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COUNCIL TRANSMITTAL: REPORT FROM THE LOS ANGELES HOUSING DEPARTMENT REGARDING THE FEASIBILITY OF CREATING A PILOT PROGRAM TO HOUSE FORMERLY HOMELESS ANGELENOS IN ACCESSORY DWELLING UNITS (ADUs)

SUMMARY

The General Manager of the Los Angeles Housing Department (LAHD) respectfully submits this report in response to a motion (C.F. 21-0541), which directed:

1. LAHD, City Administrative Officer (CAO), and Chief Legislative Analyst (CLA) to report back on the feasibility of creating a citywide program that provides financing for the construction of ADUs that will be used to house formerly homeless Angelenos which would be administered by the City or a contracted partner;

2. LAHD, CAO, and CLA to prepare for Federal and State funding opportunities and report back with available financing tools such as: grants, low-cost tax-exempt financing, loan loss reserve fund available for the construction of such ADUs; and funding sources to manage a citywide program that provides case management services for tenants;

3. The report should include a cost comparison between financing these ADUs and other forms of homeless housing including permanent supportive housing; and

4. The Department of Building and Safety (DBS) and LAHD to report back on scaling up the existing ADU Accelerator Program and including ground up construction of ADUs citywide and developing a programmatic framework to expand the tenant base beyond older adults.

Additionally, the Department reports back on supplemental research that provides more detailed options for a financial incentive program to construct and upgrade ADUs for low-moderate homeowners. Information covered in this additional research includes the following and can be accessed in Attachment(s) A-C to this report:

1. Existing ADU programs
2. Financing for land acquisition and construction
3. Opportunities to leverage SB9 incentives for affordable housing and CLTs (C.F. No. 21-1045)
4. Identifying low-income homeowners at risk for foreclosure and connecting them to CLTs
5. Utilizing REAP properties for CLTs

Recommendations corresponding to the research outlined in the attachment are also stated in the attachment (Attachment C).

RECOMMENDATIONS

AUTHORIZE the General Manager of LAHD, or designee, to allocate $175,000 from SB2 funding (43/64R Appr#43VB50-ADU Accelerator Program) to release a request for proposals that would secure a partner to manage a program modeled after the Senior ADU Pilot that includes overseeing outreach activities to recruit ADU owners, administering financial homeowner incentives, managing the lease-up process for households already enrolled in a Time Limited Subsidy program within the City, and providing case management and landlord support services.

BACKGROUND

At a Housing Committee meeting on June 9, 2021, the committee considered a Motion (Blumenfield - Price) relative to the feasibility of creating a citywide program that provides financing for the construction of ADUs to house formerly homeless Angelenos by exploring opportunities for public-private partnerships as well as a master lease program that could include the provision of supportive services; and, explore proposals to create a City financing program to scale up homeless housing opportunities throughout the City. On June 29, 2021, the City Council adopted this motion under C.F. No. 21-0541.

In preparation for this report, LAHD conducted research on similar ADU programs that were piloted in Los Angeles County and other major cities and looked into various funding opportunities available for ADU programs on a Federal and State level. LAHD also examined its current master lease agreement policy and current funding sources within the department for potential utilization. This report outlines LAHD's findings, which include information gathered from the California Housing Finance Agency (CalHFA), Los Angeles County Development Authority (LACDA) - Housing Investment & Finance Division, the City of Pasadena, and various other sources. Based on this research, LAHD has divided research findings into: (1) those related to creating a master leasing program, identifying funds for lease and operations, to provide scattered site housing for people experiencing homelessness currently enrolled in a Time Limited Subsidy Program (TLS), and (2) those related to creating a City financing program to encourage the production of ADUs.

USING ADUs TO PROVIDE HOUSING FOR PEOPLE EXPERIENCING HOMELESSNESS

ADU production in Los Angeles is increasing every quarter. The most recent Planning Department's quarterly Housing Progress Report shows that from 2017 to 2021, 18,893 permits were issued to build or legalize ADUs, and 9,988 Certificates of Occupancy were issued to completed ADUs. Given this significant level of production, the simplest approach to house people experiencing homelessness (PEH) or to create a homeless prevention program using ADUs could be to lease privately-built ADUs via a master lease program, similar to what the City is already doing with the ONEgeneration Senior Housing Pilot Program, however, this program could focus on PEH who currently receive (TLS) or are at-risk of homelessness. A Master Lease Agreement, in this context, would be a lease between an ADU owner and an intermediary, usually a nonprofit service provider, that then leases the ADU to an eligible program participant. The lessee must pay the agreed rent for the life of the lease and may be responsible for paying a share of property taxes, utility bills, insurance, and maintenance costs.

There are various non-profit organizations that work with the property owners to identify vacant units to house people experiencing homelessness (PEH). Two organizations known for this work in Los Angeles are Brilliant Corners and People Assisting the Homeless (PATH).

Brilliant Corners administers the Flexible Housing Subsidy Pool (FHSP) housing vouchers, which is a supportive housing rental subsidy program funded by the Los Angeles County's Department of Health Services. Brilliant Corners works with property owners to identify vacant units in their multifamily rental buildings and provides rental subsidies to them in exchange for housing a Brilliant Corner's voucher holder in their vacant units. In LAHD's research, staff found that the biggest challenge in this endeavor is that the majority of people with FHSP housing vouchers need on-site case management services and are referred by the county's Department of Health Services, Department of Mental Health, or the Coordinated Entry System (CES). According to Brilliant Corners and DHS staff, these scattered site leases work best to serve people with moderate health needs, rather than high acuity, high need residents who benefit from the services provided on-site in a supportive housing environment.

PATH's LeaseUp program also matches rent-ready people experiencing homelessness, who have rental subsidy or other income to pay for rent, with property owners to make renting easier and more reliable. Over the last four years, 3,409 people have moved into LeaseUp units through PATH's program. The program's clients must be connected to a voucher or rental subsidy to access the program's database. At that point, LeaseUp staff organize a viewing and coordinate with the landlord. Any person or family at risk of homelessness, or currently homeless and receiving some form of rental assistance, is eligible for the program.

Both Brilliant Corners and PATH work with rental housing owners to identify vacant units to house rent-ready clients who are homeless or at risk of becoming homelessness. Both organizations have clients with the FHSP.

Although master leasing scattered ADUs may not be a good solution for higher needs individuals referred by the Coordinated Entry System, it could be a good solution for people whose primary need is affordable housing, and who do not require intensive case management. One example of this is the ONE generation Senior Housing Pilot, officially known as the Los Angeles Accessory Dwelling Unit Accelerator Program (LAADUAP), which was approved by the Council and Mayor this year for a contract extension. In addition to the monthly rent, the City pays the service provider to provide lease support of approximately $500 per client household per month and in resolving any issues between the senior and the homeowner, and support in finding the senior additional housing resources as their needs change. In the aforementioned proposal for ADU's serving people experiencing homelessness, the City would not take on the monthly cost or rent for clients because the target population would be clients that already receive a housing subsidy. This would reduce the cost for the City, wherein the City would only pay for the lease up support as well as case management.

EXISTING FUNDING SOURCES FOR PRODUCTION OF ADUs THAT COULD SUPPORT SERVING PEOPLE EXPERIENCING HOMELESSNESS

Subsidies for construction of ADUs would be an eligible use of some City funds, including Community Development Block Grant (CDBG) funds, the Homeless Housing Assistance and Prevention (HHAP) Grant Program, and the Permanent Local Housing Allocation (PLHA / SB2). These sources have been allocated by the Council and Mayor to various uses including the operating support of Tiny Homes and The Bridge Home program, neighborhood improvement projects, and permanent housing production. In the FY 2022-23 Budget, $2 million has been allocated to an ADU pilot program using linkage fee funds.

OPPORTUNITIES TO SCALE UP ADU ACCELERATOR PROGRAM TO SERVE PEOPLE EXPERIENCING HOMELESSNESS

The City's Accessory Dwelling Unit Accelerator Program addresses the housing needs of the low acuity senior population who are at risk of homelessness. This model could be expanded or replicated to include the elements of housing navigation and support to tenants and ADU owners, with the households enrolled in the TLS program, formerly known as Rapid Rehousing.

The LAADUAP was designed to be a three-year pilot program to provide immediate housing for extremely low-income older adults with their portion of the rental obligation to be no more than 30% of their annual income, thereby preventing them from becoming homeless, while they wait for permanent affordable housing placements. The program participants are the homeowners willing to rent their already constructed legally permitted ADUs for a minimum period of three years, the low income seniors, and the City's third party contractor ONE generation. The City contracts with ONE generation to provide housing navigation and tenant matching services, as well as a City-funded rental subsidy to cover the difference between the current market rent for the equivalent dwelling unit and 30% of the tenant's annual income.

The LAADUAP is working with various permanent housing organizations to receive tenant referrals from their waitlists and house them in the ADUs while those tenants wait for permanent housing. The program was originally overseen by the former Mayoral administration, but effective March 1, 2022, it became a program within LAHD. To date, the program has placed 32 seniors in 25 ADUs. These seniors were at risk of homelessness but were not enrolled in DMH or DHS intensive case management services. ONE generation, the program's contractor and service provider, implements the daily operations of the program and acts as the housing navigator in assisting tenants to apply to permanent housing opportunities with project-based vouchers, which will potentially replace the rental subsidy that the City is currently providing to the homeowners. The LAADUAP is partially funded by the $2.6M General City Purposes Fund allocation set aside for this purpose in the FY 2021-22 Adopted Budget and the City's annual allocation of the Permanent Local Housing Allocation Plan Program (SB2).

The ADU Accelerator model could be used to serve people experiencing homelessness or at-risk of homelessness if the City contracted with a non-profit partner(s) that could provide ADU owner outreach, case management, oversight of landlord relations, and connection to clients receiving TLS through the homeless services system. The TLS program connects families, individuals, and youth experiencing homelessness to permanent housing through a tailored package of assistance that includes the use of time-limited financial assistance and targeted supportive services, with at least one case management visit per month. This pilot program would focus on providing temporary housing to single adults or couples given the small size of accessory dwelling units. Recipients of TLS are not required to be employed and must be at or below 50% Area Median Income. Additionally, the length of time an individual exists in a given homeless category is not a factor for determining client eligibility, in other words, the client could be homeless for 24 hours or 24 months, and they would still qualify for TLS. The program targets people living in emergency shelters, at Project Roomkey sites, in their cars, on couches, or in interim housing. It seeks to solve the practical and immediate challenges to obtaining permanent housing while reducing the amount of time someone experiences unsheltered homelessness, avoiding a near-term return to homelessness.

The TLS program can provide up to 100% of a participant's rental assistance, as long as the rent is considered "reasonable," (an average of the existing rents for neighboring properties) for 12 months, after which financial assistance can be provided for up to 12 additional months but is reduced over time using a progressive engagement approach to providing housing and financial assistance. In short, it is a short-term, two-year shallow subsidy program for individuals and families that don't need intensive and ongoing support to quickly exit homelessness and return to permanent housing. Some TLS clients are currently employed, working towards creating a pathway to stable housing. The lease term for families or individuals with this subsidy in a possible ADU pilot program should be no less than 24 months or 2 years given the length of the subsidy.

COST COMPARISON OF ADU CONSTRUCTION

LAHD gathered information from various organizations and construction companies to better calculate ADU construction costs in Los Angeles. Based on this information, a cost comparison for initial capital costs of three different types of ADU construction is shown in Table 1, below:

TABLE 1 - COST COMPARISON OF ADU TYPES			
	ADU (new construction)	**GARAGE CONVERSION**	**MODULAR**
TOTAL COST	Attached: \$150K - \$250K Detached: \$185K - \$350K	\$75K-\$150K	\$135K - \$325K (incl. site prep, installation & finishes)

While the comparison of relative construction and related costs ("production costs") among ADU types and between ADUs and other types of housing is informative, when considering housing opportunities for those experiencing homelessness, it is important to also consider the cost to operate the units, and understand there are additional costs associated with providing necessary services for the intended population such as case management, over the term that the unit is designed to be used.

FEASIBILITY OF CREATING A CITYWIDE FINANCING PROGRAM FOR ADUs RENTING TO PEOPLE EXPERIENCING HOMELESSNESS

Financing ADUs is an emerging market - cities and lenders are testing pilots, as has the City of Los Angeles, to provide loans and grants to encourage ADU production. Attachment A of this report provides an overview of existing ADU financing tools from other jurisdictions and Attachment B provides a more detailed summary of the types of financing tools available to build or rehab ADUs.

In Attachment C, LAHD summarizes research findings and makes recommendations for establishing an ADU financing pilot that encourages the production of ADUs for low to moderate homeowners The pilot described in Attachment C would not require homeowners to rent their ADUs to people at risk of or those experiencing homelessness, however, the Council may decide to combine the two programs outlined in this report and the Attachment. It should be noted that LAHD staff spoke to State officials about tying financial incentives to a requirement that homeowners rent to people experiencing homelessness. The State indicated that upon inclusion of this type of requirement, consumer interest plummeted.

CONCLUSION

The expansion of the existing ADU Pilot model beyond the current tenant base of older adults to include Angelenos who were currently, formerly homeless or at risk of homelessness, targeting those currently enrolled in TLS, could be an opportunity to offer more and varied types of housing to those who need a safe, affordable place to live. With the support of an agency or provider that could assist with coordinating ADU lease-ups and providing necessary assistance to match ADU owners and tenants who can stabilize with a short-term rental subsidy expands housing opportunities without the need for production of City-funded ADUs or City-funded rental subsidies. However, given that housing people who were formerly homeless in ADUs is a new concept that has not been tested in the City, LAHD would require flexibility to test and refine this idea to determine if ADU owners would be interested in partnering in this effort. This concept hinges on ADU owner participation and without their interest, this pilot may not be effective.

LAHD recommends that the Council and Mayor direct LAHD to return with recommendations for funding sources and partnerships to create a pilot program modeled after LAADUAP to link TLS households with ADUs in the City. This would include identifying one or more partner agencies administering either City-funded or Measure H funded TLS, as well as one coordinating agency or provider to provide the housing navigation, ADU outreach, lease up support, financial homeowner incentives, and services to support both ADU owners and tenants for at least twenty-four months. The recommendations would also identify a possible exit plan for tenants and owners if the tenants are unable to pay the entire ADU rent at the end of the TLS.

FISCAL IMPACT

There is no impact to the General Fund.

Approved By:

ANN SEWILL
General Manager
Los Angeles Housing Department

ATTACHMENTS:

Attachment A - Summary of Existing ADU Programs
Attachment B - Existing ADU Financing Tools
Attachment C - ADU Construction & Rehabilitation Incentive Program Structure

Attachment A
Summary of Existing ADU Programs

LA County ADU Pilot Program

The countywide program targeted both existing unpermitted ADU units that needed to be brought into compliance with local building codes and construction of new ADU units. If qualified, the county will provide a subsidy in the form of a soft loan or forgivable loan tied to a ten-year commitment to rent the ADU to an eligible tenant (an individual or family transitioning out of homelessness) under the approved programs listed below:

- Existing Unpermitted ADU - maximum Loan of $50,000 for one property
- Construction of New ADU - maximum Loan of $75,000 for one property

The program was piloted using three vetted property owners within L.A. county. The challenges encountered included the following:

- No clarity of homeowner's eligibility on the program and on the forgivable loan process.
- Homeowners had to look for other funding sources, which LACDA still had to confirm. This made financing very difficult and very time consuming for the homeowners. This approval process added at least six months to the timeline.
- Difficulty finding qualified contractors.
- Confusion on the overall ADU permitting process.
- Difficulty in setting landlord expectations.

Though there was high interest from the homeowners throughout the life of the program, the program is now being shut down.

The City of Pasadena

The City of Pasadena has a similar program, called the Pasadena Second Unit ADU Program, in which it offers an innovative form of ADU financing (similar to a construction loan) with different terms for property owners at different levels of incomes. As such, social impact was bifurcated into either 1) supporting a lower income property owner to build an ADU and build equity; or 2) supporting a lower income tenant by requiring affordable ADU rental by a property owner who participated in the financing program. The ADU financing is designed to cover the entire cost of the project up to the maximum loan limits listed below:

- Existing Unpermitted ADU - maximum Loan of $75,000 for one property
- Construction of New ADU - maximum Loan of $150,000 for one property

This pilot ADU loan program utilizes inclusionary zoning program funds and the City of Pasadena is the direct lender for this program. It has two loan options: the New ADU Construction Loan and the Existing Unpermitted ADU Loan. Its New ADU Construction Loan involves a 3-year loan term with 1% simple interest and a 3-year deferred payment period (with two 1-year extension options). The loan must be refinanced prior to the end of the deferred payment period. The intent of Pasadena to only have a 3-year loan term is to have the homeowners refinance their loans prior to the end of the deferred payment period so funds could be lent out again to construct additional ADUs.

The eligibility criteria are that the main residence must be single-family owner occupied during the past two years, the proposed ADU structure must not exceed 750 square feet, and the credit score must be greater than 650, among others. Applications that make it through the preliminary eligibility will then be separated by application preferences. The first group to receive priority are properties located in CDBG eligible census tracts, with several other preferences that follow. For the tenant selection process, homeowners will meet with Pasadena's Housing Department to become a Section 8 landlord. Homeowners may rent their ADUs to any person they choose who has a Section 8 voucher and are required to lease their ADU to a Section 8 tenant for seven (7) continuous years.

Its Existing Unpermitted ADU Loan involves a 20-year loan with 1% simple interest and payments are deferred for the first five years. In addition, the loan must be repaid in full upon sale, refinance, or title transfer. The eligibility criteria are that the property must be single-family owner occupied, the ADU structure is limited to 750 square feet, and household income cannot exceed 80% of the AMI. For this loan option, applications are scored and those with a property that has an open citation for an unpermitted ADU and is located in a CDBG eligible census tract get scored higher. The ADU tenants are selected by homeowners without any restrictions.

Through this program, homeowners are provided comprehensive assistance for financing, designing, permitting, and constructing a new ADU in the City of Pasadena. Upon verification and approval of the loan package, homeowners will work with the program's contracted ADU consulting firm for pre-design, permitting, bidding, and construction. The consultant services are paid for by the City of Pasadena, and not charged to the homeowner.

This is currently a pilot program only, therefore it has limited funding and can only assist 5 households. If the program is successful, it will seek additional funding to continue the program. According to the program manager, the ADU housing type has not been envisioned as a suitable model for the high acuity homeless population.

The City of Oceanside

The City of Oceanside provided up to $40,000 per household in grant proceeds to pay down entitlement and costs associated with the construction of ADUs. This approach made it less expensive to build an ADU. The City did not require any covenants and did not try to use the ADUs for people experiencing homelessness.

The City of Oakland

The City of Oakland provides up to $100,000 as a deferred payment construction loan to support low-income homeowners in the design, permitting, and construction of an ADU. However, the ADU must be an existing partial or established unpermitted unit that is located next to or within a single family home. Eligibility requirements for applicants include an owner-occupied single family residence, a property located in an Opportunity Zone, and a household income of 80% AMI or less. Eligibility requirements for projects include the legalization of a single secondary unit, ensuring the secondary unit is less than 1,000 square feet or up to 50% of the size of the primary dwelling unit, a dedicated entrance to the unit or the possibility to provide one, and a commitment from the owner to begin the approval process immediately in order to complete the loan process by February 2023 and complete construction by end of 2023.

Attachment B
Existing ADU Financing Tools

Grants

The California Housing Finance Agency (CalHFA) ADU Grant Program provides a grant of up to $40,000 to reimburse homeowners for pre-development costs necessary to construct an ADU, including site plans, architectural designs, demolition, permits, soil tests, impact fees, property surveys, energy reports, and other non-construction expenses.

The goal of this grant program is to create more housing units in the state by providing a grant to reimburse homeowners for pre-development and non-recurring closing costs associated with the construction of ADUs. The program is for low- to moderate-income homeowners that are building an ADU on their owner-occupied property and there are no affordability requirements or restrictions. After the eligible predevelopment activities are completed and costs are incurred and approved, CalHFA approves the grant and wires the funds to the homeowners' construction loan account. This lowers the ADU construction loan principal amount that the homeowner has to repay. Homeowners who are low- or moderate-income, have low equity, and who live in socially disadvantaged communities may apply for the grant. Since CalHFA is not a direct lender, interested homeowners apply for a construction loan offered through participating private lenders who have been approved and trained by CalHFA. These program lenders will guide the homeowners through the ADU renovation loan and ADU grant processes. There are multiple ADU-approved lenders currently listed on the CalHFA website. During LAHD's calls with CalHFA in February and June, CalHFA indicated that thus far, only one (1) ADU grant has been issued for a new construction ADU built in South El Monte in Los Angeles County. The cost to construct a 1,000 sq ft ADU was approximately $325,000.

Loans

Federally backed ADU construction loans come in the form of renovation loans. One of those loans is the Fannie Mae HomeStyle Renovation Loan, which permits borrowers to include financing for home improvements in a purchase or refinance of an existing residential property. With this loan, borrowers can finance improvements, repairs, or renovations up to 75% of the as-completed appraised value of the property with a first mortgage, rather than a second mortgage. Allowable repairs are flexible enough to finance the construction of either an attached or detached ADU and borrowers can be either owner-occupants or non-owner occupant investors. Other requirements are needed for this loan. This loan does not provide too many restrictions on what the renovation funds cannot be used for, as long as it is permanent to the home and provides value.

Another renovation loan is the FHA 203(k) Loan, which is a loan insured by the Federal Housing Administration that enables homebuyers and homeowners to finance the purchase (or refinancing) of a house and the cost of its rehabilitation through a single mortgage or to finance the rehab of their existing house. This loan offers a single, long term, fixed or adjustable rate mortgage that covers both the acquisition and rehab of a property. The parameters for the rehabilitation component allow the FHA 203(k) loan to finance attached ADU construction that builds off of the existing foundation.

The third renovation loan is Freddie Mac's CHOICE Renovation Loan, which allows homebuyers to include the financing of their home improvements/renovations with their purchase loan, saving them money with only one set of closing costs. It is available to owners and homebuyers to repair or renovate their house. This loan allows for the addition and renovation of ADUs provided they meet the local zoning code. Repairs must be completed within 12 months. It permits first-time homebuyers who haven't owned a home in the past three years to put as little as 3% down and build an ADU. Repeat homebuyers who have owned a home within three years will need to put 5% down. A contingency must be set aside for cost overruns. Essentially, lenders are on the hook for any delays, cost overruns, and poor quality workmanship, therefore most lenders are unwilling to take the risk. On June 1, 2022, Freddie Mac announced updates to its ADU mortgage financing. It stated that ADU rental income on a single-unit primary residence can be used to qualify for a mortgage. In addition, it increased its mortgage options to now provide purchase or refinance loans for one ADU on 2- and 3-unit properties, whereas previously it was only for single-unit properties. The big opportunity now is a combination loan, which will cover the purchase of a home and the construction of an ADU. In addition, there are no income restrictions to qualify for the loan. The loan can also be used to refinance one's existing first mortgage and pay off short-term debt used for ADU construction.

On May 16, 2022 President Biden released the Housing Action Supply Plan, where he announced several new housing initiatives, including creating new financing tools for the creation of ADUs. The action plan expresses the need for a simpler and more affordable financing products for ADUs and that "FHA and FHFA are exploring avenues to help lenders pilot and scale renovation and construction financing for ADUs – particularly for low- and moderate-income homeowners – in addition to new financing options for other single-family renovations and for 2-4-unit rehabilitation. FHA and FHFA will evaluate the credit performance of these loans to identify opportunities to add features and flexibilities to existing loan programs, expanding affordable financing options for homeowners and builders."

Private construction loans are also an option for homeowners looking to finance their ADU construction.

LAHD's First-Time Homebuyer Program provides purchase assistance to eligible, first-time low- and moderate-income homebuyers seeking to buy a home in the City of Los Angeles. The purchase assistance is in the form of a deferred loan which includes down payment, closing costs, and acquisition financing. The concept of offering an ADU Construction Loan with the First-Time Homebuyer Program's current LIPA (Low Income Purchase Assistance) and MIPA (Moderate Income Purchase Assistance) Loan Programs could be taken into consideration; however, adding an ADU at the time of purchase for the LIPA and MIPA Programs' first-time homebuyers is not economically or financially feasible. Due to the high home prices in the City, the vast majority of LIPA/MIPA homebuyers can barely afford a condominium with LIPA/MIPA purchase assistance.

During the last two years, 74% of the LIPA/MIPA homebuyers purchased condos, and 26% purchased single-family homes.

The construction of an ADU is a complex lending and construction endeavor that is best suited for existing homeowners who have overcome the initial challenges of first-time homeownership and have acquired tangible experience in sustaining a home. Existing homeowners, in today's market, have acquired some equity in their homes and other financial resources, which could be leveraged with a suitable construction loan when it becomes available in the market. The proposed ADU loan program report back under C.F. No. 22-0040 will focus on a City-subsidized or guaranteed loan program for existing homeowners who need assistance to finance a new or legalized ADU.

LA Mas had partnered with the Self-Help Federal Credit Union (SHFCU) for their Backyard Homes Project to offer a permanent mortgage product that will allow a qualified homeowner to fund the costs of ADU construction by refinancing their existing mortgage and taking out funds to pay for ADU construction costs. It factored in projected future rental income from the unbuilt ADU to boost the borrower's loan-to-value (LTV) ratio. This program had two offerings: 1) Option A - Design + Construction Support; 2) Option B - Financing + Design + Construction Support. During LAHD's call with Genesis LA on June 7, 2022, they indicated that SHFCU is no longer involved with the Backyard Homes Project. Both SHFCU and Genesis LA were financing partners for the Backyard Homes Project. LA Mas has closed this program as people's interest and eligible homeowners were insufficient to keep it running. Interested homeowners that went through the Backyard Homes Project used HELOC (Home Equity Line of Credit) and got their own lending. There were various barriers that prevented homeowners from participating in this program. Some homeowners didn't have enough income and/or were over indebted. In addition, the requirement for the ADU tenants to be Section 8 voucher holders was a factor in preventing many homeowners from applying for the program. The program had a pipeline of five projects, but only one ADU was completed.

Tax-Exempt Bonds

Tax-exempt bonds (TEB) are complex financing sources and will not work for ADUs. The bonds are issued through LAHD and have been used mainly to finance multifamily projects. The TEBs are currently competitive and oversubscribed.

Loan Loss Reserve

The Loan Loss Reserve (LLR) is a credit enhancement approach that improves the chances that financing will be repaid. The LLR is commonly used by state and local governments to provide partial risk coverage to lenders—meaning that the reserve will cover a pre-specified amount of loan losses. For example, an LLR might cover a lender's losses up to 10% of the total principal of a loan portfolio. The financial institution working with each state or local government can draw on the LLR to cover losses on defaulted loans according to the terms of the loan loss agreement between the lender and the state/local government. LLRs and other credit enhancements can be used in any market, from residential to commercial lending to multifamily housing lending to nonprofit lending. To set up the LLR program, state and local governments must identify and research potential financial institutions that are interested, procure the financial institution partner, establish a strong working relationship, and structure the loan program together.

Attachment C
ADU Construction & Rehabilitation Incentive Program Structure

PROPOSED LAHD PILOT ADU INCENTIVE PROGRAM STRUCTURE

LAHD is recommending leveraging city funds with a private partner's funds and capacities by selecting a participating lending partner(s) for the Pilot ADU Financial Incentive Program. The participating lender(s) would provide ADU construction financing that low-and moderate-income homeowners can qualify for such as a combined, construction-to-permanent loan that will provide the construction disbursements and oversight with a loan that then converts to a permanent 15-30-year loan, that is subordinate to the homeowners' original first mortgage loan that remains undisturbed. The combined, construction-to-permanent loan, in a second-lien position, is beneficial to homeowners because it allows the homeowners to borrow funds for the ADU while leaving their existing first mortgages, with historically low-interest rates (e.g. 3%), intact and not having to refinance and replace their existing first mortgages to take out additional funds to pay for the construction of the ADU with much higher interest rates of 6.3%, for example, which is the current average 30-year, fixed-rate mortgage per Freddie Mac. Primary Mortgage Market Survey®. Other construction or renovation loan financing products will also be considered so long as they provide the ADU construction financing needed for low-and moderate- income homeowners and can provide construction disbursements and oversight.

RECOMMENDED PROGRAM GUIDELINES

LAHD is recommending the approval of broad program guidelines for the Pilot ADU Financial Incentive Program as described below. Program guidelines would allow for flexibility to ensure the Pilot ADU Financial Incentive Program adequately serves low- and moderate-income homeowners who need the assistance to upgrade and build ADUs in the City.

Program Component	ADU Grant	ADU Take-Out Loan
Maximum Grant or Loan Amount	Up to $40,000	Up to $150,000
Eligible Homeowners	Households earning up to 120% of the Area Median Income (AMI)	Households earning up to 120% of the Area Median Income (AMI)
Eligible Properties	Detached Single Family Residences	Detached Single Family Residences

Loan Terms	N/A	Deferred payment, 3% simple interest, 20-year repayment term
Prepayment Penalty	N/A	None
Eligible Costs	Loan Fees, Non- Recurring Closing Costs, and Pre-Development Costs	To take-out or replace an existing ADU construction loan, home equity loan, or HELOC
Minimum Middle Credit Score	660	660
Maximum Combined Loan-to- Value (CLTV)	To be determined	To be determined
Owner Occupancy	The grant recipient must occupy the main property as his/her primary residence	The borrower must occupy the main property as his/her primary residence
ADU Rent Restriction	ADU must be rented to a household earning at or below 120% of the Area Median Income (AMI)	ADU must be rented to a household earning at or below 120% of the Area Median Income (AMI)

$40,000 GRANT OPTION

Under the Pilot ADU Grant Program, LAHD is proposing to provide a grant of up to $40,000 to eligible low-to-moderate-income homeowners to pay for loan fees, non-recurring closing costs, and predevelopment costs associated with upgrading or building an ADU or JADU. The eligible costs for the grant include, but are not limited to:

Loan Fees	Non-Recurring Closing Costs	Predevelopment Costs
Discount Points	Credit Report	City Permits and Fees
Application Fees	Title Charges	Surveys, Studies, and Reports

Underwriting Fee	Escrow Fees	Engineering Costs
Processing Fee	Recording Fees	Architectural Costs
Other Related Loan Fees	Transfer Fees	Utility Hookups
	Other Related Closing Costs	Initial Assessment
		Soil Tests
		Development Impact Fees
		Property Surveys
		Energy Reports
		Site Prep
		Mechanical, Plumbing, or Electrical Design Costs
		Other Related Predevelopment Costs

To apply for the LAHD ADU Grant, homeowners would apply for an ADU construction mortgage through a private lending partner and prequalify the homeowner for LAHD's ADU Grant. The lender's construction mortgage would have to provide construction monitoring and oversight of the project. LAHD's ADU Grant would be leveraged with the lender's construction loan, thereby lowering the cost of building an ADU for the homeowner and making it easier for the homeowner to qualify for the total development funds needed to upgrade or build the ADU or JADU.

TAKEOUT LOAN OPTION

Under the Pilot ADU Financial Incentive Program, LAHD is proposing to provide a take-out loan of up to $150,000 to eligible low-to-moderate-income homeowners. It will provide a long-term loan to the homeowner with more favorable financing terms to "take out" or replace an existing, previously obtained second-lien mortgage, such as a construction loan, home equity loan, or home equity line of credit (HELOC), obtained by the homeowner from other creditors, to upgrade or build an ADU or JADU.

The terms of the LAHD ADU take-out loan will have a 3% simple interest rate, deferred payment for 20 years, with no prepayment penalty, due and payable upon sale of the home, title transfer, first mortgage repayment, or at the end of 20 years as a balloon payment. These loan terms are more favorable than the typical financing terms currently available in the market for construction loans, home equity lines of credit, or HELOCs. As such, eligible homeowners may be incentivized to construct an ADU or JADU in the city, and upon completion of the project, apply for a LAHD ADU take-out loan to replace their existing construction loan, home equity loan, or HELOC, thereby saving the homeowner significant money over the length of the loan because the interest paid with LAHD's loan would be substantially less than the interest paid with a construction loan, home equity loan, or HELOC.

To apply for the LAHD ADU take-out loan, upon completion of the ADU and issuance of the Certificate of Occupancy (CofO) by LADBS, eligible homeowners would submit an ADU take-out loan application to LAHD to determine if they qualify for the loan. If approved, LAHD's take-out loan would replace the existing homeowner's ADU construction loan, home equity loan, or HELOC.

In order for homeowners to be eligible for LAHD's proposed ADU Grant or Loan, the household income must be at or below the income limits, for the City of Los Angeles, as established by the U.S. Department of Housing and Urban Development (HUD), which are shown in Table 1, below:

TABLE 1, HUD INCOME LIMITS								
Household Size	**1 Person**	**2 Persons**	**3 Persons**	**4 Persons**	**5 Persons**	**6 Persons**	**7 Persons**	**8 Persons**
Mod 120 (81%-120% AMI)	**$100,050**	**$114,350**	**$128,650**	**$142,900**	**$154,350**	**$164,800**	**$177,200**	**$188,650**

ADU RENT AFFORDABILITY RESTRICTIONS

LAHD is recommending that the ADUs assisted under this pilot program be available for rent to households earning up to 120% of AMI per the income chart above. LAHD is considering an affordability covenant to be recorded against the homeowner's property for 30 years requiring the homeowner to rent the ADU to a household whose qualifying maximum annual income does not exceed 120% of AMI, as determined and published annually by HUD, with maximum allowable State rents levels applicable to affordable units in density bonus projects. Alternatively, in lieu of an affordability covenant, LAHD is also considering executing a landlord agreement between the homeowner and the City, committing the ADU to be rented to a household with the same qualifying maximum annual income limit of 120% of AMI and maximum allowable rent levels as described above.

PROPOSED LOAN GUARANTEE FOR ADU CONSTRUCTION LOANS

As part of the Pilot ADU Financial Incentive Program, LAHD is also considering the option of providing a loan guarantee to the private lender(s) to top construction loan losses. LAHD will continue to research and explore this option during the program's pilot phase.

PROPOSED FUNDING SOURCE FOR ADU FINANCIAL INCENTIVE PILOT PROGRAM

LAHD proposes to utilize $3,176,471 of the Affordable Housing Linkage Fees (AHLF) funds for the Pilot Accessory Dwelling Unit (ADU) Financial Incentive Program. With the allocation of $3,176,471, LAHD is proposing to provide, for example, approximately nineteen (19) grants of up to $40,000 each, and sixteen (16) loans of up to $150,000 each to eligible low-to-moderate-income homeowners who upgrade or build ADUs or JADUs in the city. LAHD will have the flexibility to allocate the program funds and determine the number of grants or loans to issue depending on the demand and usage of the funds during the pilot phase. Additionally, LAHD is proposing to utilize up to $16,471 for marketing and outreach of the Pilot ADU Financial Incentive Program to make homeowners, lenders, real estate professionals, and other stakeholders aware of this ADU financial incentive program.

OUTREACH AND MARKETING

The Pilot ADU Financial Incentive Program will be available citywide, however, marketing and outreach will be performed in pilot neighborhoods that have a high percentage of low- and moderate-income homeowners that can qualify for the program.

Interested homeowners may apply for the Pilot ADU Financial Incentive Program funds through LAHD's participating lender and receive education on ADUs provided by a HUD-approved housing counseling agency. LAHD will engage in various outreach and marketing activities throughout the year to market the Pilot ADU Financial Incentive Program. Staff will make presentations and provide training sessions to **lenders, real estate** agents, brokers, and non-profit housing counseling and education providers; as well as provide outreach training to the public by participating in homeowner resource fairs, workshops, neighborhood council committee meetings, and other community events. The Pilot ADU Financial Incentive Program information will be posted on LAHD's website. Printed program information will be made available in English and Spanish, and disseminated to the public via City Council offices, City Libraries, Parks and Recreational Centers, Family Source Centers, LAHD's Public Counters, and via a vast network of Los Angeles' real estate professionals and lenders. Department outreach, in combination with various training opportunities and support from real estate professionals, provides hundreds of residents each year with multiple ways to obtain program information.