities tend to be much smaller than Los Angeles, including Newton, Massachusetts, and Goodyear, Arizona. However, Denver created a Development Services office, which is a "one-stop" location with all relevant city agencies.

to provide detail on all financing commitments, title reports, ownership reports, control entities, architectural plans, property management, and social services providers who may be partners. Developers often have to submit updates as contractor estimates change. Application timelines for various funding sources may not be coordinated; one source of financing may expire before another necessary infusion of capital comes through.

Some funders require commitments from other backers before they will commit. This leads to a collective action problem and a Catch-22, as developers struggle to acquire initial funding because they do not yet have initial funding.

Developers in the region report that affordable housing projects in Los Angeles may require up to 52 months of preconstruction time, compared to 30 months or less for market-rate developments. Some of that discrepancy is due to the complexity of financing. Market-rate developers need to secure only one or two sources of financing, while affordable housing developers may need to turn to ten or more.

Streamlined financing could cut the preconstruction timeline by up to

45%

A true streamlining should aim to cut the timeline for financing affordable projects to at least match the typical timeline for market-rate developments. This could shorten the preconstruction phase by up to 45 percent.

Several solutions could address this problem. First, the funding award process should operate with greater transparency and predictability. Related to this, the city and county should strive to publish a notice of funding availability calendar.

One portal could serve as a clearinghouse where developers have access to all public and philanthropic funding sources with a single application. In fact, LA's Housing + Community Investment Department is working to roll out a universal application for all city funding sources, the Housing Authority's Section 8 program, the county's No Place Like Home Program, and other public funding sources; this initiative could go a long way in simplifying the financing process. While tax credit applications will still be controlled by the state, the timeline for the city and county applications will mirror them as closely as possible. Just as a "one-stop shop" can streamline the permitting and approval process, a similar model could simplify financing. A central office could assign a dedicated liaison to shepherd each high-impact project through until sufficient funding is secured. Los Angeles will also have to identify stable sources of funding for affordable housing. Since 2008, cuts in federal and state funding have reduced investment in affordable housing in LA County by more than $496 million annually, a drop of 70 percent. Most of this drop occurred after California dissolved local redevelopment agencies.[95] Now the region needs new strategies to create and tap into other funding streams (see Box 8, "Stabilizing funding for affordable housing").

6. Strengthen the safety net for the most vulnerable tenants

This report largely focuses on increasing the supply of affordable housing. But local authorities also need to support the most vulnerable low-income tenants in the short term.

Three groups in particular are vulnerable. First, as the region undertakes large-scale redevelopment, tenants affected by that construction need assistance. Current regulations have various ways to incentivize development of housing on sites that are vacant, commercial, or underbuilt, minimizing displacement. The vast majority of projects utilizing Transit Oriented Communities incentives, for example, have been developed either on vacant land or on properties with single-family homes. But it will take a much higher build rate, with development on many more sites, to meet higher housing goals. Los Angeles should be prepared to support tenants affected by the new builds—because it cannot risk letting more people slip into homelessness.

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95 *Los Angeles County annual affordable housing outcomes report,* California Housing Partnership, April 2019.

Box 8.

Stabilizing funding for affordable housing

To mobilize private capital, Los Angeles will have to rally a range of actors, including private and institutional investors and philanthropies. If LA can create a system in which housing can be built efficiently and with the right economics, much of this funding will flow in organically. However, the region will also need to leverage all possible city, county, state, and federal sources.

One option would be to create an integrated agency for financing affordable housing, either at the city or county level, following a model similar to New York City's Housing Development Corporation or the newly authorized Bay Area Housing Finance Authority.[1] In Los Angeles, this could involve setting up a new agency or expanding the mandate of an existing one. A public agency can act as a financial intermediary. It can consolidate funding from multiple public, private, and social sources; allocate it to the highest-impact projects; and provide appropriate guarantees. If well designed and executed, it could not only streamline the financing process for affordable developers but also unlock more capital through effective partnerships with private and social investors.

Such an agency could also take on professional management of city-owned land and other real estate assets, as New York City, London, Copenhagen, and Stockholm have done, generating additional revenue for affordable housing. There are 14,000 publicly owned parcels in the City of LA, of which 7,500 are owned by the city itself.[2] Professional management of this real estate can identify suitable city-owned sites for affordable developments; other sites can be developed commercially, with the returns channeled back into affordable housing. However, Los Angeles would have to attract expert talent and carefully design the required governance and management structures to ensure effective operations.

1 In 1971, the New York State Legislature created the New York City Housing Development Corporation (HDC) as a supplementary and alternative means of supplying financing for affordable housing that was independent from the city's capital budget. The flexibility built into HDC's authorizing statute allows it to amend its programs and goals in response to the changing economic climate. In 2018 alone, HDC issued more than $1.8 billion in bonds to finance affordable housing.

2 See Property Panel, City of Los Angeles Controller's Office, lacontroller.org/propertypanel.

We take it as an underlying principle that redevelopment should not force low-income tenants from their neighborhoods. Today, developers are required to pay relocation assistance (typically 12 months of rent), which has to be factored into project costs. But tenants may need additional logistical help to find suitable alternative housing. Cities across the region could play a coordinating role in monitoring when new units come online and connecting displaced tenants with those openings. The LA Homeless Services Authority has developed a "coordinated entry system" to match homeless individuals with affordable housing units funded by the city. Now the city may need to establish a similar program for a wider population of at-risk tenants. LA's Housing and Community Investment Department is currently building an online inventory of all non-subsidized affordable units to provide a single platform for tenants to apply; this effort could be accelerated and replicated across other cities in the region. It could eventually a broader population in need of affordable housing, in addition to those affected by redevelopment.

>10,000

affordable units will soon convert to market rates

Second, some tenants currently in affordable units are facing the prospect of sharp rent hikes. Between 2019 and 2023, 10,673 affordable units in the City of Los Angeles will convert to market rates as their affordability covenants expire. These agreements were established through a variety of federal, state, and local subsidies when the units were originally built, and they are not permanent.

A region that already has a severe shortage of affordable housing cannot afford to lose this many units. Unless Los Angeles preserves its existing affordable housing stock, it will take even more new construction to narrow the gap.

Extending the expiring covenants by compensating the property owners would be expensive. Buyouts typically reflect the difference between perpetual payment of rent of the affordable unit and market rent; it may run anywhere from $150,000 to $600,000, depending on the unit type and neighborhood median rent. By contrast, new affordable units can be built from the ground up for $175,000 to $500,000, depending on the housing type (refer to Exhibit 9 in Chapter 2). Overall, it can be cheaper to build a new unit than to extend a covenant.

A regional strategy and program can help cities and neighborhoods extend expiring covenants or place affected tenants in new affordable units nearby, making case-by-case assessments. The LA Housing + Community Investment Department's 2018–21 strategic plan provides a foundation for what could be an effective citywide initiative. Assessing the cost of extension versus the cost of building new affordable units, and negotiating with the property owners, will have to be undertaken on a case-by-case basis. If the neighborhood is able to produce an equivalent number of new units before a covenant expires, it might be beneficial to move tenants into the new construction. But if alternatives are not available in time, it would be expedient for the city to extend the covenant, either permanently or until another new affordable unit is available. Decisions should be influenced by whether tenants are able to relocate (some seniors and people with disabilities may find moving harder), the flexibility of the owner, the age of the building and its need for renovation, and its operating cost.

Cities across the region will need to set up a system to monitor property covenants, track looming expirations, assess which plan of action makes sense, and negotiate with property owners if necessary. Not every situation calls for a full buyout; the city could also offer options such as adding additional market-rate units on the same property or covering the cost of renovations to increase energy efficiency and reduce operating costs. If tenants are to move into new construction, cities should also monitor whether the replacement units will be ready on time. City offices responsible for this work will need to be well funded, perhaps with philanthropic support supplementing public sources.

The third and largest group of vulnerable tenants includes many thousands of Angelenos in financially precarious circumstances and substandard housing. Many are on fixed incomes or living paycheck to paycheck. The city already coordinates available rental assistance effectively, but it should explore all avenues for increasing the pool of funding. The philanthropic community can step into this gap.[96]

Los Angeles can also consider providing free legal assistance to low-income tenants facing unnecessary evictions, similar to the tenant right-to-counsel programs in New York, San Francisco, and Newark.[97] LA County has instituted landlord incentives, such as deposit payments and an emergency fund for any potential damage in the units, a program that can be replicated regionwide. Providing grants to tenants facing unemployment, eviction, or sharp rent increases can also help the vulnerable tenants bridge times of crisis. Taking preventive action to keep people from slipping into homelessness in the first place is preferable to assisting them after the fact.

The six strategies described here are not exhaustive, and they can be executed in a variety of ways. But if Los Angeles undertakes all of these actions, it can dramatically accelerate progress toward its goals and pivot toward a more sustainable and inclusive vision for the future. In the next chapter, we take a more detailed look at how these high-level actions might play out with variations in different neighborhoods.

96 For more on this topic, see *A tool kit to close California's housing gap: 3.5 million homes by 2025*, McKinsey Global Institute, October 2016.

97 The Los Angeles City Council is considering a proposal to create a "right to counsel" program offering legal advice and emergency payments to keep struggling renters in their homes. The Los Angeles County Board of Supervisors is exploring a similar proposal.


Hollywood

4. A neighborhood lens

Greater Los Angeles is a huge, sprawling patchwork of distinct neighborhoods and separately incorporated cities, each with its own look, feel, and community demographics. Some areas are dense, urban, and plugged into LA's steadily expanding public transit networks. Others are dominated by single-family homes and have a distinctly suburban feel. The city is home to ethnic communities, wealthy enclaves, downtown high-rises, and modest beach bungalows.

The diversity of LA neighborhoods means that the solution set described in the previous chapter cannot be applied in a uniform way across the entire region. Each neighborhood has its own starting point, and the mix of housing types that work in one context will not necessarily make sense elsewhere.

This chapter takes a look at how two of LA's largest neighborhoods might address large affordability gaps, looking at their demographics and the choices they can make. We focus on Hollywood, a neighborhood with both density and transit, and South Los Angeles, a large swath of the city with more single-family homes.

Hollywood can take advantage of density and demographics

Beneath the iconic Hollywood sign, LA's housing crunch is playing out in full view. With a median household income ($40,000) roughly 30 percent below the citywide average, the neighborhood's residents face a serious shortage of affordable options.

More than 90 percent of the neighborhood's approximately 65,000 households are renters. Someone earning between $30,000 and $35,000 per year, just below the Hollywood median, can afford to pay about $750 in monthly rent, but most local residents pay between $1,000 and $1,500.[98] This is actually less than the neighborhood's average rent per square foot for a standard 970-square-foot unit, implying that many people are making do by living in smaller quarters, sharing spaces, or relying on subsidies.

In this dense mixed-use neighborhood just west of Downtown, the major employers include Paramount Pictures and the pre- and postproduction services in the Media District; a large Kaiser Permanente hospital and a cluster of medical offices and facilities; and multiple neighborhood schools. Numerous attractions, theaters, and restaurants draw millions of tourists to Hollywood each year, employing thousands of service workers.

The typical full-time bartender, nursing assistant, or substitute teacher working in Hollywood might need to spend 70 percent of their income to afford a standard unit there. Even broadcast technicians, radiology technicians, emergency dispatchers, and school administrators would likely have to spend well over the recommended income allocation to live there. Barring a stroke of luck in finding a rare deal or the decision to make serious compromises in living standards, most of Hollywood's army of service workers cannot afford to live near their jobs without support from some other source. A single parent working in a restaurant, for example, might have to take on a second job in order to maintain an apartment there. Young singles in their first job—including those hoping to break into arts and entertainment—might move in with roommates.

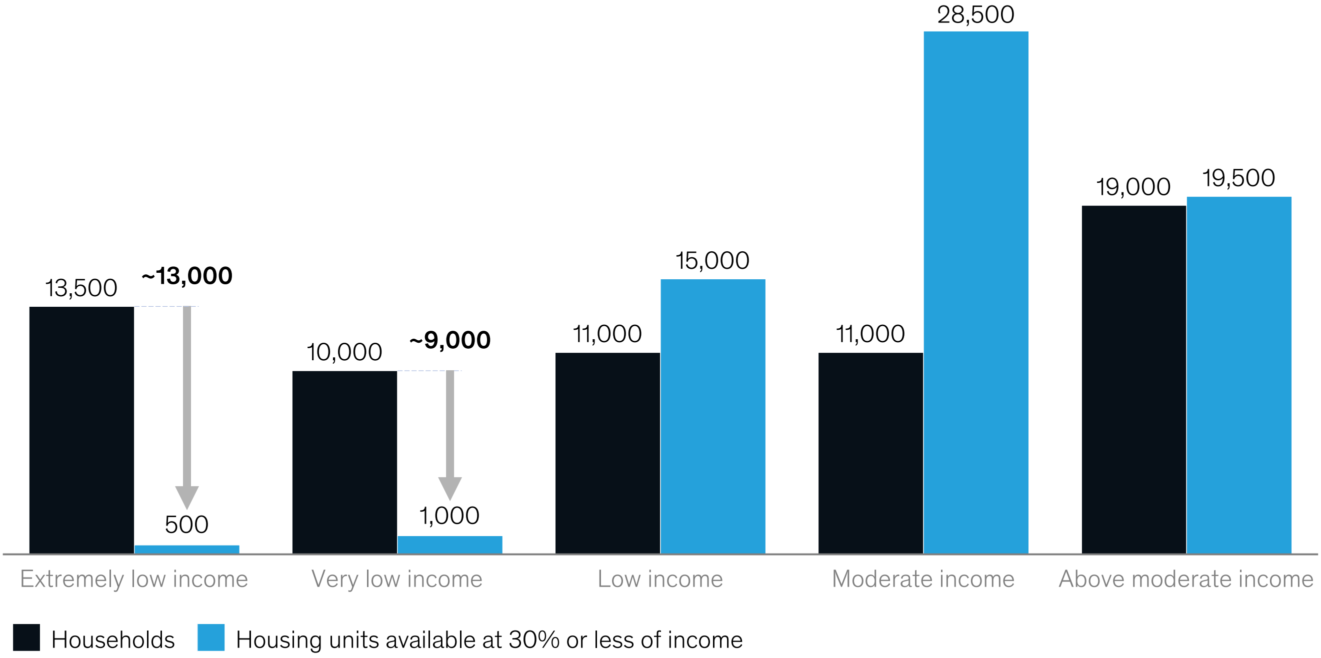
[98] American Community Survey.

Comparing the number of households in each income cohort with the corresponding availability of affordable homes for that cohort reveals a gap of roughly 13,000 units for extremely-low-income and 9,000 units for very-low-income households in Hollywood (Exhibit 14).[99] Affordability covenants and rental assistance programs likely assist some of this population, but certainly not all. Moreover, this number does not count the thousands of neighborhood workers who would like to live near their jobs but cannot do so today.

Exhibit 14

Approximately 22,000 Hollywood households in the lowest income brackets could not afford standard housing units in the neighborhood.

Households and number of local affordable housing units by income cohort



Note: Census tract data is available for 18 different income cohorts, which we have consolidated into five cohorts.
Source: American Community Survey; US Census Bureau; McKinsey Global Institute analysis

Hollywood has been receptive to new housing construction in recent years, with an average of about 560 units (across all income cohorts) permitted per year from 2013 to 2018.[100] But the problem is moving faster than the solutions. In Hollywood, affordability covenants are set to expire on more than 800 existing units by 2023.[101] Without targeted action to produce affordable housing, Hollywood's most vulnerable residents could slip into homelessness, potentially adding to the more than 3,000 individuals already living on the streets in the immediate area.[102]

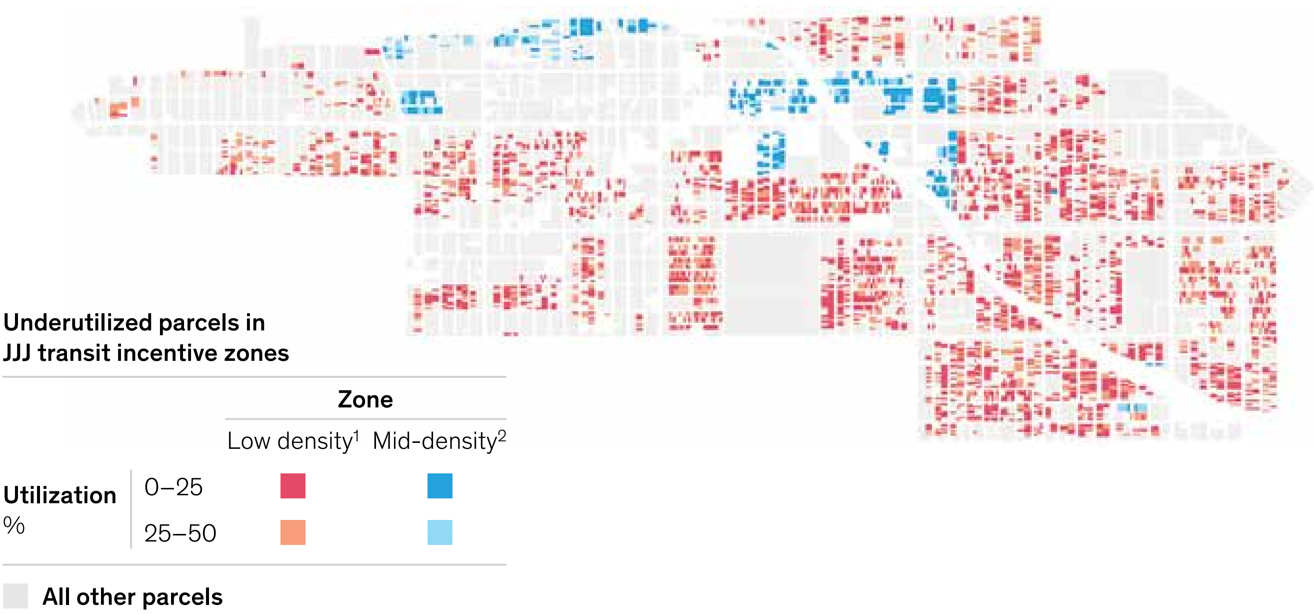
99 Data from American Community Survey, Experian 2018, and US Census Bureau. These numbers reflect reported income and rent distributions as well as the distribution of renting and owner-occupied households across cohorts.
100 Neighborhood Data for Social Change platform, University of Southern California Price Center for Social Innovation.
101 HCIDLA At-Risk Affordable Housing Database.
102 The 2019 Point-In-Time Homeless Count conducted by the Los Angeles Homeless Services Authority found a 10 percent year-over-year increase in homelessness in City Council Districts 4 and 13 (encompassing Hollywood).

Closing the gap

Already heavily developed, Hollywood is characterized by low-rise, multifamily residential properties. The vast majority of residentially zoned land falls in transit corridors as defined by Measure JJJ. Many of them are Tier 3 parcels, meaning that developers can receive density bonuses of up to 70 percent. Our analysis shows that 2,500 of these parcels utilize less than a quarter of the density they are allowed under current zoning, excluding the density bonus incentive (Exhibit 15). An additional 1,400 parcels utilize less than half of their maximum allowable density. Ninety percent of these underutilized parcels are zoned for residential, low-rise development and have the potential to accommodate more than 100,000 units in total under current zoning.

Exhibit 15

More than 2,500 parcels in Hollywood transit zones utilize less than 25 percent of their zoning potential, meaning that the neighborhood has sites for more than 100,000 new units.



Note: A parcel qualifies as "near transit" if it falls within Tier 1, Tier 2, Tier 3, or Tier 4 under Measure JJJ guidelines. Utilization of a parcel estimated using total number of units currently on the parcel divided by the maximum number of allowable units on the parcel (based on SCAG Countywide Land Use and Zoning data).
1. Residential zones R2, R3, RD2, and RD3.
2. Residential zones R5, R6, RD4, RD5, and RD6.
Source: City Assessor's Parcel Data; JJJ TOD legislation; LA Metro; McKinsey Geospatial Analytics; McKinsey Global Institute analysis

By contrast, just over 2,400 single-family homes currently exist in Hollywood, which means that adding accessory dwelling units and converting single-family homes into small multiunit properties would not be high-impact strategies. Similarly, Hollywood has relatively little nonresidential and public vacant land. Thus, Hollywood's most feasible path to adding more affordable housing lies in making use of underutilized residentially zoned parcels for greater density.

Micro-unit and co-living properties can be a natural fit for a subset of Hollywood's households. As discussed in Chapter 2, they achieve substantial cost savings per bedroom relative to standard property types. They can be highly attractive layouts for Hollywood's many young small and single-person households. These options might even appeal to some of the neighborhood's moderate-income professionals, including studio employees, hospital technicians, and school administrators, who might value the central location and urban lifestyle over having a large amount of pricey personal space. They can also be viable for aspiring artists, restaurant workers, and small young families, who may find that the combination of private bedrooms and shared co-living spaces add up to a better quality of life than what they can afford now. While the majority of new housing would still consist of standard units, some could be micro-units and co-living spaces. The neighborhood can support the additional density that goes hand-in-hand with these housing types better than other parts of LA because of its relatively good public transit connections, including the Metro Red Line.

South Los Angeles

South Los Angeles is the broad central swath of the city, south of Downtown and Mid-City. It encompasses affluent areas such as View Park, Windsor Hills, and Baldwin Hills/Crenshaw, and it is home to the University of Southern California, one of the wealthiest private universities in the country. But persistent poverty is the reality in many parts of South LA.

Almost 60 percent of the area's nearly 60,000 households are low income or below; almost a quarter are in the extremely-low-income bracket. South LA's median household income is just under $35,000, which is almost 40 percent lower than the median in the city as a whole. The neighborhood has few large employers, but its central location means residents can commute elsewhere in the city. South LA has a large number of both public and charter schools employing teachers and support staff. The commercial sections of the area support restaurants, bank branches, auto shops, post offices, and smaller medical offices.

Roughly 63 percent of households are renters, a share roughly on a par with the rest of the city. According to the American Community Survey, most South LA renters pay between $700 and $1,300 per month, varying greatly by community. However, as in Hollywood, this is less than the average rent for a standard (970-square-foot) unit in the area. This indicates that many people are making do by living in substandard spaces, sharing with extended family or roommates, or benefiting from existing housing assistance programs.

South LA has many middle-income blue-collar families (with the primary earner perhaps working in construction or warehousing) as well as single-parent households. Almost one-fifth of local residents are low-income single-person households, from seniors living alone on limited fixed incomes to struggling service workers employed in retail or food service. While young, affluent singles or couples without children make up almost 10 percent of the population in the city as a whole, they are notably absent in South LA.

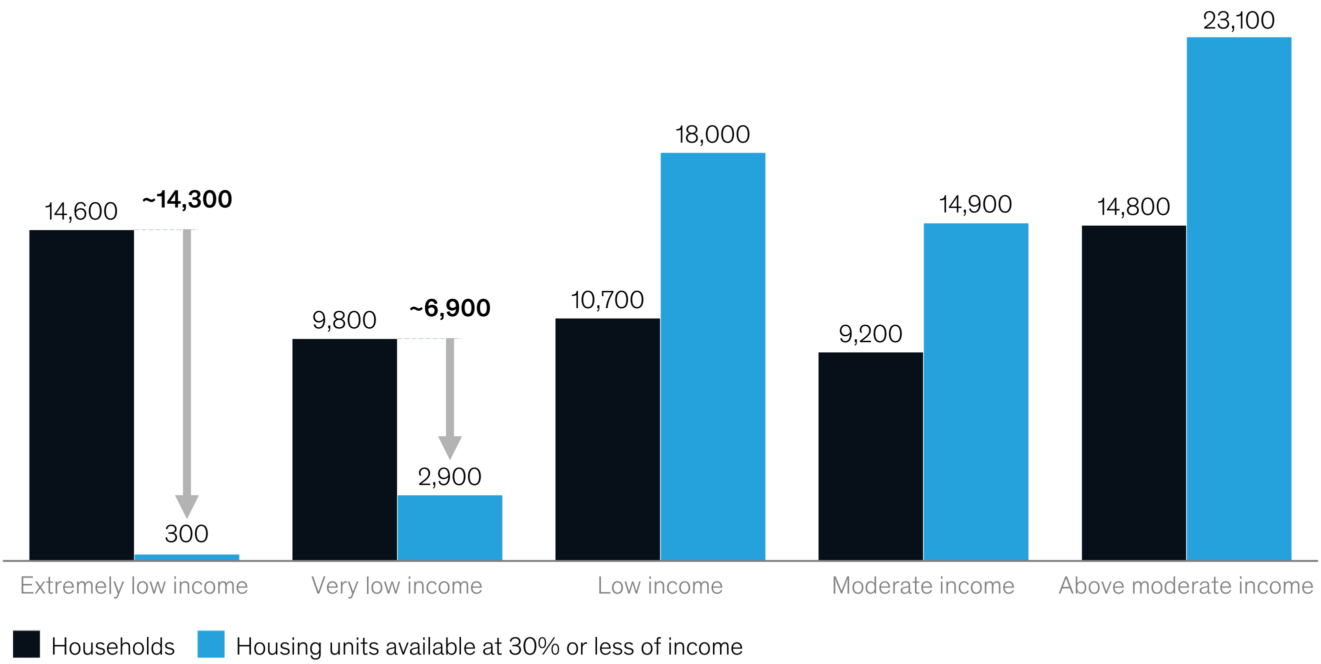
Comparing the number of households in each income cohort with the corresponding availability of affordable homes for that cohort reveals a gap of roughly 14,300 units for extremely-low-income and 6,900 units for very-low-income households in South Los Angeles (Exhibit 16).[103] In addition, South LA will likely lose almost 400 affordable units due to expiring affordability covenants. In 2019, the Los Angeles Homeless Services Authority identified more than 7,000 individuals in City Council Districts 8 and 9 (representing portions of South LA) experiencing homelessness, with 60 percent of them unsheltered. This represented a more than 30 percent year-over-year increase—a trend that South LA urgently needs to turn around.

[103] Data from American Community Survey, Experian 2018, and US Census Bureau. These numbers reflect reported income and rent distributions as well as the distribution of renting and owner-occupied households across cohorts.

Exhibit 16

Approximately 21,200 South LA households in the lowest income brackets could not afford standard housing units in the neighborhood.

Households and number of local affordable housing units by income cohort



Note: Census tract data is available for 18 different income cohorts, which we have consolidated into five cohorts.
Source: American Community Survey; US Census Bureau; McKinsey Global Institute analysis

Closing the gap

South LA has a mix of low-rise multifamily residential properties and single-family homes. In total, we identify the potential to build approximately 140,000 housing units based on current zoning.

A large chunk of residentially zoned land falls in transit corridors as defined by Measure JJJ. Our analysis shows that 6,000 of these parcels utilize less than a quarter of the density they are allowed under current zoning (excluding the density bonus incentive). More than 90 percent of these underutilized parcels are zoned for residential, low-rise development. They have the potential to hold more than 135,000 units under current zoning. Another 1,300 parcels utilize less than half of their maximum allowable density (Exhibit 17).

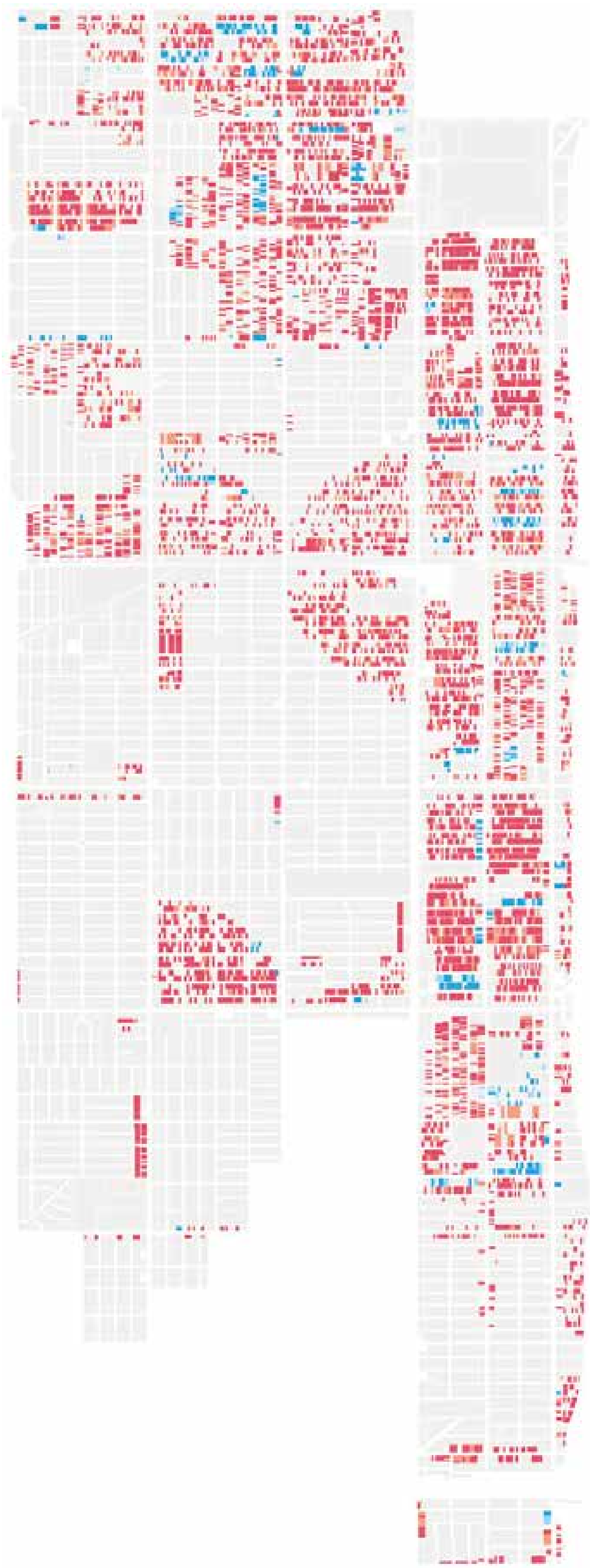
Exhibit 17

More than 6,000 parcels in South LA transit zones utilize less than 25 percent of their zoning potential, giving the neighborhood potential sites for more than 135,000 new units.

Underutilized parcels in JJJ transit incentive zones

		Zone	
		Low density[1]	Mid-density[2]
Utilization %	0–25	(red)	(blue)
	25–50	(light red)	(light blue)

All other parcels



Note: A parcel qualifies as "near transit" if it falls within Tier 1, Tier 2, Tier 3, or Tier 4 under Measure JJJ guidelines. Utilization of a parcel estimated using total number of units currently on the parcel divided by the maximum number of allowable units on the parcel (based on SCAG Countywide Land Use and Zoning data).

1. Residential zones R2, R3, RD2, and RD3.
2. Residential zones R5, R6, RD4, RD5, and RD6.

Source: City Assessor's Parcel Data; JJJ TOD legislation; LA Metro; McKinsey Geospatial Analytics; McKinsey Global Institute analysis

In addition, South Los Angeles has more than 350 non-transit-adjacent multifamily residential parcels that utilize less than 25 percent of their allowed density. They can provide an additional capacity of 4,900 units. South LA also has 3,400 parcels of commercially zoned land, some of which can be used for mixed housing and commercial developments.

A little over 21,000 single-family homes currently exist in South LA. Approximately 7,200 of them are on parcels zoned for multifamily properties (Exhibit 18). They represent a small but meaningful opportunity to add accessory dwelling units or convert some large single-family homes into small multiunit properties.

Co-living properties, ADUs, and single-family home conversions can provide an attractive set of housing types for South LA. With an average household size of 3.5 individuals, the neighborhood has many middle-class, middle-aged families. Co-living can be an attractive option for larger families and for hospital technicians, school administrators, and bank tellers who might value living closer to their work and in their community over a large amount of pricey private space. They could also be viable for aspiring lower-income singles in school or looking to start careers, who may find that the combination of private bedrooms and shared co-living spaces adds up to a better quality of life than what they can afford now. ADUs and multiplex conversions can offer families more privacy and independent space at a lower cost than standard units. South LA could consider adding more of these formats to its housing mix over the next decade to supplement standard units.

Exhibit 18

More than 7,200 single-family homes in South LA are on multifamily-zoned parcels, giving homeowners an option to add units on their properties.

Single-family home on

- Multifamily zone parcel
- Single-family zone parcel
- All other parcels

Note: A single-family home is considered to be on a multifamily-zoned parcel if it is on an R1.5 to R6 zoning code and corresponding (D) variations.

Source: City Assessor's Parcel Data; Measure JJJ legislation; LA Metro; McKinsey Geospatial Analytics; McKinsey Global Institute analysis

5. Moving Los Angeles forward

Consensus is growing that LA's approach to housing needs rapid and radical change. Before the region can move forward, however, it needs to confront the cost of delivering affordable housing and decide who will shoulder those costs.

The six actions identified in Chapter 3 can help unlock a significant amount of affordable development through market-driven projects with set-asides. But that may not be enough to achieve the upcoming RHNA goals for 2021 to 2029. There are choices to be made about how much of the problem is solved through market-driven development and how much to rely on public funding.

Across Los Angeles, many stakeholders with expertise on different aspects of housing issues can contribute to the solution. Bringing them together to work in a collaborative fashion could give this effort momentum and creativity. It could also make LA's fragmented, complex housing ecosystem more cohesive and easier to navigate.

What will it cost?

Los Angeles will need to marshal both private and public capital to increase affordable housing production. In general, building more, increasing density, and capitalizing on set-asides in private-sector developments will improve the region's chances of meeting its goals in a timely manner—with fewer public- and social-sector dollars. We estimate the funding needed to achieve the recently announced sixth-cycle RHNA allocation for Los Angeles County to show the impact of different choices and actions.

The total amount of public subsidies required depends what kind of build rate the region is able to achieve, what mix of housing types it embraces, and whether projects are built using traditional or more cutting-edge construction methods.

4.5X

higher building rate needed to meet the county's new housing production goals

In November 2019, LA County was given an overall housing production goal of 818,943 units, of which 475,694 units should be affordable to households earning less than 120 percent of the area median income.[104] These goals are highly ambitious in the context of how much has been built in the past. The county would have to increase its build rate by at least 4.5 times over current levels to achieve its overall housing production goal.[105] It would have to boost the current rate of affordable housing production by more than 20 times to meet its new goal for adding units affordable to households earning less than 120 percent of area median income.

The affordable housing goal can be achieved in two ways: through public subsidies or through market-driven developments with set-asides for affordable units. Building 100 percent of the affordable housing goal through public subsidies would require more than $130 billion

[104] "SCAG approves modified plan for allocating 1.34 million units as part of the 6th cycle RHNA process," Southern California Association of Governments press release, November 7, 2019. See also Liam Dillon, "Coastal cities give in to growth. Southern California favors less housing in Inland Empire," *Los Angeles Times,* November 7, 2019.

[105] Based on data from the California Department of Housing and Community Development, from 2014 to 2018, LA County averaged 22,500 permitted units per year, including 2,700 affordable units.

over the entire eight-year period (Exhibit 19).[106] The alternative is taking steps to achieve a significant portion of this goal through the private market.

LA County could adopt an incentive program similar to the Transit Oriented Communities provision in Measure JJJ, which has already had success in the City of LA. If the county fully meets its goals for adding new housing geared to above-moderate-income households, it would gain enough set-asides to meet almost 9 percent of its affordable housing goal.[107] This could reduce the public funding requirement by $13 billion. If the region adopts new housing formats and lower-cost construction techniques as described in previous chapters, it could achieve an additional 8 percent of its affordable housing goals through set-asides and further reduce the public funding requirement by another $13 billion.[108] New housing formats and lower-cost construction techniques also make it possible to produce housing that is affordable to moderate-income households without the need for subsidies.[109] This amounts to 28 percent of the overall affordable housing goal and reduces the required public funding by an additional $26 billion.

Together, these approaches create the potential for Los Angeles to achieve almost 45 percent of the next cycle's affordable housing target through market-driven development alone. Covering the remaining 55 percent of the RHNA target for new affordable units would require $41 billion to $81 billion in subsidies.[110] The size of this range reflects variations in housing formats, whether lower-cost construction techniques are used, and the level of affordability desired. The funding requirement could shrink further if prefab and modular construction of affordable units continues to scale up.

Public funds are a critical resource for affordable housing production. But they are limited and are best used in situations where market-driven solutions do not work. As a point of reference, the City of Los Angeles drew on a pool of roughly $550 million from various government funding streams in 2018 for affordable housing.[111] LA County made an additional capital investment of $180 million toward affordable housing in 2018.[112] It should be noted that taking public funds comes with the requirement to use public-sector procurement and development processes, which add cost and time.

[106] The subsidy amount is calculated based on the number of units required for each income cohort and the per-unit subsidy required to build a standard-size unit for the respective income cohort. See the technical appendix for detailed methodology. Briefly, the per-unit subsidy for a given income cohort was calculated as the amount of funding required to make the project feasible, taking into account the rental income expected from a tenant in that income cohort.

[107] This estimate assumes that LA County builds all of the above-moderate-income units allocated in the 6th cycle (343,249 units), with 80 percent of these units added in multifamily developments near transit that follow set-aside requirements similar to those set in Measure JJJ's Transit Oriented Communities incentive program.

[108] This estimate assumes that LA County builds all of the above-moderate-income units allocated in the 6th cycle (343,249 units), with 80 percent of these units added in multifamily developments near transit but a higher 30 percent set-aside requirement.

[109] Our analysis shows that accessory dwelling units, bungalow-style housing, conversions of single-family homes into multiplexes, and micro-units in multifamily developments can be affordable to moderate-income households (those earning 80 to 120 percent of area median income).

[110] The higher end of this range assumes all units are standard-size (970-square-foot) units. The lower end assumes that 60 percent of the units are standard size, 20 percent are micro-units, and 20 percent are co-living units. The funding estimate changes if these ratios shift.

[111] The largest single source of federal funding is low-income housing tax credits, which totaled almost $102 million in 2018 in the City of Los Angeles. Other federal sources (Community Development Block Grant, HOME, HOPWA, ESG, Continuum of Care, Public Housing Capital Fund, Community Services Block Grant, and others) totaled just over $319 million. The city itself had approximately $42 million available from its General Fund. Approximately $100 million in annual HHH funding is available for the next ten years, but almost all HHH funding had been committed as of September 2019.

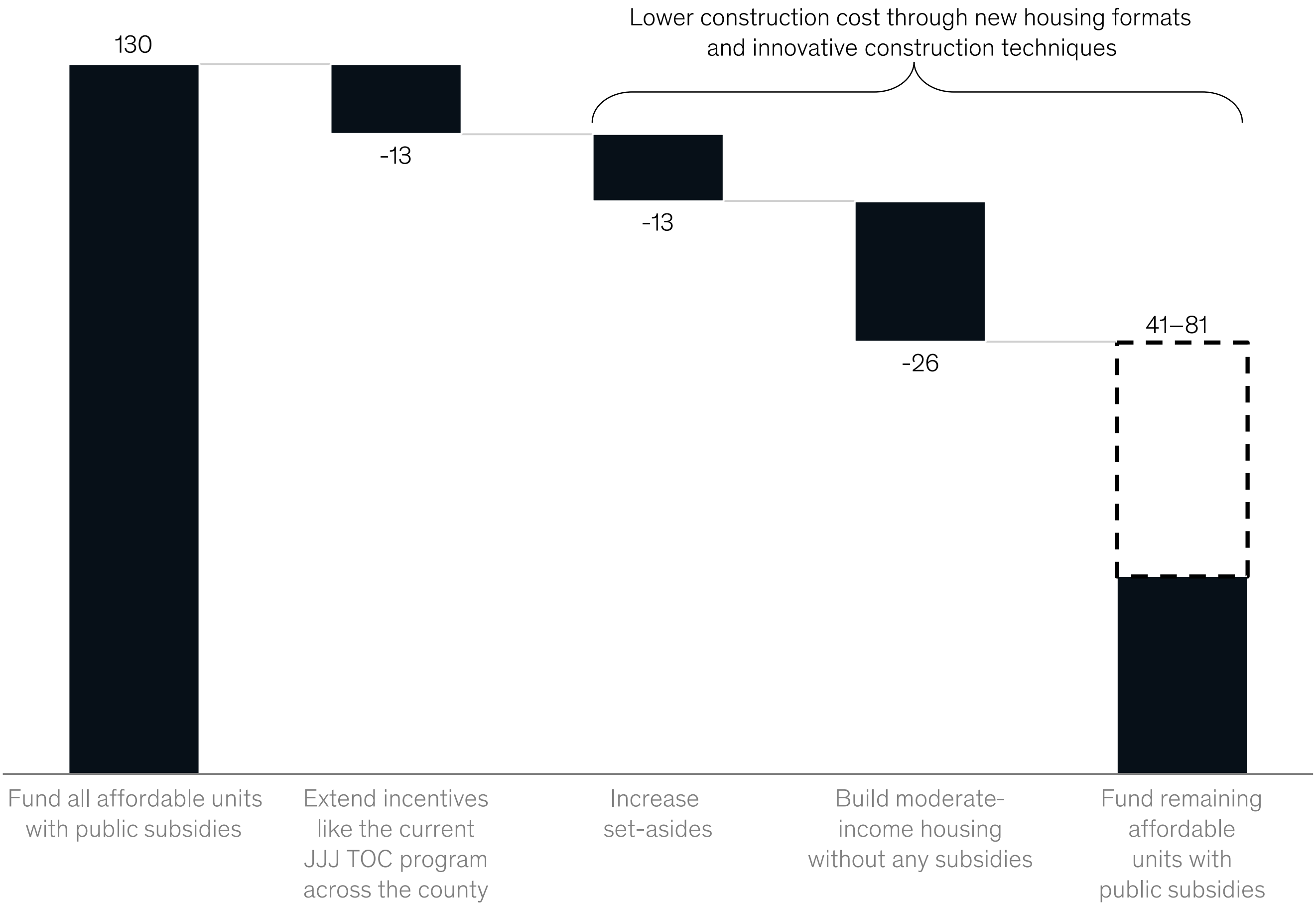
[112] *Los Angeles County annual affordable housing outcomes report,* California Housing Partnership, April 2019.

Exhibit 19

Los Angeles will have to make decisions on transit-oriented development, density, and housing mix to reduce the public funding required to achieve the next cycle's RHNA goals.

Cumulative public funding required to achieve the sixth cycle RHNA goal for affordable units for LA County, 2021–29[1]

$ billion



[1] Affordable housing goal refers to units affordable to households earning moderate income or lower.
Source: McKinsey Global Institute analysis

Reliance on the private sector has its own trade-offs. If demand for market-rate units holds steady, the commitment of more private capital can be beneficial for Los Angeles. It produces more construction jobs, economic activity, and returns that can be recycled into future housing production. However, in the event of a market downturn, the region could find itself with an excess of market-rate units that creates downward pressure on prices and rents. While this could potentially benefit renters in the short term, it would affect homeowners and reduce the economic ability to provide affordable housing via set-asides. (The funding analysis described in this chapter assumes that demand for market-rate units remains stable at current levels.)

The combination of density around transit, innovative construction techniques and housing formats, and higher set-aside requirements could be a powerful one to mobilize private capital. Policy makers can consider giving projects that follow this model by-right approvals and incentives. When the state and city took broad action to allow accessory dwelling units, permit applications shot up citywide, a positive trend that could be replicated on a bigger scale with micro-units and prefab construction. Public dollars could be directed toward efforts to support households with more acute needs such as supportive services, rental assistance, preservation, and eviction support.

Los Angeles will likely have to take an “all of the above” approach to meet its affordable housing goals. Increasing the build rate is a must, along with higher set-asides for deed-restricted units that are within reach for low-income households. Ramping up to this degree would also affect labor demand. The region should take steps to bolster the local workforce in the construction industry to mitigate the risk of shortages.

Additional funding is needed for rental assistance

The funding estimates in the scenarios presented here do not include any rental assistance for existing units. While the long-term solution is building more affordable units, those homes are years away for many people. The city needs to take action in parallel to stabilize the situation and prevent the gap from widening even further. With rents climbing and a homeless population of 36,000 in the city and almost 60,000 across the county, Los Angeles cannot afford to lose any more ground.

According to HUD, public housing authorities in Los Angeles County collectively allocated some 94,000 tenant-based vouchers in 2018.[113] An additional 7,000 households were given rental assistance through the Flexible Housing Subsidy Pool. Even though rental assistance programs have expanded in the past few years, these numbers are significantly smaller than the one million renter households across LA County that are cost-burdened, according to California Housing Partnership estimates, or the 1.9 million households that fall into the affordability gap in our own analysis.

Recent moves to allow the use of up to 30 percent of its vouchers on a project basis and to forbid discrimination against tenants using vouchers are positive steps that will ensure the most effective use of current resources. But the region will have to continue identifying additional public and philanthropic sources for rental assistance, especially as it undertakes large-scale redevelopment and needs to support residents during that disruption (see Box 4, “Redevelopment and temporary tenant displacement,” in Chapter 2).

How can Los Angeles deliver on its goals?

Los Angeles needs to turn its fragmented housing market into a cohesive and action-oriented delivery system for affordable housing. The region needs to harness and integrate the considerable energy, expertise, ideas, and capital found across disciplines and different parts of the city.

A public-private-social delivery coalition could advance solutions that are beyond the capacity of any single actor. It should bring together for-profit and nonprofit developers, builders, the relevant public agencies, and neighborhood representatives—plus the city’s major employers, investors, and philanthropists. Apple’s recent pledge of $2.5 billion signals that the private sector recognizes affordable housing as a corporate social responsibility priority.[114] Hopefully other companies will follow suit. Major corporate commitments can be used to plug short-term emergency needs, but they can also help to put long-term enablers in place.

A delivery coalition, perhaps united in one physical space, can provide a forum for conversations and debates on some of the difficult decisions that need to be made. It can take up specific bite-sized initiatives and form dedicated task forces to move them forward, drawing on its broad range of partners to shape the action plan and resolve bottlenecks. Part of its mandate could be monitoring progress and ensuring public accountability to the collective goal of ensuring affordable housing for all. It can also provide technical assistance and serve as a clearinghouse of information, from helping neighborhoods with their community plans to providing resources to individual homeowners who want to add accessory dwelling units.

[113] *Los Angeles County annual affordable housing outcomes report,* California Housing Partnership, April 2019.
[114] Andrew Khouri, “Apple pitches in on pressing state problem,” *Los Angeles Times,* November 4, 2019.

This kind of entity could also serve as an incubator of ideas, hosting exhibits and events that showcase innovative designs, successful programs, relevant technologies, and best practices. The coalition could introduce digital innovators, philanthropists, and social services providers into the mix. Enlisting the LA architecture community will emphasize that design matters—and that building a more affordable city can go hand-in-hand with building a more beautiful city.

By creating a public-social-private initiative with a civic mandate, LA can draw on the ideas and resources of its full set of leaders who care deeply about how the city is evolving and are eager to be part of the solution.

Los Angeles has always been a place that welcomed people from all over the country and the world with a sense of wide-open opportunity. In recent years, the affordable housing shortage and the homeless crisis have dampened that promise—and if these issues continue, the region could lose the next generation to places where it is easier to gain a foothold. But Los Angeles is starting to respond. All indications point to a realization that it's time to shake up the old way of doing things and bring a real sense of urgency to meeting this challenge. This is first and foremost about meeting the basic needs of the majority of residents today, but it is also an opportunity to reimagine a more inclusive Los Angeles.

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