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The Landscape of Middle-Income Housing Affordability in California

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Introduction

Between 1940 and 1960, California built over 3.3 million new homes, more than doubling the existing housing stock. The average home cost $15,000 to purchase, equivalent to about $140,000 today. Average rents were around $80 a month, or $760 in today's dollars, and the state's average house prices were largely in line with the rest of the country's. Although the state's post-war housing landscape was not without fault—racial discrimination and poor housing quality limited access to safe and affordable housing for many—housing costs were largely in line with household incomes. The average factory worker, teacher, nurse, or line cook was able to rent a home and spend less than thirty percent of their income on housing.

Today, California's housing market is dramatically different. For the last fifty years, California has not built enough housing to meet demand. The statewide median sales price for a single-family home in October of 2021 was $800,000; in San Francisco, it reached $1.3 million. Average market rents hover above $2,500 in all coastal markets. Even in cities like Fresno, which have historically been more affordable, the average rent is over $1,800 a month. Housing costs in California are now among the highest in the nation.

Some of these higher housing costs have been offset by higher wages. New jobs—for example, in information technology, finance, and real estate—pay significantly higher wages than similar occupations twenty years ago. For instance, the average salary for a computer and information systems manager rose from $120,000 in 1999 (adjusted for inflation) to over $185,000 in 2019. The growth in higher-paying jobs has pushed up the household median income in some regions of the state, meaning that the definition of a "middle-income" household varies across places, and in the state's coastal regions, tops $100,000. For many occupations that have traditionally been considered middle class, wages have not kept up with rising house prices. This mismatch between housing costs and incomes—especially in the state's coastal areas—are straining household budgets and putting homeownership increasingly out of reach for middle-income families.

The lack of lower-cost options for those earning median incomes have negative consequences for the state's housing and labor markets. More middle-income households are staying renters, decreasing the available housing stock that is affordable to lower-income groups, as middle-income households are able to outbid low-income households for available units. The lack of lower-cost homeownership opportunities also limits pathways to wealth building and access to higher-resourced neighborhoods, especially for households of color.[1] And there is growing concern about the loss of middle-income households to other, lower-cost housing markets, such as Portland and Austin.[2] As housing cost burdens move up the income ladder, the state also risks losing essential workers, such as teachers and nurses.

The lack of housing affordability for middle-income households is in part due to the lack of housing production overall; this lack of supply is foundational to California's housing crisis. But it also reflects a set of market conditions that raise the costs of development and encourage the construction of larger, higher-cost, and "luxury" units that can be unaffordable to middle-income households. In response to a lack of overall supply and market dynamics unlikely to produce the needed stock of homes affordable to middle-income households, policymakers are beginning to consider new solutions. However, there remains a lack of consensus on the appropriate tools for catalyzing middle-income housing. Existing financial governmental resources remain scarce, meaning that direct-subsidy programs are rightfully reserved to address the housing needs of low-income households, who have the highest risk of housing insecurity and homelessness.[3] Given this, policymakers at the state level have considered proposals in recent years to catalyze housing affordable to middle-income households by reforming existing affordable housing tools, such as property tax exemptions or the density bonus, though these ideas have not passed. Some California cities have pursued strategies to finance deed-restricted middle-income housing through bonds, but they have needed to weigh the positives of this strategy against lost tax revenue and public benefits—including revenue that could be used towards housing at greater levels of affordability where there is greater need. Given the limitations of the aforementioned options, many California policy makers have instead looked at a different set of potential solutions to address the housing affordability challenges of middle-income households, without relying on direct government subsidy.[4] By making land use, building code, and regulatory reforms to encourage new housing construction that is not "luxury" or large-format, these pathways would incentivize and create the conditions for the market to provide new homes that are attainable to middle-income households.

In this brief, we focus on the opportunities for and challenges to building more market-rate supply that is affordable to middle-income families in California. We begin by providing an overview of housing cost burdens for middle-income households and show how the market is failing to produce enough housing for this market segment. We then present four case studies of cities that are trying to expand the production of middle-income housing through land use and zoning strategies. The final section presents policy recommendations for how jurisdictions and the state could help close the gap for middle-income households.

What Does Middle-Income Mean? A Note on Methodology

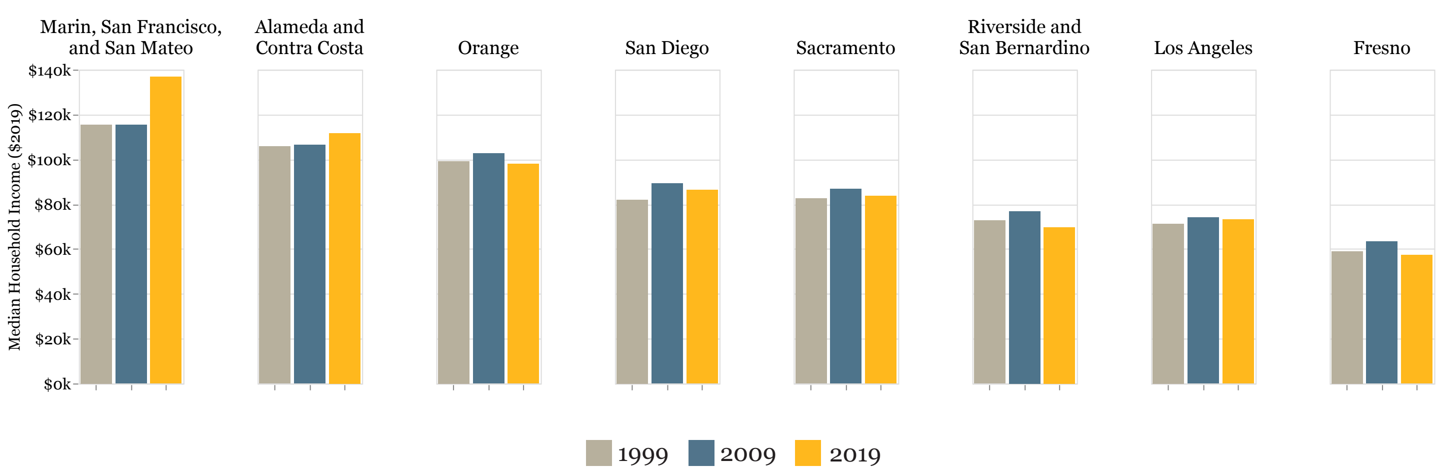
There are lots of different ways of categorizing household incomes, and terminology across programs and reports can be confusing. Research and policy often peg housing affordability to a county's median income, referred to as the area median income or AMI. For example, most housing programs will target households earning less than 50 or 60 percent of the AMI for assistance. Benchmarking income classifications to a local median helps to account for geographic differences in the cost of living. But it also means that who is classified as "middle income" can vary significantly by region.

In Fresno, for example, the median household earns around $60,000—less than half that of a median family in San Francisco (Figure 1). The Bay Area in particular has seen a significant growth in higher income earners since 2009, skewing the median upwards and belying a common understanding of what it means to be a middle-income household. In 2019, a household of four in San Francisco could earn between $130,000 and $165,000 and still be considered statistically "middle-income." Across California as a whole, the median household income in 2019 was $80,440.[5]

Households earning close to the median are statistically in the middle part of the income distribution, and so researchers commonly refer to households with incomes between 80 and 120 percent of AMI as "middle-income" households. But this calculation often differs from the programmatic thresholds used by government agencies, which are adjusted to account for household size and housing market conditions. Both the U.S. Department of Housing and Urban Development (HUD) and California's Department of Housing and Community Development (HCD) make adjustments to the thresholds that determine eligibility in high-cost areas of the state. This can lead to some anomalies in who is considered middle-income: the 80–120 percent AMI threshold band for a family of four in Los Angeles, for example, is $83,500 to $87,700, even though the median income for the county is $73,100.[6] In contrast, in Madera County, program thresholds align almost exactly with the mathematical calculation of 80–120 percent of the median.

Further complicating the definition is that different agencies use different terms to refer to the same concept. The Community Reinvestment Act, an important source of funding for affordable housing construction, refers to households at 80–120 percent of AMI as "middle income." However, California's Department of Housing and Community Devel-

Figure 1. Differences in Household Median Income, Selected California Counties, 1999–2019



Source: 2000 Decennial Census, 2009 and 2019 1-year American Community Survey. Household incomes for 1999 and 2009 adjusted for inflation to 2019 dollars.

opment (HCD) refers to those at 80–120 percent of AMI as “moderate income.” The California Statewide Communities Development Authority uses both “moderate income” and “middle income” to refer to households with incomes between 80 and 120 percent of AMI.

Housing affordable to middle-income earners is also sometimes referred to as “workforce housing” and references not only a particular income band (sometimes 80–120 percent AMI, sometimes 60–100 percent AMI, sometimes 80–150 percent AMI) but also particular occupations or industries that typically pay a middle-income wage (for example, teachers and social workers). This term, however, obscures the fact that the vast majority of extremely low-income (ELI) and low-income households are also important members of the workforce. There is also increasing interest in “missing middle” housing, which refers to the lack of new construction of smaller, lower-cost housing typologies like townhomes, duplexes or fourplexes, and courtyard apartments, but that housing type does not necessarily describe the income of the household that lives there.

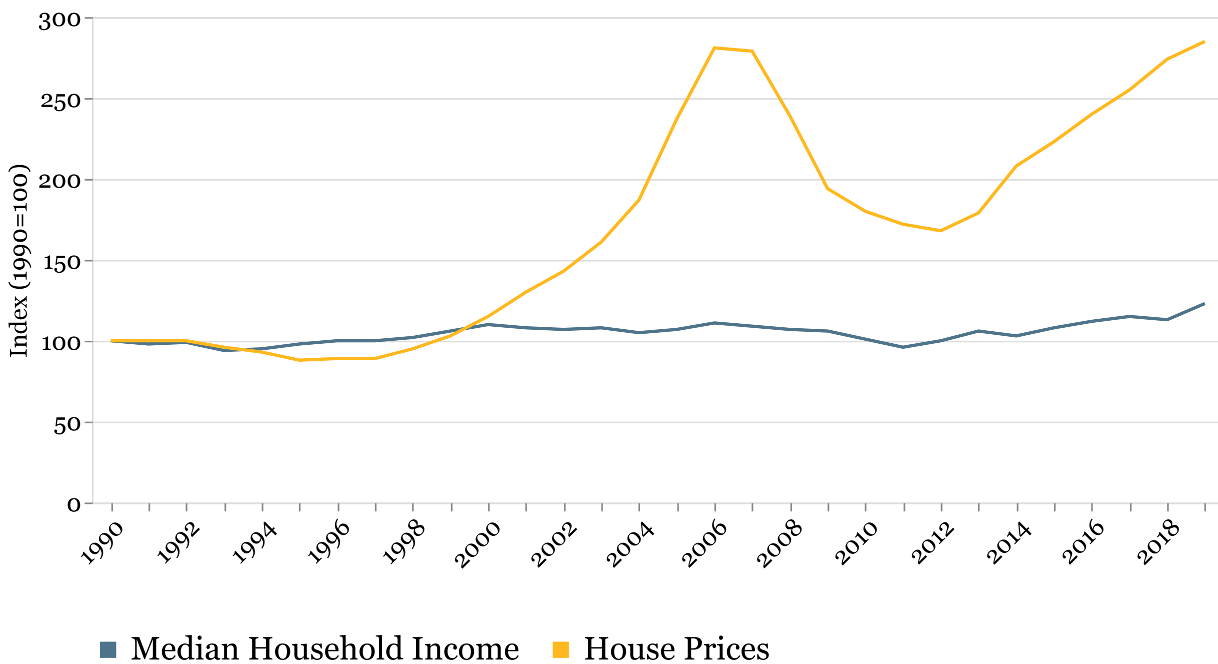
In this report, we focus on households earning 80–120 percent of AMI, as defined by HCD for state programs. We refer to this group as middle income throughout this brief, except when specifically referring to Regional Housing Needs Allocation (RHNA) targets and data from jurisdictions’ Annual Progress Reports, when we use HCD’s “moderate income” terminology.

The Rising Challenge of Housing Affordability for Middle-Income Families

Although wages in California are higher than in other states, over the past two decades, home values have risen significantly faster than household incomes (Figure 2). Even with housing price volatility related to the foreclosure crisis and Great Recession, house values increased by roughly 180 percent between 2000 and 2019. In contrast, median household incomes in California increased by only about 23 percent over the same time period.

The mismatch between housing costs and incomes leads to housing cost burdens across the state. In 2019, about 39.5 percent of California households were housing cost burdened, with rents or homeowner costs taking at least 30 percent of their household income. This represents a new record of 5.2 million households in the state facing housing cost burdens. Renters are more likely to face housing cost burdens than owners: 53.1 percent of renter households in the state are cost burdened, compared to 29.6 percent of owner households. Cost burdens are also highest for ELI and very low-income (VLI) households: 91.8 percent of ELI and 83 percent of VLI renters are cost burdened (Figure 3).

Figure 2. Growth in House Prices Compared to Median Household Incomes



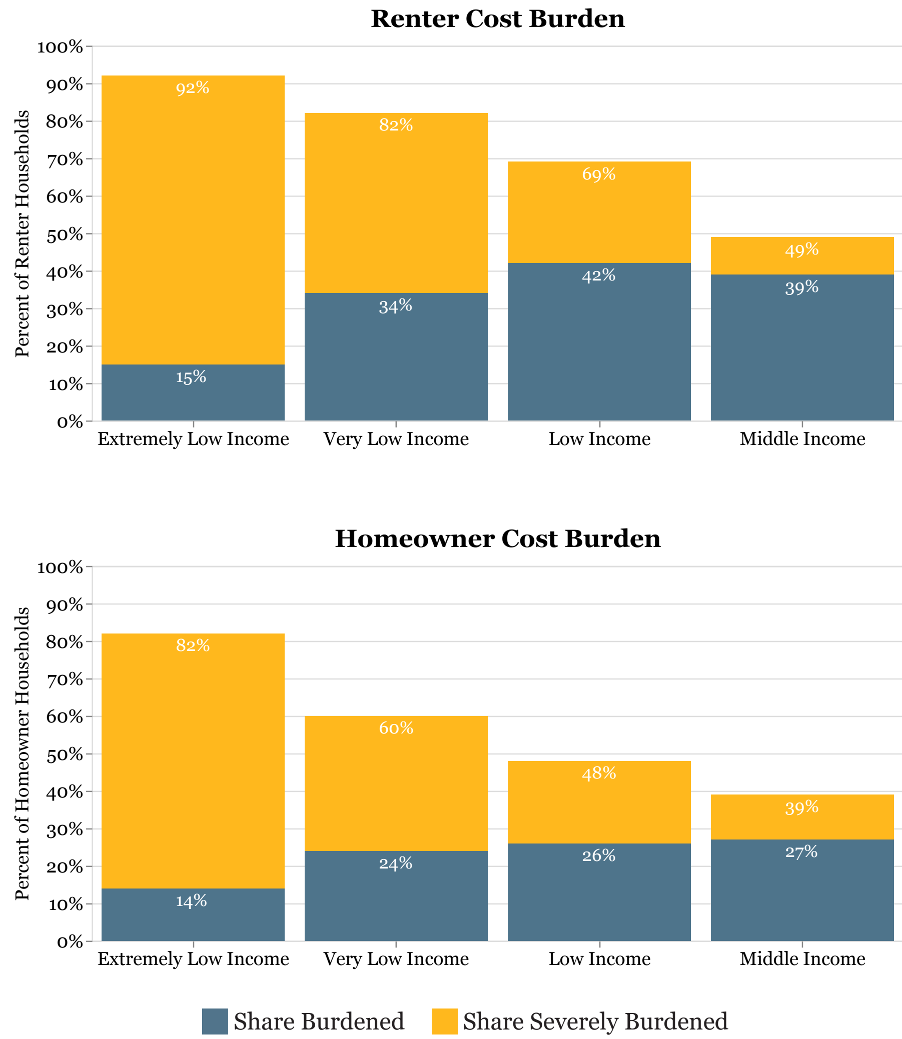
Source: Federal Reserve Bank of St. Louis, Federal Reserve Economic Data (FRED), Economic Research Division, 1990-2020.
Note: All-Transactions House Price Index for California, Index Q1 1990=100, Quarterly, Not Seasonally Adjusted. Median household income inflation adjusted using 2019 CPI-U-RS adjusted dollars.

However, the data show that cost burdens also affect middle-income households. Approximately 39 percent of middle-income renters are spending more than 30 percent of their income on housing, while 10 percent are severely cost burdened, meaning that more than half of their monthly income is spent on rent. Among middle-income homeowners, around 39 percent are either cost or severely cost burdened.

These cost burdens have grown significantly over time. Between 2010 and 2019, the share of middle-income renters who were cost burdened increased by roughly 9 percentage points, from 39.6 to 48.7 percent. Despite regional differences in housing market conditions, rent burdens for middle-income households increased in the majority of California's ten most populous Metropolitan Statistical Areas (MSAs) (Figure 4). While some of these cost burdens may reflect middle-income households choosing to live in larger or nicer homes, the data point to the fact that middle-income households in many of the state's urban areas are devoting a significantly larger share of their incomes to rent than just a decade ago.

High housing costs also contribute to the state's low homeownership rates: only 58.8 percent of Californians own their home, the third lowest homeownership rate in the country (behind only New York and Washington, D.C.). Of particular concern is the lack of "entry-level" homes that are accessible to first-time homebuyers. First-time homebuyers tend to have less savings to put toward a down-payment, and generally also have lower credit scores that influence their ability to get a mortgage (or the pricing on that

Figure 3. Housing Cost Burdens in California by Tenure and Income Level, 2019

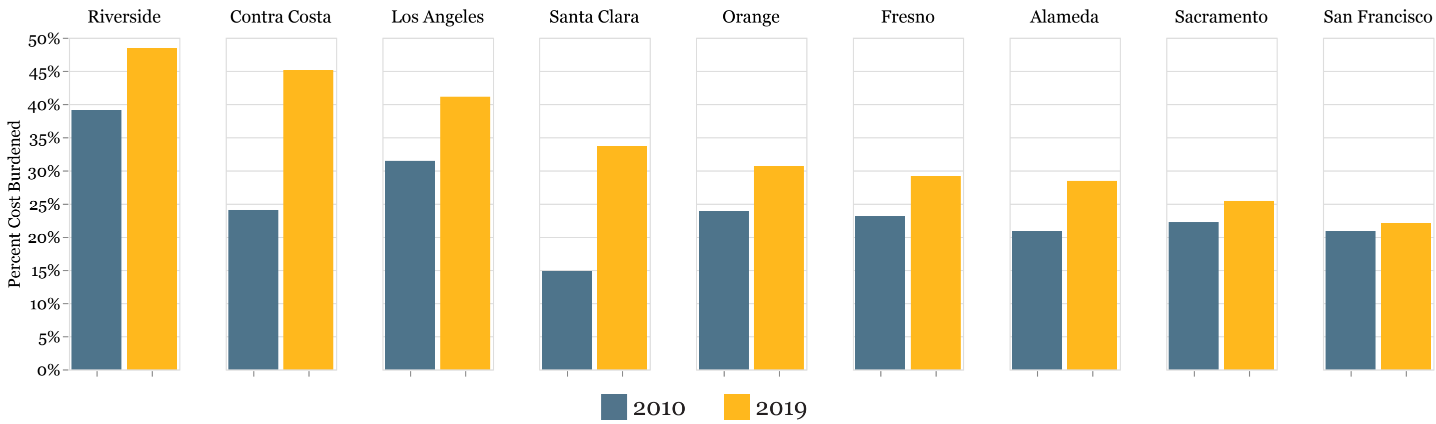


Source: U.S. Census Bureau, Public Use Microdata Sample (PUMS), 2019. Notes: Extremely Low-Income (0–30 percent AMI), Very Low-Income (30–50 percent AMI), Low-Income (50–80 percent AMI), Middle-Income (80–120 percent AMI).

loan).[7] Figure 5 presents house values for entry-level homes in three markets: San Francisco, Los Angeles, and Sacramento. In San Francisco, lower-cost properties are selling for an average of $1 million, approximately $200,000 more than a typical household at 120 percent of AMI can afford. Only in Sacramento are entry-level homes affordable to middle-income households. These regional differences in house prices contribute to workers commuting longer; for example, between 2014 and 2019, the number of workers who commuted from Sacramento to San Francisco increased by nearly 10,000.

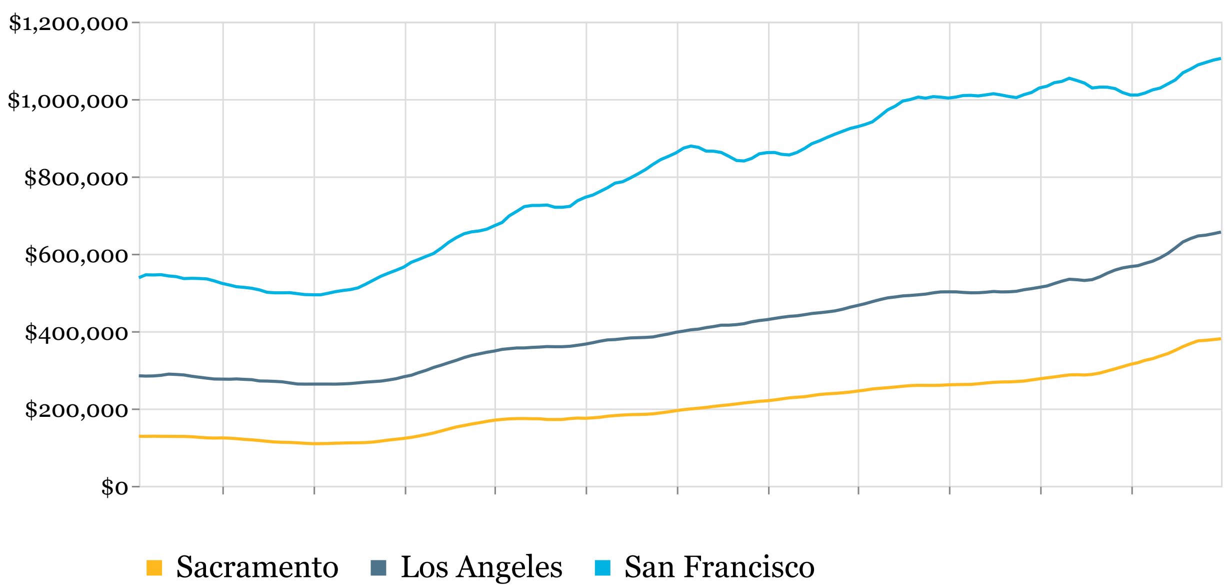
As prices have risen, middle-income households have seen their homeownership rate erode significantly. In 2000, 59.2 percent of middle-income households in California owned their home; by 2019, that share had dropped to 51.7 percent.[8] Analysis of mortgage lending data show that in the state's largest counties, the share of homes that sold in 2019 that would have been affordable to a middle-income household earning up to the median (100 percent of AMI) has dropped considerably since 2010.[9] In Los Angeles and San Francisco, for example, less than a quarter of homes sold would have been affordable

Figure 4. Share of Middle-Income Renters Paying More than 30 Percent of Income in Rent, Selected California Counties, 2010 and 2019



Source: US Census Bureau, Public Use Microdata Sample (PUMS), 2010 & 2019.

Figure 5. Trends in Entry-Level Home Prices, 2010–2021

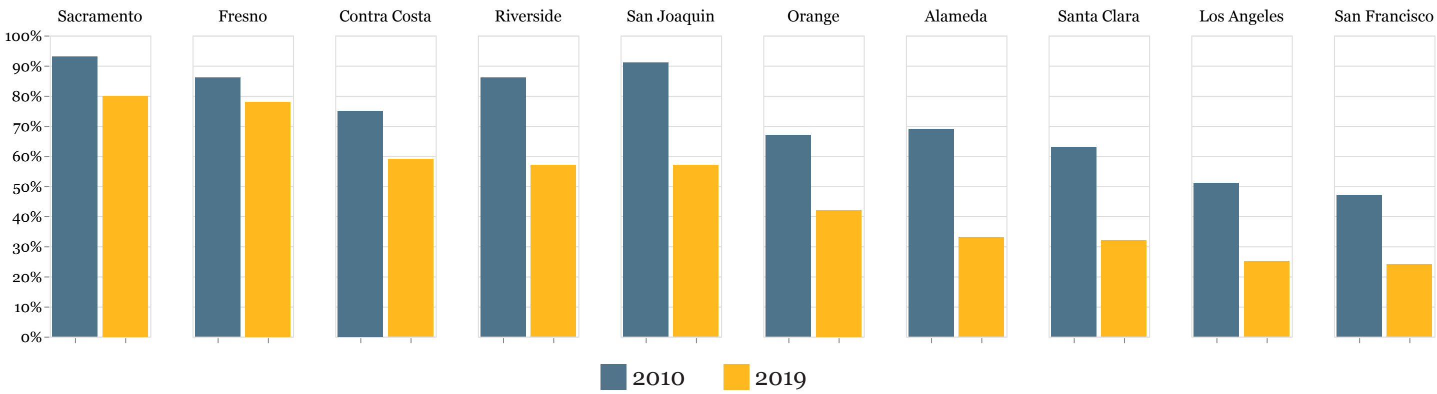


Source: Zillow House Value Index, available online at https://www.zillow.com/research/data/. Entry-level homes are defined as those that fall within the 5th to 35th percentile range for a given region.

to a middle-income household. But even in places like San Joaquin County—which has become part of the larger Bay Area mega-region—the share of homes sold that are affordable to middle-income families dropped from 90 to 58 percent over the course of the decade (Figure 6).

The impact of declining homeownership access for middle-income households is particularly pronounced for households of color, who are more likely to be renters. Nearly two-thirds of Black middle-income households in California rent their homes, compared to just 37 percent of non-Hispanic White middle-income households (Figure 7). The inability of households of color to buy homes reinforces long-standing structural racial inequities, as current generations are shut out of the wealth building aspects of homeownership just as past generations were excluded when houses were more affordable but

Figure 6. Share of Homes Sold Affordable to Middle-Income Households, Selected California Counties, 2010–2019



Source: Terner Center analysis of 2010 and 2019 Home Mortgage Disclosure Act data.

mortgage discrimination was legal. This can be seen clearly in the breakdown of home purchases by race (Figure 8) where 51 percent of overall purchases went to non-Hispanic White households, even though they represent only 35 percent of California's population. This is likely an undercount as our data cannot account for people who bought their homes entirely with cash.

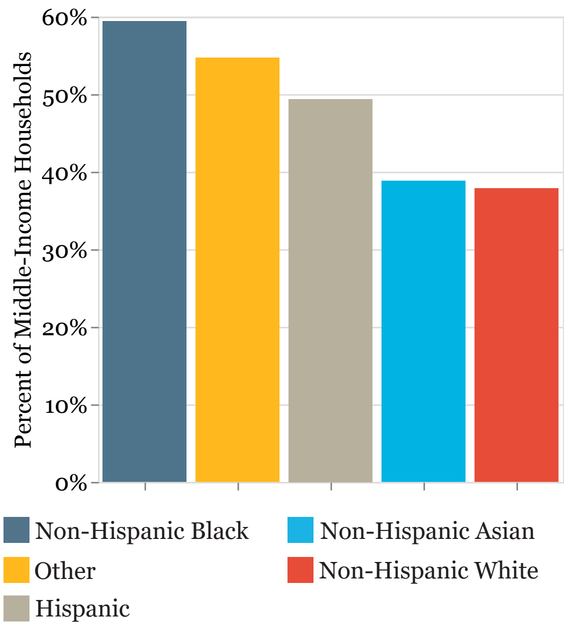
While many factors contribute to declining affordability, the inability to build sufficient housing supply, particularly at deep levels of affordability, is a key driver.

California ranks 49th among all U.S. states in terms of housing units per capita, with 358 units per 1,000 people, far below the national average of 419 units per 1,000 people.[10] Although estimates of the actual production needed to address the lack of supply vary, HCD estimates that the state needs to build more than 2.5 million new homes by 2030 to meet projected needs—approximately 312,500 units per year.[11] Since 2010, California has only built an average of 87,000 units per year, less than one third of this goal.

Across the state, jurisdictions are failing to meet the production targets established by the Regional Housing Needs Allocation (RHNA) process. Although there is significant debate about the RHNA process and the methodology by which the allocations are set, data show that even with relatively "modest" targets, jurisdictions are far behind their allocations. While the 5th RHNA cycle—which spans 2014-2022—is not complete for all jurisdictions, none of the 10 largest MSAs in the state have come close to meeting their RHNA targets for units under 120 percent of AMI (Figure 9). While very-low and low-income categories are the most underbuilt—in part due to the scarcity of subsidies—statewide, only 40 percent of units targeted at those earning 80–120 percent of AMI have been built.

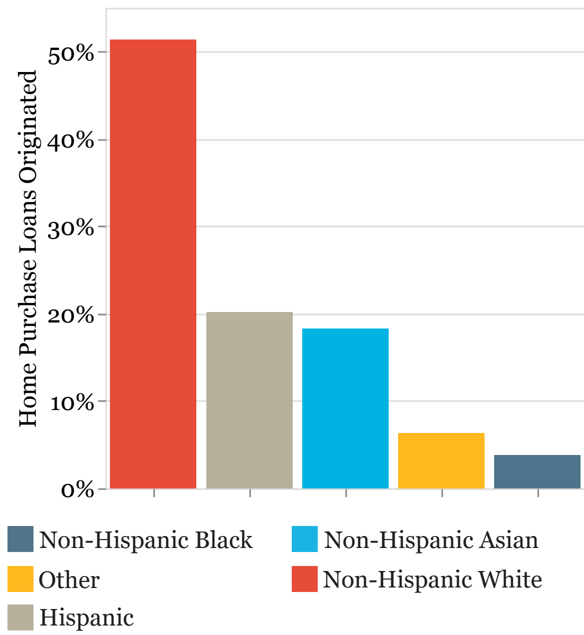
The lack of market production of units affordable to middle-income households can be traced to two major and interrelated dynamics: stringent land use regulations and exclusionary zoning that limit what can be built and the rising costs of housing development.

Figure 7. Share of Middle-Income Households that Rent, by Race/Ethnicity, 2019



Source: US Census Bureau, Public Use Microdata Sample (PUMS), 2019.

Figure 8. Number of Home Purchase Loans Originated, by Race/Ethnicity, 2020



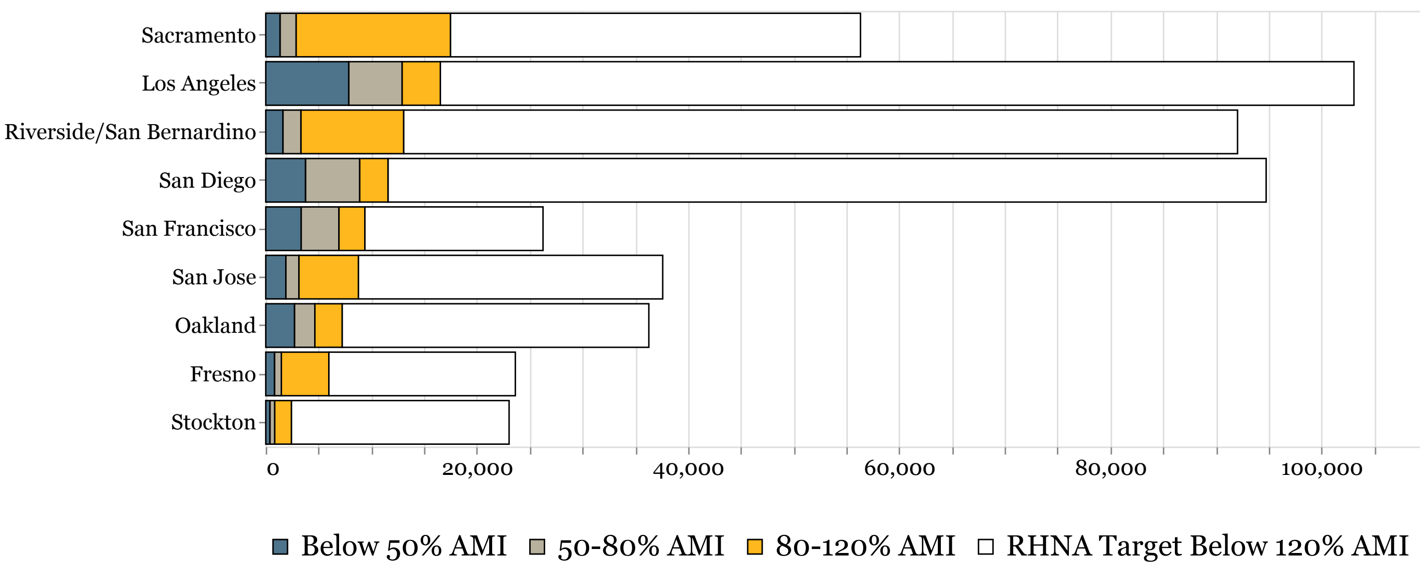
Source: 2020 California HMDA data filtered for loans that were originated, for non-commercial home buying, 1-4 unit properties, owner occupied, and 1st lien.
Note: There are also a significant number of loans—42,469—for which race and/or ethnicity data were not collected.

California's land use practices privilege single-family homes and constrain the production of smaller, multifamily, and lower-cost units.

A Terner Center survey of local jurisdictions in California found that on average, nearly 75 percent of land within cities was zoned to only allow single-family homes, while only 20 percent allowed for multifamily or denser development.[12] In major metropolitan areas, land use has become more—rather than less—restrictive over time.[13] These tightened land use and zoning regulations contribute to California's high housing costs.[14] A recent study found that zoning restrictions impose a "tax"—in other words, the difference in costs over what would otherwise be built without the restrictions—of over $400,000 a unit in the San Francisco metro area, and between $150,000 and $200,000 in Los Angeles and San José. This extra cost is three to eight times higher than cities such as Dallas and Atlanta, and it has a meaningful impact on housing affordability.[15]

Other factors also drive up the costs of development, including the high cost of land, rising construction and labor costs, parking requirements, building codes (including those requiring energy efficiency and other sustainable construction techniques), and local impact fees. Not all of these costs are easily addressed by local or state level policy: for example, the cost of materials as well as a tight labor market are influenced by macroeconomic factors that can be hard to address. But other aspects of city planning decisions and processes do influence the ability of the market to produce lower-cost units.

Figure 9. Progress Towards RHNA Production, California Metros, 5th Cycle



Source: California Department of Housing and Community Development's 5th Cycle Annual Progress Report Permit Summary, Reporting Year 2019.

For example, development fees in California can exceed $150,000 per unit, not including utility fees, which adds significantly to the sales and/or rental costs.[16] Delays in the entitlement process, as well as lack of coordination among city departments, also drive up costs.[17]

All of these factors raise costs to the point where the housing market, particularly in high-cost areas of the state, only delivers expensive, luxury units. In Los Angeles, a newly built, 2-bedroom apartment rents at $3,564 per month on average—a rent level affordable only to those with an annual income of more than $143,000.[18] This means that a three-person household earning 80 percent of AMI in Los Angeles would have to pay 57 percent of their income to live in that unit.[19] The ongoing production of luxury, new construction also increases concerns about the impacts of those developments on neighborhoods and gentrification, especially when they are located in places that have traditionally provided more affordable housing options.

In the next section of the paper, we profile four cities that have tried to encourage market development of homes that meet their moderate-income RHNA targets, drawing out lessons learned from their approaches as well as ongoing challenges.

Case Studies: Approaches and Barriers to Expanding the Supply of Lower-Cost Market Supply

To better understand the opportunities and constraints that shape the production of middle-income housing, we conducted interviews with staff at Metropolitan Planning Organizations (MPOs) and city planning departments for four cities: Woodland, Rocklin, Irvine, and San José. While not representative of all California cities, these four were selected for the progress they had made towards their 5th

Table 1. Housing Characteristics of Case Study Cities, 2019

Case Study City	Median Home Value	Median Gross Rent (All Occupied Units)	Median Gross Rent (Structures Built 2014 or Later)	Area Median Income
Woodland	$412,654	$1,317	Data unavailable	$87,900
Rocklin	$557,700	$1,787	$1,814	$83,600
Irvine	$933,600	$2,480	$2,788	$97,900
San Jose	$999,900	$2,223	$2,823	$131,400

Source: Home value and rent data for Rocklin, San José, and Irvine are from American Community Survey 2019 1-Year Estimates. Estimates for Woodland, CA are from ACS 2019 1-Year Supplemental Estimates. Area median income data is for a four-person household and comes from HCD 2019 State Income Limits.

Cycle RHNA moderate-income targets. Woodland and San José, while not on pace to meet their goal, reported building between 35 and 60 percent of their moderate-income production targets; Rocklin and Irvine reported exceeding their moderate-income production goals. Each city has been grappling with how local land use and zoning codes and market conditions come together to either support or limit the development of market-rate housing affordable to those earning between 80 and 120 percent of AMI. These case studies point to opportunities for local governments to spur the development of middle-income housing but also highlight the need for broader state actions to streamline housing production and reduce the costs of development. The four cities highlighted in these case studies have additionally all struggled to meet their low-income housing production goals, underscoring the deep, continued need for a better toolkit of strategies and funding sources to produce housing affordable to households with low and very low incomes.

Interviews with staff at HCD, MPOs, and city planning departments also raised the challenge of determining the affordability levels of newly-permitted market-rate units. Since 2018, jurisdictions have been required to show how they are achieving affordability thresholds when they report moderate-income units that are not deed restricted. While HCD encourages cities to calculate affordability for new units using market rent and sales price data, developers do not always provide this information during the permitting process. Cities each use their own methodology to determine affordability, and HCD has not reviewed or verified these calculations.[20] As a result, annual progress report (APR) data on new moderate-income units are limited in their ability to accurately assess the affordability of market-rate housing stock in California.

Woodland, CA

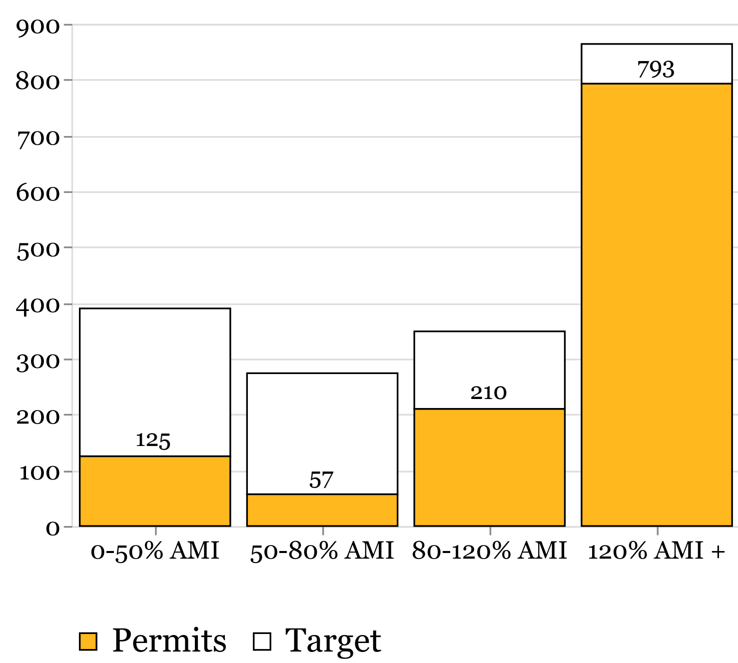
Woodland is located in Yolo County and has a population of about 60,000 people. The city has a rental vacancy rate of less than 3 percent, in part due to high demand related to the large population of students because of its proximity to UC Davis. The median rent in 2019 was about $1,300 and the median home value was approximately $413,000 (Figure 10).

Successes and Challenges to Producing Moderate-Income Supply

Woodland produced about 60 percent of the moderate-income units allocated to them through the 5th Cycle Regional Housing Needs Assessment (RHNA). Nearly all of these units were built for homeownership rather than rental. Staff estimated the affordability of these units using building permit unit size, property valuation data, and HUD income limits. While lower land values relative to the Bay Area and new construction of smaller format homes has helped to maintain a healthy for-sale market, interviewees noted that the city is struggling to meet the needs of the moderate-income rental market, particularly in Woodland's infill areas.

One way that Woodland has been able to establish entitlements for for-sale units affordable to middle-income households is through small-lot single-family development, particularly in a specific plan area in the southeastern part of the city called Spring Lake. Planning staff estimated that these units—typically built by large developers that expressed an interest in building smaller-format homes—are likely to be affordable to middle-income families, assuming that the area's Mello-Roos tax and homeowner association fees do not push the cost out of the moderate range.[21,22] Interviewees also described an uptick in splitting or subdividing lots

Figure 10. Woodland 5th Cycle RHNA Progress



Source: California Department of Housing and Community Development's 5th Cycle Annual Progress Report Permit Summary, Reporting Year 2019.

throughout the city, and attributed this in part to a market shift in which people are more willing to purchase—or can only afford—smaller properties.

In contrast, interviewees acknowledged that the city is struggling to generate new rental housing affordable to middle-income renters. Woodland has not had any new construction of market-rate multifamily housing since 2006, despite a number of regulatory changes made to encourage production of infill projects and "missing middle" housing typologies that can be developed at a lower cost. For example, the Woodland City Council passed an "urgency resolution" in 2019 that decreased development impact fees for smaller multifamily units in parts of the city, in an attempt to provide more housing at lower price points by incentivizing higher-density infill projects and smaller unit types.[23] In February of 2018, the city amended its Affordable Housing Ordinance to allow the city to accept in-lieu fees to satisfy a developer's affordable housing obligations, and to exempt new multifamily infill projects of 30 units or less from inclusionary requirements. Many cities have instituted inclusionary housing ordinances that require developers to dedicate a certain share of new units for affordable housing restricted at different income levels; in-lieu fees allow developers to satisfy this requirement by paying a fee that the city can then use towards the development of affordable housing elsewhere in the city. In addition to amending their inclusionary requirements, Woodland also sought to reduce zoning constraints for infill development by reducing parking requirements, establishing higher-density mixed-use areas, and offering entitlement streamlining through their 2020 Interim Zoning Ordinance.[24]

While these changes helped to catalyze two recent infill condominium projects targeted towards middle-income home-buyers—the 14-unit Downtown Suites and 16-unit Cleveland Lofts—interviewees noted that the smaller, local developers that are committed to building multi-family infill developments still struggle to make their projects pencil out. Respondents cited increases in the cost of labor and materials, and the additional costs associated with the complexities of infill development—which requires more tailored and flexible design work—as the primary barriers. One interviewee noted that these developers tend to need additional assistance from the department in order to meet building codes and other standards, and that the Planning Division provided a significant amount of technical assistance to help get the Downtown Suites and Cleveland Lofts off the ground. Furthermore, despite the regulatory and land use changes that have been made in Woodland, smaller infill and multifamily developers continue to request a reduction in impact fees, saying that rents are not high enough to make projects pencil. One respondent gave an example of a recently entitled project that fell through because the developer said it was too costly to build. The project had moved quickly through the entitlement process, utilized objective development standards, and had planned to pay in-lieu fees instead of planning for deed-restricted units, and still the developer came back saying "the pro forma doesn't work. It's too costly, it's too expensive."

Rocklin, CA

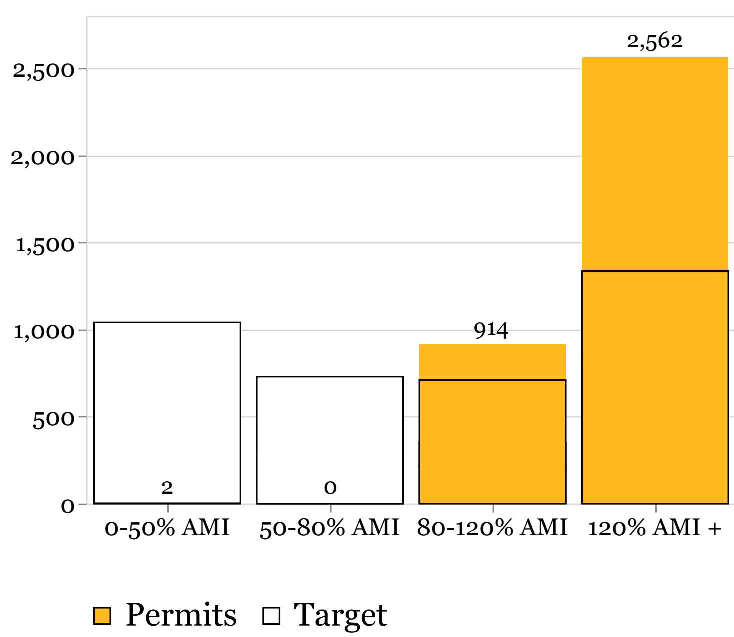
Located in Placer County, Rocklin has a population of about 65,000 people. The median rent in 2019 was about $1,800 and the median home value was approximately $558,000 (Figure 11). Unlike the majority of jurisdictions, Rocklin has surpassed its 5th Cycle RHNA target for moderate-income units, according to their most recent APR. However, interviewees noted that the loss of funding that accompanied the state's dissolution of Redevelopment Agencies in 2011 has hurt the City's ability to assist expansion of very-low and low-income units.[25]

Successes and Challenges to Producing Moderate-Income Supply

Planning staff in Rocklin have attributed their progress in middle-income housing production to land use amendments and rezoning that has allowed smaller homes to be built. Staff collect data over the course of the year—from marketing materials developers publish about new projects, home listings on Zillow, and landlords of Accessory Dwelling Units (ADUs)—to estimate rents and sales prices for new units, which they then compare to HCD income limits and affordable rent breakdowns to determine affordability. Rocklin has permitted 914 moderate-income units during its 5th Cycle Housing Element, exceeding the 709-unit target allocated to them through RHNA. The majority of moderate-income units in the city are for-sale products, with staff estimating that about 30 percent are located in multifamily structures and the rest in detached small-lot single-family format.

As in Woodland, the small-lot single-family product type is new to Rocklin and is possible because of middle-range impact fees and lower land costs relative

Figure 11. Rocklin 5th Cycle RHNA Progress



Source: California Department of Housing and Community Development's 5th Cycle Annual Progress Report Permit Summary, Reporting Year 2019.

to surrounding high-cost jurisdictions. Rocklin also made a number of land use amendments and rezones to accommodate this type of housing, upon request from developers who cited market demand from people who did not want to live in an apartment but also do not want or cannot afford a large yard or property. The city agreed to these amendments for a large number of sites throughout Rocklin and prioritized locations close to parks, commercial services, and other community facilities. Many of these conversions were done in commercially-zoned areas. One respondent described the use of commercially-zoned land for housing as initially “hard for a council to consider” because commercial uses have historically been more revenue-generating for cities than residential ones. Developers were, however, more interested in producing housing than retail, particularly in small-lot format, and the requisite land use changes contributed significantly to Rocklin’s success in producing moderate-income housing throughout the city, including in their downtown area, East Rocklin, Granite Drive, and along the Highway 65 corridor.

Still, staff noted that other fees—like connection fees from special utility districts that don’t vary with the size of the lot being developed—can hinder new production. Rocklin is looking towards potential zoning changes that could help encourage small multifamily structures—such as duplexes—to facilitate a boost in production at lower price points. Staff also acknowledged that they struggle to produce units affordable to lower-income households, citing insufficient public funds for affordable housing. One interviewee noted that state redevelopment monies—now gone—were once a major source of funding for affordable housing in Rocklin and that some newer state funding for low-income housing that is tied to greenhouse gas reduction targets and proximity to transit is out of reach in Rocklin’s suburban environment. Housing projects that pencil in the Rocklin market and regulatory regime are not dense enough and do not have reduced parking sufficient to be competitive in these programs. APR data show that the city has only produced two new units affordable to households earning below 80 percent of AMI since 2013. Only one Low-Income Housing Tax Credit-financed property—the Whitney Ranch Apartments—has been placed in service since 2010 and the city did not provide any funding to preserve existing affordable units during the 2013-2021 planning period.[26]

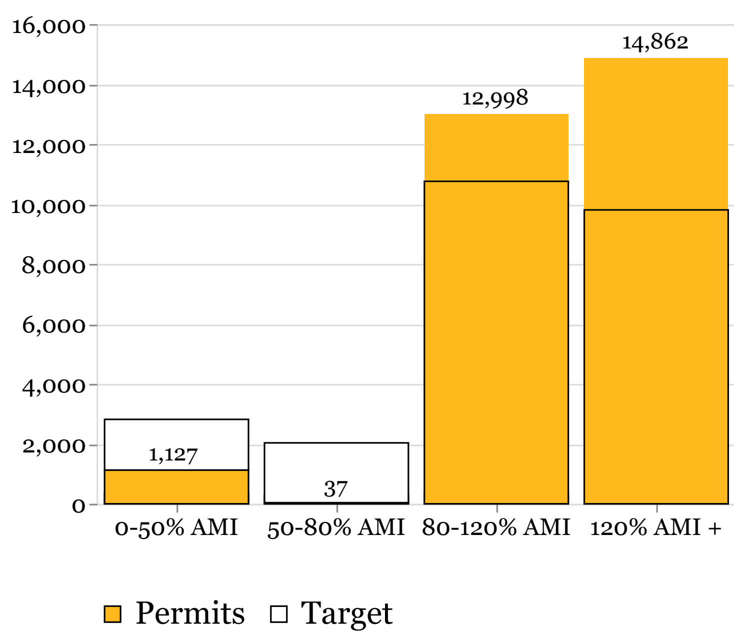
Irvine, CA

Located in Orange County, Irvine is a master-planned city with a population of just over 270,000 people. In contrast to Rocklin and Woodland, Irvine has much higher land values as well as higher median rents and home values. In 2019, median rent for units built since 2014 was approximately $2,800, and median home values were around $934,000 (Figure 12). Despite this, Irvine reports having permitted more than five times the number of middle-income units allocated to them through RHNA.

Successes and Challenges to Producing Moderate-Income Supply

Irvine's high rate of housing production above 80 percent of AMI is due to a combination of large parcels of vacant land and a commitment to zoning for multifamily residential development. At the beginning of the most recent 8-year APR cycle in 2013, Irvine had a substantial amount of vacant, underutilized land—in the former Marine Corps Air Station El Toro and in the Irvine Business Complex (IBC). The former marine base had been rezoned to allow less-intensive uses, including housing, in 2002 with the passage of Measure W. In 2010 the city created a residential and mixed-use overlay zone to spur new housing construction in the Irvine Business Complex—an area of the city previously zoned for commercial and light-industrial uses—allowing for up to 15,000 units of residential development.[27] In addition, the city's Inclusionary Housing Ordinance includes a moderate-income category, requiring 5 percent of units in any new development to be deed-restricted for households earning between 81 and 120 percent of AMI.[28] If fullfillment of affordable housing obligations are demonstrated to be infeasible,

Figure 12. Irvine 5th Cycle RHNA Progress



Source: California Department of Housing and Community Development's 5th Cycle Annual Progress Report Permit Summary, Reporting Year 2019.

developers may be permitted by the City to pay in-lieu fees per unit, rather than include deed-restricted affordable units on-site.

Interviewees noted that major areas of development for new moderate-income units in Irvine have been the IBC and the Irvine Spectrum district, an office and entertainment area on the southeast edge of the city.[29] The majority—apart from one project made up of 68 for-sale units affordable to moderate-income households through deed-restrictions—are located in higher-density apartment buildings.

Despite Irvine's reported progress towards facilitating homes affordable to middle-income households, past lack of oversight of APR reporting may have overstated this progress. Prior to 2018, when HCD began requiring jurisdictions to provide justification for how they determined that non-deed restricted units were affordable to households earning 80–120 percent of AMI, Irvine categorized units in projects with more than 30 units per acre as moderate-income, regardless of ultimate rental prices. Since most of the new construction in Irvine—especially in the IBC area—met this criteria, unrestricted units in these developments were counted towards the city's moderate-income RHNA target. As a result, it is unclear if new "moderate-income" units reported in Irvine's 5th Cycle APR that are not deed-restricted are actually affordable to this income group. One respondent noted that they could not be sure that all of the units categorized as such actually ended up being affordable to families making 80-120 percent of AMI.[30] Since changes to APR middle-income reporting requirements were implemented, the rate of middle-income housing production in Irvine has dropped off significantly.

Unlike in Woodland and Rocklin, new moderate-income restricted units in Irvine are almost entirely made up of rentals. An interviewee indicated that low-density moderate-income housing is challenging to build without subsidy and that new for-sale housing tends to be priced at levels above 120 percent of AMI, making those units out of reach for moderate-income households. For example, the typical home value in the Orange County Great Park area—a neighborhood located on the site of the former El Toro marine base with significant amounts of new development—was $1.1 million dollars in 2019. In the Irvine Spectrum neighborhood—another area with substantial new development—the typical home value was $1.8 million.[31] Still, the city continues to explore new ways to overcome high land and construction costs. An interviewee highlighted that Irvine is considering government bond-funded programs that enable local governments to partner with private owners to convert market-rate buildings into deed-restricted housing, affordable up to 120 percent of AMI, as a way to increase the availability of moderate-income housing. In February 2022, the Irvine City Council voted to move forward with two proposals to convert market-rate apartment buildings into units restricted to households earning between 80 and 120 percent of AMI, one with the California Statewide Communities Development Authority (CSCDA) and the other with the California Municipal Finance Authority (CMFA).[32]

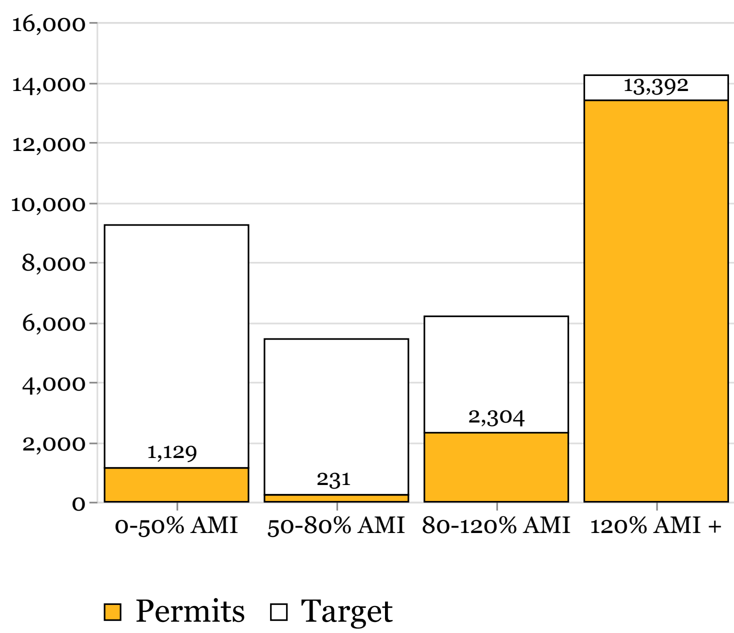
San José, CA

Located in the Bay Area's Santa Clara County, San José has a population over one million people and a median home value just under one million dollars, at $999,900 (Figure 13). Prior to 2011—when local redevelopment agencies (RDAs) were dissolved—the city produced a large share of their RHNA allocations each cycle. This was in part because the San José Redevelopment Agency was the second largest RDA in the state and provided $40 million dollars for affordable housing annually. This funding enabled them to subsidize a significant number of new units restricted to households making below 50 and 60 percent of AMI. However, in recent RHNA cycles, San José has not met its targets below 120 percent of AMI—including in the moderate-income category—in part due to rising land, construction, and labor costs. Substantial job growth has contributed to higher housing costs and a rise in RHNA allocations. In addition, 94 percent of San José's residential land is zoned for single-family homes, and the city struggles with significant levels of neighborhood opposition to multifamily construction, alongside challenges securing sufficient tax credits and bonds to support affordable housing production. Recent 5th cycle APR reporting shows that the city has built only 18 percent of the nearly 21,000 units of housing at prices affordable for housing with incomes below 120 percent of AMI.

Successes and Challenges to Producing Moderate-Income Supply

San José has built 37 percent of their 5th cycle moderate-income unit allocation. San José is one of few jurisdictions with a published methodology for counting moderate-income units that are not deed-restricted.[33] Their approach involves selecting the more conservative estimate

Figure 13. San José 5th Cycle RHNA Progress



Source: California Department of Housing and Community Development's 5th Cycle Annual Progress Report Permit Summary, Reporting Year 2019.

of two distinct methods that rely on a variety of sources, including data from residential building permits, Costar data on average effective rents by bedroom size and zip code, and a 2019 survey of utility costs paid by tenants in new apartment buildings. They additionally use HCD Occupancy Guidelines and Income Limits in their calculations, and even adjust rent estimates to approximate what they will be in a couple of years once occupied, before counting units as affordable to moderate-income households.

According to planning staff, certain submarkets in the city are able to produce unrestricted rents affordable to households at the top end of what is considered moderate-income for the area.[34] For example, new construction in the Midtown area of San José has yielded a number of units that rent for just under 120 percent of AMI. For Santa Clara County—because of the region's high wages—120 percent of AMI translates into an annual income of $157,700 for a four-person household. However, respondents emphasized the challenges of producing new housing affordable to moderate-income households. Typically, construction—especially high-rise buildings that require steel framing—have to be priced at above-moderate rents in order to cover construction costs. One interviewee noted that the city waives park fees and inclusionary housing requirements for downtown high-rise developments, highlighting that the cost of land and construction for these projects would make them financially infeasible if they had to account for these additional costs as well.

San José has been exploring additional moderate-income housing strategies to address the shortfall in units. For example, the city considered joining the California Community Housing Agency (CalCHA)'s moderate-income housing program as a means to generate more deed-restricted moderate-income housing. Like the CSCDA and CMFA products that Irvine is pursuing, the CalCHA product uses a tax-exempt bond financing structure for the conversion of multifamily buildings into restricted moderate-income housing. While staff expressed excitement at the prospect of being able to restrict affordability and cap rent increases, there were concerns about the approach, and San José ultimately voted not to move forward.[35] Staff highlighted challenges such as limited control over affordability levels, insufficient input on the underwriting process and fees charged, and concern over the balance between lost property tax revenue and public benefit as reasons not to join existing programs.

State laws have also helped to facilitate an increase in ADU production in San José. Respondents noted that incentivizing ADUs is a good strategy for the city because of its low-rise landscape. The city has been working on putting together a grant program that would supply upfront cash to individuals to help cover the development costs for an ADU, in exchange for restricting rentals to moderate-income households for a period of time. Plans for the program have been on hold due to COVID-19, but the city plans to return to them in the near future.

Lastly, the city was considering enabling smaller-scale, multifamily housing in single-family neighborhoods to address San José's extreme housing shortage, a strategy the city called "Opportunity Housing." This strategy would have enabled duplexes, triplexes, and fourplexes for properties citywide with a Residential Neighborhood land use designation. Interviewees described financial and political barriers to making this type of housing affordable at moderate-income levels. The median sales price for a single-family detached property—approximately $1,475,000 at the end of 2021[36]—is too high to make new subdivisions affordable for households earning below 120 percent of AMI to purchase or rent. A respondent reported that internal city analysis estimated that projects would need to be between 6 and 8 units in size to be affordable to middle-income households. Moreover, planning staff described high levels of—and "hyperbolic"—neighborhood opposition to middle-density housing development—like those being considered through Opportunity Housing—in areas zoned for single-family. Overall, staff estimated that it is unlikely that 2-4 unit structures generated through this proposal would be affordable below 120 percent of AMI. Moving forward, the City Council has elected to instead focus on effective implementation of Senate Bill 9, which was passed into law in September 2021 and allows for duplexes and lot-splitting in neighborhoods zoned for single-family without discretionary review.

Recommendations

The share of rent-burdened middle-income households has increased over the past decade, all the while the vast majority of jurisdictions are not meeting the state-mandated targets for housing production affordable to this market segment. However, as highlighted by the case studies in this paper, some jurisdictions have reported being able to facilitate the production of homes that are lower-cost but that do not rely on direct subsidies to be financially viable. These examples offer lessons on how cities can catalyze moderate-income development, and form the basis for the recommendations listed below.

Jurisdictions should consider policy changes to facilitate the creation of housing more affordable to middle-income households.

Jurisdictions looking to address a shortfall of housing affordable to middle-income households should revise their existing zoning, land use, and other regulatory structures to better catalyze smaller-scale housing that can be offered at lower overall price points than larger homes. This can include allowing for more "missing middle" housing typologies like duplexes, triplexes, townhomes, cottage clusters, or other smaller home types in areas that currently do not allow such housing to be built, such as lower density areas or commercial zones. Cities profiled in this brief—specifically Woodland and Rocklin—noted that their ability to generate moderate-income housing was due in part to intentional zoning changes meant to facilitate small-lot single-family homes. Rocklin and San José have also expressed that opening up more land—particularly land zoned for single-family as well as underutilized commercial areas—to these low-density multifamily products may help address existing housing shortages. Additionally, cities exploring the use of tax-exempt bonds, paired with property tax exemptions for acquisition of existing multifamily rental and conversion to moderate-income rents, should pursue these agreements only after careful analysis, given that early evidence suggests that the policy benefits do not always outweigh the foregone revenue and real estate risks associated with these projects. In addition to local measures, statewide approaches to facilitating more deed-restricted middle-income housing—such as a middle-income density bonus category or an expansion of property tax exemptions for units affordable to middle-income households—may also be a part of the solution.

Changes in reporting are needed to accurately capture middle-income housing production.

In addition to city-specific strategies, state-level changes should also occur to ensure proper data collection is taking place. Interviews with HCD and MPOs revealed that the method of assessing new housing unit affordability varies substantially by jurisdiction, and that limited documentation exists for these estimates. While jurisdictions have been required since 2018 to provide some reasoning for estimating that permits for units that are affordable to households earning 80–120 percent of AMI but not deed-restricted, there is no specific metric or calculation that cities uniformly apply, and HCD does not have the capacity to review individual methodologies for each jurisdiction. As a result, APR estimates are limited in their ability to accurately assess new middle-income housing production.

As California grapples with how to best address cost burdens that are reaching further up the income ladder and affecting middle-income households, it may also be important to examine the ways in which "middle" is defined and categorized. The household incomes of those earning 80–120 percent of AMI, as defined by HCD, can vary significantly by region—and in the case of the Bay Area—within regions as well. Policies and programs seeking to address the shortage of units affordable to middle-income households must carefully consider how to determine eligibility thresholds, in order to ensure that proposed solutions will reach the people that they are designed to support.

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20. Interview conducted on January 25, 2021.

21. Interview conducted on February 5, 2021

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