Missing No Longer?
Taking Stock of Local and Statewide Middle Housing Reforms in California

| December 2024 |

UC Berkeley Center for Community Innovation
with University of Texas, Austin

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Acknowledgements

The Center for Community Innovation would like to thank all of the developers, advocates and city officials who spoke with us. We would like to thank Carolina Reid, Muhammad Almeldin, Jared Basler, David Pearson, Celeste Goyer, Denise Pinkston, Gary Geiler, Dori Ganetsos and Paul McDougall for their additional feedback and commentary on sections of this report. This research was funded by the California Department of Housing and Community Development; however, the authors are solely responsible for its content.

Cover photo

Victoria Beckley

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The Department awards loans and grants to public and private housing developers, nonprofit agencies, cities, counties, and state and federal partners. The Department also develops housing policy, building codes, and regulates manufactured homes as well as mobile home parks.

The Center for Community Innovation (CCI) at UC Berkeley nurtures effective solutions that expand economic opportunity, diversify housing options, and strengthen connection to place.

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Executive Summary

Over the past several years, California legislators have passed numerous, successful bills aiming to unlock housing supply through statewide zoning reform. A series of accessory dwelling unit (ADU) bills have successfully established by-right approval for a minimum of two ADUs (one ADU and one "junior" ADU within the primary residence) across the state. Simultaneously, another slate of laws has streamlined approvals and mandated density bonuses for larger, multifamily developments that meet minimum affordability thresholds.

Comparatively little legislation has targeted the scale of development in between–small-scale multifamily housing like duplexes, fourplexes, or small apartment buildings–commonly referred to as the "missing middle." This report analyzes several state and local housing policies that attempt to unlock "missing middle" housing and evaluates what factors have contributed to their success or lack thereof.

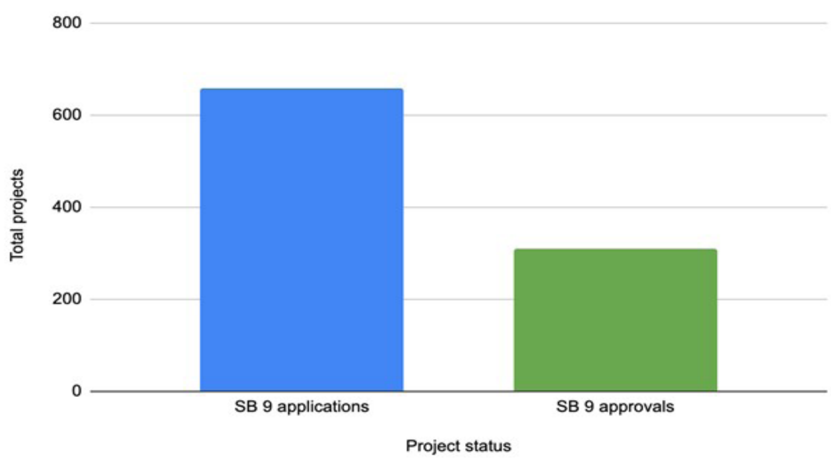
SB 9

The most notable of these policies is SB 9. The law went into effect at the beginning of 2022 and it upzoned most single-family parcels in the state to allow for a lot split and two units of housing on each lot.

How SB 9 Works:

- Homeowners of any eligible, single-family parcel can develop an additional unit of housing on the original parcel by-right via an ADU, a duplex conversion, or demolition and replacement of a single-family home with two units
- In addition, homeowners of eligible parcels can split their lot by-right, selling or developing up to two additional units of housing.
- New housing units must conform to local design and zoning standards unless those standards preclude the development of two 800 sf units on each lot.
- An SB 9 applicant must sign an affidavit stating their intent to remain as an owner-occupant in the existing or new unit for at least three years.
- Adjacent lots cannot be split by the same property owner.

Figure ES1: Total SB 9 projects, applications versus approvals



Source: HCD APR data, 2022 and 2023

Despite high expectations, SB 9 has produced very little new housing thus far. Out of 6.1 million eligible parcels, only 266 projects have been permitted or completed as of the end of 2023 (Metcalf, 2021; HCD APR data, 2023).[1] We find three key barriers limiting uptake.

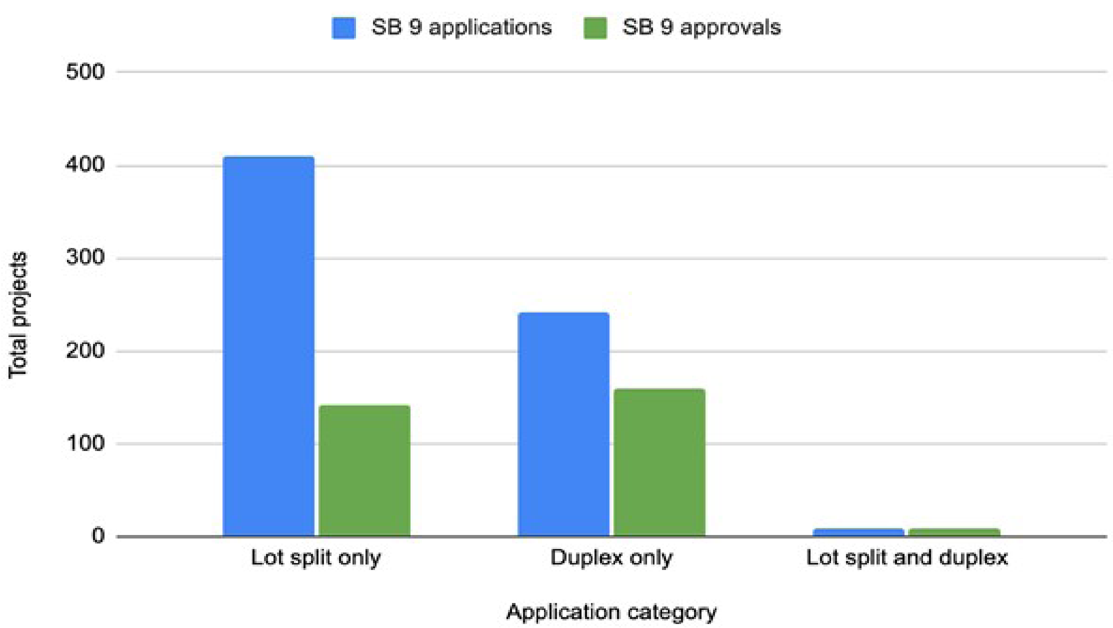
First, the owner-occupancy requirement–long since removed as a requirement for ADU development–has prevented developers from utilizing the law. Jurisdictions are enforcing this requirement inconsistently and developers remain uncertain whether the requirement will or will not prevent SB 9 approvals.

Additionally, local jurisdictions have adopted prohibitive fees and design standards that render most SB 9 projects infeasible. Upfront fees to apply for a lot split can be as much as $30,000 to $50,000; and total utility connection fees can cost $50,000 to $100,000 depending on the jurisdiction. These fees prevent many homeowners and developers from utilizing the law. HOAs have also enacted development standards that prohibit SB 9 development entirely.

Lastly, lending obstacles, particularly the opaque partial lien release process, have stymied homeowners from pursuing lot splits. Conventional loan servicers are hesitant to grant the partial lien releases necessary for a property owner to split their lot and sell off a new parcel for development.

Difficulties securing a partial lien release may help explain the relatively low approval rate for lot split applications as compared to applications for a duplex only. Thus far, property owners have been more successful in utilizing SB 9 for the by-right development of duplexes in single-family zones rather than lot splits, as seen in the figure below.

Figure ES2: Total SB 9 applications versus approvals, by category



Source: HCD APR data, 2022 and 2023

1 Of the 660 total applications, 409 are for a lot split only, 242 are for a duplex only, and 9 are for both a lot split and duplex. Of the 310 approved projects, 141 are for a lot split only, 160 are for a duplex only, and 9 are for both a lot split and a duplex. See Figure ES2.

San Diego Bonus ADU Program

Other missing middle models have proven more successful. The San Diego Bonus ADU Program is one of the most effective middle housing reforms in the country. The program allows developers to construct "bonus" market-rate ADUs, so long as they pair each additional market-rate unit with an income-restricted, affordable ADU. In Transit Priority Areas (TPAs)–anywhere within a half mile of a major transit stop, an area that covers a large, contiguous central swath of the city–developers are permitted to build an unlimited number of units, constrained only by existing height limits and FAR.

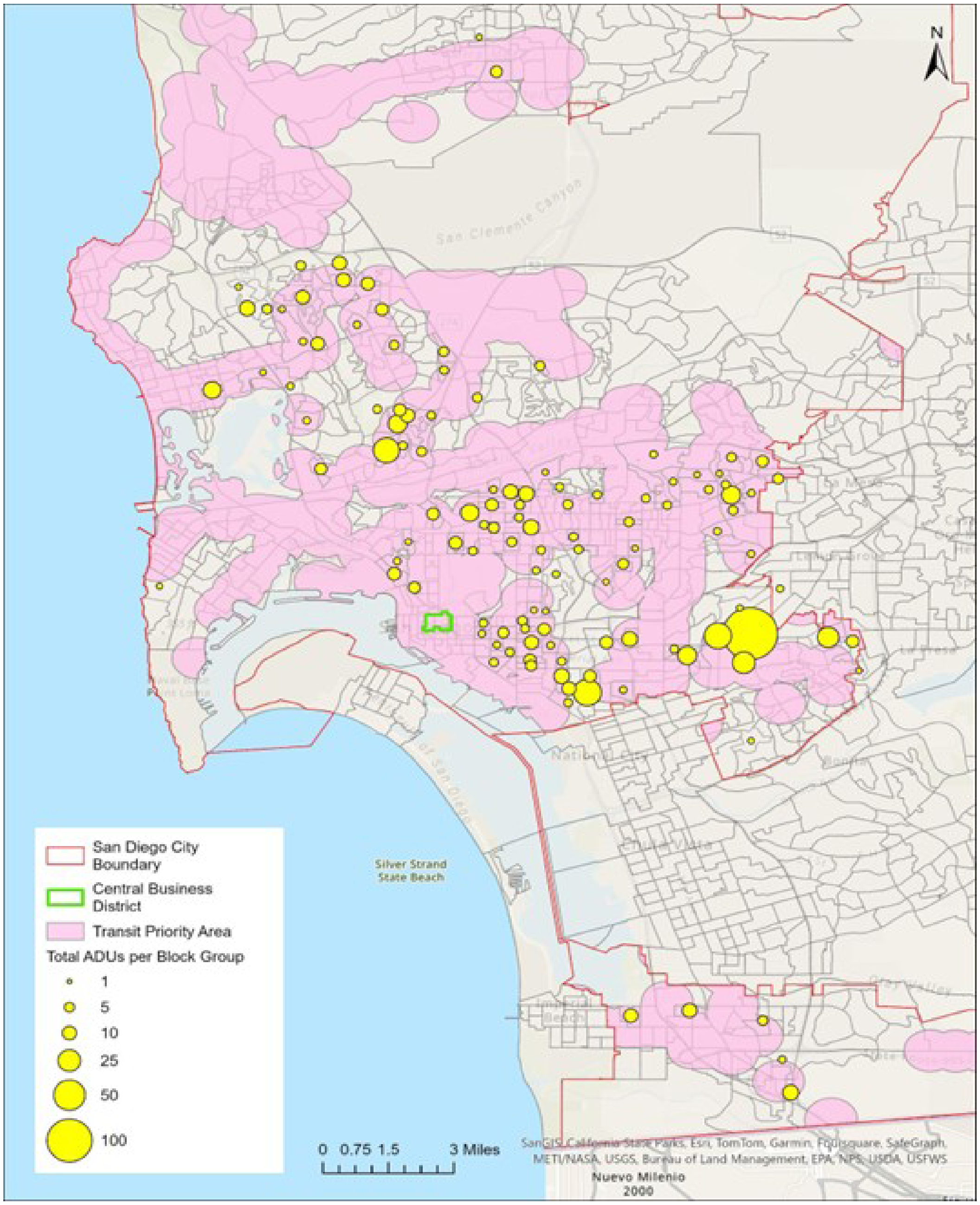
How the Bonus ADU Program Works:

- On any residential property in the city, property owners can build, by-right, at least two bonus ADUs in addition to the two ADUs already permitted by state law.
- Each market-rate bonus ADU must be paired with an affordable ADU, restricted to rent limits based on 110% or 80% of AMI. A unit restricted at 110% AMI must remain affordable for 15 years, while a unit restricted at 80% AMI must remain affordable for 10 years.
- Unlimited Bonus ADUs are permitted on properties located in a TPA.
- Within TPAs and elsewhere, developers must conform to existing standards such as floor area ratio (FAR), lot coverage and height limits.
- Any Bonus ADU project that nets 10 or more new units must deed restrict one unit as affordable to residents at or below 50% AMI or pay an inclusionary housing fee.

By allowing unlimited Bonus ADUs on any site located in a TPA, without a parking requirement, the program has produced remarkable results. As of February 2024, nearly 1,300 units have been proposed under the program, half of which will be deed-restricted as affordable if built (Figure ES1).

Driving these outcomes are the development costs and revenue projections for Bonus ADU projects. Drawing on extensive conversations with developers and analysis of their pro formas, we built a composite case study representing the development costs of a typical Bonus ADU project within a TPA. Bonus ADU developers are able to keep their development costs relatively low and generate significant profit.The FAR and high utility connection costs are the only significant constraint on development. The program has succeeded in producing significant new supply for moderate-income households, although it has not produced low-income units.

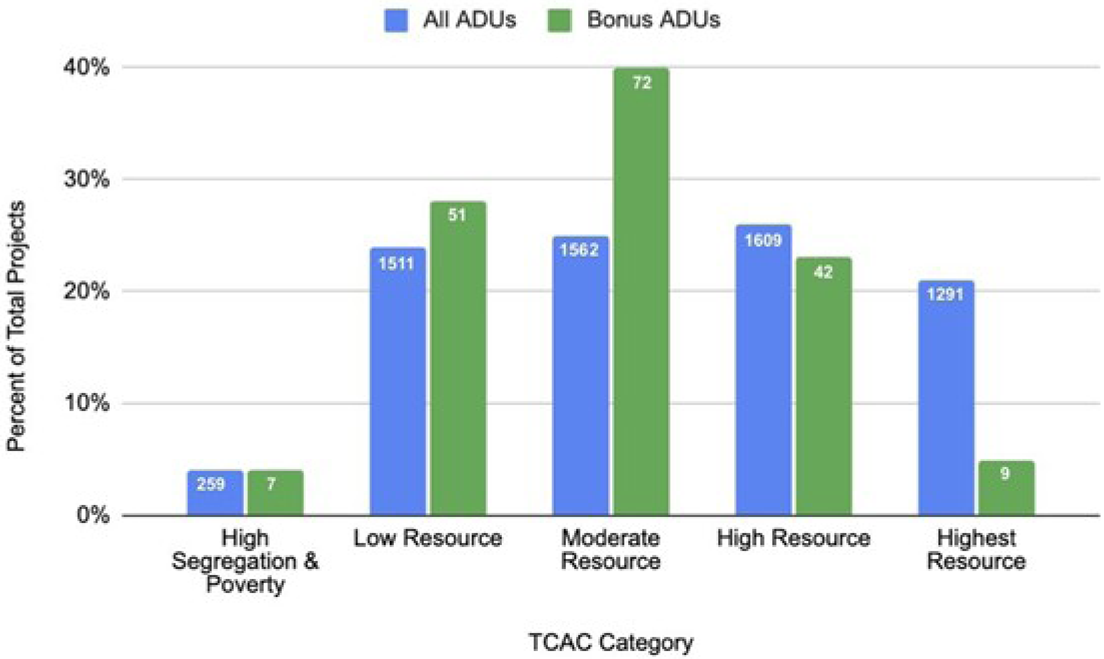
Figure ES3: Bonus ADU projects, by total units per block group, in Transit Priority Areas (TPAs)



Source: Internal data, San Diego Housing Commission.
Notes: TPAs are defined as any area within 0.5 miles of a major transit stop

We also find that the Bonus ADU program has helped San Diego fulfill its mandate to Affirmatively Further Fair Housing increasing affordable housing in high-income neighborhoods. The program has been very successful in creating new housing in neighborhoods that the State of California classifies as “Moderate Resource” and “High Resource,” a promising early outcome. Forty percent of proposed Bonus ADUs are located in “Moderate Resource” areas, compared to only 25% of total ADUs citywide and 10% of total housing permits (Internal data, San Diego Housing Commission; HCD APR Data, 2018 - 2022).

Figure ES4. Share of proposed or permitted projects by TCAC Opportunity Area, All ADUs (2018-2022) versus Bonus ADUs (2021-Present)



Source: Internal data, San Diego Housing Commission; APR Data, HCD, 2018 - 2022

Notes:"High Segregation & Poverty" is a designation for census tracts that are within "Low Resource" areas. This chart counts projects proposed or permitted in "High Segregation & Poverty" census tracts separately from the "Low Resource" category. Column data labels refer to the absolute number of projects permitted or proposed in each category

Scaling Middle Housing Statewide

Our research indicates that the San Diego Bonus ADU program could be successfully scaled statewide, allowing for varying levels of density depending on the jurisdiction. We apply a pro forma feasibility analysis to five cities across California. We find that the program would be feasible and highly effective in producing new units in cities with very supply-constrained markets and relatively low development costs, but not so much in cities with higher land and development costs.

Additionally, we survey several promising missing middle policy alternatives within California and beyond (Table 1). Policies like the Residential Infill Project (RIP) in Portland, Oregon offer a successful model to improve SB 9. Starting in August 2021, RIP allowed for by-right duplexes, triplexes and fourplexes, along with two ADUs per lot, in most areas zoned for single-family homes across the city. In its first year alone, 334 new units were permitted under the program, 76% of which were fourplexes (Cascadia Partners, 2023). Through the Middle Housing Land Division process, developers and homeowners across Oregon can split their lots by-right, allowing RIP to more easily create homeownership units along with rentals. The condoization process facilitated under Texas state law presents another possible model. We conclude that these others may be more effective in California than SB 9, at least in certain contexts. In addition, the recently passed California law AB 1033–which allows jurisdictions to voluntarily opt-in to permitting ADU condos–could unlock a new market for ADU homeownership.

Table ES1: Key findings, comparison of middle housing programs.

	California: SB 9	San Diego: Bonus ADU	Portland: RIP	Texas: Condoization
Advantages	• Applies statewide, allows up to four units on 6.1 million parcels • If utilized, could expand homeownership opportunities	• Leverages existing ADU and parking law to circumvent lengthy rezoning processes • Requires half of all bonus units to be deed-restricted affordable • Produces significant amounts of new housing near mass transit	• Uses sliding scale FAR to incentivize smaller, more affordable homes • Creates both rental and for-sale homes, using existing condo regime and lot-split law	• Applies statewide, creating a consistent business model to developers, lenders and condo attorneys • Detached condos are structured as "site condominiums," simplifying ownership and insurance complications
Limitations	• Owner-occupancy requirement & local design standards prevent developers from creating a replicable business model • Inconsistent lending standards prevent homeowners from readily utilizing SB 9	• Produces mostly studios and 1-bedrooms • Creates units at 110% AMI, but has yet to produce units at 80% AMI	• Does not produce high-density housing near transit • Developers have not produced affordable units in exchange for density bonus	• Small-scale detached condos do not produce moderate or high-density. • Inconsistent lending standards can still be an obstacle at scale
Results	• **Unsuccessful** • 266 SB 9 projects permitted or completed	• **Successful** • 1,300 units have been proposed under the program, 488 have entered into a recorded agreement with the city	• **Successful** • 334 units permitted in the program's first year • 76% of units permitted were fourplexes • 99% of units permitted had 2 bedrooms or more	• **Successful** • Over 3,000 detached condominiums in Travis County alone, as of 2022
Recommendations	• Standardize federal lending standards for lot splits • Remove the default owner-occupancy requirement • Strengthen the law against local design obstacles	• Incentivize units affordable at 80% AMI • Incentivize large family units	• Incentivize units affordable at 80% AMI • Incentivize large family units	• Incentivize units affordable at 80% AMI • Incentivize large family units

Moving Forward

The path to unblocking the market for missing middle in California is not easy, but other states have shown that it is clearly viable. Unless state legislators are serious about strengthening or expanding SB 9, our research suggests that leveraging state ADU law, parking reform and newly legalized condo regimes, may be a more effective path to creating middle housing in California.

Below we offer fixes for both SB 9 and San Diego's Bonus ADU program that will be important to consider if the state relies on either to scale up the missing middle:

Recommendations for SB 9

- Remove the default owner-occupancy requirement.
- Facilitate partial lien releases for urban lot spits.
- Work with Fannie Mae, Freddie Mac, and mortgage lenders to establish clear guidelines for approving partial lien releases and the process of lot splitting.
- Clarify that the state law supersedes any local standards (such as setbacks) which prohibit eligible SB 9 lot splits and two-unit developments.
- Specify that SB 9 requires ministerial approval for two-unit condominium developments on eligible parcels.
- Change the law's "preclusion" threshold to protect two units per parcel with a combined area of 1,600 sf (rather than two 800 sf units) to encourage more diverse housing types.
- Consider policies that limit lot split, utility connection, and development impact fees.

Recommendations for Bonus ADU programs

- Identify ways to create affordable housing for low-income residents (at or below 80% AMI) without jeopardizing the existing business model.
- Identify ways to lower utility upgrade costs, such as the original draft of SB 1210 – proposed by Senator Skinner – which would cap utility costs at 1% of a new unit's building permit value.
- Incentivize community development corporations, community land trusts and other community-based organizations to utilize the Bonus ADU program, encouraging local economic development.
- Explore other, possible incentives to create more 3- and 4-bedroom units for large families.
- Continue to monitor where large-scale Bonus ADU projects are being proposed and identify incentives to encourage moderate- and large-scale projects in High Resource and Highest Resource neighborhoods of the city.

1. Introduction

Over the past several years, California policymakers at the state and local level have passed several housing reforms in an attempt to unlock "missing middle housing." The concept refers primarily to small-scale multifamily housing (like duplexes, fourplexes, or small apartment buildings), but is sometimes used to refer to housing that serves middle-income households (Parolek, 2020). In this report we use the former definition, which focuses on their physical form rather than their price or rent.

These housing types are largely absent in comparison to others that have been unlocked through statewide legislation. A spate of successful ADU laws have mandated by-right approval for a minimum of two ADUs (one ADU and one "junior" ADU, i.e., within the primary residence) on any eligible lot in California and removed local barriers to ADU development.[2] Meanwhile, another series of state laws have streamlined approvals and mandated density bonuses for large, multifamily developments that meet minimum affordability thresholds.[3]

These major legislative achievements have unlocked ADU development and boosted the supply of large-scale, multifamily affordable housing. The early results from these reforms have been tremendously successful. From 2018 to 2021, SB35 alone streamlined 156 projects–most of which are 100% affordable–comprising over 18,000 new units of housing. Base ADU law has similarly unlocked significant development—-over 100,000 ADUs have been permitted statewide since 2017.[4] Of the 750,000 total housing units permitted in California during this time period, ADUs account for almost 15%.

However, relatively little legislation has successfully targeted the scale of development in between. This report analyzes several state and local housing policies that attempt to unlock the missing middle. It begins with SB 9, a statewide law that upzoned most single-family parcels to allow for a lot split and two units of housing on each lot. Despite high expectations, the law has produced very little new housing thus far. Our analysis focuses on what factors may be limiting uptake.

We then closely analyze the San Diego Bonus ADU program, which allows developers to construct "bonus" market-rate ADUs, so long as they pair each additional market-rate unit with an income-restricted, affordable ADU. In Transit Priority Areas (TPAs)–anywhere within a half mile of a major transit stop, an area that covers a large, contiguous central swath of the city–developers are permitted to build an unlimited number of units, constrained only by existing height limits and floor area ratio (FAR). The early results of this program have been remarkable–as of early this year, nearly 1,300 units have been proposed, half of which would be income-restricted affordable if built.

After summarizing our key findings and recommendations for the Bonus ADU program, we estimate whether this program could be scaled up statewide. We apply a pro forma feasibility analysis–based on several estimates provided by San Diego developers–to five cities across California. We then use these financial feasibility projections to provide a rough estimate of the expected Internal Rate of Return (IRR) that development in each city could yield under a statewide analog to San Diego's Bonus ADU program. We include a policy "menu" to demonstrate the potential development intensity of three different versions of the program–a small-scale program (4 unit cap), a moderate-scale program (4-12 unit cap), and the large-scale program (unlimited units) that currently exists in San Diego.

2 Senate Bill (SB) 1069 and Assembly Bill (AB) 2299 were particularly significant, along with AB 68, AB 881, SB 13.
3 SB 35, SB 423, AB2011, AB1287, among others.
4 The development intensity of base ADU law in California is best understood as the "missing little," a concept coined by Michael Piper at the University of Toronto that distinguishes two to four unit development from small to midsize apartment buildings (Ashtari et al. 2023).

The final section of the report is a survey of several promising missing middle policy alternatives. We begin with a discussion of the "condo-ization" of ADUs, which has been successful in cities such as Austin, Texas and Seattle, Washington. We consider whether the recently passed AB 1033–which allows jurisdictions to voluntarily opt-in to allowing ADUs to be sold as condos–could unlock a new market for ADU homeownership. We then briefly discuss three local zoning reforms–in Berkeley, San Jose and Portland, Oregon–that allow for missing middle development. We conclude by discussing the merits of utilizing base ADU law to create missing middle housing–as in the case of the San Diego Bonus program and AB 1033–versus entirely new zoning reforms such as SB 9.

Informed by initial data on SB 9, pro forma analysis from successful SB 9 projects, and 20 interviews with developers, lenders, and advocates, our research has identified three major barriers to SB 9 development.

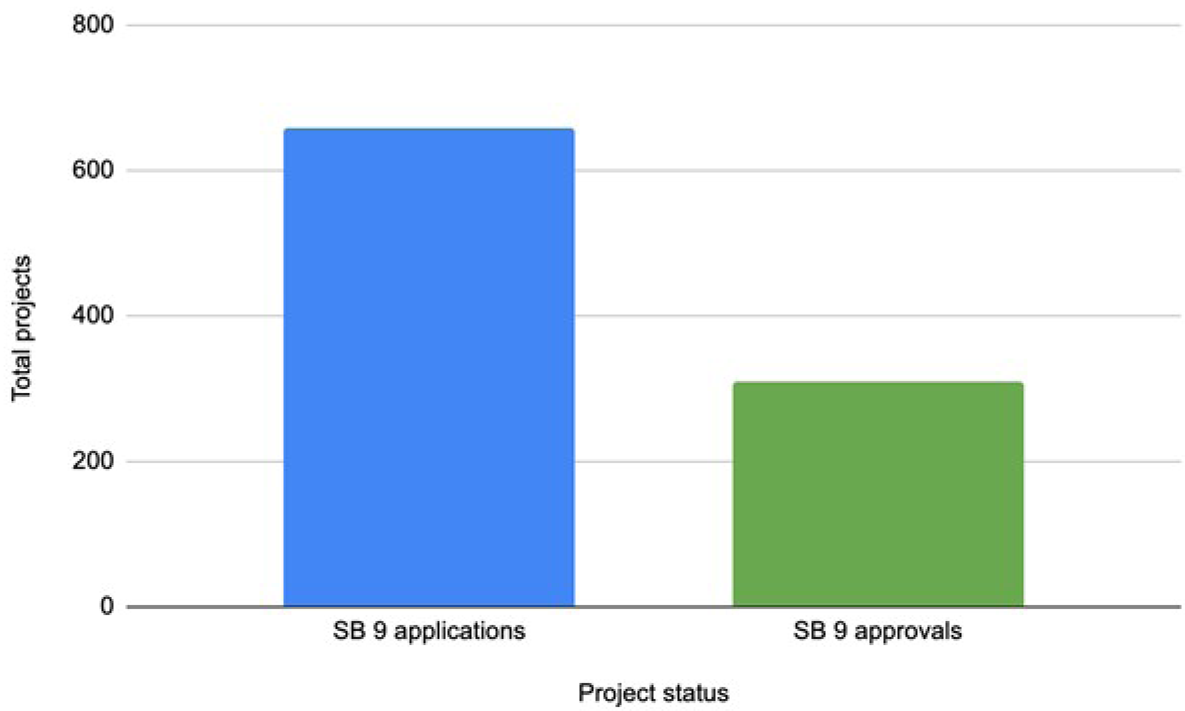
2. SB 9: Barriers to Uptake

At the beginning of 2022, the California HOME Act—commonly referred to as SB 9—went into effect to significant fanfare among housing advocates and media. The law allows homeowners of single-family properties to split their lot into two parcels, both of which can then hold up two homes.

In effect, the law upzoned 6.1 million eligible single-family parcels to allow for up to four units of housing (Metcalf, 2021). Land-use reform advocates have long identified exclusionary single-family zoning as a major barrier to addressing California's housing affordability challenges, achieving the state's climate goals, and fulfilling its mandate to affirmatively further fair housing. While ADUs have already added significant rental housing in single-family neighborhoods across California, they generally cannot be developed and sold separately from primary residential units.[5] SB 9, on the other hand, was intended to create new opportunities for homeownership at more affordable price points (SB 9, 2022).

The law was heralded as an unprecedented step, abolishing single-family zoning statewide and allowing for significant production of missing middle housing. Yet after two years, just 660 SB 9 applications have been submitted–310 of those projects have been approved and only 25 projects have been completed (HCD, APR data, 2022-203).[6] This section identifies the most significant factors that are limiting uptake of the new law.

Figure 1: Total SB 9 projects, applications versus approvals



Source: HCD APR data, 2022 and 2023

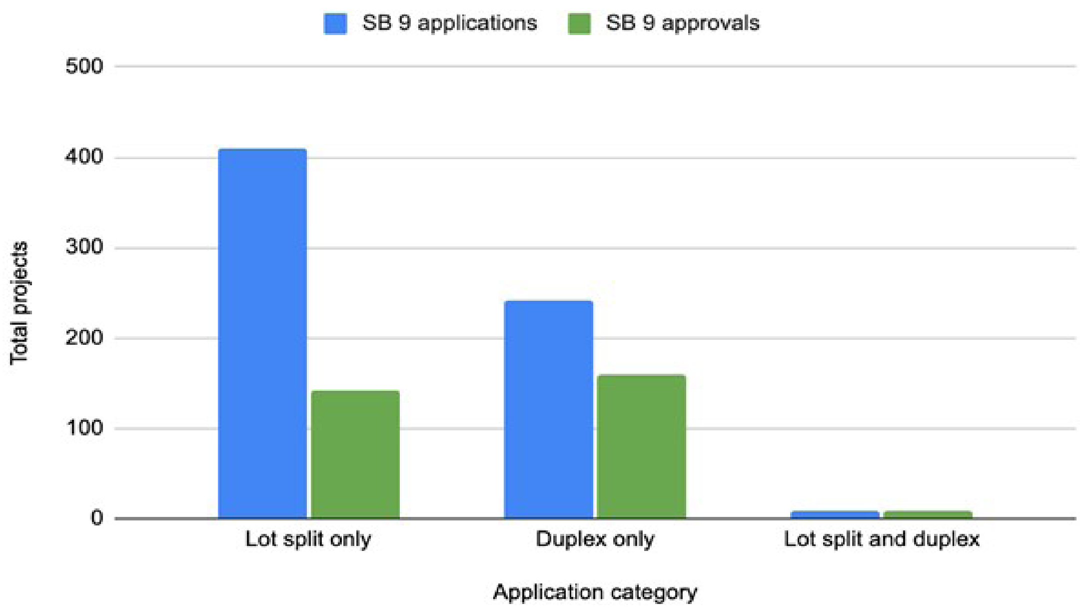
5 AB1033, passed in October 2023, allows local jurisdictions to choose whether or not to allow ADUs to be sold separately as condominiums. The law is discussed in greater detail in the final section of the report.
6 Of the 660 total applications, 409 are for a lot split only, 242 are for a duplex only, and 9 are for both a lot split and duplex. Of the 310 approved projects, 141 are for a lot split only, 160 are for a duplex only, and 9 are for both a lot split and a duplex. See Figure 2.

How SB 9 Works:

- Homeowners of any eligible, single-family parcel[7] can develop an additional unit of housing on the original parcel by-right.
    - This additional unit can be the result of an ADU, a conversion of a single-family home to a duplex, or two units that replace a demolished existing single-family home.
- In addition, homeowners of eligible parcels[8] can split their lot by-right.
    - They can sell this newly-created lot or develop up to two additional units of housing—including a duplex or a single-family home with an ADU.
- New housing units must conform to local design and zoning standards unless those standards preclude the development of two, 800 square feet (sf) units on each lot.
    - The law requires new units to be at least 800 sf.
- An SB 9 applicant must sign an affidavit stating their intent to remain as an owner-occupant in the existing or new unit for at least three years.
- Adjacent lots cannot be split by the same property owner.

The law was an adaptation of California State Senator Toni Atkins' similar bill—SB 1120—which failed to become law before the 2020 legislative session expired. The updated bill provided more flexibility to homeowners—for instance, allowing a newly created lot to be at least 40% of the original lot size, rather than requiring the new lots to be equally sized. Several other provisions added more stringent requirements like the owner-occupancy requirement, which was intended to prevent real estate speculation and encourage stable homeownership (Metcalf, 2021).

Figure 2: Total SB 9 applications versus approvals, by category



Source: HCD APR data, 2022 and 2023

7 Only parcels zoned exclusively for single-family housing that have not yet developed an ADU are eligible for SB 9. The law does not apply to homes in historic districts, fire hazard zones, flood zones, environmentally-protected areas or prime farmland. SB 9 cannot be applied to properties that are deed-restricted as affordable housing, properties that are rent-controlled or properties that have been rental housing within the last three years.
8 Lots must be large enough to allow for each new, split lot to be at least 1,200 square feet or 40% of the original lot size.

These provisions are far from a simple, blanket upzoning of single-family parcels. Instead, SB 9 is a highly conditional development tool that maintains many local zoning standards and includes additional requirements that do not typically apply to housing development. For instance, there is no requirement that a property owner live on site as an owner-occupant in order to develop an ADU in the backyard of a single-family rental unit. Nor is there a requirement that a developer cannot split adjacent lots when they build a suburban subdivision of single-family homes. But both restrictions apply to SB 9.

While each of these constraints on its own is tied to a reasonable policy goal, taken together, they are not advancing the law's primary objective: creating more missing middle (or "missing little") housing. In this respect, SB 9 should be viewed as a first iteration, rather than a finished product. In order to unlock the full potential for missing middle development in California, lawmakers must continue to update and improve SB 9 if it is to unlock housing production at meaningful scale. The continual process through which state legislators have made it easier and less expensive to develop ADUs offers a helpful guide.

Background: The Iterative ADU Revolution

ADUs—also known as backyard cottages, "mother-in-law suites," or "granny flats"—had ostensibly been legal to build in California since 1982. But for decades, jurisdictions were not required to permit ADUs ministerially nor were they required to establish clear standards for ADU applications.

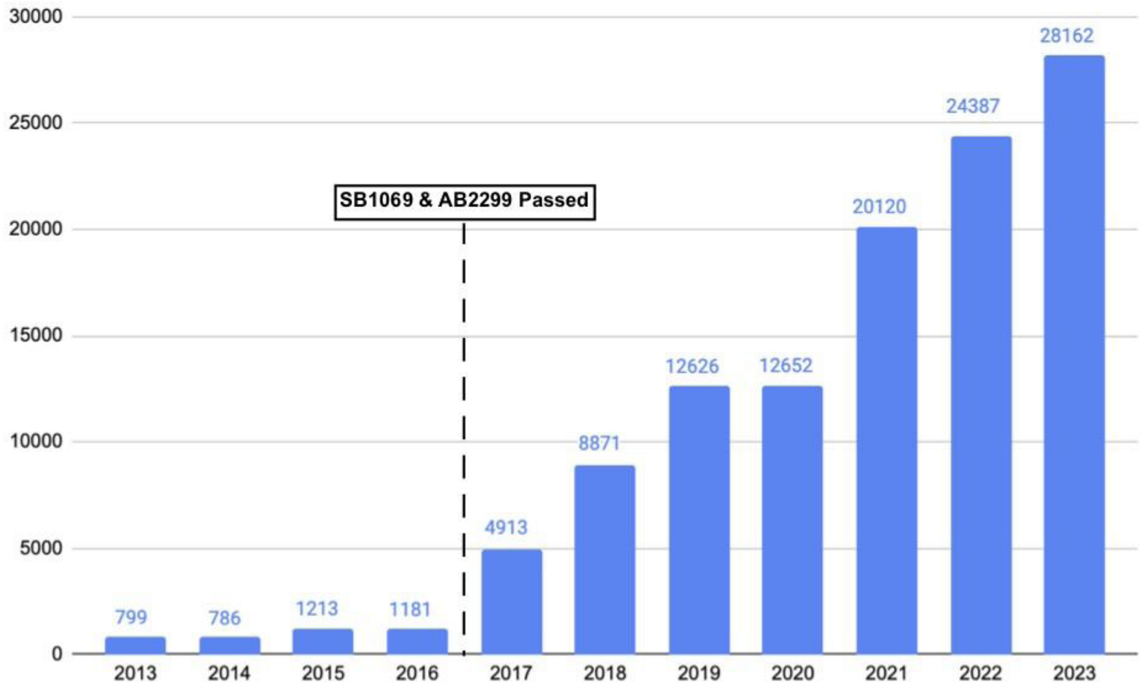
In 2002, state legislators passed AB1866 which required local jurisdictions to permit ADUs through a ministerial, rather than discretionary review process. Crucially, however, the law allowed jurisdictions to establish their own objective design standards. Many jurisdictions responded by enacting standards which rendered ADU development infeasible, effectively blocking a growing market for backyard units. As a result, fewer than 800 ADUs were permitted statewide in 2013, more than a decade after AB1866 went into effect (Minnot, 2023).

In 2016, legislators in Sacramento passed two pivotal bills—SB1069 and AB2299—which established objective zoning and parking standards for ADUs, capped utility connection fees, and required jurisdictions to complete their ministerial review process within 120 days. The following year, statewide ADU permits tripled (Figure 1). Importantly, as several jurisdictions continued to resist these requirements, legislators responded by passing over a dozen laws clarifying ADU permitting standards and processes (Dubler, 2022).

By making it easier and less expensive to develop ADUs, legislators unlocked an entire submarket—credit unions and banks developed ADU financing products, general contractors began specializing in ADU development and a trade association, Casita Coalition, emerged as an important advocate for pro-ADU policies. Legislative reforms created more predictable development conditions that have allowed the ADU market to flourish across the state: over 28,000 ADUs were permitted in 2023 alone and over 100,000 have been permitted since 2017, accounting for nearly 15% of total housing units permitted statewide during that time period (HCD, APR data, 2023b).

SB 9 may mark the beginning of another iterative process. Similar to the initial ADU reform passed in 2002, it did not account for many potential obstacles and constraints. Learning from the decade of local resistance and anemic development that followed AB1866, lawmakers now have an opportunity to proactively strengthen by addressing the most significant barriers to uptake. Informed by initial data on SB 9, pro forma analysis from successful SB 9 projects, and ten interviews with developers, lenders, and advocates, our research has identified three major barriers to SB 9 development.

Figure 3: Total ADUs permitted in California, 2013 - 2022



Source: CA Department of Housing and Community Development; Bipartisan Policy Center
Notes: The first major ADU reform bills – SB1069 and AB2299 – were passed in 2016.

Barrier #1: Owner-Occupancy Requirement

The original version of the bill, SB1120, did not include an owner-occupancy provision. SB1120 passed the State Assembly and Senate, but ran out of time to reach the Governor's desk before the 2020 legislative session expired. The following year, Senator Atkins proposed a similar version of the bill with several key updates, including a new owner-occupancy provision (Metcalf, 2021).

Initially, the provision gave local jurisdictions the option to impose a requirement that lot split applicants make one of the units on the property their primary residence for a minimum of one year. This would have allowed jurisdictions that wanted to encourage more development to opt out of the owner-occupancy requirement, thereby allowing small-scale developers, not just homeowners, to utilize the law.

In the course of negotiations during the summer of 2021, however, the provision was expanded. The owner-occupancy requirement was changed from an option that local jurisdictions could impose, to a requirement that applied to all jurisdictions statewide. Additionally, the provision was extended, requiring an SB 9 applicant to sign an affidavit declaring their intent to live in a unit on the property for a minimum of three years (Ward, 2023).

According to a report from the Terner Center in the summer of 2021, this more stringent provision was intended to "address concerns that current homeowners could be incentivized to sell to private entities interested in speculative investment on single-family parcels" (Metcalf, 2021). Indeed, after the bill was passed, Senator Atkins' office published a website for SB 9 which declared that the law "benefits homeowners NOT institutional investors" (SB 9, 2022).

The owner-occupancy provision reflects the authors' intent for homeowners alone to utilize SB 9. Much like the early advocates of ADUs, the proponents of SB 9 have pitched the law as a way for existing homeowners, rather than professionals (i.e., developers), to generate income and wealth while adding much-needed housing supply. But state ADU law eventually evolved to allow landlords and developers to build ADUs without establishing residency. In 2020, SB13 went into effect, ending owner-occupancy requirements for ADUs statewide. The reform likely contributed to total ADU permits reaching 20,000 in 2021—a 59% increase from the previous year (see Figure 1 above).

For now, SB 9 is designed to encourage existing homeowners to split off a portion of their property and either sell that new lot or develop housing on it, all while remaining in their home. But the added costs and complications of splitting a lot and building up to three units of housing, all while living in the midst of a multi-unit construction site, make SB 9 development much more difficult for a homeowner than building an ADU in their backyard.

Developers are much better equipped to navigate the complexities of SB 9 development and eager to pursue a market for missing middle housing. However, due to the owner-occupancy requirement and its inconsistent enforcement, developers remain uncertain whether they can create an effective business model using SB 9.

Inconsistent Enforcement

Interviews with several developers revealed that the owner-occupancy requirement is not being implemented consistently across jurisdictions. For example, a mission-driven developer is pursuing an SB 9 development under a for-profit LLC and a non-profit partner. Their goal is to complete a replicable SB 9 project that will produce affordable homeownership, deed-restricted to households making 80% to 120% of area median income (AMI). The team has site control over a corner lot in a low-income neighborhood in South Central Los Angeles (Anonymous LA developer, interview, 2023).

The city is supportive of the project, but was unable to confirm with the developer whether their ownership entity—which included a for-profit LLC—could legally apply for a lot split under SB 9. The text of the law exempts "qualified nonprofit organizations" from the owner-occupancy requirement, but does not specify whether joint ventures that include for-profit entities are similarly exempt. The city government can test the parameters of this provision by approving the project, but without further clarification via amendment or HCD guidance, the city could be vulnerable to potential litigation (Anonymous LA developer, interview, 2023).

The developer believes that the city is open to their joint ownership structure and hopes that planning staff will approve their application; but they expressed broader skepticism about the requirement:

> "Developers are smart. They're gonna figure it out…If you say it has to be an [individual owner], okay, then maybe I'll buy it as an entity. And I will sell it to myself….But that's disingenuous, right? I would be looking to create a loophole for something that shouldn't even exist. I don't want to have to do that…I would rather just be straightforward with the planning department and say, look, we're buying it under an LLC, the nonprofit is a member. The city has accepted that structure on hundreds of major transactions, you should do the

same here. And so far, I think the City of Los Angeles is going to be amenable to that, but we don't know yet" (Anonymous LA developer, interview, 2023).

The owner-occupancy requirement is ostensibly designed to increase access to homeownership and prevent displacement in vulnerable communities. In this case, the requirement may prevent a mission-driven community development entity from creating deed-restricted, affordable homes in a low-income community.

Likewise, their observation that developers will likely find loopholes within the requirement proved to be correct based on conversations with other developers. One East Bay developer, who spoke on background, has completed multiple SB 9 projects in an affluent East Bay suburb. According to the developer, the city allows LLCs to purchase homes and apply for SB 9 lot splits, but requires that the prior owner-occupant signing the affidavit have at least a 25% ownership stake in the LLC. As long as the developer provides operating agreements that demonstrate this proof of ownership, the city will approve SB 9 development on parcels owned by an investor-backed LLC (Anonymous developer, interview with author, 2023).[9]

In response, the development team created a clever business model: they recruited someone interested in living in a new home to invest in their LLC at 25%. The LLC then purchased an existing, 2,000 sf single-family home for $1.3 million and remodeled it, adding 400 sf at a cost of $400,000. They plan to sell the original home for $2.3 million—a 35% increase in value after accounting for the cost of renovation (Anonymous developer, 2023).[10]

As part of the LLC's lot split application, the recruited owner-occupant, or "owner-investor," signed an affidavit stating their intent to live on the property for at least three years from the time the lot split was approved. Having met the owner-occupancy requirement, their lot split was approved and the developer built two condominiums at a total cost of $1.2 million plus $80,000 for utility upgrades. The LLC plans to sell the condominiums for $1.3 million each. After accounting for the $50,000 in fees to complete the lot split application, the LLC expects to make $1,845,000 in profit before taxes, a 60% profit margin. This development is entirely investor-financed rather than debt-financed, so a significant portion of the profit will go to investors as a return on their initial capital (Anonymous developer, 2023).[11]

Once completed, this development will add two much-needed units of housing to a supply-constrained, exclusive city. But in this case, the owner-occupancy requirement has not protected an existing homeowner from displacement or investor speculation, as the advocates of SB 9 hoped. Instead, it forced the developer to pursue a strange and circuitous strategy: recruiting a future homebuyer to be an investor in their development company at a 25% share.

The owner-occupancy requirement appears to be failing on two fronts. The uncertainty surrounding the requirement has likely prevented cities and mission-driven developers from utilizing the law, while determined, for-profit real estate developers have found ways to circumvent it—at least in markets where the expected profits are worth jumping through the extra legal hoops.

9 This standard is not listed in the official SB 9 guidance published on the city's website.
10 The LLC purchased the home in December of 2022 and sold the home in July of 2023. Over those seven months, the median single-family home price in the area rose from $2.1 million to $2.5 million—a 17% increase.
11 The developer could not disclose the share of revenue going to investors.

Table 1: Development costs and revenue, East Bay SB 9 project

Original lot: single-family remodel	
Acquisition	$1,300,000
Improvements	$400,000
Sale price:	$2,300,000
New lot: two condos	
Lot split fees	$50,000
Construction costs	$1,200,000
Utility connection upgrades	$105,000
Sale price (per condo)	$1,300,000
Total Investment	**$3,055,000**
Total Revenue	**$4,900,000**
Total Profit (pre-tax)	**$1,845,000**

The same East Bay development company has continued to pursue this strategy. It recently recruited another owner-occupant investor and purchased a 2,200 sf single-family home in the same East Bay suburb. It plans to build an addition, bringing the house to 3,800 sf. Once approved for the lot split, it will either sell the new lot, build two condos or build another single-family home. Going forward, the developer has considered advertising online in local news sites to find future SB 9 partners. They believe that many people would be interested in utilizing the law, but are intimidated by the complexity of the process (Anonymous developer, 2023).

Still, even having created a unique business model, the developer is clear-eyed about the owner-occupancy requirement. “This is preventing developers from using SB 9. Homeowners are not builders and the way it’s written right now, it’s for homeowners” (Anonymous developer, 2023). If state officials hope for SB 9 to produce significant amounts of infill housing, they will need to revisit this requirement to allow professional developers to readily utilize the law. Legislators should consider reinstating the initial version of the provision, which gave jurisdictions the option to adopt an owner-occupancy requirement. As discussed earlier, this flexible provision would allow jurisdictions that want more development to encourage small-scale developers, not just homeowners, to utilize the law.

Barrier #2: Partial Lien Release

An unexpected obstacle to regular homeowners taking full advantage of SB 9 is their mortgages. If a homeowner has paid off their mortgage and owns their property free and clear, applying for an SB 9 lot split is relatively simple. However, if the homeowner has a significant amount of their mortgage left to pay down, this process requires their loan servicer to approve a partial lien release. The loan servicer releases a portion of the property from the original mortgage and restructures the existing mortgage around the remaining property and its new assessed value.[12]

Brian No—former Vice President for Policy and Public Affairs at BuildCasa—explained that the process of securing this partial lien release is "extremely opaque and frustrating." BuildCasa is a start-up that works with homeowners to execute an urban lot split on their property, brokers a sale of the new lot to a builder and then shares an agreed-upon percentage of the total profits with the homeowner. Their value-add is to achieve the primary benefit of SB 9 for the homeowner, while sparing them from the complications of splitting their lot and selling it to a homebuilder (Brian No, interview, 2023).

But No's team has discovered that loan servicers are often not amenable to approving or providing guidance for partial lien releases. In some instances, BuildCasa has worked with clients who have been unable to get a loan servicer to return their calls. In other instances, loan servicers have been unable to clarify to their clients who they can speak to regarding their request for a lien release. "It's a total black box," No explained.

When his team has reached loan servicers willing to entertain a lien release, they have not offered clear or consistent guidelines for homeowners. Loan servicers are most concerned with the loan-to-value (LTV) ratio and typically want to stay at or under the existing LTV. The loan servicer completes a new appraisal of the property based on the proposed lot split. Since a large portion of the land will be split off from the property, the new appraised value decreases, which raises the LTV ratio.

For a property with a loan at 65% LTV, a proposed lot split might raise the LTV for the original, remaining parcel to 90%. In this case, loan servicers typically require homeowners to pay down the principal to get the LTV back to 65%. According to No, some loan servicers have allowed homeowners to pay the principal reduction after the split lot is sold. Others, however, have required that homeowners pay down the principal before they approve the partial lien release, an amount that can easily run into the tens or hundreds of thousands of dollars, no small sum for a typical homeowner. There appears to be no standard procedure or consistent guidelines, even within the same loan servicers (Brian No, interview, 2023).

Multiple lenders with decades of experience in the industry emphasized that loan servicers are not required to approve a partial lien release, even if the homeowner can meet certain LTV standards. A senior housing finance consultant explained that loan servicers are not even obligated to respond to a request for a partial lien release. The original mortgage lender loaned on a specific piece of property and may be unwilling to consider any changes to that collateral (Interview with anonymous lenders, 2023).

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12 The loan servicer is often a different entity than either the original mortgage lender or the entity that currently owns the loan. The original mortgage lender—which could be a bank or an independent mortgage company—may currently hold the loan or the loan could be bundled into a mortgage-backed security held by investors.

An executive at an independent mortgage company said that their subservicers would entertain a lien release only under certain conditions. If the borrower made a significant downpayment and the LTV was roughly 40-50%, the subservicers could consider granting a release. But she noted that most of the company's loans are at much higher LTV ratios. Lending experts also highlighted that subservicers are not necessarily operating based on rigid guidelines; instead, they tend to make discretionary, case-by-case decisions about partial lien releases based on previous experience and varying standards (Interview with anonymous lenders, 2023).

To make matters more complicated, one lending executive believes that a homeowner would have a much tougher time trying to subdivide a property with an FHA loan, since that loan is federally insured at an original loan amount with a specified LTV. They estimate that about 30% of home mortgages are FHA loans, a sizable share of the market.

Standardizing Fannie and Freddie Guidelines:

Several lending experts spoke about the need for standardization and clearer guidelines, particularly from the Government Sponsored Enterprises (GSEs) Fannie Mae and Freddie Mac, both of which have been under direct federal ownership since 2008. They emphasized that the lending industry tends to follow the processes outlined by Fannie and Freddie (Senior lending executive, interview, 2023).

Both aforementioned GSEs have published updated guidelines for servicers regarding partial release of loans within the last two years—Fannie in July of 2023 and Freddie in August of 2022. In each case, the guidelines require a borrower to pay down their mortgage balance to maintain an LTV of 60% or the LTV ratio immediately prior to the lot split, whichever is higher (Fannie Mae, 2023; Freddie Mac, 2022).[13]

However, the guidelines do not offer clarity on the process that servicers should follow, which lending executives argue is crucial in order to spur a response from the lending industry. One former executive encouraged lawmakers and state officials to bring Fannie Mae, Freddie Mac and mortgage lenders to the table to specify the process for partial release and promote it widely across the industry. These stakeholders could possibly develop a standard for a new purchase mortgage that allows for the option of a partial lien release and lot split in the future (Senior lending executive, interview, 2023).

While SB 9 is the first statewide law of its kind, lenders expect that more states experiencing affordability challenges will legalize lot splits to encourage infill development. As they do, the absence of clear guidance for how lenders should respond to these requests will increasingly become a problem (Senior lending executive, interview, 2023).

Another housing finance consultant offered a similar analysis, arguing that a concerted effort to educate lenders and borrowers on this process could go a long way. Lenders need to understand that the process is not necessarily complicated—it is a simple matter of conducting a new appraisal, evaluating LTV, and then approving or disapproving the lot split. Fannie and Freddie are likely the best platform to standardize and communicate this process.

Homeowners, on the other hand, need to understand that there is no legal obligation for their lender to approve a subdivision. They also need to be given guidance for how they can work with their servicer to increase the likelihood that they will approve a partial release (Housing finance consultant, interview 2023).

13 See Appendix I and Appendix II for Fannie Mae and Freddie Mac's complete guidelines.

Even with clear standards and processes in place, lenders and homeowners may simply need time to adjust to the new reality of widespread, individual lot splits. One senior housing finance consultant clarified that this concept is not necessarily new—commercial lenders regularly loan to a builder on an entire residential subdivision and execute partial lien releases as each property is sold. But the lending industry is not used to individual homeowners requesting to change the collateral on their loans across a state as large as California. "That's a new concept: thousands of homeowners reaching out to their lenders for a lien release," she explained (Housing finance consultant, interview 2023).

The former lending executive similarly emphasized that widespread adoption of partial lien releases in California is going to take time. As a result, he believes that significant uptake of SB 9 will take longer than it did for ADUs, largely due to the much more complicated nature of residential lot splits as compared to adding backyard units. In other words, if it were to be primarily utilized by homeowners—as its authors seem to have intended—this would require a significant shift in lending practices.

Potential Lender Requirements

For those that want to capitalize on the promise of SB 9 now, waiting for an organic shift in lending industry practices may not be viable. BuildCasa is pushing state legislators to include additional requirements on how lenders process lien release requests. Their legislative "wish-list" includes "requiring that existing lenders 1) be transparent about their requirements for a partial lien release due to an SB 9 lot split and 2) respond/approve a partial lien release within a specific timeframe" (BuildCasa, "Priority fixes to SB 9," 2023).

The senior housing finance consultant believes the state needs to proceed very cautiously with any efforts to impose requirements on lenders. She cited a history of lenders raising rates or backing out of markets that required them to take on additional risk. She acknowledged that it is very unlikely that lenders would back out of California, given its share of the market; but she suggested that a well-intentioned requirement to help borrowers could have serious unintended consequences if it were drafted without input from lenders. Requiring loan servicers to grant partial lien releases for loans at higher LTVs, for instance, would likely make the cost of lending very expensive since lenders would then have significant, additional risk associated with mortgages (Housing finance consultant, interview 2023).

BuildCasa's suggested provisions would not impose a requirement for lenders to approve partial lien releases, but they would mandate that lenders share their standards for lien releases with borrowers. These standards could include LTV thresholds and whether the borrower is required to pay the principal reduction before the partial lien release is approved.

This requirement might be in line with suggestions for a "roadmap" that could educate borrowers on what they need to do in order to successfully request a lien release and lot split. Still, it is unclear how lenders would respond to these requirements.

Even requiring loan servicers to respond to requests within a certain time frame could increase the cost of lending in California. If the loan servicer were obligated under state law to conduct a new appraisal and evaluate LTV for any lot split application it received, this would represent a significant, additional cost (Housing finance consultant, interview 2023).

The former lending executive highlighted that lenders are generally resistant to any new requirements, simply due to the administrative processes needed to document compliance. That effort alone is costly in the eyes of the lending industry, regardless of the substance of the regulation. But he noted that lenders' resistance does not mean that the requirement is not worth pursuing. Instead, he urged legislators to proceed thoughtfully and emphasized that they should not expect a response requirement to solve the underlying issue. “Simply requiring a response doesn’t help you a lot because lenders don’t know how to respond,” he explained. Working with lenders to establish new standards, along with implementing new requirements as needed, will be more successful in achieving the desired outcome of a more transparent and efficient process (Housing finance consultant, interview 2023).

The Challenge of High Interest Rates

One obvious alternative to the barrier of partial lien releases is for homeowners to refinance their mortgage and create a second loan on the split lot. The current interest rate reality makes refinancing impossible for most borrowers—it simply does not make sense to refinance a 3% interest rate mortgage at today’s 7% rates. But if rates do come down, refinancing a mortgage in order to subdivide a lot may become a viable option.

Assuming interest rates fall, several lenders suggested that lenders would be quicker to adopt a refinance product tailored to SB 9 subdivisions than they would be to adopt widespread partial lien releases. Indeed, one senior loan officer operating in California plans to pursue that business model if demand increases. “If somebody can’t get their servicer to react, my answer is gonna be ‘okay, let’s go refinance and create two loans. I will generate that into business” (Senior lender, interview, 2023).

Notably, SB 9 went into effect at the beginning of 2022, immediately before a sharp and persistent rise in interest rates that ended a multi-decade period of historically low rates. In other words, we have yet to see the law in action during a period of interest rates favorable to borrowers. It may be that lowered rates will lead to significantly more uptake of SB 9 across the state, by allowing homeowners to refinance at a more reasonable cost.

Barrier #3: Local Constraints

Much like the early implementation of ADU laws, SB 9 development has been constrained by inconsistent and onerous local standards. Developers and advocates highlighted several examples of local policies that have rendered infeasible lots that are otherwise ideal for SB 9 applications. In most cases, these policies take advantage of gaps or ambiguities in the original text of the law.

Local Design Standards and Land-Use Restrictions

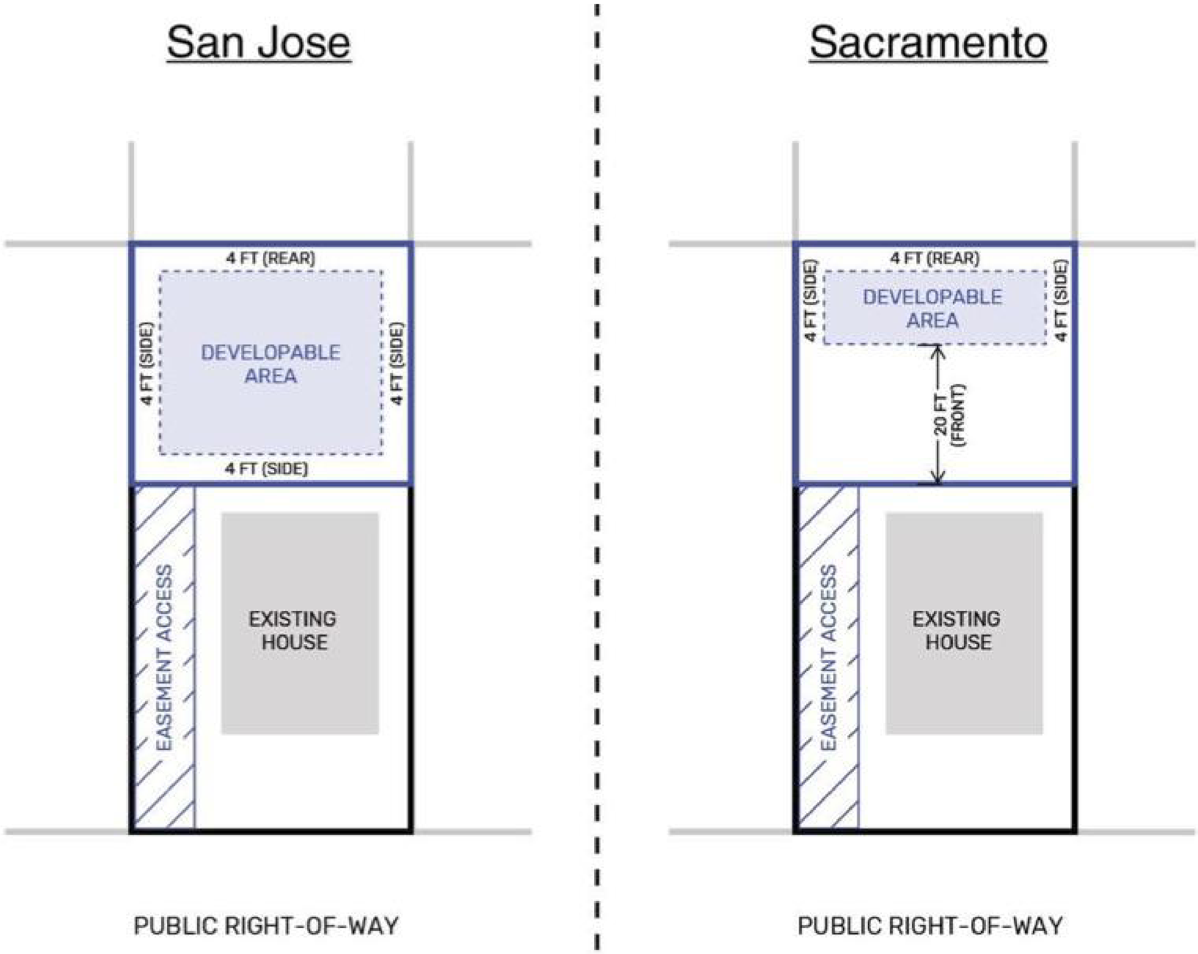
SB 9 explicitly prohibits local jurisdictions from imposing objective zoning, subdivision or design review standards that would preclude the construction of two units on either of the resulting parcels or would result in a unit size of less than 800 square feet. But the original law did not specify enforcement mechanisms for the “preclusion” standard and consequently, local jurisdictions have implemented policies that likely violate it.

For instance, several jurisdictions have imposed significant front setbacks on SB 9 development. Mirroring ADU law, SB 9 explicitly states that rear and side setbacks can be no more than 4 feet, but does not clarify the maximum standard for front setbacks. Backyard ADUs are not affected by a front setback standard since they already share the same parcel as the existing primary dwelling unit; but many potential SB 9 lots are severely impacted by this requirement (No, 2023).

In the summer of 2022, the Terner Center published a sample of SB 9 requirements that had been implemented by 10 local jurisdictions. The City of Los Altos Hills, for example, requires a 40 foot front setback for any new SB 9 unit, rendering most developable land infeasible under the law (Garcia and Alameldin, 2022).

BuildCasa has found that even jurisdictions with more reasonable front setbacks define the requirement in ways that preclude SB 9 development. Sacramento defines its front setback requirement as 20 feet from the newly created lot line, rather than 20 feet from the original property line abutting the public right-of-way. By contrast, cities like San Jose do not require a 20 foot setback from the newly created lot line, as seen in the comparison figure below (BuildCasa, 2023).

Figure 4: Differing interpretations of front setbacks, San Jose versus Sacramento



Source: BuildCasa

The current iteration of the law does not clearly prohibit Sacramento from imposing this standard, even though it likely precludes the creation of two, 800 sf units on many otherwise feasible lots. Future clean-up bills must explicitly clarify that a front setback starts from a property line that abuts a public right-of-way, not the newly-created, internal property line. Ideally, legislators would also set a maximum front setback. The Terner Center's statewide land-use survey found that the median front setback for single-family homes in California jurisdictions is 20 feet, which could be a reasonable maximum requirement (California Residential Land-Use Survey, 2018).

The SB 9 developer working in the East Bay has similarly encountered that jurisdictions interpret standards very differently, even requirements that are specified clearly in the law. When the developer submitted a proposal for a new SB 9 unit with four foot side and rear setbacks, city staff rejected the application citing a different interpretation of the setback standard. The developer contacted HCD, which reviewed the application and confirmed that the city's interpretation was incorrect; however, HCD staff explained that they did not yet have enforcement authority at that time. At the start of 2024, HCD was granted full authority to enforce SB 9, which the developer views as an important step in standardizing implementation of the law across the state (Anonymous developer, 2023).

HCD enforcement should also help clarify that local requirements fall under the preclusion threshold if they prevent a residential lot split, not just if they prevent the construction of two, 800 sf units. Several jurisdictions have existing zoning requirements that they claim are not subject to the preclusion threshold, even if they directly preclude a residential lot split. Sacramento County, for instance, requires that newly created SB 9 parcels must comply with the zone's underlying lot width and street frontage requirements—a minimum of 65 feet for both in the case of its single-family zones. As of now, Sacramento County has not waived or modified these standards even when they have prevented SB 9 development, as seen in the example below (BuildCasa, 2023).

Figure 5: Street frontage and lot width requirement prevent SB 9 use, Sacramento County corner lot

Source: BuildCasa

Similarly, the cities of Sonoma and Beverly Hills have both implemented standards that prohibit flag lots, which refers to the shape of a parcel that provides right-of-way access to the rear lot via a narrow strip of land (Garcia and Alameldin, 2022). If a potential SB 9 parcel is not a corner lot, then creating a flag lot of some kind is often necessary for the development to be feasible. Like Sacramento County, these cities claim that the prohibition on flag lots is not subject to the preclusion threshold because they regulate only the issue of lot splits, but do not directly prevent the construction of two, 800 sf units. HCD is unlikely to accept this explanation and should issue enforcement guidance that makes clear that precluding an otherwise eligible SB 9 lot split violates the law.

More broadly, lawmakers should consider making the preclusion standard more flexible. Advocates and developers shared that invoking the preclusion threshold is often the only way to successfully apply for SB 9 in many jurisdictions. If that trend continues, jurisdictions may see repetitions of the same two-unit configuration, rather than a more diverse array of missing middle types. BuildCasa's legislative wish list includes a proposal to change the preclusion standard to protect two units per parcel whose combined floor area is 1,600 sf, rather than two 800 sf units. This adjustment would have the added benefit of accounting for another local restriction that has stymied SB 9 development (BuildCasa, 2023). At least five jurisdictions have implemented an 800 sf maximum unit size, meaning that units must be exactly 800 sf in order to be eligible for SB 9 (Garcia and Alameldin, 2022).

Fees

Fees are a significant barrier to utilizing SB 9, particularly for homeowners. BuildCasa's costs to submit a complete application for a lot split are routinely as high as $30,000 (No, 2023). This includes the fees charged by the city to file a new parcel map under the Subdivision Map Act (roughly $15,000) and the cost of hiring civil engineers and surveyors to complete the mapping ($10,000-$15,000). In one affluent East Bay suburb, the total cost of completing the lot split application for one SB 9 development was $50,000 (Anonymous developer, 2023).

Utility connection upgrades are similarly very costly. The East Bay SB 9 development required utility upgrades costing $105,000 (see Table 1). East Bay Municipal Utility District (EBMUD), the water utility, charged $35,000 for each of the two condos on the new lot, plus $15,000 for a storm drain and sewer connection. Meanwhile, Pacific Gas and Electric (PG&E) charged $20,000 for the upgraded power connection (Anonymous developer, 2023).

For an investor-backed development company generating $1.8 million in sales, these costs do not break a deal. But for a fixed-income or low-income homeowner who wants to generate additional income by building and renting additional units on their property, these costs can be prohibitive.

One legislative proposal under consideration in Sacramento, SB1210, offered a promising solution. The initial draft of the bill–authored by Senator Nancy Skinner–would have required that public utilities and municipal utility districts cap any upgrade fees at 1% of a new housing unit's building permit value.[14] The original draft also required that this 1% fee be charged over the course of a minimum of 10 years, smoothing the upfront costs for developers.[15]

14 Building permit value refers to the total value of the construction costs–materials and labor–for which a building permit is issued. This figure is self-reported by developers when they apply for building permits. Developers may under-report this number.

15 As of May 2024, this bill has been amended and no longer includes the 1% cap; instead, it requires that utility districts publish their fee schedules and service timelines. However, legislators should continue to evaluate and consider caps on utility connection costs.

Even if the original draft of SB1210 or a similar bill were to become law, SB 9 units will continue to be subject to development impact fees, which can also be prohibitive for homeowners seeking to utilize the law. State ADU law prohibits local jurisdictions from imposing development impact fees on ADUs that are less than 750 square feet. Legislators should consider adopting a similar prohibition on development impact fees for SB 9 units smaller than 800 sf If the preclusion threshold were made more flexible, as described in the previous section, legislators could prohibit impact fees for new SB 9 parcels with a combined unit size of 1600 sf This adjustment would allow for local jurisdictions to continue collecting development impact fees on larger SB 9 units.

Legal Ambiguities

Local jurisdictions have varying standards regarding the "condo-ization" of SB 9 units. The SB 9 developer working in the affluent East Bay suburb has exclusively pursued projects that produce two condominium units on the newly created lot. It has completed a similar project in Oakland, which also allows condominium units. The city of St. Helena, however, expressly prohibits SB 9 units on the same lot from being conveyed or sold separately as condominiums (BuildCasa 2023). While most jurisdictions have not prohibited SB 9 condominium units, the law does not specify if condominiums are permitted nor whether jurisdictions have to review SB 9 condominium proposals ministerially.

Likewise, homeowners' associations (HOAs) and existing covenants, conditions, and restrictions (CC&Rs) present additional obstacles to SB 9 development. AB670, passed in 2019, forbids HOAs from enforcing CC&Rs or any other by-laws which disallow ADU construction. Two years later, AB3182 prohibited HOAs from enforcing any by-laws that disallow ADU owners from renting their units, though HOAs can still enforce a 30-day minimum lease term (Dubler, 2022).

Legislators should amend SB 9 to include similar prohibitions. As the law is currently written, it is unclear whether SB 9 supersedes pre-existing CC&Rs or even new by-laws passed by HOAs to prevent SB 9 development. For instance, BuildCasa encountered a discriminatory deed restriction from 1940 in the title report for a potential SB 9 parcel. In addition to prohibiting any non-white resident from owning, renting or occupying the property, the deed restriction also prohibited the property from being subdivided into plots of less than 6,995 feet and blocked the construction of any unit other than a detached single-family dwelling. While the racially discriminatory provision cannot be enforced, there is legal ambiguity as to whether SB 9 overrules the prohibition on lot splits and duplexes (Brian No, interview 2023). Loan servicers, in particular, may be hesitant to approve a partial lien release and lot split until this ambiguity is clarified.

More alarmingly, some jurisdictions have seized on this ambiguity to prevent SB 9 development by encouraging HOAs to adopt new by-laws and CC&Rs. In its official SB 9 guidance, the City of Loomis urges HOAs to "act quickly" to update its CC&Rs to prohibit lot splits and duplex construction (emphasis added below):

> "has the practical effect of removing obstacles to property owners splitting their lots and constructing additional dwelling units on those lots at the local government level…Importantly, however, homeowners' associations can still enforce their CC&Rs and other governing documents containing prohibitions and restrictions on lotsplitting and the construction of additional dwelling units. Without the local government impediments described above, **an association's CC&Rs may operate as a last line of defense against lot-splitting and construction of additional dwelling units** on lots within a community. In this regard, it is important that an association's CC&Rs and other governing documents prohibit lot-splitting and the construction of more than one dwelling unit on a single

> lot. **Association managers and boards of directors should act quickly to ensure the proper prohibitions and restrictions are in place**," (emphasis added; City of Loomis, 2023).

Although this guidance is a brazen attempt by a local jurisdiction to circumvent state housing law through private HOAs, it appears to be legally sound advice until the law is amended. Loomis' official guidance later explains that "until the courts or state legislators tell us otherwise, SB 9 does not prohibit homeowners associations from enforcing their CC&Rs or provisions within other governing documents" (City of Loomis, 2023).

Brian No of BuildCasa shared a similar assessment. "It seems to be a legal gray area..It doesn't seem like SB 9 overrules CC&Rs or HOAs." Homestead—a start-up with a similar business model as BuildCasa—offers the same guidance on its website. "There is nothing in the text of SB 9 that explicitly overrides HOA rules. Because of this, homeowners' associations do have the power to veto most SB 9 developments" (Homestead, 2022). Legislators must clarify in future amendments that SB 9 not only supersedes the zoning standards of local jurisdictions and agencies, but also the CC&Rs and by-laws of HOAs.

The most concerning legal challenge to SB 9 is a recent ruling from a Los Angeles County Superior Court Judge that declared the law unconstitutional. As of May 2024, the ruling applies only to the five charter cities that were plaintiffs in the case. But if the case is appealed, the appellate court's ruling will apply to all charter cities statewide—including San Francisco, Oakland and San Jose (Baldassari, 2024).

In order to impose superseding laws upon charter cities, state legislators must demonstrate a statewide concern that the superseding law addresses. The text of SB 9 states that "the Legislature finds and declares that ensuring access to affordable housing is a matter of statewide concern." The plaintiffs, however, argued that SB 9 fails to address this statewide concern because it does not require deed-restricted, below-market-rate, affordable housing. The Superior Court Judge Curtis Kin agreed with the plaintiffs and ruled that SB 9 was unconstitutional (Baldassari, 2024).

In an interview with KQED, Chris Elmendorf—Professor of Law at UC Davis—explained that legislators can easily fix this gap in the law by clarifying the statewide concern. But he noted that even legislators who supported SB 9 may not move swiftly to amend it because they are uneasy with the implications of doing so. "That unease is reflected in SB 9 itself," he explained. "SB 9 is written with loopholes" (Baldassari, 2024).

In this sense, the legal ambiguities and silences in the original law may have been an intentional compromise on the part of its authors rather than an oversight. If pro-housing lawmakers want SB 9 to be more than a symbolic victory, however, they will need to address these ambiguities and loopholes directly (Dubler, 2022).

Moving Forward

The first "clean-up" bill for SB 9 was passed by the state legislature in August 2024. SB450—proposed by Senator Atkins—addresses some of the barriers discussed in this report. The bill did address the issue of "statewide concern" raised in the legal challenge to SB 9, which will likely resolve the case. Its most impactful provision is an application "shot clock," requiring jurisdictions to approve or deny an SB 9 application within 60 days, similar to current ADU law. The bill also further clarifies that HCD's Housing Accountability Unit has authority to enforce SB 9. SB450 slightly strengthens the preclusion threshold, by adding a provision which requires all objective standards to "apply uniformly to development within the underlying zone." This clause prevents jurisdictions from implementing zoning, subdivision or design standards which apply exclusively to SB 9 development, but not to the underlying single-family zoning. However, the law does not prevent jurisdictions from implementing potentially prohibitive design standards so long as they apply to both the underlying zoning and new SB 9 development.

SB450 is a modest, first attempt to improve SB 9. In addition to side-stepping specific, local standards that could be prohibitive, the bill does not address the most controversial and impactful constraints on development. It does not cap development impact fees, specify that SB 9 supersedes HOAs and CC&Rs, change or clarify owner-occupancy standards, or address the challenge of partial lien releases.

The choice not to address these issues suggests that bolstering SB 9 and unlocking its full potential may not be a priority for legislators in Sacramento. Legislators may simply not want to disrupt the fragile compromise struck in the original bill. In order to secure the necessary support for a bill this sweeping, Senator Atkins and her co-authors needed to account for three distinct priorities:

- Producing as much missing middle housing as possible;
- Helping existing homeowners generate additional equity and rental income, while protecting existing residents from real estate speculation and displacement;
- Preserving local jurisdictions' authority to implement their own standards.

These policy goals are not strictly incompatible, but they often directly conflict with one another. The conflicting priorities of SB 9 are likely reflected in the low uptake of the law thus far. Unlocking the law's full potential requires revisiting the legislative compromise between these competing interests.

Strengthening SB 9:

The competing priorities of SB 9 along with the complications inherent in residential lot splits may prevent the law from fulfilling the transformative expectations originally held by legislators and advocates.

If the primary goal of SB 9 is to maximize the production of missing middle housing, it is fundamentally flawed. The owner-occupancy requirement, the prohibition on lot splits of adjacent parcels, and the authority it preserves for local jurisdictions all prevent housing developers from readily using the law to build small-scale, infill housing.

Meanwhile, if the law is intended primarily to generate additional equity and rental income for existing homeowners, it has been similarly unsuccessful. As of now, SB 9 development is too costly and complicated for most fixed- and low-income homeowners to utilize widely.

Lastly, if the law aims to maximize pathways to affordable homeownership, it is a limited tool to do so. The developers equipped to navigate the costs and complexities of SB 9—like the developer working in the affluent East Bay suburb—are doing so because they can generate significant profits selling remodeled single-family homes and new condominium units at high price points.

Senator Atkins and her co-authors have succeeded in establishing an important, first iteration of statewide, missing middle housing policy. Much like the statewide adoption of ADUs, it will take time for homeowners, developers, lenders and local jurisdictions to adjust to the reality of legalized lot splits and duplexes. Legislators, state officials and advocates should not expect swift uptake immediately; but they can advance widespread adoption by standardizing lending practices and strengthening SB 9 to address its most significant barriers.

Recommendations:

- Owner-occupancy requirement
  - *Barrier: Jurisdictions are enforcing this requirement inconsistently and developers remain uncertain whether the requirement will or will not prevent SB 9 approvals.*
  - *Recommendations:*
    - Remove the default owner-occupancy requirement.
    - Clarify whether the requirement allows for-profit entities to pursue SB 9 development on otherwise eligible parcels.
- Partial lien releases for urban lot spits
  - *Barrier: Conventional loan servicers are hesitant to grant the partial lien releases necessary for a property owner to split their lot and sell off a new parcel for development.*
  - *Recommendation:*
    - Legislators and HCD officials should work with Fannie Mae, Freddie Mac, and mortgage lenders to establish clear guidelines for approving partial lien releases and the process by which loan servicers evaluate and respond to lot split requests.
    - These officials should also establish a standard for new home mortgages that would allow for a future lot split.
- Local land-use restrictions, design standards, and CC&Rs
  - *Barrier: Several jurisdictions and HOAs have enacted development standards that render SB 9 development financially infeasible or prohibit it entirely.*
  - *Recommendations*:
    - Legislators and/or HCD officials should clarify that the law supersedes any local standards which prohibit eligible SB 9 lot splits and two-unit developments—including front setbacks, minimum street frontage and prohibitions on flag lots.
    - Legislators and/or HCD officials should specify that SB 9 requires ministerial approval for two-unit condominium developments on eligible parcels.
    - Legislators should change the law's "preclusion" threshold to protect two units per parcel whose combined area is 1,600 sf (rather than two 800 sf units) to encourage more diverse housing types.
- Significant lot split, utility connection and development impact fees
  - *Barrier: Upfront fees to apply for a lot split can be as much as $30,000 to $50,000; and total utility connection fees can cost $50,000 to $100,000 depending on the jurisdiction. These fees prevent low-income homeowners from utilizing the law.*
  - *Recommendations*:
    - Legislators should consider policies that limit these fees, such as the original draft of SB1210, which would cap utility connection fees for new housing at 1% of the new unit's building permit value.
    - Legislators should cap development impact fees for SB 9 units of a certain maximum size, similar to the existing cap on impact fees for ADUs less than 750 sf.

3. San Diego Bonus ADU Program

In 2020, the City of San Diego launched a first-of-its-kind program to spur the development of affordable missing middle housing. The program allows property owners and developers to build “bonus” ADUs in addition to the two minimum ADU units currently allowed by state law. Importantly, property owners can build a bonus unit and rent it at market rate only if they pair it with an income-restricted, affordable unit. These deed-restricted units must be capped at rents for 110% of AMI over 15 years, or 80% of AMI over 10 years.

How the Bonus ADU Program Works:

- On any residential property in the city–including parcels zoned as mixed-use residential–property owners can build at least two Bonus ADUs in addition to the two ADUs already permitted by state law.[16]
- Bonus ADUs, like base ADUs, are permitted ministerially, or “by-right,” meaning that there is no discretionary review process.
- Each market-rate Bonus ADU must be paired with an affordable ADU, restricted to rent limits based on 110% or 80% of AMI. A unit restricted at 110% AMI must remain affordable for 15 years, while a unit restricted at 80% AMI must remain affordable for 10 years.
- Unlimited Bonus ADUs are permitted on properties located in a Transit Priority Area (TPA)–defined as any area within a half-mile of a major transit stop.[17] In San Diego, a large swath of the city, including most of its central neighborhoods without steep topography, is covered by TPAs.
- Within TPAs and elsewhere, developers must conform to existing standards such as FAR, lot coverage, and height limits.
- Any Bonus ADU project that nets 10 or more new units must deed restrict one unit as affordable to residents at or below 50% AMI or pay an inclusionary housing fee.
- The San Diego Housing Commission (SDHC) completes income verification and ongoing monitoring for deed-restricted units, at a cost of $150 per unit.

This section draws from research recently published in an interim policy report on the San Diego Bonus ADU program. The first subsection analyzes the program’s outcomes in terms of numbers, affordability, and size of units. The next two subsections examine financial feasibility and location of the units. A conclusion provides recommendations for policymakers.

Program Background and Expectations

Since 2017, staff in the Planning Department and Development Services Department had been observing ADU production and identifying possible barriers that led to higher costs, slower permitting and fewer units. They first allowed ADUs on lots that had not yet reached maximum density, eliminating a requirement that had made ADU development infeasible on many lots (Gary Geiler, interview, 2023). (The original ADU code required that a single-family home on a lot zoned for a duplex be demolished and rebuilt as a duplex before any ADUs could be built.) Later, staff updated the regulations to allow for ADUs on any residential parcel, not just single-family and small-multifamily parcels as the original code required but also large-multifamily parcels with larger lot sizes.
These earlier reforms laid important groundwork for the Bonus ADU Program to be effective. The

16 State law permits the construction of one attached JADU and one detached ADU on any eligible parcel. The law also permits a conversion of an existing structure, such as a garage, which would allow three ADUs under certain circumstances.
17 A major transit stop is defined as any light or heavy rail station, ferry terminal or bus line with service intervals of 15 minutes or less during peak commute hours.

program was put forward in response to Assembly Bill (AB) 671, which required cities to include a plan in their housing elements to "incentivize and promote the creation of accessory dwelling units that can be offered at affordable rent for very low, low-, or moderate-income households." With this goal in mind, planning staff designed the program, and in October 2020, the San Diego City Council voted unanimously to adopt a "Housing Legislation Code Update," which included the Bonus ADU program and the elimination of all parking requirements for ADUs citywide (City of San Diego, 2020).

Although the passage of the program went largely unnoticed outside of city government officials and housing developers, it eventually gained attention for producing ADU projects of unprecedented scale. Local staff and elected officials did not design the Bonus ADU program with the expectation that it would produce large-scale development (Gary Geiler, interview, 2023). However, earlier reforms meant that large-scale ADU projects were now feasible under the parameters of the bonus program. Since the city had already permitted ADUs on large-multifamily parcels and eliminated all parking requirements, the unlimited unit counts within TPAs unlocked significant scale on multifamily parcels larger than 10,000 square feet, even with low FAR and lot coverage limits.

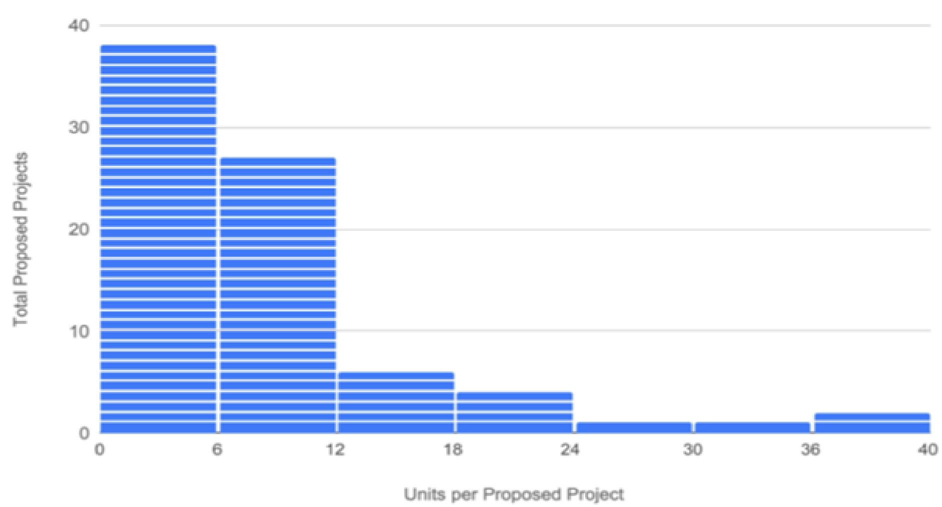
Program Outcomes

Unexpected Unit Counts

The Bonus ADU program has led to several large-scale multifamily developments. There are a total of 33 projects under review as of February 2024 that we classified as large-scale, defined as projects adding 10 or more ADUs. Among the projects in review is a proposal for 148 Bonus ADUs, located in the city's Encanto neighborhood. For now, this project is an outlier. The remaining large-scale proposals range from 10 to 38 units.

However, a local San Diego developer shared with our team details of large-scale projects they plan to submit to the city for review, including a 126-unit Bonus ADU project in the Pacific Beach neighborhood (Christian Spicer, interview, 2024). Other projects in his development pipeline of 2,200 units propose over 100 units, the largest of which would produce 151 ADUs. Other ADU developers have projects with as many as 36 units (David Pearson, interview, 2023).

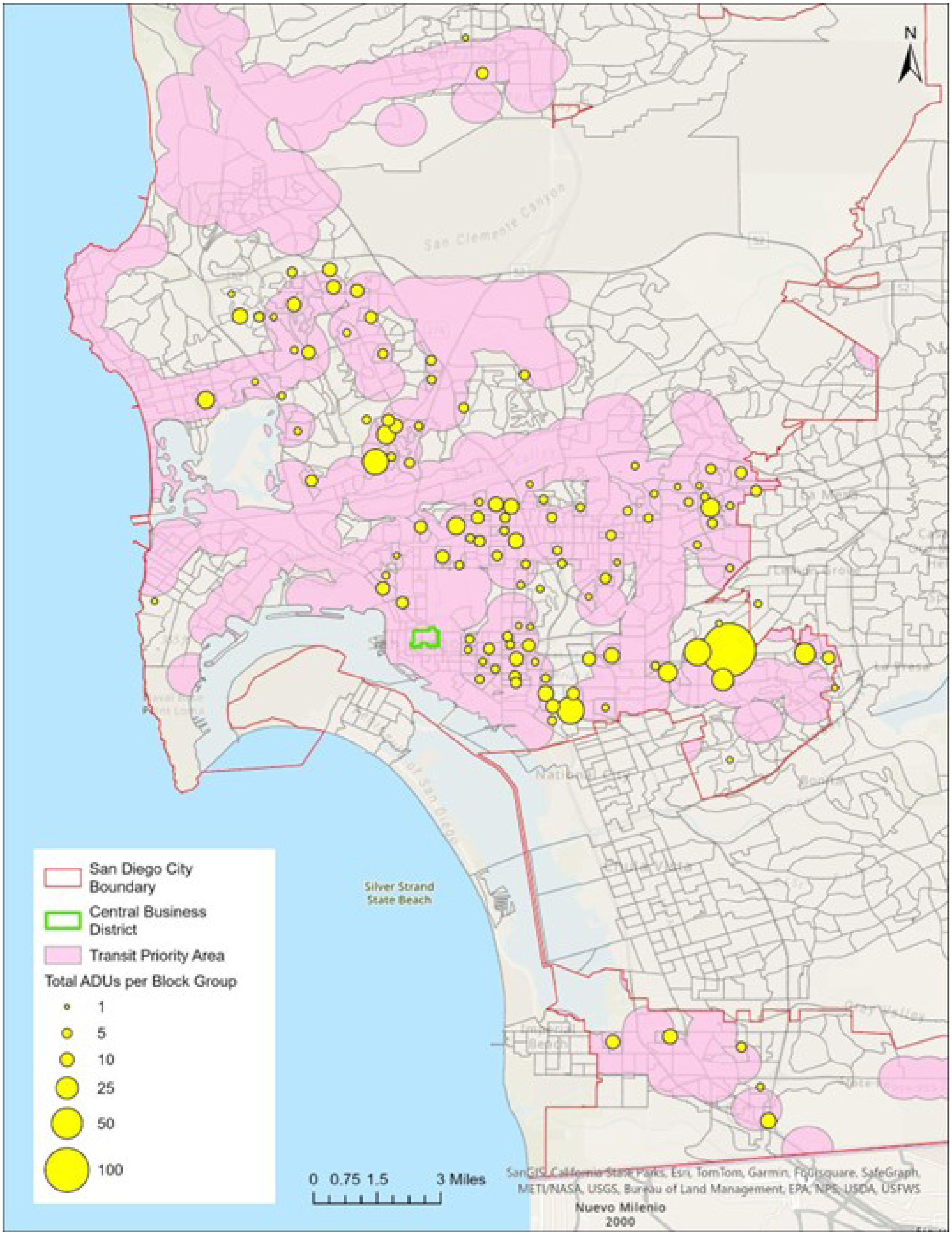
Figure 6. Total Proposed Projects by Units per Project



Source: Internal data, San Diego Housing Commission

Notes: This chart has removed one outlier, a 148-unit proposed project

Figure 7: Bonus ADU projects, by total units per block group, in Transit Priority Areas (TPAs)



Source: Internal data, San Diego Housing Commission
Notes: TPAs are defined as any area within 0.5 miles of a major transit stop.

To be clear, the majority of Bonus ADU projects have produced smaller-scale development. Of the 181 projects currently under review, 148 will produce fewer than 10 units. It is also worth noting that only 90 of the projects under review have actually entered into a recorded agreement with the city.

Few lots are actually large enough to allow for 100-plus units under the parameters of the program. For example, the city is currently reviewing a 100-plus unit project on a 125,000 square foot lot with an FAR of 0.45. That configuration allows the developer 56,000 square feet of floor area to work with. The lot is currently zoned for single-family (R-1-7) and has one single-family dwelling which will be demolished. Lot size, existing FAR and height limits will likely constrain the total unit count (Gary Geiler, interview, 2023).

Affordability Challenges

Housing affordability is perhaps the most significant issue facing San Diego. Roughly half of the city's households are cost-burdened – spending more than 30% of their income on housing. Average rent prices in San Diego increased 46% from 2012 to 2019 and the city's median household rent is $2,200 as of 2022 – making it one of the most expensive rental markets in the country (City of San Diego, 2020). These housing costs take the biggest toll on low-income and very low-income households across the San Diego region. As of 2023, 141,544 low-income renter households in San Diego County do not have access to an affordable home (CHPC, 2023).

As part of required updates to the city's housing element, San Diego must plan for 108,000 new units of housing including over 32,000 for households making between 30-80% AMI and an additional 19,000 for households making between 80-120% AMI. The Bonus ADU program is a key part of the city's efforts to dramatically increase its supply of deed-restricted affordable housing.
For every market-rate bonus ADU that a developer builds, it must create a deed-restricted affordable ADU. Developers have two choices for this affordability requirement: the affordable unit can be restricted for 15 years at a rent limit based on 110% of the county's Area Median Income (AMI) or for 10 years at a rent limit based on 80% of AMI. City staff designed this two-tiered system based on feedback they had received from developers (Gary Geiler, interview, 2023).

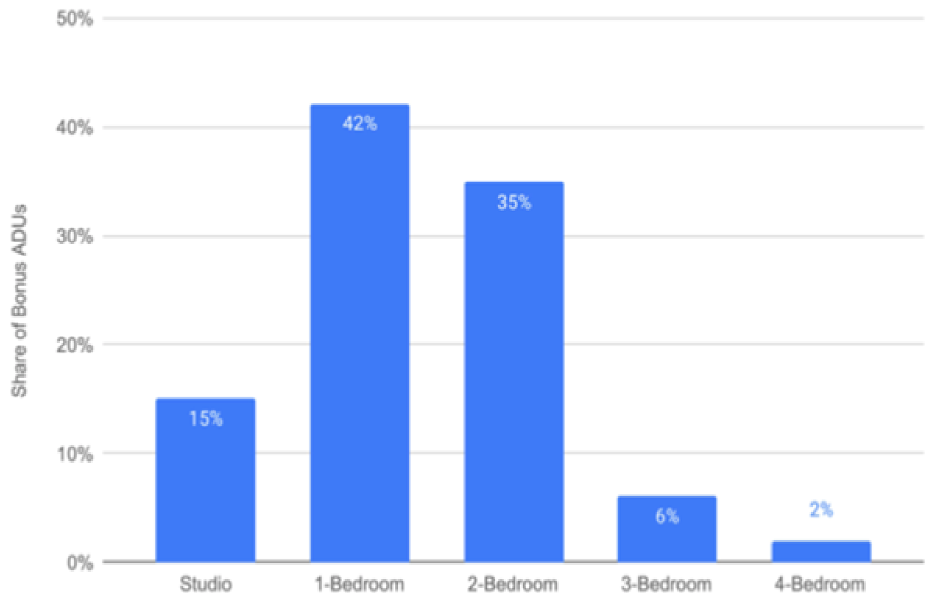
Of the 181 projects in review and the 92 projects with a recorded covenant, every single affordable ADU has been restricted to 110% AMI for 15 years. When given the choice, developers uniformly prefer a longer affordability covenant with higher allowable rents.

Our interviews with developers explained this preference. One developer builds mostly 1-bedroom units, renting half for $2,500 (reserved for residents making less than 110% of AMI), and half at market-rate, between $3,000 and $3,200 (Christian Spicer, interview, 2024). This gap represents a significant savings for moderate-income residents. Another, focusing on studios, estimated that a market-rate Bonus ADU studio unit would rent between $1,700 and $2,500, depending on the neighborhood (David Pearson, interview, 2024). Affordable rent limits for studios are $1,930 at 80% AMI and $2,249 at 110% AMI respectively. In other words, the affordable units are comparable to market-rate prices in some neighborhoods of the city.

Unit Size

The city knows the bedroom size for only about half of the 1,300 proposed units. Figure 8 shows that 1- and 2-bedroom units represent the largest share of proposed Bonus ADUs. Several developers predicted that an increasing share of the units going forward will be studios and 1-bedrooms. Per state ADU law, any ADUs under 750 square feet are exempt from development impact fees, which incentivizes developers to build smaller units. These studios and 1-bedrooms will boost the supply of rental housing for students and young professionals, a large and growing demographic in San Diego. According to the city's housing element, 60% of San Diego households have only one or two persons – a share that is expected to grow as younger residents wait longer to purchase homes and start families.

Figure 8: Unit sizes for proposed Bonus ADUs under review, by individual units



Source: Internal data, San Diego Housing Commission
Notes: 55% of projects did not specify unit size.

However, studios and 1-bedroom units will not provide rental housing for large families, which remains a significant need across the city. The housing element calls for the creation of a "Large Family Unit affordable housing incentive program encouraging 3-bedroom units in quality transit areas." As of now, the Planning Department has not yet specified or implemented that incentive program (City of San Diego, 2020).

Rental housing for large families is a significant need across the city, but it may be in tension with the incentive developers currently have to keep new ADUs under 750 square feet, which allows them to avoid development impact fees. City officials should explore additional incentives that can align these policy goals. Additionally, city officials could consider increasing the ratio of allowable bonus, market rate ADUs for large family, affordable units.

Bonus ADU Policy Menu

In summary, we find three common use cases for the Bonus ADU program in San Diego. These options offer a policy menu to jurisdictions seeking to replicate the Bonus ADU program:

Figure 9: Completed low-density Bonus ADU project (one market-rate and one affordable ADU)

Source: Victoria Beckley

The low-density option, capped at one bonus market-rate and one affordable ADU, currently applies to lots outside of TPAs. The photo above shows a newly constructed project adding two ADUs, each with its own garage, behind an existing duplex (not visible in the photo).

Figure 10: Completed moderate-density Bonus ADU project (6 market-rate and 6 affordable ADUs)

Source: Victoria Beckley

The moderate-density option is the most common use of the program in San Diego within TPAs. These projects tend to create 4-12 new units behind existing single-family homes or duplexes. This photo shows two, detached ADU triplexes, both three stories tall. This project creates a total of six new units behind an existing fourplex with an ADU (not visible in the photo). There is no off-street parking.

Figure 11: Proposed high-density Bonus ADU project (63 market-rate and 63 affordable ADUs)

Source: SDRE Homebuyers

The high-density option is a surprising outcome of the San Diego Bonus ADU program. Still, it is rare. We identified several proposed projects adding over 100 units, including a 126-unit project shown in the rendering above. The project will consist of 19 buildings, a mix of two- and three-story ADU fourplexes and sixplexes. The lot is 125,000 square feet with an existing FAR of 0.45, allowing for a remarkable level of infill density within the parameters of the program.

Financial Feasibility

Driving these outcomes are the development costs and revenue projections for Bonus ADU projects. Drawing on extensive conversations with developers along with pro formas that they shared, our research team built a composite case study representing the development costs of a typical Bonus ADU project within a TPA:

Case Study Characteristics[18]

Site size	6,000 square feet
Building size	Existing duplex: 1,500 sf 12 new ADUs: 350 sf
Total units	14 units
Unit mix	1 duplex: 2 separate 2 bed/1 bath units 12 ADUs: studios
Parking	5 spots (2 curb cut spots, 3 in alley)
FAR	1.0

18 See Appendix I for detailed assumptions.

Basic Development Costs

Hard costs	Materials labor	New construction ($400/sf)	$1.68 million	$2 million
		Remodel ($70k/unit)	$140,000	
		Hard cost contingency (10%)	$183,000	
Soft costs	Fees, consultants, financing costs, tax and insurance	Pre-dev and utility consultants	$30,000	$603,000
		Architecture & engineering	$140,000	
		Utility connection upgrade	$90,000	
		City utility permit	$5,000	
		Development impact fees	$40,000	
		Insurance	$50,000	
		Taxes (15 months)	$12,000	
		Legal & accounting	$10,000	
		Construction loan interest	$209,442	
		Soft cost contingency (5%)	$16,850	
Acquisition	Initial value	Land	$792,000	$950,000
		Structure	$158,000	
			Total uses	**$3.55 million**

Sources of Funds

Total equity investment	$1,343,850	**$3.55 million**
Total amount financed	$2,212,442	
	Total sources:	**$3.55 million**

Rental Revenue

Unit type	Total units	Rent per unit per month	Rent per unit per annum	Total rent (PUPA)
Duplex	2	$3,000	$36,000	$72,000
Market-rate ADU	5	$2,500	$30,000	$150,000
Affordable ADU (110% AMI)	6	$2,110	$25,320	$151,920
Inclusionary ADU (50% AMI)	1	$1,067	$12,804	$12,804
			Annual revenue:	**$387,000**

Property Before Tax Cash Flow (PBTCF)

Potential gross income	$387,000
Vacancy rate (5%)	($19,350)
Effective gross income	$367,500
Operating expenses (30%)	($110,250)
Net operating income	$257,250
Capital reserve set-aside	$42,000
Property before tax cash flow	**$215,250**

10 Year Internal Rate of Return (IRR)	**15.9%**

The composite case study reveals that Bonus ADU developers are able to achieve significant densities on infill sites, while keeping their development costs relatively low and generating significant profit. With unlimited units allowed and zero parking required, the FAR is the only significant constraint on development. As demonstrated above, even a low FAR permits 12 studio ADUs. The resulting rental revenue allows these projects to pencil, even with some notable costs.

Developers highlighted the cost of upgrading utility connections, in particular, as a serious pain point. Most bonus projects are adding 4-10 new units behind an existing single-family or duplex unit. The existing low-intensity use means that developers must upgrade the electrical and water utilities at a significant expense in order to add even a small number of additional units. The costs below are a more granular breakdown of utility costs included in the case study:

Table 2: Typical costs of upgrading utility connections for Bonus ADU projects

Utility-related expenditure	Cost
Electrical utility upgrade	$50,000
Water utility upgrade	$40,000
City permit for utility upgrades	$5,000
Utility consultant	$30,000
Civil engineers	$10,000
Total	**$135,000**

These costs are a serious barrier to infill, missing middle development. Developers suggested that without reforms to lower the costs of utility upgrades, it will be financially difficult to restrict affordable ADUs at 80% AMI. In other words, capping these costs could allow the program to target deeper affordability levels.

As previously discussed, the original draft of SB1210–authored by Senator Nancy Skinner–would have required that public utilities and municipal utility districts cap any upgrade fees at 1% of a new housing unit's building permit value. Applied to the case study pro forma above, Senator Skinner's original bill would have lowered utility connection costs alone from $90,000 to $18,200–not including other possible savings on consultants and fees. Since the remaining fees can be paid over 10 years, the proposed cap would effectively eliminate utility connection fees as an upfront development cost. The resulting savings in equity investment are shown in the table below:

Table 3: Total equity investment with and without cap on utility connection fees

	Total equity investment
Without 1% cap on utility connection fees	$1,343,850
With 1% cap on utility connection fees	$1,255,670
Total savings	**$88,180**

These savings in upfront equity investment can potentially allow developers to provide units at deeper levels of affordability. So far, no developer has produced a Bonus ADU restricted at 80% AMI over 10 years; instead, all affordable ADUs have been restricted at 110% AMI over 15 years.

When adjusted to reflect the savings from the 1% cap, the case study pro forma shows modest gains in IRR. The table below shows the effect of the cap on 10 Year IRR, for the existing rental mix (110% AMI) and a more affordable rental mix (80% AMI):

Table 4: 10-Year IRR with & without cap on utility connection fees, by affordability level

	80% AMI	110% AMI
IRR without 1% cap	15.3%	15.9%
IRR with 1%	15.8%	16.5%

Developers opting for deeper affordability still achieve significant IRR. The rate for projects restricted to 80% AMI with a cap on utility fees is 15.8%–not far below the 15.9% IRR achieved under current conditions. The case study suggests that a cap on utility connection fees could be an opportunity to require deeper affordability levels from developers.

It is also worth noting that lowering these costs would particularly benefit smaller-scale projects, since these fees represent a larger share of those projects' development costs. However, even if the original draft of SB1210 or a similar bill were to become law, utility-related delays remain a significant issue that needs to be addressed as cities like San Diego push for streamlined, infill housing development.

The difficulty of upgrading utility connections has also affected the pool of construction labor available. Several developers highlighted a shortage of small-scale general contractors who have previous experience working with utility districts. Bonus ADU developers must choose between paying a large project management fee to a sophisticated general contractor with expertise in large-scale apartment buildings, or paying an affordable rate for a small-scale contractor who typically works on small ADU projects or renovations. The former option is costly, while the latter option often leads to delays with the utility districts (David Pearson, interview, 2023).

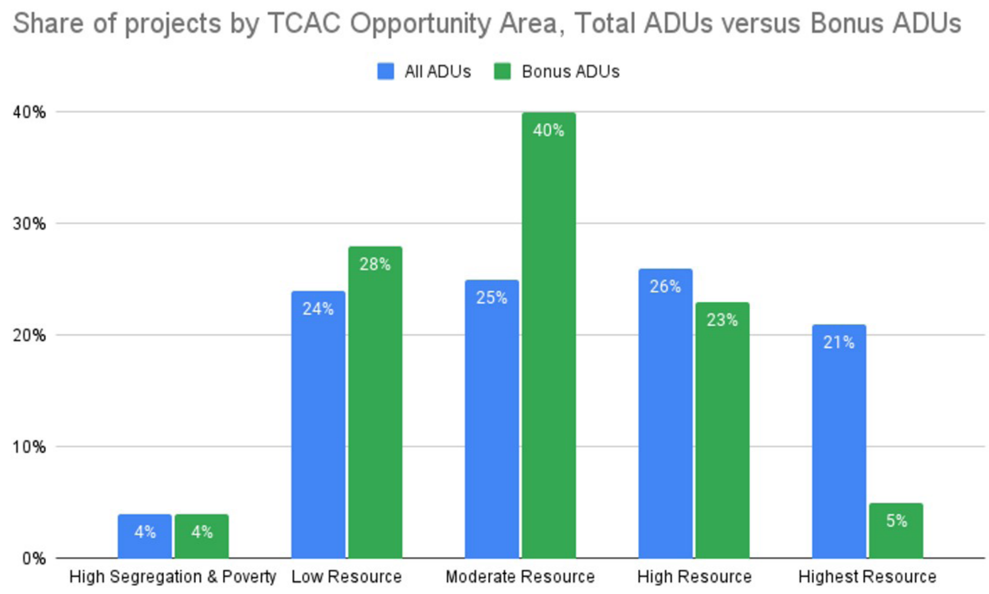
David Pearson described a "trial and error" process with general contractors who are learning the particularities of the Bonus ADU program. He believes that small-scale general contractors will slowly build an expertise with this new 9-12 unit type, including how to upgrade utility connections more efficiently. Until then, however, the complexity and costs associated with utility upgrades will make it very difficult for inexperienced, small-scale developers to utilize the Bonus ADU program (David Pearson, interview, 2023).

Location: Does the Bonus Program Fulfill AFFH Goals?

Under state law AB 686–passed in 2018–California cities are mandated to enact policies that Affirmatively Further Fair Housing (AFFH). A key indicator the state uses to measure progress towards AFFH goals are the TCAC Opportunity Maps. The TCAC Maps classify census tracts according to five categories based on socioeconomic status: High Segregation & Poverty; Low Resource; Moderate Resource, High Resource and Highest Resource.

Revisions to AFFH in 2021 required jurisdictions to enact policies in their housing elements that "increase affordable housing in high-resource neighborhoods that have often been exclusionary and bring additional resources to traditionally under-resourced neighborhoods." Has the Bonus ADU program helped San Diego achieve this goal?

Figure 12: Share of proposed or permitted projects by TCAC Opportunity Area, all ADUs (2018-2022) versus bonus ADUs (2021-Present)



Source: Internal data, San Diego Housing Commission; APR Data, HCD, 2018 - 2022

Notes: "High Segregation & Poverty" is a designation for census tracts that are within "Low Resource" areas. This chart counts projects proposed or permitted in "High Segregation & Poverty" census tracts separately from the "Low Resource" category.

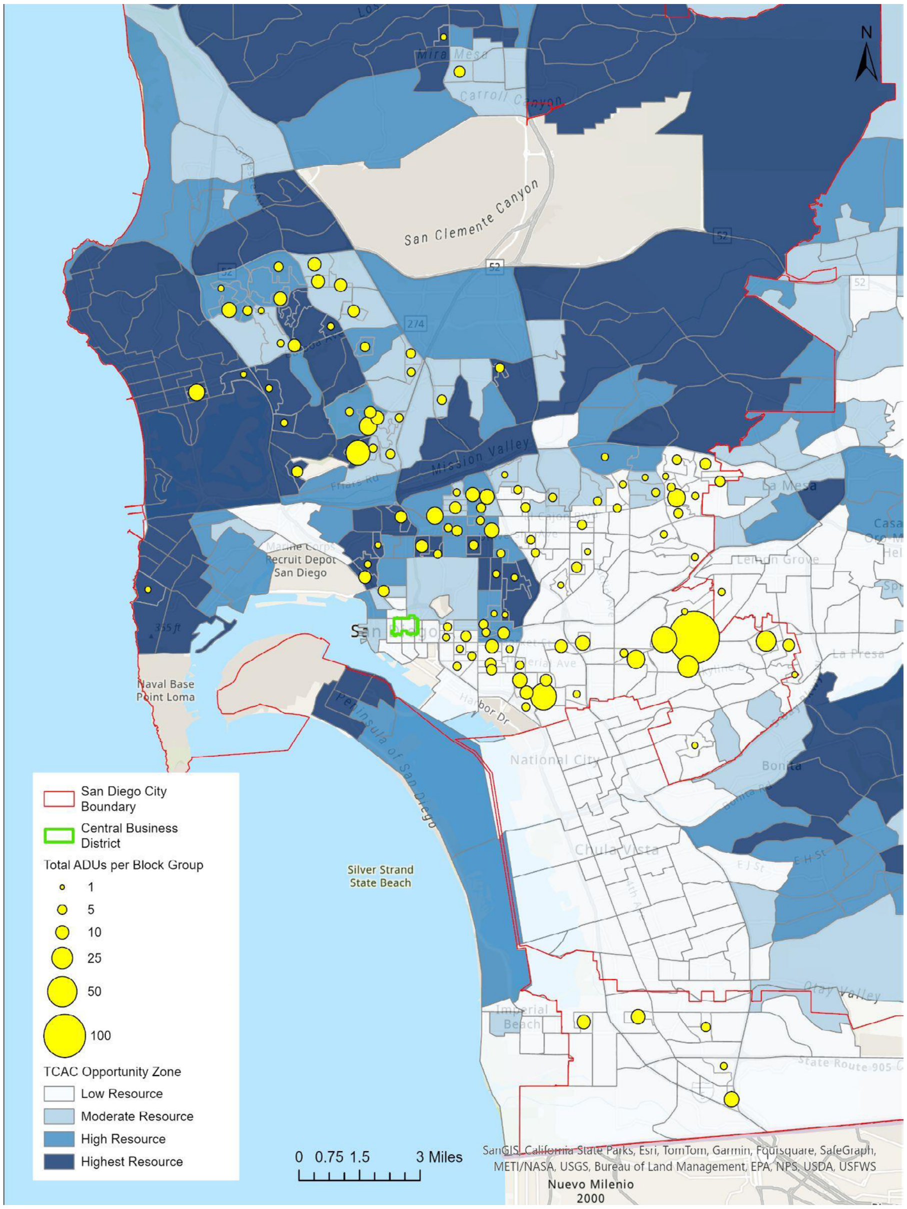
The initial results are mixed. The program has been very successful in creating new housing in neighborhoods classified as "Moderate Resource" (middle income), which is a promising, early outcome. Forty percent of proposed Bonus ADUs are located in these areas, compared to only 25% of total ADUs citywide and 10% of total housing permits.

A very small share of proposed Bonus ADU projects are located in "Highest Resource" areas, as compared to the total ADUs and total housing permits across the city. These data are too limited and preliminary to draw firm conclusions about where the program is being utilized. However, if this result holds as the program continues, the city will have missed a significant opportunity to create income-restricted affordable units in its wealthiest and most exclusionary neighborhoods. These data also suggest that in lower resource areas of the city, nonprofit organizations like community development corporations (CDCs) and community land trusts (CLTs) have an opportunity to build Bonus ADUs, which could generate permanently-affordable housing at relatively low development costs.

An additional pattern the city should monitor is where large-scale Bonus ADU projects are being proposed by for-profit developers. Of the Bonus ADU projects currently in review, the largest would create 148 units. It is located in the city's Encanto neighborhood, a predominantly Black and Latino community categorized as a "Low Resource" area. Although income-restricted units may provide stability to renters in lower-income neighborhoods, the city may not want to see such a high concentration of units in areas that have historically absorbed more than their fair share of housing development.

On average, higher-unit count Bonus ADU projects are being proposed in "Low-Resource" areas more than any other TCAC zone. However, a regression analysis of project data found that there was no statistically significant relationship between a project's unit-count and any particular TCAC zone.

Figure 13: Bonus ADU projects across TCAC Opportunity Areas, by total units per block group



Source: Internal data, San Diego Housing Commission

There are signs of demand for large-unit projects in higher-income areas of the city. If approved, Christian Spicer's 126-unit project will bring 63 income-restricted ADUs to the Pacific Beach neighborhood, located in a "Highest Resource" area of the city. If city officials hope to use the Bonus ADU program to pursue AFFH goals, city staff should identify ways to incentivize larger-unit projects in "Highest Resource" areas like Pacific Beach.

One program the city should consider expanding is the recently created ADU Finance Program. The city could open the program up to CDCs and other local non-profit organizations trying to develop affordable housing in moderate- and high-resource areas. By providing soft loans and technical assistance, the city can encourage CDCs to build Bonus ADU projects that target deeper levels of affordability for longer periods of time throughout San Diego, including in historically exclusionary neighborhoods. Likewise, this subsidy could incentivize or require these organizations to create a minimum percentage of affordable, large family units.

Moving Forward

San Diego has unlocked a very successful pathway to infill development. Thanks to years of iterative updates in Sacramento, state ADU law provides a reliable, by-right approval process that developers can trust. By attaching its missing middle housing initiative to well-established ADU laws, San Diego may have discovered a procedural "backdoor" to infill housing that usually requires politically-challenging rezonings.

Unintentionally, the city has also created a more streamlined pathway to large-scale multifamily development. The resulting typology and business model are atypical for ADU development. Instead of a homeowner developing a backyard in-law suite, San Diego's program sees more experienced developers purchasing single-family and duplex properties with large lots in order to add multifamily ADU buildings. It is not uncommon for these projects to include 10 or more units and several will produce over 100 units if approved.

While these surprisingly large projects will add much-needed supply to the city's rental housing stock, they are not necessarily the kind of "gentle density" promoted by advocates of missing middle housing. As developers continue to utilize the program, larger-scale projects may begin to concentrate in low-resource neighborhoods that have absorbed more than their fair share of previous housing development.

Notably, the program has not been effective in producing housing affordable for low-income residents. No developer has opted to produce affordable ADUs at or below 80% AMI; instead, every single affordable Bonus ADU has been deed-restricted for residents at or below 110% AMI. Early data also suggest that developers are producing very few large family units, opting largely for studios and 1-bedroom units. To ensure that the Bonus ADU program can further the city's AFFH goals and create housing affordable to low-income residents and large families, city officials should consider the following recommendations.

Policy Recommendations:

- Identify ways to create affordable housing for low-income residents (at or below 80% AMI)–not just moderate-income residents (at or below 110% AMI)–without jeopardizing the existing business model.
    - Implement an additional density incentive for projects that produce units affordable for low-income residents (at or below 80% AMI).
- Identify ways to lower utility upgrade costs, such as the original draft of SB1210–proposed by Senator Skinner–which would have capped utility costs at 1% of a new unit's building permit value.
    - Cap utility costs at a lower rate for projects restricted at or below 80% AMI.
- Incentivize community development corporations (CDCs), community land trusts and other community-based organizations to utilize the Bonus ADU program, encouraging local economic development.
    - Expand the ADU Finance Pilot Program to make more pre-development funds or loan assistance available to CDCs and nonprofits that apply to utilize the Bonus ADU program.
    - Incentivize CDCs and other local nonprofits to produce large family units using the Bonus ADU program.
- Explore other, possible incentives to create more 3- and 4-bedroom units for large families.

    - Waive development impact fees for projects that produce large-family ADUs restricted at or below 80% AMI.
    - Increase the ratio of allowable bonus, market rate ADUs for large family, affordable units. For example, the program could allow 1.5 market rate ADUs for every 3-bedroom affordable unit, and 2 market rate ADUs for every 4-bedroom affordable unit.
- Continue to monitor where large-scale Bonus ADU projects are being proposed and identify incentives to encourage moderate- and large-scale projects in High Resource and Highest Resource neighborhoods of the city.

4. Scaling the Bonus ADU Program Statewide

To assess the feasibility of scaling up the program across California, our team selected five case study cities to test a San Diego-style Bonus ADU policy. We selected Fresno, Palo Alto, Sacramento, Santa Barbara and Truckee to ensure regional diversity and a wide variety across rental and development costs.

Table 5: Descriptive statistics for case study cities

City	Population	Median household income	Median gross rent	Population density (persons per square mile)	Percentage of housing built since 2000
Fresno	541,528	$63,001	$1,427	4,722	26.3%
Palo Alto	67,901	$214,118	$3,306	2,853	18.1%
Sacramento	523,600	$78,954	$1,779	5,374	24.7%
Santa Barbara	88,640	$98,346	$2,285	4,547	9.1%
Truckee	16,784	$107,423	$2,042	518	24.8%

Source: American Community Survey 2022 5-Year Estimates. Tables DP05, S1901, B25064, B25034

Case Study Characteristics[19]

Site size	6,000 square feet
Building size	Existing duplex: 1,500 sf 12 new ADUs: 350 sf
Total units	14 units
Unit mix	1 duplex: 2 separate 2 bed/1 bath units 12 ADUs: studios
Parking	5 spots
FAR	1.0

Our findings suggest that San Diego's Bonus ADU program would be feasible and highly effective in producing new units in cities with very supply-constrained markets and relatively low development costs, but not so much in cities with higher land costs. In our model, Truckee stands out with an exceptionally high IRR: 40.2%.

Jurisdiction	Projected IRR
Fresno	12.6%
Palo Alto	5.9%
Sacramento	9.3%
Santa Barbara	15.2%
Truckee	40.2%

Truckee has the lowest development costs out of the five cities in our model, due in part to significantly lower labor costs. Meanwhile, Truckee's popularity as a tourist destination and ski resort town boost its median rents.

19 See Appendix I for detailed assumptions. These are the same assumptions as those used in the original San Diego case study pro forma.

Perhaps most importantly, new construction in Truckee has not kept pace with rising demand. In its most recent Housing Element, Nevada County–which is the jurisdiction that governs housing policy in the Town of Truckee–projects that the county will see a total of 914 new dwelling units built by 2027. This estimate is less than 50% of the state-mandated target of 2,062 through the Regional Housing Needs Assessment. In this context, an addition of 12 ADUs would represent a significant boost to local supply, which may explain the extraordinarily high IRR.

A key feature of the San Diego Bonus ADU program, however, is that it takes advantage of existing state law that prohibits parking minimums in Transit Priority Areas (TPA). Due to infrequent and limited transit service, the Town of Truckee does not include a TPA. State ADU law limits local parking requirements to one space per ADU, a standard that would likely apply in the case of Truckee. Accounting for nine additional parking spaces within the developable envelope, the IRR for this hypothetical development would decrease.

When applied to Santa Barbara, our model projects a similar IRR as that of San Diego. Unlike Truckee, Santa Barbara does include several TPAs, which would allow for a low parking ratio in a hypothetical Bonus ADU project. Still, it is unclear whether local market conditions would allow for so few parking spaces. One very practical use case for a Bonus ADU program in Santa Barbara would be off-campus student housing. Santa Barbara, similar to San Diego, has a growing student population that is increasing demand on the existing rental housing supply. A Bonus ADU program–highly effective in producing studio and 1-bedroom units–may meet this demand among students, who are less likely to own a car than other residents.

Our model projects surprisingly low IRRs for Fresno (12.6%), Sacramento (9.3%) and Palo Alto (5.9%). Rental demand in Fresno is lower than any of our other case study cities, which may partially explain lower IRR. Although the city has several Transit Priority Areas, it is unclear whether there is significant demand for rental housing among residents without cars. A Bonus ADU program in Fresno could be effective if utilized by local CDCs looking to expand their inventory of income-restricted affordable housing.

In Sacramento and Palo Alto, it seems that very high development costs may be limiting the success of a potential Bonus ADU program. Sacramento has higher construction costs than San Diego, possibly due to the cost of labor, with lower expected rents.

Palo Alto has the highest construction costs of the five case studies. More importantly, the cost of land in Palo Alto is notably higher than any other city in our case study and significantly higher than that of San Diego. We estimate that the cost of purchasing an existing duplex in Palo Alto is $2.2 million as compared to $950,000 in San Diego. Thus, while expected rents in Palo Alto are high, they simply cannot offset the significant upfront development costs. Meanwhile, Stanford University's commitment to offer housing to all undergraduate and graduate students limits pressure on the off-campus student housing market. By comparison, Santa Barbara–which is home to a similar number of university students, not all of whom are offered housing–has higher expected rents than Palo Alto.

Taken together, our case study analysis suggests that a San Diego-style Bonus ADU Program will be most feasible in cities that meet the following key criteria:

- Significant demand for studio and 1-bedroom apartments, such as cities with a high need for student housing or workforce housing.

- Sufficient demand for housing without parking.
- Comparatively low costs for land and construction.

Although development costs are lower in San Diego, Santa Barbara and Truckee, these costs appear to be a less significant factor than the cost of land and rental demand. Our case studies indicate that a Bonus ADU program is most likely to succeed in cities with very high demand for housing among students, young professionals and service-industry workers. However, even in cities with high rental demand, comparatively high land costs can render a Bonus ADU program infeasible, as in the case of Palo Alto.

Crucially, demand for car-free living plays a significant role in the feasibility of a hypothetical Bonus ADU program in any California city. It is unlikely that a large demographic of renters in Truckee do not own or use a car. Even if the city adopted the parameters of the San Diego program as it applies to TPAs (no parking minimums), the local market conditions may not allow for the program to work. In that case, Truckee may need to fall back on existing state ADU law with regard to parking: one space per unit. The resulting loss in developable land will lower Truckee's IRR.

Still, San Diego's Bonus ADU program offers a promising model for other California cities to boost their supply of missing middle housing without pursuing complicated rezonings. Mid-size and large cities with an existing local ADU construction industry and large student populations should seriously consider adopting the San Diego program as is. A Bonus ADU Program may be very effective in Berkeley, Davis, San Luis Obispo and Los Angeles, in particular; but each city may opt for varying levels of density.

5. Alternative Models

Portland Residential Infill Project (RIP):

Missing middle housing reforms undertaken in Portland, Oregon present another promising model: the Residential Infill Project (RIP). The program was a response to state law HB2001, which passed the Oregon State Legislature in 2019. HB2001 ended exclusive single-family in all municipalities with populations of 25,000 or more. The law required all cities, including Portland, to comply no later than July 2022.

The Portland City Council adopted the first version of RIP, RIP1, in August of 2020 and the program went into effect a year later, in August 2021. RIP1 changed local zoning codes to allow for market-rate duplexes, triplexes, fourplexes and affordable four-, five- and sixplexes,[20] along with two a ADUs per lot, in most areas zoned for single-family homes across the city (R2.5, R5, R7). Beginning in July 2022, a revised version, RIP2, went into effect, allowing for even more housing options such as cottage clusters and townhouses in all single-family zones (R2.5, R5, R7, R10 and R20).

Zoning Changes Under RIP

Housing types allowed before RIP
• Single-family dwelling • Single-family dwelling plus one ADU • Corner Duplex
Additional housing types allowed under RIP1 (August 2021 - July 2022)
• Duplex • Triplex • Fourplex • Four-, five- and sixplex (affordable) • ADU allowances (two per lot)
Additional housing types allowed under RIP2 (July 2022 - Present)
• Duplex • Triplex • Fourplex • Four-, five- and sixplex (affordable) • ADU allowances (two per lot) • Detached duplex • Cottage cluster • Attached houses (townhouse/rowhouse)

20 Affordable four-, five- and sixplexes are permitted so long as rental units are deed-restricted for residents making less than 60% MFI for 99 years; and for-sale units are deed-restricted for residents making less than 80% MFI for at least 10 years. MFI is defined by HUD for the Portland Metropolitan Statistical Area. Although market-rate fourplexes are permitted under RIP, an affordable fourplex is granted an FAR bonus (see Table 6 below).

Early Results:

During both iterations of RIP, Portland has seen a significant increase in middle housing development across the city. Since its adoption, 53% of new housing units in the city's single-family zones are middle housing units or expanded ADUs that are permitted through RIP's new zoning standards (Cascadia Partners, 2023). Citywide, the share of middle housing in new housing developments increased from 5.7% before RIP to 18.5% after RIP (Dong, 2023).

In the program's first year, 271 new units in the form of duplexes, triplexes and fourplexes were permitted on just 81 lots–a housing unit replacement rate of 3.4 to 1. During that same period, 126 units in the form of new single-family homes or new single-family homes with one ADU were permitted on 102 lots. By comparison, the housing unit replacement rate for single-family homes was 1.2 to 1 (Dong, 2023).[21]

RIP has achieved these notable increases in efficiency and density not only through permissive zoning, but also through limitations on floor area ratio that grow more permissive with increasing unit count (FAR). By implementing new maximum FAR requirements on a sliding scale, RIP has encouraged more and smaller units on existing lots. As Table 6 shows, RIP allows higher FAR for projects that produce more units. The FAR also changes for each housing type based on the existing density of the single-family zone.

Table 6: Floor area ratio (FAR) by zone

Units	Housing type	R20	R10	R7	R5	R2.5
1	House or attached house	0.4	0.4	0.4	0.5	0.7
2	Duplex or house + ADU	0.5	0.5	0.5	0.6	0.8
3	Triplex or Duplex + ADU or House + 2 ADUs	0.6	0.6	0.6	0.7	0.9
4	Fourplex	0.7	0.7	0.7	0.8	1.0
4-6	Affordable four-, five-, or six-plex	1.2	1.2	1.2	1.2	1.2

The effects of this sliding scale on affordability have been remarkable. Cascadia Partners, an urban planning consulting firm, conducted an analysis of housing development before and after RIP was implemented. Its analysis found that 44% of the new, detached single-family homes built and sold between 2018 and 2022 are no longer possible to build under RIP's updated FAR limits. Notably, among this pool of new single-family homes built and sold between 2018 and 2022, the difference in average sales prices for homes above and below RIP's FAR limit was $117,000 (Cascadia Partners, 2023).

RIP has effectively rendered infeasible what had been the most expensive portion of Portland's housing market: very large single-family, detached homes. Of course, detached single-family homes are still permitted in these zones and are still being developed, but they are required to be much smaller and therefore sell at a lower price point. More importantly, due to the sliding scale FAR, developers have a strong incentive to increase the number of units on these lots. Thus, Portland has leveraged maximum FAR limits to make middle housing products more competitive in its local housing market.

21 It is worth noting that Portland's housing market has been relatively cool during the period of RIP implementation. In August 2021, when the program went into effect, the median home price was $525,000. Dr. Dong's analysis captures data up until August 2023, at which point the median home price was $515,000. As of August 2024, the median home price has risen slightly to $529,000. It is unclear whether RIP, in particular, has impacted this slow growth of home prices citywide.

Recent reserach analyses the Portland housing market from 2016 to 2023 in an attempt to better understand the effects of RIP on development patterns and affordability (Dong, 2024).
The per unit price of middle housing located in single-family zones dropped by 34.6% after the adoption of RIP. Prior to RIP, the price ratio of middle housing versus single-family homes was 0.85 to 1.00. After RIP, that ratio dropped to 0.55 to 1.00. In addition, Dong finds that prior to RIP, the price ratio of middle housing in single-family zones versus middle housing in non-single-family zones was 1.27 to 1.00. After RIP, that price ratio fell to 1.03 to 1.00. In other words, RIP appears to have made middle housing in single-family zones almost as affordable as middle housing in non-single-family zones. These findings indicate that RIP significantly lowered the per unit price of missing middle housing within single-family zones. Dong cites the decrease in unit size as the primary driver of increased affordability (Dong, 2023).

Importantly, the shifting FAR limits appear to incentivize fourplexes over other types of middle housing. In RIP's first year, fourplexes represented 76% of all new middle housing permitted under the program, excluding new ADU allowances.

Table 7: New housing units permitted under RIP1 by housing type, August 2021 - July 2022

Housing type	Units
ADU allowances	69
Duplex	34
Triplex	27
Fourplex	204
Sixplex (affordable)22	2

Thus far, fourplexes appear to be a sweet spot for developers seeking to maximize efficiency within the FAR limits. Although the option of developing a sixplex essentially functions as a density bonus– unlocking an FAR of 1.2 in exchange for deed-restricting half of the units as affordable–developers are avoiding it, opting instead for the returns of market-rate fourplexes.

As in the case of the San Diego Bonus ADU program, the lack of any off-street parking requirements appears to be enabling more units. Of the 51 total fourplex projects that were permitted through RIP1, 46 had no parking and zero had more than one space per unit.

Table 8: Number of parking spaces per unit by housing type under RIP1, August 2021- July 2022

Housing type	No parking	<1 space/unit	1 space per unit	>1 space per unit
Duplex	5	1	11	2
Triplex	6	1	2	0
Fourplex	46	1	4	0

22 The only sixplex permitted under RIP1 was a two-unit conversion of a fourplex into a sixplex. It is not clear if this conversion required affordability restrictions.

These early permit data suggest that RIP is incentivizing developers to trade parking for dwelling units, since developers need as much of the site area as possible in order to maximize the FAR. Only duplex projects appear to include consistent off-street parking, while triplexes and fourplexes have far fewer spaces. This trend aligns with where these projects are generally being developed within Portland. Of the duplex, triplex and fourplex units permitted under RIP1, 86% are located within a quarter-mile of a center or corridor, as designated by Portland's 2035 Comprehensive Plan. Meanwhile, 80% of these units are located within a quarter-mile of a transit stop. As in the case of San Diego, RIP seems to allow developers to meet a growing demand for car-free living (Cascadia Partners, 2023).

Unlike San Diego's Bonus ADU program, however, RIP is not disproportionately producing studio and one-bedroom units. Instead, more than 99% of middle housing units permitted under RIP1 have 2 or more bedrooms.

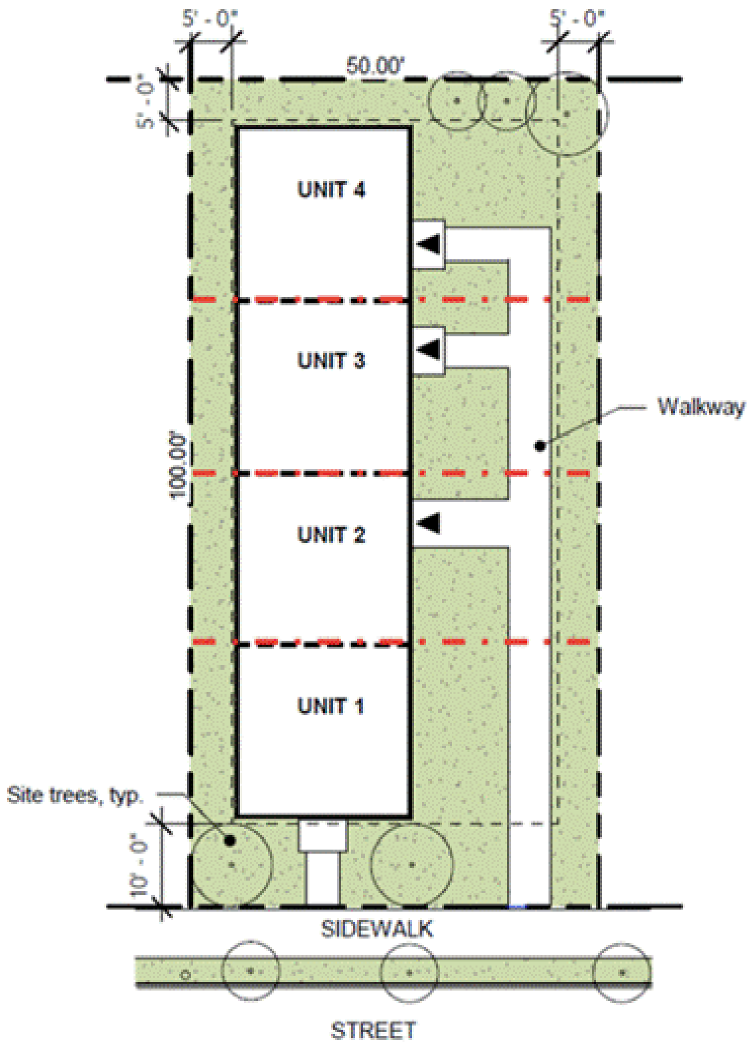
Table 10: Units permitted under RIP1 by housing type and bedroom count, August 2021 - July 2022

Housing type	Studio	1 bedroom	2 bedroom	3 bedroom	4+ bedroom	**Total**
Duplex	0	1	13	20	2	35
Triplex	0	0	13	11	3	27
Fourplex	0	0	176	21	7	204
Total	0	1	202	52	12	267

As Table 9 shows, 2-bedroom units make up the overwhelming majority–nearly 75%–of all new middle housing units. 2-bedroom fourplexes are particularly dominant, suggesting that there is a strong and unmet demand for larger units in Portland. It is also notable that 3-bedroom units–which represent 6% of all Bonus ADUs in San Diego–represent nearly 20% of all middle housing permitted under RIP1. These larger units enable growing households and large families to have access to housing at lower price points in desirable neighborhoods. Although ADUs still represent a significant share of new housing in Portland, ADUs tend to be smaller. By expanding its middle housing zoning reform beyond ADUs, Portland has unlocked a much wider variety of homes at more affordable prices (Cascadia Partners, 2023).

It is also worth noting several other statewide housing policies in Oregon which complement RIP and may deepen the program's impact on housing affordability in Portland. SB458, which went into effect in August 2021, was a companion bill of HB2001 that allowed certain types of middle housing projects to be divided in order to create separately owned lots, in contrast to RIP projects, which are usually structured as condos on single lots. The resulting lot-split mechanism under SB458 is the Middle Housing Land Division (MHLD).

Figure 14: Example of a potential Middle Housing Land Division (MHLD)



Source: City of Portland, Middle Housing Land Divisions

Through an MHLD lot split, any duplex, triplex, fourplex or cottage cluster housing types can be divided into separate lots so long as the resulting lots have no more than one unit each. This requirement excludes lots with ADUs from utilizing an MHLD. The lot split is an expedited approval and waives any street frontage or minimum lot size requirements under existing zoning. MHLD applies to existing or to new middle housing development that meets the law's requirements. Thus, developers have a straightforward and reliable path to creating for-sale subdivisions using RIP, even when some of the resulting subdivided lots lack direct street frontage.[23]

Similarly, Oregon state law permits the condoization of ADUs, meaning that ADUs can be conveyed and sold separately from a primary dwelling unit. Although MHLD excludes property owners from utilizing the lot split for an ADU, they can opt instead to create a condo regime for the existing primary residence and the ADU(s). Since RIP allows for two detached ADUs per lot, ADU condoization also represents a promising way to create more for-sale, starter homes and homes for those who want to downsize within Portland.

23 MHLD requires easements for pedestrian access to each new lot and allows for easements for vehicle access as well. Under specific circumstances, the law also requires utilities easements for lots that do not have direct street frontage.

Increasingly, developers in Oregon have been pursuing ADU condominium conversions as a business model. According to one senior loan officer operating in Oregon, most ADU condo regimes are being created by developers, although a significant portion have been created by existing homeowners (Felsman, Casita Coalition, 2023). Since Oregon does not require owner-occupancy for ADU condo conversions, developers are able to use this tool to build new, for-sale homes. As our early findings from SB 9 indicate, few homeowners have the capital, resources, or time to develop an additional unit on their property or to pursue a lot split. Oregon's statewide Middle Housing Land Division and ADU condominium conversion, combined with middle housing zoning reforms like Portland RIP, offers a promising alternative to SB 9. Oregon's model provides homeowners with opportunities to build wealth or age in place on their existing property by creating middle housing lot splits or ADU condo regimes; but it also creates an effective business model that allows developers to profitably pursue small-scale, infill housing. The results are more housing options at more affordable prices.

California ADU Condoization

As Oregon demonstrates, the wide-scale condoization of ADUs could be a promising pathway to affordable homeownership in California. AB1033—authored by Assemblymember Phil Ting—was signed into law this past fall and is now in effect. The law authorizes any jurisdiction to pass an ordinance allowing ADUs to be sold or conveyed as condominiums. Prior to AB1033, ADUs could only be rented and not sold separately from the primary dwelling unit on a property.[24] Thus far, the law has been fully implemented only by the City of San Jose, while the Berkeley City Council voted unanimously in May to begin the process of implementing the law. Officials from several cities, including San Diego, have expressed interest in opting into AB1033 as well (Geiler, interview, 2023).

Even with widespread adoption, however, AB1033 would face some of the same challenges as SB 9. The law will be subject to the requirements of the Subdivision Map Act along with any lot split fees that local governments require to file an application. Additionally, newly constructed ADU condos will still be subject to costly utility connection upgrades, barring the passage of legislation that caps those costs.

Most importantly, lenders emphasized that the "condo-ization" of an existing single-family property with one or multiple ADUs is not necessarily simple or straightforward, particularly if the existing homeowner has not paid off their home mortgage. The guidelines for condominium lending are quite different from home mortgages—the lender needs to evaluate risks associated with the condominium association, especially how it is handling insurance for the property (Interview with anonymous lenders, 2023).

It is worth noting that Texas (as described below) and Oregon have seen significant uptake of ADU condoization, which bodes well for jurisdictions that adopt AB1033. The success of these policies in other states also provides lenders with some precedent and guidance for how to proceed, unlike in the case of SB 9 (Garcia, 2023).

ADU Condoization Case Study: Texas

Under Texas state law, the right to convert a multi-unit property of any size into condominiums is an entitlement under the Texas Uniform Condominium Act. Whether one is converting an apartment building or a single-family home with an ADU, state law allows for property owners to create condo regimes by-right. As a result, ADU condominiums are a popular and growing housing product across the state, particularly in high-cost metro areas like Austin (Alexander, Casita Coalition, 2023).

24 There was an exception to this prohibition for community land trusts and qualified nonprofit organizations.

Thanks to a 2015 update to the City of Austin's ADU ordinance and state condominium regulations, homeowners and developers have been able to build ADUs on more properties in the Austin area to rent or sell. As of 2022, there are an estimated 3,052 detached condominium units in Travis County that exist in small-scale condominium regimes (McHugh, 2022).

Small-scale detached condominium regimes have become a popular solution for homeowners wanting to further develop their properties. By establishing a condominium regime, homeowners are able to circumvent the lot subdivision process — a process that is impossible in many areas due to zoning restrictions, and a lengthy and difficult process in other areas where a variance or rezoning request would be required (McHugh, 2022). Another benefit of small-scale condominium regimes is lower minimum site area requirements. This allows for denser development, which promotes a more efficient use of city infrastructure and utilities. It also allows land costs to be spread out over more units, leading to slightly lower prices per unit (Valenzuela 2018).

Importantly, small-scale detached condos in Texas are structured as "site condominiums," meaning that the homeowner's condo ownership interest consists of both the unit and the land it sits on. Since the units as well as the land are owned by the various homeowners as separated bundles, homeowners are able to acquire separate, more affordable and more comprehensive insurance policies than those of typical condominium associations. Similarly, these site condominiums typically require no monthly dues, as all expenses are covered directly by the separate owners and each homeowner maintains their own house and yard (Alexander, Casita Coalition, 2023).

In Texas, condominium conversions provide property owners the right to build a new unit at any stage of development–with an existing unit on the property, with a unit under construction, or with raw land. This allows a homeowner to sell their primary residence and then use those funds to build a detached ADU and remain on their property with a smaller mortgage or with no mortgage at all. This structure also allows families to live together on the same lot, while owning, financing and being able to sell separately (Alexander, Casita Coalition, 2023).

As demand for small-scale detached condos has risen in Texas, local banks and credit unions have made financing more accessible for new homebuyers and developers. This suggests that lenders can adapt over time in markets where small-scale detached condos are currently less common.

Despite the growth of ADU condominiums in Texas, barriers remain. Homeowners with an existing mortgage to pay off must receive partial release approval from their lienholder. According to one Texas condominium attorney who has created over 4,000 small-scale condo units over the past 20 years, this process is onerous but improving. Lenders are increasingly seeing small-scale condoization as a product that improves value rather than destabilizing properties. Still, the attorney stressed that a streamlined lender approval process for partial releases would significantly improve the feasibility of small-scale condoization for existing homeowners (Alexander, Casita Coalition, 2023).

This barrier will affect uptake of ADU condo regimes in California municipalities that adopt AB1033. A subsection of the law states that "neither a subdivision map nor a condominium plan shall be recorded with the county recorder in the county where the real property is located without each lienholder's consent" (Section (D)(i), AB1033). As our previous findings regarding SB 9 indicate, securing consent from a lienholder for a partial release can be very difficult and time-consuming. Often homeowners are unable to even reach the loan servicer who can provide approval. If a homeowner cannot secure approval for a partial lien release, they would need to take out a much more expensive, temporary loan in order to pay off their initial debt, before then securing new financing for the development and condoization of an ADU. This step is not only onerous, but likely cost-prohibitive for many homeowners interested in ADU condo conversion (Felsman, Casita Coalition, 2023).

Advocates affiliated with the Casita Coalition have strongly encouraged local jurisdictions to make reasonable accommodations to this requirement for homeowners who intend to pay off their existing debt using the funds from condo conversion. Texas, for example, has a similar statute requiring lienholder consent for the approval of subdivision maps or condominium plans. However, in practice, the law is simply not enforced so long as homeowners demonstrate their intent to pay off their existing mortgage with the funds they receive at closing. A similar de facto policy could be permitted by local jurisdictions who opt-in to AB1033.

There are additional limitations on existing homeowners developing and condoizing ADUs at a wider scale. Homeowners must navigate the complexities of financing, city zoning and building codes, construction, leasing, property management, and more, essentially having to take on the role of a small-scale developer (McHugh 2022). Due to these barriers, an alternative model has emerged: a partnership between developers and homeowners where the developers "purchase the backyard" from the homeowner, develop an ADU, and establish a condominium regime. This partnership sidesteps the aforementioned barriers to development and creates a more streamlined process for the homeowner, who can receive a larger upfront sum by selling rather than renting out an ADU for a smaller amount. (McHugh 2022).

A more profitable model for developers to pursue is to purchase single-family homes, demolish the original unit and build new condominium units on the property. This appears to be a growing market for developers in Austin, particularly with recent land-use reforms. In December 2023, the Austin City Council voted to allow 3 units by-right on any parcel zoned for single-family housing. As a result, developers are already pursuing new 3-unit condos in the city. This developer-driven model, as opposed to homeowners pursuing condo conversion, could produce a significant amount of new middle housing across the city (Alexander, Casita Coalition, 2023).

6. Conclusion: Statewide Policy Recommendations

These alternative models in Oregon and Texas offer ways to strengthen California's first iterations of middle housing reforms. The San Diego Bonus ADU program has successfully leveraged existing statewide ADU and parking law to produce significant amounts of new rental housing, half of which is deed-restricted affordable. Still, as a singular middle housing reform applied statewide, the program would have limitations–namely, that it does not meet the urgent need for affordable, for-sale starter homes.

In this respect, legalizing ADU condo regimes statewide offers a very promising pathway to more affordable homeownership in California. As our analysis suggests, a San Diego-style Bonus ADU program would likely be market feasible in supply-constrained jurisdictions across the state. If these same jurisdictions were to opt-in to AB1033, they would unlock a significant amount of new, small-scale and naturally affordable homes for sale. Ideally, legislators in Sacramento will eventually follow the lead of Texas and Oregon and move beyond AB1033, instead allowing for ADU condo conversion by right across the state. HCD officials and state legislators should closely monitor the early results of San Jose's implementation of AB1033 and consider expanding the law.

Harnessing the strength of existing base ADU law, in conjunction with wide-scale condoization, may render middle housing reforms like SB 9 less salient. As our analysis of early results indicates, SB 9 is dramatically underutilized given the state's housing supply shortage. Based on conversations with developers, senior lenders and housing finance experts, the low uptake of the law is largely the result of its design. Unlike the highly refined and strengthened base ADU law that exists today, SB 9 does not yet account for the variety of ways that local jurisdictions have evaded the law. If legislators hope to increase SB 9 uptake, they will need to iterate on the law and respond to jurisdictions that are using loopholes to avoid compliance and charging cost-prohibitive lot split fees.

Similarly, legislators will need to reconsider the owner-occupancy requirement of SB 9 if they hope for it to unlock middle housing development statewide. Until developers are able to reliably utilize the law, SB 9 will not yield significant amounts of new housing supply. Oregon's middle housing reforms—which have no owner-occupancy requirement–demonstrate that more permissive zoning and expedited lot splits can create profitable business models for developers, while also shaping development patterns to meet public needs. In the case of Portland RIP, the program's innovative use of maximum FAR limits has incentivized developers to build more efficiently—leading to a larger number of smaller units, with less parking, at lower price points. Prior to RIP, local developers' most profitable product offering in single-family zones was large, detached single-family homes. RIP rendered that existing business model infeasible; but crucially, it replaced it with one that made middle housing competitive in the local market.

Legislators should consider similar ways to use SB 9 to shape the statewide housing market. Maintaining the law as is–so that only homeowners can utilize it reliably–will not advance the public goal of creating more infill, middle housing in single-family zones across the state. Instead, legislators should amend the law to proactively encourage the kind of private development that is needed: smaller, more naturally affordable starter homes. Developers in Oregon can utilize the Middle Housing Land Division to create urban lot splits for duplexes, triplexes, fourplexes and cottage clusters within single-family zones. Developers in California should be able to utilize SB 9 to do the same–create an urban lot split and build duplexes on the resulting parcels.

Lastly, whether California pursues statewide middle housing through SB 9-style lot splits or through ADU condominium conversion, legislators will need to more closely consider obstacles within the lending industry. Both pathways require new parcel maps to be drawn, a process that in turn requires homeowners with existing mortgages to secure a partial lien release from their loan servicer. Our findings demonstrate that conventional lenders are not currently equipped to process these requests at scale and homeowners are often unable to even reach the appropriate representatives to make this request. As more jurisdictions adopt AB1033 and more homeowners attempt to utilize SB 9, HCD officials and state legislators should work with Fannie Mae, Freddie Mac and mortgage lenders to establish clear guidelines for approving partial lien releases and the process by which loan servicers evaluate and respond to lot split requests. Officials at Fannie Mae and Freddie Mac should also consider establishing a standard for new home mortgages that would allow for a future lot split or condo conversion.

It is possible that as interest rates fall, homeowners will be more likely to refinance existing mortgages in order to create lot splits or condo conversions, rather than receive partial lien releases on their current loans. Even so, state officials and legislators should be proactive in bringing lending officials to the table to standardize guidelines. As the need for infill, middle housing becomes more acute across the country, it is crucial that the lending industry is prepared to adapt to new housing policies that will create new types of housing and ownership structures.

Below, we offer a matrix evaluating the success of each of the middle housing models discussed in this report, including recommendations for state legislators and officials seeking to replicate or improve these policies. The path to unblocking the market for missing middle in California is not easy, but other states have shown that it is clearly viable.

Table 10: Comparing middle housing programs

	California: SB 9	San Diego: Bonus ADU	Portland: RIP	Texas: Condoization
Advantages	• Applies statewide, allows up to four units on 6.1 million parcels • If utilized, could expand homeownership opportunities.	• Leverages existing ADU and parking law to circumvent lengthy rezoning processes • Requires half of all bonus units to be deed-restricted affordable • Produces significant amounts of new housing near mass transit	• Uses sliding scale FAR to incentivize smaller, more affordable homes • Creates both rental and for-sale homes, using existing condo regime and lot-split law.	• Applies statewide, creating a consistent business model to developers, lenders and condo attorneys • Detached condos are structured as "site condominiums," simplifying ownership and insurance complications
Limitations	• Owner-occupancy requirement & local design standards prevent developers from creating a replicable business model • Inconsistent lending standards prevent homeowners from readily utilizing SB 9	• Produces mostly studios and 1-bedrooms • Creates units at 110% AMI, but has yet to produce units at 80% AMI	• Does not produce high-density housing near transit • Developers have not produced affordable units in exchange for density bonus	• Small-scale detached condos do not produce moderate or high-density. • Inconsistent lending standards can still be an obstacle at scale
Results	• **Unsuccessful** • 266 SB 9 projects permitted or completed	• **Successful** • 1,300 units have been proposed under the program, 488 have entered into a recorded agreement with the city.	• **Successful** • 334 units permitted in the program's first year • 76% of units permitted were fourplexes • 99% of units permitted had 2 bedrooms or more	• **Successful** • Over 3,000 detached condominiums in Travis County alone, as of 2022.
Recommendations	• Standardize federal lending standards for lot splits • Remove the default owner-occupancy requirement • Strengthen the law against local design obstacles	• Incentivize units affordable at 80% AMI • Incentivize large family units	• Incentivize units affordable at 80% AMI • Incentivize large family units	• Incentivize units affordable at 80% AMI • Incentivize large family units

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