ECONorthwest
ECONOMICS • FINANCE • PLANNING

DATE: April 19, 2021
TO: Matt Hastie, Angelo Planning Group
CC: Terri Harding, City of Eugene
FROM: Becky Hewitt and Tyler Bump, ECONorthwest
SUBJECT: Impacts of Code Scenarios (Allow/Encourage/Incentivize) on Small Rental Units

Introduction

The City of Eugene is in the process of preparing Middle Housing Code Amendments to comply with Oregon House Bill 2001 (HB 2001). In brief, as required by HB 2001, these code amendments will allow middle housing—duplexes, triplexes, fourplexes, cottage clusters, and townhomes—in all residential zones that allow single-family detached housing, at densities higher than those for single-family housing and without restrictions that would create "unreasonable" cost or delay for middle housing development. The City is currently considering options for the specific standards that will apply to middle housing. **This analysis considers the impacts of varying development regulations on small, rental units that tend to be lower cost. The purpose is to determine how the City's code choices can increase the affordability of middle housing development.**

ECONorthwest's prior analysis showed that:

- New middle housing is comparatively less expensive than new single-family housing, because sales prices and rents tend to be lower for attached housing than for comparable detached housing, and new single-family detached housing tends to be larger and sometimes more luxury-oriented than even high-end middle housing.
- While many types of middle housing development are potentially feasible as rental or as ownership, typically building new ownership housing is more financially feasible.
- The smallest middle housing units will offer the lowest prices/rents overall; however, they are also likely to be higher priced on a per-square-foot basis, and may be less financially feasible to develop than larger units.

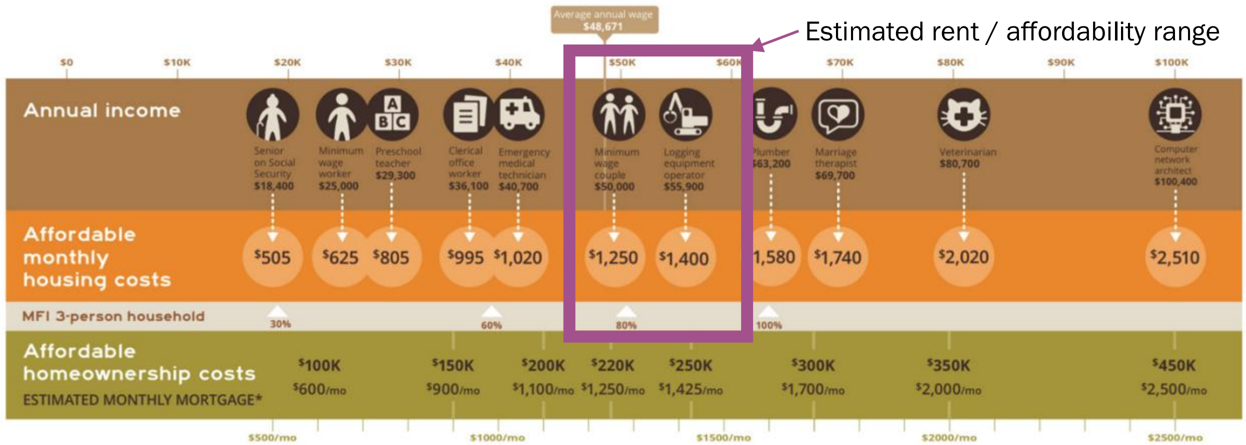
Based on these findings, the City asked ECONorthwest to look at whether the code options under consideration could help encourage middle housing at lower costs that would be attainable by people earning 80% to 120% of area median income (AMI), such as smaller rental housing units.

Approach

Unit Type and Affordability Level

We evaluated the financial feasibility of developing small rental duplex, triplex, fourplex examples, with two-bedroom units that would be roughly affordable to a three-person household with two minimum wage earners, or a three-person, single-income household with a job paying under $60,000 per year, as shown in Exhibit 1.

Exhibit 1: Housing Affordability by Income, 2-Bedroom Middle Housing Rental Units
Source: Lane County Affordable Housing Action Plan



Code Options

We compared financial feasibility of development with different standards based on three code options—Allow, Encourage, and Incentivize packages. In particular, we tested how variations in lot size and parking affected feasibility. (The other code standards had less impact for this type of development.) The standards tested with each package are summarized in brief below. These standards reflect draft code packages as of early April 2021; however, the specific recommendations may continue to change through community and planning commission discussion.

Exhibit 2: Minimum Lot Size (square feet) by Code Package

	Allow	Encourage	Incentivize
Duplex	4,500	3,000	2,250
Triplex	5,000	4,500	3,500
Fourplex	7,000	6,000	4,500

Exhibit 3: Parking Requirements per Unit by Code Package

	Allow	Encourage	Incentivize
Duplex	1	1	0
Triplex	1	0.67	0
Fourplex	1	0.5	0

We kept unit size (810 square feet, two bedrooms) the same across the duplex, triplex, and fourplex development examples, and across the different code options, in order to isolate the impacts of density and parking on smaller rental units.

Feasibility Measures

Our analysis used residual land value (RLV) per square foot of land as an indicator of relative financial feasibility. RLV is a measure of what a developer is able to pay for land, given expected construction, operating costs, and revenue. In other words, it is the budget that developers have remaining for land after all the other development constraints have been accounted for. It is a useful metric for assessing how code changes and potential development incentives interact to impact development feasibility. A development with a higher RLV can spend more on land, which expands the options for where the development can occur (all else equal). When two types of development are both possible on a given site, the one with the higher RLV may be more likely, because the developer can spend more to acquire the site. Higher RLV does not itself indicate greater affordability, but if a more affordable housing type has an RLV comparable to that of a more expensive housing type, it makes it more likely that the lower-cost housing type will get built at least some of the time.

We compared the RLV of the small, rental plexes to two example development types evaluated in earlier testing—single-family detached homes and townhouses. To the extent that the code options increase the RLV of the small, rental plexes, this increases the chances that this type of development will be built rather than single-family detached homes and townhouses.

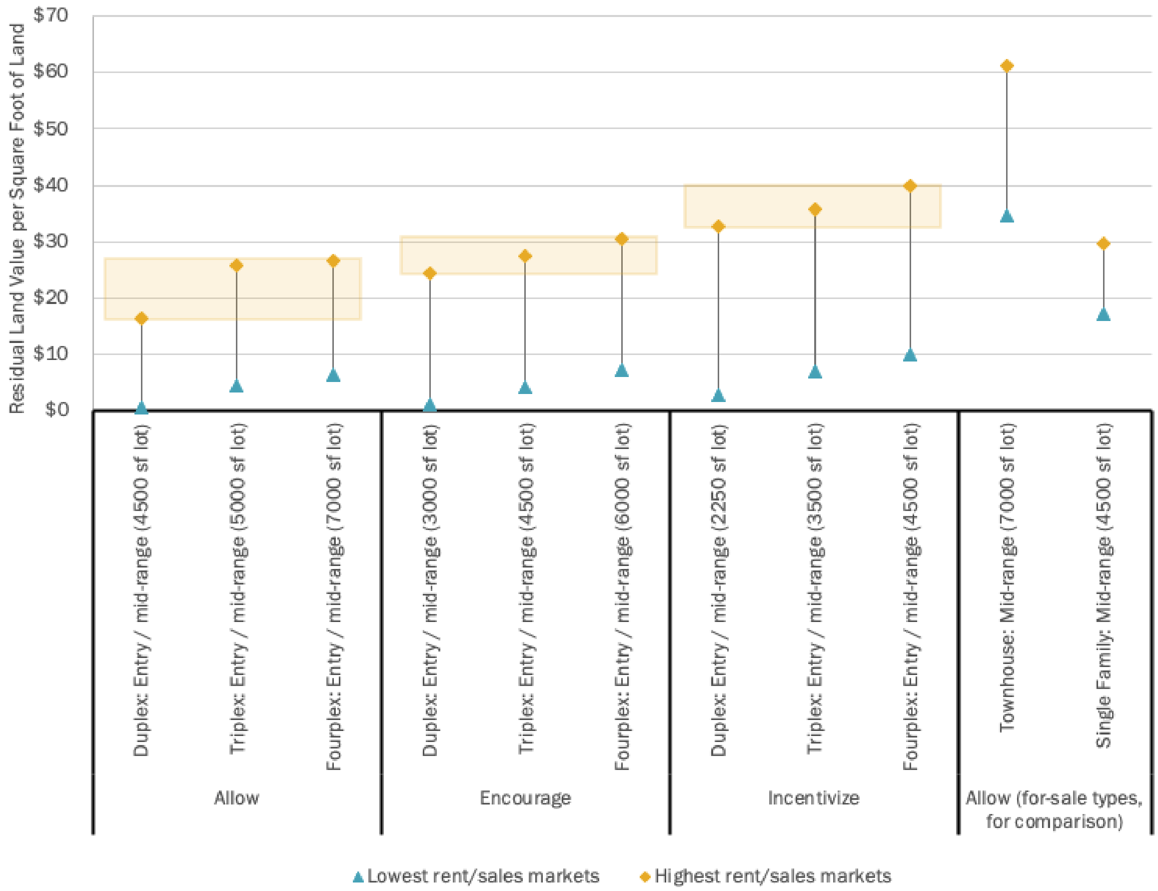
Findings

Impact on Feasibility

Exhibit 4 shows how RLV varies for each prototype across the different code packages. It shows that:

- The Encourage package improves feasibility somewhat relative to Allow, but Incentivize helps noticeably more in making plexes with smaller rental units feasible. The RLV per square foot for the smaller rental housing development examples is roughly double with Incentivize compared to Allow, meaning that they could afford substantially higher land costs and still be financially feasible to develop.
- With Encourage, smaller rental units are roughly comparable in terms of financial feasibility with single-family detached development. With Incentivize smaller rental housing is more feasible than single-family detached development.
- Even with the Incentivize package, smaller rental plexes still don't compete very well with townhouses. However, they are more comparable. This is true despite not applying any code incentives for townhouses.
- Fourplexes have the highest RLV among the small rental plexes, making these more likely to be financially feasible than the other small plexes if each is developed at the lot sizes assumed here.

Exhibit 4: Residual Land Value Range by Housing Type and Code Package



Most of the impact on feasibility is a result of needing less land. Not building off-street parking reduces construction cost somewhat, but its primary impact is to allow the development to fit on a smaller lot.

One other consideration is that by allowing units on smaller lots, there is a greater chance that someone could split their existing lot and sell part of it for middle housing development without needing to redevelop the whole lot, though this depends on the layout of the site.

Impact on Affordability

The rent is anticipated to be lower for the options that provide less or no off-street parking. This reduces construction cost slightly, as noted above, but the main reason for the difference is market-driven: people generally will pay a bit less for unit without parking. However, as noted above, the smaller lot size makes this option more financially feasible on a per square foot basis, despite the lower rents.

The rents for this type of development are likely to vary more based on variations in market conditions around the City. Assuming a three-person family (which is the standard that HUD uses for setting rent limits for a two-bedroom unit), these smaller rental plexes would be affordable at roughly the percentages of AMI listed below.

- Allow: 75-94% of AMI
- Encourage: 74-93% of AMI
- Incentivize: 71%-89% of AMI

This affects development feasibility as well as affordability. At the low end of the rent range, development has a lower RLV (shown with the blue markers on Exhibit 4) and is less likely to be financially feasible, particularly in a redevelopment situation.

Conclusions

The Encourage and Incentivize code provisions related to reducing minimum lot size and minimum parking requirements for middle housing positively impact the feasibility and affordability of smaller rental units. These units would be affordable to households between 71% and 94% of AMI, generally earning less than $60,000 per year. While they will continue to face challenges competing with townhomes, with the Incentivize code provisions they may be more feasible than single-family development. This suggests that these code options support the City's affordability goals and expand development potential for middle housing.