

**NEW REFLECTIONS ON
AFFORDABLE HOUSING DESIGN,
POLICY AND PRODUCTION:**

Overcoming Barriers to Bringing Accessory Dwelling Unit Development to Scale

By Ahmad Abu-Khalaf



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ABOUT THIS SERIES

The need for affordable housing is on the rise. Nationwide, more than 10 million renter households are severely cost burdened – that is, they spend more than 50 percent of their income on housing. Through our Expanding the Supply of Affordable Homes research initiative, the Enterprise Policy Development and Research (PD&R) team has identified the use of design, construction and production innovations as a particularly promising approach to help expand the supply, contain the cost and improve the quality of affordable housing development.

The housing industry has been eager to utilize innovative design, construction and production strategies, including off-site construction, accessory dwelling units (ADUs) and 3D home printing, to substantially improve the cost effectiveness and efficiency of the housing delivery system. This series looks at opportunities and challenges to innovate around construction, design and production to bring these innovations to scale to help expand the supply of affordable homes and address cost challenges. The objective of this research initiative is to reframe the national conversation on construction and design innovations. It aims to shift the conversation from how these innovations could completely change how we build and deliver housing to how these tools can function effectively as part of the existing housing delivery system.

In July 2019 Enterprise released the first piece of this series of white papers, exploring strategies to overcome barriers to bringing off-site construction to scale. Continuing our research on design, construction and production innovations, this white paper looks at opportunities and barriers to bringing accessory dwelling unit (ADU) development to scale to boost affordability and diversity in housing options, especially in predominantly single-family zoned neighborhoods. This research was informed by practitioners' responses to a short survey on barriers to ADU development, as well as interviews with a group of industry experts and practitioners.

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BACKGROUND

Housing Policy Goals

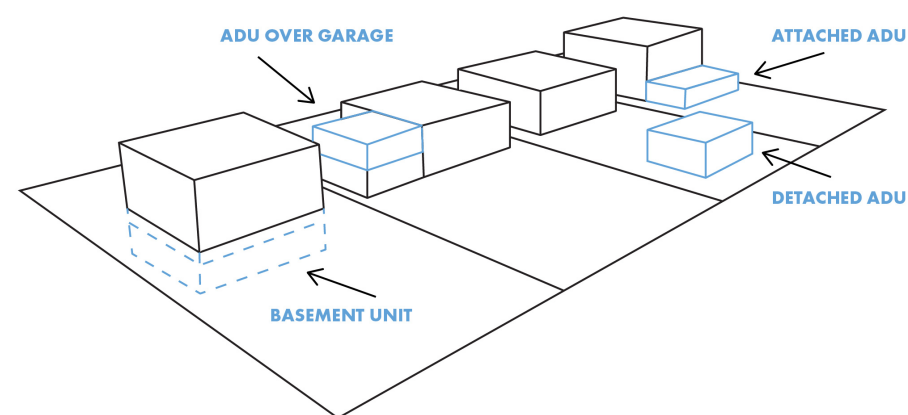
Accessory dwelling unit (ADU) development continues to be perceived by many stakeholders, including policymakers, affordable housing practitioners, advocates and researchers, as a housing production solution with great potential to increase density, housing options and affordability, especially in predominantly single-family neighborhoods. Interest in ADU development has been gaining steady traction among these stakeholders due to a combination of factors, including:

- Allowing for ADU development, the lowest end of the “Missing Middle” spectrum¹, typically requires a low regulatory lift that does not induce heavy local opposition.
- ADU development can support aging in place and multigenerational housing strategies, which are essential for addressing challenges facing senior households.
- Permitting rental ADUs can boost the diversity of housing types in single-family zoned areas, creating smaller rentals that are typically cheaper to develop and rent than single-family homes.
- Lower- and moderate-income homeowners, in support from policymakers and philanthropy, can utilize ADU development to generate additional income and build wealth by boosting property value.

It is important to note that ADU development is a homeowner-initiated process. That is, bringing this housing production strategy to scale primarily relies on homeowners' willingness to navigate the planning, design, permitting, financing, construction and approval processes to create ADUs on their properties. And there are inherent and perceived complexities in these processes that often discourage many homeowners from pursuing ADU development. First, there are local jurisdictions that still prohibit ADU development and other forms of "gentle density" in their single-family zoned neighborhoods. And not all jurisdictions that allow for ADU development permit it as a "by right" use, requiring either a conditional use or special exception (see page 13). This requirement creates a significant risk in covering the costs of hiring an expert to prepare and submit an application with necessary technical drawings and documents as well as the application fee, without any guarantees that the submitted permit application will be approved. Further, there have been persisting regulatory barriers in many markets, such as occupancy, minimum lot size and on-site parking requirements, and while these barriers do not explicitly inhibit ADU development, they often constrain homeowners' ability to create ADUs and discourage them from pursuing this housing production strategy. Finally, there are significant barriers to financing ADU development, especially for lower- and moderate-income homeowners.

ADU Definition

Accessory dwelling unit (ADU) is a broad term that refers to a smaller, self-contained residential dwelling that is located on the same parcel as a primary, larger residential dwelling, typically a single-family home.² The term ADU is often interchangeably used with other common names, such as in-law/mother-in-law suites, granny flats, secondary dwelling units, casitas and carriage units. ADUs can be created in variety of ways. An ADU can be an internal portion of the primary dwelling that is converted into a separate, smaller unit, such as a basement unit, a sheltered garage or an attic. ADUs can also be created through the rehabilitation of an existing/construction of a new external structure that could be detached or attached to the primary dwelling. While external attached and detached ADUs are commonly built in the backyard of the primary residence, depending on the local zoning requirements and lot size and configuration, ADUs could be developed in a side/front yard, or on the top of an external, sheltered garage.



ADU Types

Homeowners, in partnership with an expert like an architect, designer, builder or contractor, should take into consideration a number of factors in selecting an ADU type for their property. This includes site size and conditions, local zoning requirements, property size, layout and placement on site, estimated development cost and desired additional space and use. It is important to note that the ADU type selection process has cost and time implications. For example, while developing an external, detached/attached ADU could provide more privacy for both the ADU's and primary unit's residents as well as more flexibility in designing and constructing desired residential spaces, this option is typically more expensive and time consuming than converting an existing internal space into an ADU. This can be partially explained by the higher construction and development costs induced by the additional site and foundation work and the need for separate, new electrical and plumbing systems (when expanding existing home systems is not an option).

ADU Development Timeline

Both internal and external ADU development projects follow similar planning, permitting and construction processes, yet new construction ADU development typically follows longer construction timelines. ADU development typically starts with working with an expert, such as an architect, designer, builder or general contractor – unless the homeowner will pursue ADU development as a general contractor and it is authorized under local codes, to draft necessary architectural and engineering drawings and documents and then submit a permit application to local authorities. In addition to collecting a building permit fee, many local jurisdictions require a range of fees for ADUs like development impact fees. Once

a building permit is received and the needed financing is secured (see page 22), ADU construction could proceed. Depending on the complexity of the project and the homeowners' preferences, the homeowner could hire a general contractor who manages the whole project and find subcontractors for mechanical and electrical work, or hire a designer and a builder and then identify subcontractors to do the mechanical and electrical work (the builder could also serve as a general contractor if needed). Once the ADU development process is complete, an inspection is typically required to ensure the compatibility of the developed ADU with the permitted architectural and engineering plans as well as local zoning and building codes.

ADU Construction Types

The building industry has developed a range of ADU construction strategies. This ranges from traditional stick-build construction to offsite construction, including modular and offsite construction.³ Under modular construction, the fabrication of the ADU as a module (a unit prefabricated and assembled off-site) is completed at a factory/fabrication facility, followed by delivery and on-site placement processes. Pursuing this construction technique for backyard ADUs on sites with limited vehicular access on the rear property line can be very challenging. Those sites cannot be easily accessed by shipping trucks that drop off the module at the site using cranes, which vertically lift the module and then place it on the site (like a LEGO block). These challenges could be addressed by using prefabricated development, a construction technique under which construction components (panels) get fabricated at a factory and then connected onsite to complete the assembly process.



Using off-site construction techniques to develop external ADUs can help homeowners attain a range of benefits. First, off-site construction projects typically have shorter timelines than traditional construction projects, as off-site construction allows for conducting site and foundation work concurrently with factory fabrication phase. Further, pursuing off-site construction can help mitigate unexpected development costs, as this construction strategy typically offers more accurate projected costs than traditional construction. It also minimizes on-site disruption throughout the construction process, as the larger chunk of the construction work takes place at the factory/fabrication facility. Finally, a number of fabricators serve as a one-stop-shop that does the planning, permitting, design, fabrication and assembly work. This means that the homeowner would only work with one expert, who is responsible of completing the development process from the beginning till the end, which can help address difficulties in navigating the ADU development process.

Barriers to ADU Development

Writing from a policy-driven perspective, we aim to facilitate a broad conversation among industry stakeholders on how common land use, regulatory and financial challenges can be addressed in order to bring ADU development to scale. In addition, this research aims to shift the conversation from how ADU development could potentially play a significant role in alleviating the nation's housing affordability and supply challenges toward understanding a range of persisting barriers holding ADU development back. This white paper, which was informed by a series of interviews with stakeholders and responses from practitioners to a short survey on challenges to ADU development, explores strategies to overcome land use, regulatory and financial challenges to ADU development.



OVERCOMING LAND USE BARRIERS

Single-family zoning continues to dominate residential land use, contributing to persisting supply shortages and affordability challenges across the country.

This challenge is especially prevalent in expensive housing markets, where many low- and moderate-income families struggle to access housing in high-opportunity, single-family zoned neighborhoods with better access to jobs, schools and daycares, healthcare facilities and other necessary services. A recent analysis from The New York Times⁴ found that single-family zoned residential land accounts for 81 percent of Seattle's residential land; 79 percent in Chicago; 75 percent in Los Angeles; and 36 percent in Washington, D.C. In addition, between 1990 and 2016, single-family homes accounted for nearly 80 percent of all new housing construction in the nation's largest 100 metro areas.⁵ Permitting ADU development in single-family zoned areas can unlock underutilized land and potentially (depending on demand for

ADU development among homeowners and the local regulatory and financial landscapes) could boost "gentle density," housing type diversity, affordability and opportunity for less-affluent, renter households, who have been excluded from those neighborhoods for years. Gentle density, as defined by Brent Toderian, is "attached, ground-oriented housing that's more dense than a detached house, but with a similar scale and character."⁶ This type of density, which is also known as the missing middle housing, includes ADUs, duplexes, semi-detached homes, rowhouses and townhouses.

Addressing Local Opposition to Gentle Density

Proposals to increase density in predominantly single-family zoned areas often face local opposition. These proposals are generally perceived as a green light for high-density residential development, often conceived of as towering apartment buildings, that would lead to a range of issues, including high traffic, increases in demand for parking, drops in home value and changes in neighborhood character, among other concerns. Allowing ADU development has been utilized by policymakers and urban planners as a strategy to navigate debates/concerns around boosting density in an easier, more expedited manner. Allowing for ADU development in single-family zoned areas could help reassure opponents of density by proving that the outcome will be the lower end of the “gentle density” spectrum and far away from any form of high-density development. That said, proposals to allow for ADU development still face local opposition in many single-family neighborhoods on the basis of the aforementioned factors — yet allowing for ADU development is likely to face less local opposition than proposals for higher forms of density. Despite this, some state and local governments have recently moved toward a stronger stance on allowable density, permitting a broad range of “gentle density” approaches that allow for more than adding one secondary unit, including duplexes, triplexes, fourplexes and small multifamily housing.⁷ Here are three brief examples:

- In 2019, Oregon became the first state to adopt a zoning reform on a statewide basis.⁸ The state has eliminated local bans on duplexes in every low-density residential area in all cities with more than 10,000 residents and all urban lots in the Portland metro area. And in cities of more

than 25,000 and within the Portland metro area, the state authorizes triplexes, fourplexes, attached townhomes and cottage clusters on some lots in all areas zoned for residential use.

- In 2019, the Minneapolis City Council officially adopted Minneapolis 2040⁹, a comprehensive plan to permit duplexes and triplexes in single-family home zones across the city; eliminate parking minimums for all new construction; and allow for higher density along transit corridors.
- Also, in 2019, the Seattle City Council passed Mandatory Housing Affordability (MHA) upzones¹⁰ to allow higher density and impose affordable housing requirements on more than two dozen neighborhoods. This measure upzones around 27 neighborhood hubs, requiring developers in those areas to set aside between 5 and 11 percent of their developments as affordable units or pay \$5 to \$32.75 per square foot in fees. It also allows for denser housing on about 6 percent of lots where new construction is currently reserved exclusively for single-family homes, as well as upzones blocks where apartment buildings and commercial buildings are already allowed by one or several stories.



Using Gentle Density to Support Aging in Place

In addition, unlocking gentle density through ADU development has also been utilized by housing stakeholders as an aging in place strategy. ADU development can help empty-nest seniors who own single-family homes stay in their homes, while either creating multigenerational housing that is desired and needed in some communities or adding smaller, rentals units to the market. The latter can support density, housing type diversity and affordability in single-family zoned neighborhoods. Under this strategy, seniors who own single-family homes and would like to downsize could live in either the primary unit/ADU and rent out the other unit, when permitted by local codes, or let their adult child/grandchild/relative move into the primary/secondary unit while they occupy the other unit. The former option allows empty-nest seniors to generate additional income while downsizing, and the latter helps facilitate a multigenerational living

situation, which is particularly helpful for seniors who need more care and attention. In addition, an adult child could build an ADU on their single-family lot to allow their senior parent/relative to live in an independent dwelling that is constructed on the same lot.

Using Gentle Density as an Income-Generation and Wealth-Building Strategy

A range of housing stakeholders, including policymakers, housing experts and community organizations, have been exploring how unlocking gentle density through ADU development can be utilized as an income-generation and wealth-building strategy for lower- and moderate-income homeowners. When codes allow a homeowner with an ADU to rent out either the ADU/primary unit to tenants (who are not family members and reside in the primary/secondary dwelling through an official lease with specific agreed upon terms), homeowners can use their ADU

to generate additional monthly rental income. This model is similar to the traditional model of developing duplexes, triplexes and quadraplexes to enable the property owner to live in one unit while renting out the rest of the units, generating a monthly rental income. And this explains why small-scale multifamily properties with one to four units are still considered as “single-family” housing in the U.S. mortgage system.

In addition to income generation, this model can help lower- and moderate-income homeowners build wealth by enhancing their properties and potentially increasing the total property value. This can be particularly helpful in building intergenerational wealth for low- and moderate-income homeowners of color, who were excluded from homeownership in affluent and desirable neighborhoods through discriminatory housing and lending policies like redlining.” These discriminatory policies, which also marked neighborhoods with predominantly homeowners of color as less

desirable neighborhoods, have had impacted their ability to build intergenerational wealth through homeownership. However, advancing wealth building through ADU development relies on whether there is a difference between the pre-development appraisal and the post-development valuation – an increase in the total property value after adding an ADU to the property. (See page 25).

While addressing land use barriers to ADU development is the first step toward allowing for the lowest end of the gentle density spectrum in single-family zoned areas, many single-family homeowners who are interested in creating ADUs on their properties still face regulatory and financial barriers to ADU development.



OVERCOMING REGULATORY BARRIERS TO ADU DEVELOPMENT

State and local zoning regulations are one of the prominent factors in shaping the form and scale of ADU construction. These regulations also determine the viability of using this housing production strategy to generate rental income and boost property value, which can help lower- and moderate-income homeowners build wealth.

At a minimum, municipal governments must permit ADU development in some/all single-family zones to support ADU development. However, in many jurisdictions where ADU development is permitted, there are zoning provisions that can create regulatory barriers to ADU development, which can result in complex, lengthy permitting processes; reduce the feasibility of creating ADUs; and discourage homeowners from pursuing ADU development. This research looks at some of the most common regulatory barriers to ADU development, as zoning requirements vary by jurisdiction.

Discretionary review processes

The Challenge:

- Allowing ADU development via a discretionary review process creates a complex and lengthy permitting process that could discourage homeowners from pursuing creating ADUs on their lots. A discretionary review process gives municipal, legislative or administrative bodies the authority to impose specific requirements on each ADU development proposal on a case-by-case basis, creating uncertainty, extended timelines and possible complexities for homeowners interested in creating ADUs on their lots.

- Under a discretionary review process, the applicant is typically asked to submit an application that discusses the impact of the proposed ADU development on the homeowners' neighboring lots and the overall residential area, as well as its compliance with any discretionary provisions or requirements. One common form of discretionary approvals is applying for a conditional use (special use) permit for the creation of an ADU on the lot, which otherwise would not be a by-right use in the zoning district, subject to meeting a set of specific requirements and conditions. The municipal body leading the discretionary review process could also require holding a public hearing to discuss the proposed ADU development's compliance with its criteria/guidance and the proposal's potential impacts on the lot's surroundings, inviting public input on and possible opposition to the proposed ADU construction.

The Solution:

- Allowing for the by-right development of ADUs streamlines and expedites the permitting process, potentially incentivizing more homeowners to explore this housing production strategy. By-right zoning means that an ADU development proposal would receive a permit as long as it complies with the current underlying zoning requirements for the single-family zoned lot where it will be constructed. This means that the proposed ADU development would only require a ministerial review to confirm compliance with municipal zoning requirements and would not require going under additional reviews or meeting additional site-specific conditions.

Occupancy requirements

The Challenges:

- Municipal zoning regulations can impose a range of regulatory restrictions on the occupancy of ADUs:
- One of the most stringent restrictions is prohibiting homeowners from using their ADUs as rentals to non-family members under an official lease with agreed upon terms. This restriction prohibits ADU owners from renting them out to create additional rental income, contradicting with the use of ADU development as a strategy to build wealth for lower- and moderate-income homeowners. It also inhibits accomplishing a range of ADU development's policy goals, including boosting the supply of rental housing that is more affordable than single-family homes in neighborhoods that often have higher access to opportunity.
- And even when renting ADUs out to non-family members is permitted, jurisdictions can still impose owner-occupancy regulations, which require that the homeowner continues to live in either the primary unit/ADU while renting the other dwelling out. This means that the owner of the primary residence and ADU cannot legally rent out both units if they move to a different jurisdiction or into a new home. This requirement can create legal burdens if the owner would want a relative to live in either the primary/ADU unit while renting the other unit to a non-family member, requiring adding the relative's name to the property deed. There is a generic consensus among housing practitioners that these restrictions can impact appraised home values, as it restricts the use of the property and the owner's ability to rent the primary and ADU units under a range of scenarios, such as inheriting a single-family home with an ADU while living in a different home/jurisdiction or relocating to a different neighborhood/jurisdiction.

- In addition, some municipal governments institute occupancy quotas for either the primary dwelling and the ADU or the ADU alone, which can impose further restrictions on the use of ADUs. For example, if zoning regulations impose a six-person cap on the number of people who could live in the primary dwelling and the ADU and five people already live in the primary dwelling, then only a one-person household would be allowed to live in the ADU.

The Solutions:

- Eliminating occupancy requirements – which either prohibit homeowners who own ADUs from renting them out to non-family members or require those homeowners to live in the primary dwelling/ADU to rent one of the two units out – is essential to allow for the use of ADU development as a strategy to build wealth for lower- and moderate-income homeowners and boost the supply and affordability of rental housing in single-family zoned areas. In addition, imposing occupancy quotas for either the primary dwelling and the ADU or the ADU alone should be done in a flexible way that would not add unnecessary restrictions to the use of ADUs either as a rental or a portion of a multigenerational housing.

Off-street parking requirements

The Challenges:

- Requiring that homeowners interested in creating ADUs on their lots provide one or more off-street (on-site) parking spots for the developed secondary dwelling can significantly hurt the viability of ADU development. Creating one parking space or more on the site can create additional financial and logistical challenges that could discourage homeowners from pursuing ADU development. In addition to inducing additional costs in the ADU

development process, homeowners can face logistical barriers to creating additional on-site parking spaces for the sole use of ADUs' residents. Some sites may have irregular boundaries, size limitations, challenging topographic or physical barriers like trees that can complicate the on-site parking creation process.

- Some jurisdictions require a homeowner who converts their on-site, parking structure (garage) into an ADU to replace the converted parking space by an additional parking space on top of the off-site parking requirements for the developed ADU. It is important to note that these requirements can discourage garage conversions into ADU in transit-rich neighborhoods where excessive on-site parking requirements are unnecessary. In addition, these requirements can be specifically challenging in smaller sites and/or those with physical or topographic barriers that inhibit replacing the converted parking structure and creating additional on-site parking for the ADU.

The Solution:

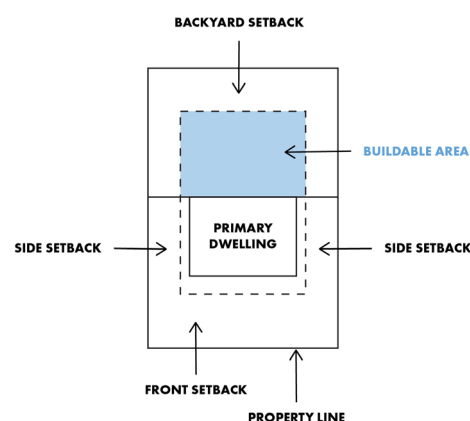
- Off-street parking requirements for ADUs must take into consideration factors that shape on ground (actual) demand for this type of parking. For example, not all households residing in ADUs own private vehicles, and therefore, the additional parking space(s) may be left unutilized. ADUs' tenants may also use alternative transportation modes, such as bicycles, scooters or ride-share services, as well as public transportation, especially when they live in transit-rich neighborhoods or close to transit hubs.
- Some municipalities have moved towards relaxing their parking requirements, including off-street parking requirements for ADUs, in areas

that are close to public transportation hubs or well served with public transportation. Relaxing or waiving off-site parking requirements for ADUs can incentivize homeowners, especially lower- and moderate-income homeowners, to pursue creating ADUs on their lots, as it eases financial and logistical barriers to ADU development.

Setbacks

The Challenge:

- Commonly, zoning codes impose setback requirements on external, attached/detached ADUs. Setbacks require complying with a minimum distance between the ADU and the property lines (the sides and the rear property lines when the ADU is constructed in the primary dwelling's backyard). In addition, some zoning and land use codes require specific setbacks between the primary dwelling and a detached ADU sharing the same lot. Setback requirements for ADUs vary across jurisdictions. Also, the way the setbacks are developed vary from one jurisdiction to another. For example, it could be 4 ft. from the side and rear property lines, or 10 ft. from the side property lines and 20 ft. from the rear property line. The rationale behind requiring setbacks is ensuring privacy and adequate light and air access to neighboring properties. However, excessive setback requirements can inhibit ADUs in smaller lots. That is because requiring large (excessive) setbacks is likely to result in a very small developable area in smaller- and moderately sized lots, and this developable area may not be sufficient for creating an ADU or may result in a micro-ADU that won't be sufficient to serve and/or be desired as a residential dwelling or a rental.



The Solution:

- Municipalities should avoid imposing excessive setbacks for external ADUs that would either create a very small developable area or inhibit ADU development in smaller- and moderately sized lots.

Lot size requirements

The Challenge:

- Municipalities that impose excessive "minimum lot size" requirements on ADU development indirectly prohibit homeowners with smaller- and moderately sized lots from creating ADUs on their lots. The higher the minimum lot size the more restrictive the requirement is. The rationale behind these requirements is preserving neighborhood characteristics and containing residential development density in single-family home zoned areas. However, excessive "minimum lot size" requirements often limit the number of ADUs that could be constructed in more dense single-family home zones with smaller lots, where there is likely higher demand for smaller rentals like rental ADUs.

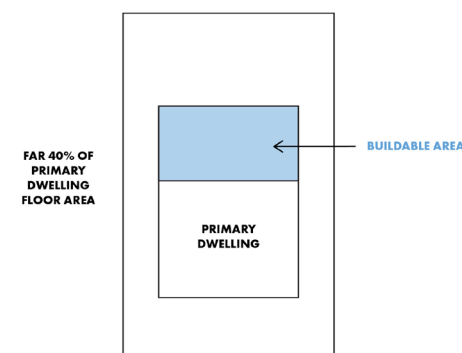
The Solution:

- Some municipal governments have shifted towards either eliminating or easing "minimum lot size requirements" to allow for more ADU development in their single-family zoned lots.

Size, height and number of allowed ADUs

The Challenges:

- Most municipal governments impose a range of size caps on ADU development. Generally, those requirements are imposed on homeowners to ensure that the resulting secondary dwelling (ADU) is smaller than the primary dwelling. Zoning codes rely on a range of measurement methods in determining ADU size caps. One prominent method is requiring compliance with the lesser of: 1) a specific square footage cap on ADUs (i.e. 450, 600, 800, 1200 sq. ft.); and 2) Floor-Area-Ratio (FARs), a ratio between the ADU's size to the total lot size, or a ratio between the ADU's floor area to the primary dwelling's floor area.



- Imposing excessive size restrictions can impede the development of ADUs that can be used as residential dwelling for two-person or more households, especially in neighborhoods with

smaller houses and/or lots. These excessive size caps often result in small ADUs that are close in size to micro-units or small studios. For example, if the primary residence is a 1,200 sq. ft. single-family home and the zoning and land use specifications require that the resulting ADU shall not exceed 30 percent of the primary dwelling's floor area, then this requirement will result in a 360 sq. ft. ADU. It is also important to note that benefiting from the allowable ADU size may not be possible on a parcel that is under excessive setback requirements and with physical barriers, such as the placement of the primary dwelling in the middle of the site or topographic slopes and barriers.

- The extent of ADU height requirements vary by jurisdiction. Zoning regulations could require that the height of the ADU does not exceed the primary dwelling's height, which allows for developing two-story ADUs. Other regulations would set a specific height limit (i.e. 10, 16, 20 or 25 ft.). Imposing low height caps, such as 10 or 12 ft., impedes developing a two-story ADU or an ADU with a mezzanine floor, which is a partial floor with low ceiling that is placed nearly halfway the highest ceiling from the ground, creating a double volume and projecting like a balcony. In an ADU, especially smaller ADUs, a mezzanine can be used as an additional bedroom, den or office space.

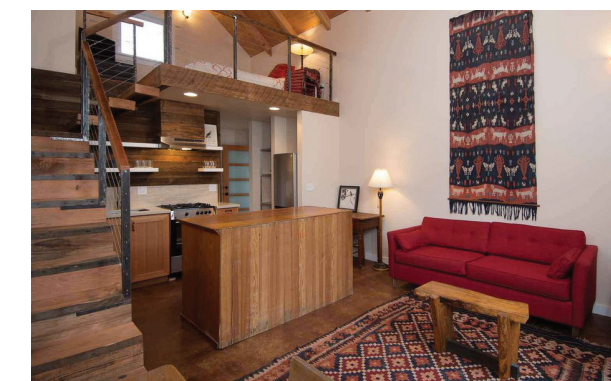
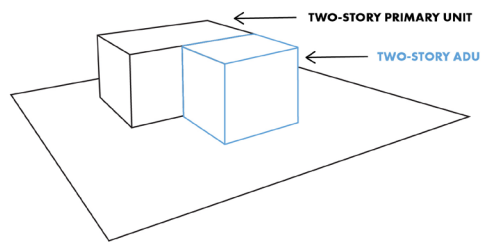
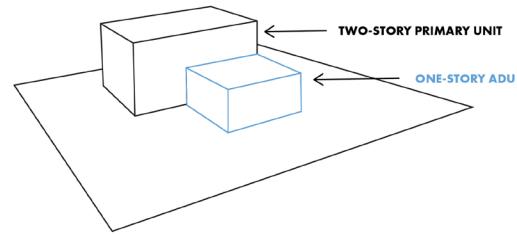
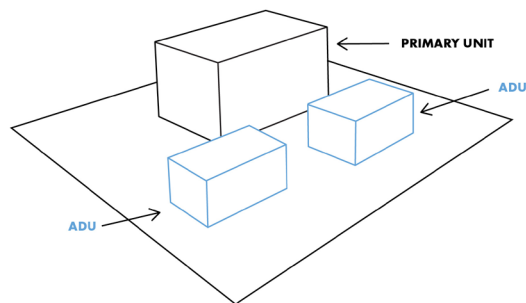


Photo Credit: BuildingAnADU.com



- On the top of size and height requirements, zoning ordinances typically set limitations on the number of ADUs per lot. The majority of local codes limit the number to one ADU per lot. However, some jurisdictions have moved toward allowing for creating more than one ADU per lot in specific areas. Some jurisdictions have also relaxed their ADU requirements allowing for creating more than one ADU per lot and/or creating ADU on certain multifamily zoned lots, requiring meeting specific conditions and standards.



The Solutions:

- Municipal governments should avoid imposing maximum size requirements for ADUs that would result in small ADUs that are close in size to micro-units or junior studios, prohibiting the homeowner from unlocking and benefitting from their lot's developable area.
- Municipal governments should allow for the development of at least two-story ADUs in any single-family zoned area, as most single-family homes comprise two stories, unless there are valid reasons for imposing different ADU height requirements.
- Municipal governments should explore permitting more than one ADU per parcel as well as ADU development on multifamily zoned lots on sites suitable for these zoning allowances.

Design standards

The Challenges:

- Municipalities typically adopt design standards for ADU development to ensure compatibility between the aesthetics and character of the developed external, attached/detached ADU and the existing primary unit. These standards vary in their specificity and scope across local jurisdictions. Design standards governing ADU development could include compatibility in exterior walls' building material and color; roof material, type and slope; and windows' treatment, proportion and spacing. Some ADU design standards prohibit having the ADU's main entrance facing the front property line (both the main dwelling's and the ADU's main entrances facing the front property line) or even a public right-of-way.

- These design standards that aim to ensure compatibility between the developed ADU's and the primary unit's design aesthetic and character vary in their stringency. That is, compatibility could mean that the developed ADU should be designed in a way that its external design completely matches the external design of the primary unit, including the windows, doors, external walls and roofs. In other instances, compatibility could be a broader term that means there would be some form of harmony without requiring matching the external design of the primary unit. However, while this lack of specificity could offer some flexibility, it can also cause confusion among designers and homeowners interested in pursuing ADU development. In addition, there are ADU design standards that can create additional financial and logistical/technical burdens. For example, requiring matching the primary unit's window treatment, placement, proportion and spacing could create logistical burdens in ADU development.

The Solutions:

- Avoiding requiring external design compatibility between the ADU and the primary unit may be necessary to limit tradeoffs between rigid requirements and vagueness and uncertainty in design standards compliance.
- Municipalities should avoid imposing prescriptive design requirements on ADU development, as these requirements can create additional financial and technical burdens. The alternative would be adopting objective design standards, which allows for flexibility in meeting the end design goals.

Impact fees and utility connections

The Challenge:

- Requiring homeowners pursuing ADUs on their lots to pay impact fees to the municipal government is one of the regulatory requirements that creates additional financial barriers to ADU development. Impact fees are generally imposed by municipal governments on real estate developers to offset the cost of new demands for public infrastructure and services created by the new development project. This one-time payment is collected by municipal governments to mitigate the cost of creating and maintaining public infrastructure, such as sidewalks, sewage and water systems, roads, parks and schools, as well as providing public security and safety services like fire stations. Some jurisdictions adopt fixed impact fees for ADU development that are typically not proportional to the ADU size and the projected impact of and demand on public infrastructure and services created by the ADU development.
- Some municipalities require that the ADU has a separate connection to and meters for the public water, sewage and electricity systems from the primary dwelling. These requirements can add significant financial barriers to ADU development as well as extend the permitting and development processes. This includes covering the costs of installing water and sewage pipes that connect the ADU to public infrastructure, which is a very costly process that will require additional permits and likely extend the ADU development process. While separating utility connections and meters could be beneficial for using of developed ADUs as rentals, these requirements can add cost burdens to the ADU development process by adding utility connection fees to the overall cost.

The Solutions:

- It is unreasonable to require an ADU owner to pay impact fees that are equivalent to those imposed on single-family homes and larger residential properties. ADUs are smaller than single-family homes and are typically occupied by smaller households, particularly one- to two-person households. One solution is halting impact fees for ADUs. For example, the City of Portland offers a waiver of system development charges (SDCs), which are collected by the city to offset the impact of new development on its storm and sanitary sewer systems, parks and recreation facilities, water and street systems, for homeowners who participate in the ADU SDC Waiver program. This program requires participating homeowners to sign a covenant stating that neither the ADU nor the primary residence will be rented as a short-term rental for 10 years.¹² In addition, some municipal governments have moved towards requiring fees that are proportional to the ADU's size, waiving/reducing those fees for smaller ADUs. And others have moved toward taking into consideration the difference between the ADU and the primary unit sizes in calculating imposed impact fees.
- To mitigate the cost and time implications of requiring that ADUs have separate connections to and meters for public utility systems, municipalities can explore either waving those utility connection fees for ADUs or making those proportionate to the ADU size and the estimated burden of the ADU on the public utility systems.

STATEWIDE REGULATORY CHANGES IN SUPPORT OF ADU DEVELOPMENT IN CALIFORNIA

In 2019, California Governor Gavin Newsom signed into law a group of bills aimed at addressing a range of regulatory barriers to ADU development across the state.¹³ Enacting statewide ADU laws requires that all local jurisdictions follow the state's rules, regardless of whether they have their own ADU laws. These adopted regulatory changes relax regulatory restrictions on and provide more flexibility in ADU development, including:

PERMITTING AND REVIEW PROCESSES

- Reducing application review time for ADUs to 60 days from the receipt day of a completed application.
- Prohibiting local agencies from requiring the correction of existing nonconforming zoning conditions as a condition for "ministerial approval of a permit application" for an ADU or junior ADU.
- Allowing ADU owners with violation of codes, upon application and approval, to correct non-health- and safety-related violations within five years.
- Prohibiting covenants, conditions and restrictions (CC&Rs) from banning or unreasonably restricting ADU development on single-family lots.

OCCUPANCY REQUIREMENTS

- Freezing owner-occupancy requirements for all proposed ADUs until January 1, 2025.

OFF-STREET PARKING REQUIREMENTS

- Capping parking requirements for ADUs at one parking space per ADU or bedroom (whichever number is smaller).
- Eliminating parking requirements for ADUs under certain circumstances, such as when the lot is located within one-half mile walking distance of public transit or when there is a car share vehicle located within one block of the accessory dwelling unit.
- Clarifying that local agencies cannot require off-street parking replacement for an ADU that was created through a garage/covered parking structure conversion.

SETBACKS

- Capping rear yard and side setbacks for ADUs at 4 feet (ft.).

LOT SIZE REQUIREMENTS

- Prohibiting imposing minimum lot size requirements on ADU development.

SIZE, HEIGHT AND NUMBER OF ALLOWED ADUS

- Prohibiting local agencies from adopting maximum ADU size requirements of less than 850 sq. ft. for a one-bedroom ADU and 1,000 sq. ft. for an ADU with two or more bedrooms.
- Prohibiting local agencies from adopting any other size limits, such as maximum lot coverage, floor area ratio and open space requirements, that do not allow for creating at least an 800 sq. ft. ADU with a minimum 16 ft. height and 4 ft. rear yard and side setbacks.
- Allowing for creating a junior ADU, in addition to the lot's larger ADU, within the walls of the proposed or existing single-family residence or accessory structure, capping the size of a junior ADU to 500 sq. ft.
- Permitting creating at least one ADU within an existing multifamily development, capping the number of the developed ADU(s) to 25 percent of the existing dwelling count. These ADUs can only be created within the "portions of existing multifamily dwelling structures that are not used as livable space, including, but not limited to, storage rooms, boiler rooms, passageways, attics, basements or garages."
- Permitting creating up to two detached ADUs on a lot that has an existing multifamily development. These ADUs are subject to a height limit of 16 ft. and 4 ft. rear yard and side setbacks.

IMPACT FEES AND UTILITY CONNECTIONS

- Exempting ADUs up to 750 sq. ft. from impact fees and requiring that impact fees for larger ADUs are proportional to the square footage of the primary residence.



OVERCOMING BARRIERS TO FINANCING ADU DEVELOPMENT

There is a consensus among housing developers and practitioners that inadequate access to financing is one of the prominent challenges to bringing this housing production strategy to scale. This includes scarcity of lending products tailored to ADU development across the country.

Further, the most common paths to covering the costs of ADU development require homeowners to tap into their personal savings or home equity, which thus excludes many lower- and moderate-income homeowners from pursuing ADUs on their lots. This section discusses two main barriers to accessing ADU financing: **1) scarcity in lending products tailored to ADU financing; and 2) challenges in using traditional lending products for ADU financing.**

Scarcity in lending products tailored to ADU financing

Generally, there is scarcity in loan products tailored for ADU development. Due to the lack of familiarity with ADU development in the lending industry, many lenders see ADU development as an unconventional investment that is more risky than traditional residential construction. And therefore, the number of lending products designed specifically for financing ADU development is very limited across the U.S. housing market. The scarcity of lending products

tailored for ADU financing has made tapping into homeowners' cash savings or home equity the most common path for financing ADU development. While this path may work well for higher-income homeowners or those who are able to tap into their home equity, lower-income homeowners are less likely to be able to use these financing mechanisms. In addition, there are challenges in using these lending products to finance ADU development, including counting the projected rental income from the ADU in calculating the loan value and determining the borrower's eligibility. Here are some of the common ADU equity financing mechanisms¹⁴:

- **Cash savings or other liquid assets**

Under this path, a homeowner would use cash savings or stocks that can be liquidated to fund ADU development on their lot. This path is typically not attainable and/or feasible for low-income and some moderate-income homeowners.

- **Home equity lines of credit (HELOC)**

Homeowners with equity in their homes can tap into it to access a revolving line of credit that can be used to finance large expenses like ADU development. Accessing HELOC is based on a recent home value appraisal, borrower's Loan-To-Value (LTV) ratio, plus a range of eligibility requirements that vary from one lender to another. Basically, showing that the borrower owns a certain share of their home's equity by looking at the current home appraised value and LTV as well as meeting a lender's eligibility requirements would allow the borrower to tap into a flexible revolving line of credit. At the same time, the borrower's home equity is considered as a collateral that can be taken over by the lender if the borrower fails to make their loan payments. The lender may allow the

borrower to pay only interest payments for a specific period of time, and once the borrower taps into the HELOC, they will be required to pay interest and principal payments moving forward.

There are challenges to using HELOC to finance ADUs. A homeowner who does not meet the lender's eligibility requirements, such as minimum LTVs and credit scores, will not be able to access a line of credit through their home equity. In addition, some lenders may require variable interest rates, which can increase the borrower's loan payments if the interest rate increases. This option can also be risky for homeowners who are not certain about their ability to make their monthly loan payments on HELOCs, as defaulting on the new loan could lead to losing their home equity.

- **First mortgage cash-out refinance**

Under this lending tool, a homeowner would replace an existing home mortgage with a new one that has a higher value and different terms, and would tap into their home equity via one lump sum payment. After paying any remaining balances, the difference between the new, higher value mortgage and the original mortgage debt (in this case it would be labeled as the balance of the homeowner's home equity) is paid to the borrower as a lump sum cash payment. Eligibility requirements vary across lenders, including minimum LTVs. This option can be helpful when the borrower is able to access a new loan with more favorable terms, such as lower interest rates. However, pursuing a cash-out refinance can create some risks. A cash-out refinance resets the home mortgage amortization schedule. That is, the homeowner will have a new mortgage

with more debt, and the homeowner's ability to make the new loan's monthly payment will rely substantially on receiving a monthly rental income from the developed ADU. And defaulting on the new loan under financial hardships could lead to the loss of the homeowner's home equity, as the home will be considered as a collateral by the lender.

In addition to tapping into the homeowners' personal savings or home equity to finance ADU development, renovation and construction loans may be used to finance ADU development. However, there are challenges to using these lending options to finance ADU development.



Photo Credit: BuildingAnADU.com

• **Renovation loans**

These loans are unsecured financing products that help homeowners cover the cost of a home improvement project. That is, the property is not considered as a collateral that can be taken over by the lender when the borrower fails to make the monthly loan payments. Those loans are typically fixed-rate loans (typically with higher interest

rates due to the lack of collateral and higher perceived risks) that cover a certain share of the projected costs based on an appraisal that includes the increase in total property value caused by completing a home improvement project, i.e. the total projected home value after adding an ADU to the lot. Attaining a fair market appraisal can be challenging due to the lack of familiarity with ADUs' property values in local market, as we still have yet to see ADU development at scale on the local or state level, and to a certain extent that would enable the industry to capture comprehensive cost and value data sets on ADU development. This may result in undervalued appraisals and lower access to financing necessary to cover ADU development costs, and under those circumstances, ADU development will not add significant value to the total property value after the completion of project.

While there are no federally backed loans tailored for ADU financing, there are some federally backed home improvement loans that can be used to finance ADUs. These lending products include Fannie Mae-backed HomeStyle Renovation mortgages and Freddie Mac-backed CHOICERenovation mortgages.

In addition, lenders commonly require that the homeowner hire a contractor who will have access to the loan's funds via multiple payments that are only received after proving progress on the home improvement project. This can extend the ADU development process and create a range of challenges, such as limitations on the number of contractors who are familiar with ADU development and are willing to take on such development projects. Also, these loans may not be accessible to all homeowners due to a range of eligibility requirements like high credit scores.



Photo Credit: BuildingAnADU.com

• **Construction loans**

Another option is using a construction loan to finance new ADU construction. These loans generally have higher interest rates, as new construction is often perceived as a risky investment due to the lack of a physical structure that can be taken as collateral in the case of the borrower's failure to make the monthly loan payments. Similar to home improvement loans, lenders typically require hiring a professional contractor who will be receiving monthly payments upon reaching certain construction milestones. Construction loans are short-term loans, typically last for only one year, as they expire upon the completion of the construction process. The homeowner can either pay off the balance of the construction loan upon the end of the construction timeline or choose to transform the construction loan into a permanent loan with different terms, including the loan type, length and interest rate.

Challenges in using traditional lending products for ADU financing

There are a range of persisting challenges in using the abovementioned traditional lending products for ADU financing. Two common challenges are not including the projected rental income in calculating the loan value and determining borrower's loan eligibility.

Accuracy in appraisals can create barriers to ADU financing, especially for ADUs permitted as long-term rentals with projected monthly rental income. Appraisals/lenders typically do not use the income approach to estimate the value of the proposed ADU development based on its projected rental income in calculating the LTV ratio. Appraising a proposed rental housing development typically includes looking at the fair market value and rental income of similar rentals located in the housing market. For example, if the homeowner has received a permit to construct a 600sq. ft. ADU on

their single-family zoned lot, which can be used as a long-term rental unit, the appraisal should include looking at the fair market value and rental income for a similar unit located in the same market, which could be anywhere between \$400 and \$1,800 or more per month, depending on the housing market. The appraiser should then include this projected rental income in the ADU appraisal process. If we assume that this 600sq. ft. ADU will generate nearly \$900/month, or nearly \$11,000/year, in rental income, then not including this estimated income in the appraisal process will result in calculating the LTV based on an under-appraised property value, which leads to the lender offering less capital based on the estimated property value. While lenders typically offer borrowers up to 80 percent of the projected development costs, receiving less capital based on undervalued appraisals typically results in needing additional gap financing resources or using additional equity for financing ADU development.

Incorporating the income approach in ADU appraisal requires some creativity and flexibility for a variety of reasons. Unlike other traditional types of residential construction, such as single-family homes, duplexes, triplexes and multifamily apartment buildings, there are challenges to accessing large, comprehensive data sets on ADUs' property values and their generated rental income. That can be largely explained by the fact that most markets have yet to witness a significant boom in long-term rental ADUs that would bring this type of residential units to scale. The significance of this challenge is likely to decrease in markets where ADU development has been rising and more ADUs are used as long-term rentals.

In addition, when lenders do not include the projected rental income from ADU development in the debt-to-income ratio (DTI), homeowners face additional burdens to securing ADU financing. The DTI is a ratio calculated by dividing the borrower's total debt over their monthly income and used to

measure borrowers' debt load and financial stress. Lenders see high DTIs (typically >40 percent) as an indication of high financial risk, and the exclusion of the projected rental income from ADU in the DTI calculation results in higher DTIs, which could result in higher loan denials for financing ADU development.

Despite those challenges, there are lending products that are tailored for ADU financing or offer gap financing that could support ADU development. One example is ADU loans for eligible single-family homeowners in Portland offered by Craft3¹⁵, a nonprofit Community Development Financial Institution (CDFI) based in the Pacific Northwest region. These fixed-interest, long-term (up to 240 months) loans finance the construction of detached or attached ADUs, allowing homeowners to borrow up to \$250,000 to cover ADU design, permitting and construction costs. This loan product offers reduced rates to households earning below 100 percent of the AMI. Another example is the city of Boston's ADU gap financing offered through its Additional Dwelling Unit Loan program.¹⁶ These interest-free loans offer gap financing to eligible homeowners who are interested in creating ADUs on their lots in the city of Boston. The program offers up to \$30,000 to owners of single- to three-family homes; the offered amount is based on the estimated cost of ADU development and can be used as gap funding. These loans do not require monthly payments and only become due when the owner sells, transfer of ownership or undertakes a cash-out refinance of the home. These loans do not attach any use or affordability requirements.

Offering subsidized financing to support deeper affordability levels

As mentioned earlier in this white paper, ADU development can add to the housing market rental units that are smaller in size and more affordable than single-family homes in neighborhoods that overall lack housing type diversity and rental housing. The creation of ADU is likely to create housing opportunities for lower- and moderate-income, renter households (possibly those earning 60–80 percent of the AMI) in single-family zoned areas that often have higher access to opportunity, such as access to jobs and necessary public and private services. That is, rental ADUs will be offered at a market-rate rent that is lower than the area's single-family homes' market-rate rents. If the desired affordability goal is deeper affordable housing targets (i.e. units that are affordable to households earning less than 50 percent of the AMI), then some form of subsidized financing will be needed to attain those deeper affordability targets.

In addition to offering subsidized funding for attaining deeper affordability targets, when homeowners become landlords of rental ADUs, they may need some form of financial and logistical assistance with handling operating and maintenance costs and responsibilities. This is especially true for lower- and moderate-income homeowners who would be operating those rental ADUs on thin margins. These homeowners will suddenly find themselves landlords who are responsible for operating and maintaining rental housing. Since lower- and moderate-income homeowners are more likely to be interested in creating and renting out ADUs, providing them with financial assistance and resources that would help them with financing the development phase, as well as with operating and maintaining those rental ADUs, is necessary to achieve desired affordability targets through ADU development.

That said, there are public and private efforts that provide financing and support to homeowners interested in pursuing ADU development on their lots, requiring that the developed ADUs are used as affordable rentals for a range of household incomes with specific affordability terms (and this often prohibits the use of ADUs as seasonal, short-term rentals). Here are three brief examples:

- **The West Denver Single Family Plus (WDSQ. FT. +) Accessory Dwelling Unit (ADU) Pilot Program, Denver, Colorado¹⁷**

This pilot aims to demonstrate the viability of ADU development as one strategy to build wealth for low- and moderate-income homeowners and new affordable rental units. It assists eligible low- and moderate-income homeowners with designing, financing and building ADUs on their residential property. The program provides income qualified homeowners — who live in the West Denver Renaissance Collaborative (WDRC) neighborhood and own a residential property in a zone where ADU development is permitted — with a range of resources, including predevelopment services, a selection of ADU design prototypes, construction management through a nonprofit partner, connections to custom ADU financing and certified housing counseling to guide homeowners through the process. This support also includes connection to affordable ADU development loans and consolidated mortgages that comprise refinancing the mortgage on primary residence and ADU construction loans.

The pilot is focused on enabling participating low- and moderate-income homeowners to rent an ADU to supplement their monthly income while expanding the neighborhood's affordability, as well as boosting their home equity by increasing the property value.

At the same time, the program requires that if the homeowner were to rent the developed ADU or the primary dwelling, it would be affordable to households earning up to 80 percent of the AMI for a 25-year term, while prohibiting the use of the ADU as short-term rental. In 2018, the pilot received an award from Fannie Mae's Sustainable Communities Innovation Challenge.¹⁸ And In 2019, the Denver City Council approved providing \$500,000 to the WDSQ. FT. + program¹⁹ to fund up to 20 \$25,000 forgivable loans during the pilot. The Strong, Prosperous, And Resilient Communities Challenge (SPARCC), an initiative of Enterprise Community Partners, the Low Income Investment Fund and the Natural Resources Defense Council, has also provided support²⁰ to the pilot, including \$250,000 additional capital grant placed as a revolving fund.

• **The Backyard Homes Project Pilot, Los Angeles, California²²**

This initiative is a collaborative effort between LA-Más, a community development nonprofit, and a group of nonprofit, private and public partners. This program incentivizes homeowners to build and rent out ADUs as affordable units by offering access to financing, design, permitting, construction and leasing support. In exchange for receiving support, the homeowners are required to commit to renting their ADUs to HUD's Housing Choice (Section 8) Vouchers holders for at least 5 years. This support includes optional access to financing in the form of a permanent mortgage product. It also requires participating homeowners to receive landlord training. While the program was launched open to all property owners in the city of Los Angeles, it has shifted toward assisting homeowners with non-hillside residential properties in Northeast Los Angeles.

• **Small Homes, Big Impact Program, Bay Area, California²²**

Housing Trust Silicon Valley, a nonprofit community loan fund, has launched an ADU financing product to assist Bay Area homeowners interested in creating ADUs with accessing construction loans. This program offers eligible homeowners access to a three-year construction loan with a fixed 5 percent interest rate, requiring that the borrower already has a first mortgage on their home. Eligible homeowners qualify for construction loans of up to \$200,000 to cover both soft and hard development costs, including design and planning fees and ADU construction or the purchase of prefabricated ADUs.

The program requires that participating homeowners rent out their ADUs as rentals affordable to households earning up to 120 percent of the AMI for at least two years. The loan amount is based on the offered rent and will be calculated using the Combined Loan-to-Value approach. That is, the first loan would cover up to 80 percent of the primary and secondary dwelling's (total property) value and the ADU construction loan would cover up to 17 percent of the remaining total property value. The borrower is only required to pay interest payments for the first year and then principal and interest payments for the remaining two years. And once the construction loan expires, it gets transformed into a permanent loan.



Photo Credit: BuildingAnADU.com

Our research highlights that bringing ADU development to scale requires addressing land use, regulatory and financial barriers to developing this housing production strategy. Addressing those barriers will require eliminating and/or easing municipal requirements and restrictions that constrain ADU development, as well as offering public and private lending products that are tailored for ADU development. In addition, this white paper emphasizes that attaining deeper affordability levels through ADU development requires offering some form of subsidized financing, in exchange for accomplishing the desired affordability levels.

- ADU development is the low end of the gentle density spectrum. Permitting ADU development in single-family zoned areas is the first step toward supporting gentle density
- Bringing ADU development to scale requires easing and/or eliminating municipal regulations and requirements that tend to create regulatory barriers to ADU development, including but not limited to:
 - Discretionary review processes
 - Owner-occupancy requirements
 - Off-street parking requirements
 - Minimum lot size requirements and large setbacks
 - Restrictive size and height caps
 - Prescriptive design standards
 - Impact fees and utility connections cost burdens

- There are persisting barriers to financing ADU development, especially for lower- and moderate-income homeowners. Public and private lending agencies can support ADU development by advancing ADU financing:
 - Federal agencies that back mortgages, such as Freddie Mac, Fannie Mae and the Federal Housing Administration (FHA), as well as private lenders can explore creating lending products tailored for ADU development. These products would:
 - Enable low- and moderate-homeowners interested in pursuing ADU development to finance and develop ADUs on their lots
 - Offer favorable loan terms and interest rates to help mitigate homeowners' risk in lending to finance ADU development
 - Include the projected rental income from the ADU in calculating the DTI and appraised value to avoid offering risk of facing higher loan denials and/or being offered lower capital due to undervalued appraised property value
 - Provide for a loan underwriting process that is tailored for the population in need of ADU financing and the use of lending products for ADU development
 - Federal, state and local agencies, as well as private and philanthropic partners can also support ADU development through offering financial support to low- and moderate-income homeowners. This includes forgivable loans or grants that could be used to cover pre-development costs, such as design and permitting costs, gap financing and/or down payments for homeowners who lack access to sufficient home equity and/or capital. This is particularly important for low- and moderate-income homeowners who are interested in using their developed ADUs as rental ADUs, as they could build wealth from additional income while boosting the supply of rental housing and affordability in their market.

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