HR&A Analyze. Advise. Act.
700 South Flower Street, Suite 2995, Los Angeles, CA 90017
T: 310-581-0900 | F: 310-581-0910 | www.hraadvisors.com

MEMORANDUM

To:	Craig Weber & Priya Mehendale, Los Angeles Department of City Planning
From:	HR&A Advisors, Inc.
Date:	August 3, 2021
Re:	Summary of Key Considerations for RSO Replacement Requirements in the Hollywood Community Plan Implementation Overlay District (CPIO)

HR&A Advisors, Inc. (HR&A) has prepared the following memorandum on behalf of the Los Angeles Department of City Planning (LADCP) to address certain housing stabilization policies of interest to decision makers. In particular, this memorandum addresses considerations related to replacement of rent-stabilized units in housing developments receiving density and floor area bonuses through the Hollywood CPIO.

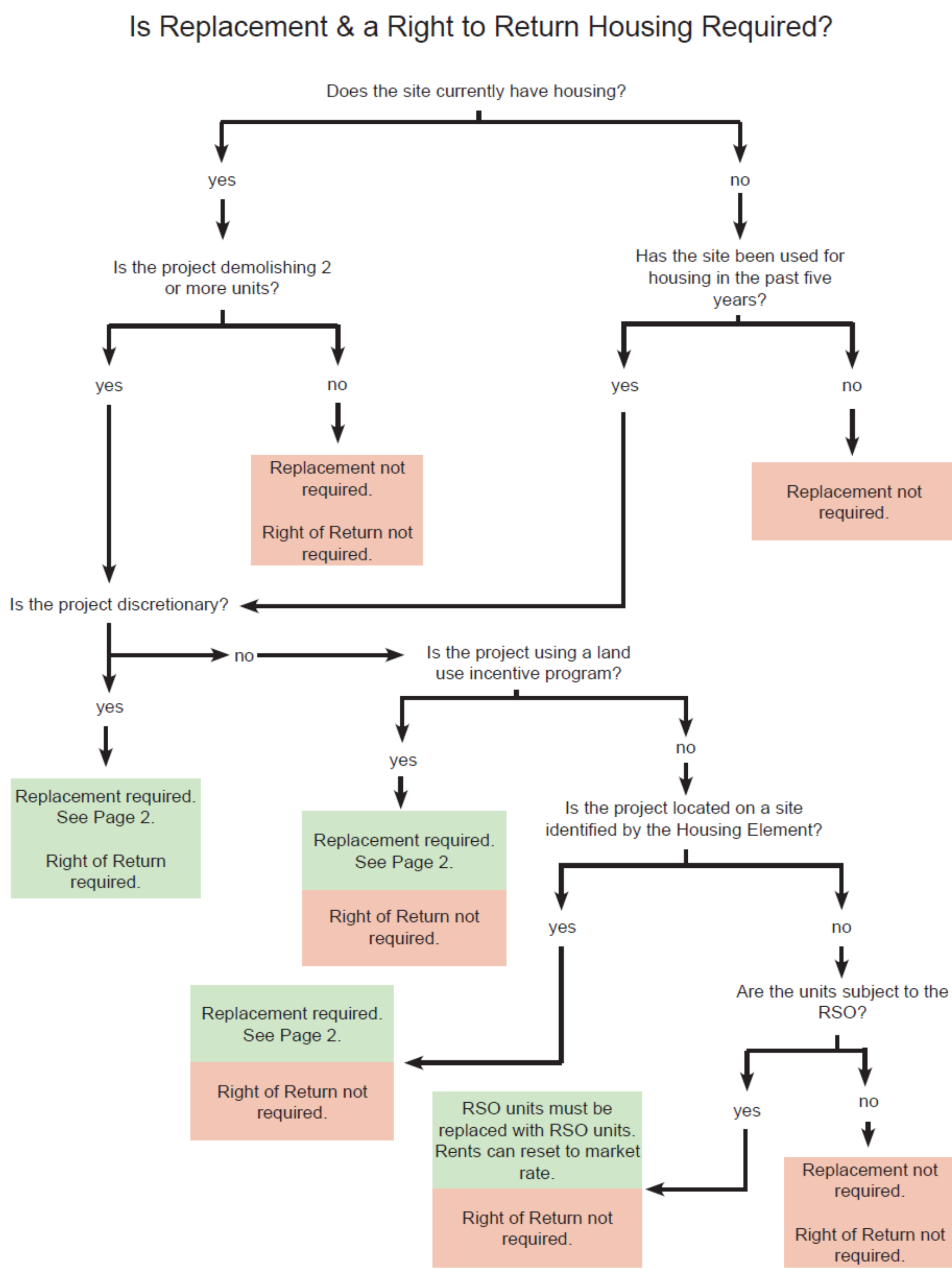
To evaluate these issues, HR&A first reviewed relevant professional literature and then facilitated two roundtable discussions via videoconference on June 23, 2021, and June 24, in which LADCP staff participated, and engaged in separate follow-up conversations with additional experts to understand the implications of these policies. The two dozen participants in these sessions represent the entire development process, and included local and regional affordable housing developers, market-rate/mixed-income developers, housing policy experts, City of Los Angeles (the "City") and other local government housing and planning officials, affordable housing funders/lenders, and land use lawyers.

The following is a summary of comments and observations derived from a combination of this research and HR&A's more than 40 years of experience developing, testing, and implementing related housing policies and programs, including previous analysis of the City's Rent Stabilization Ordinance (RSO) and related rent regulations in several other California jurisdictions.

Rent-Stabilized Unit Replacement Background

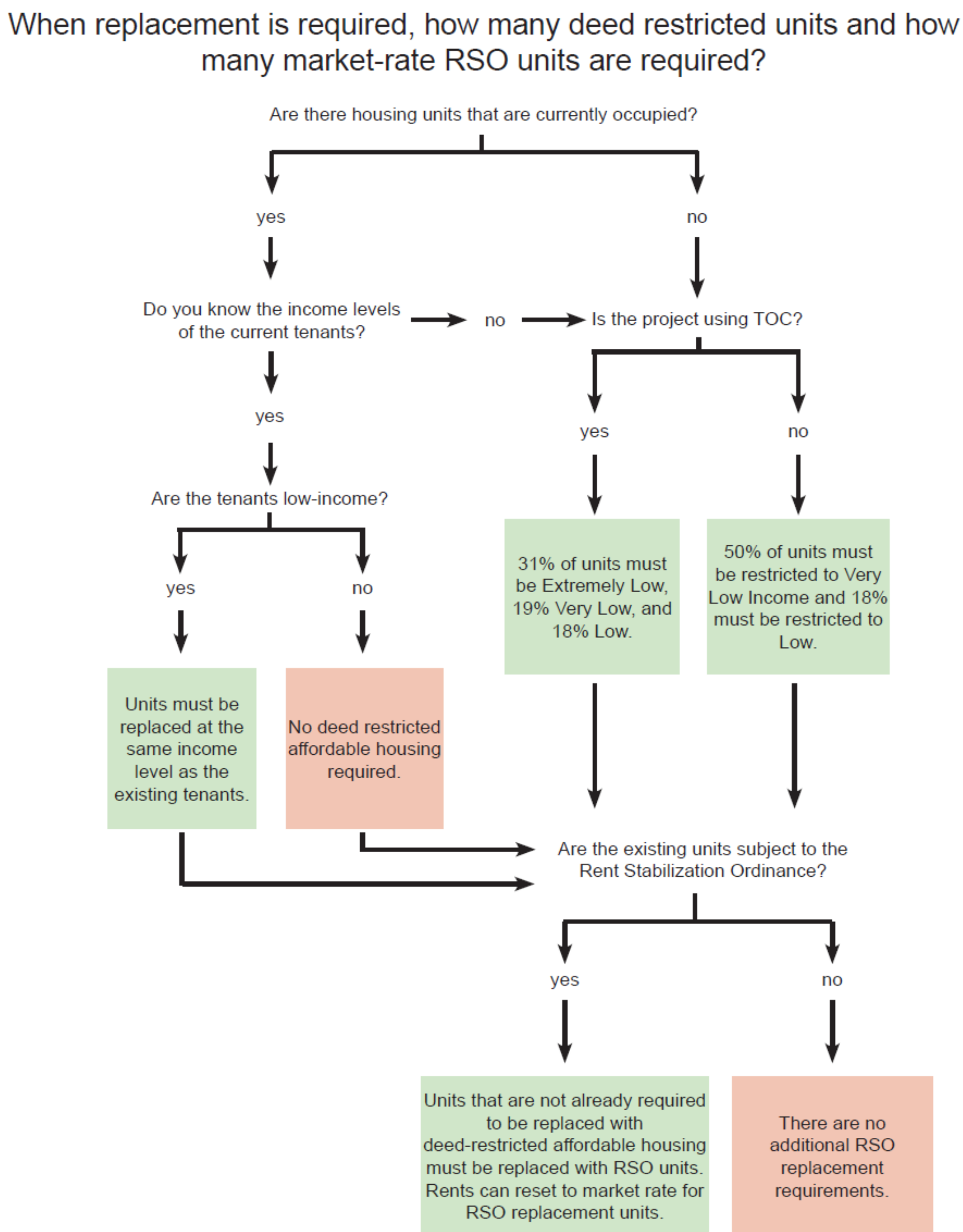
New housing development projects within the City that propose to demolish exiting rental units are currently required to replace the demolished units according to several different criteria depending on: (1) the number of units to be replaced; (2) whether the project requires discretionary approvals; (3) whether the project requests a land use incentive; and (4) whether the existing units were subject to the RSO. In some cases, the former tenants may have a right to return as renters in the new development. The affordability level applicable to the replacement unit obligation is based on the incomes of tenants living in units to be demolished. However, it can be challenging to document tenant incomes, particularly if a property has already been vacated. Currently, unless income levels are known for the existing tenants and demonstrated to be low-income (in which case replacement units must be provided at rents affordable at the same income levels), a new project must provide roughly 69 percent of the replacement units as deed-restricted with different income levels; the remainder of the replacement units can be market-rate but are subject to the RSO. These very complex procedures are shown in Figures 1 and 2 on the following pages, which were produced by the Los Angeles Housing + Community Investment Department (HCIDLA). Developers are permitted to count covenanted affordable RSO replacement units when requesting a density bonus or Transit Oriented Community (TOC) incentives.

Figure 1: HCIDLA Replacement/Return to Housing Determination Process



Source: HCIDLA

Figure 2: HCIDLA Replacement Deed Restriction Determination Process



Source: HCIDLA

In addition to and in conflict with these replacement requirements, the RSO also requires that if a new housing project is built within five years of a Notice of Intent to Withdraw (an Ellis Act milestone) the rent-stabilized building, 100 percent of the units in the new multifamily replacement rental building will be subject to the RSO, and of those, the replacement units must be deed-restricted as affordable. This requirement is detailed in Section 151.28 of the Los Angeles Municipal Code (LAMC) as follows:

> *"If a building containing a rental unit that was the subject of a Notice of Intent to Withdraw pursuant to the provisions of Subsection A. of Section 151.23 is demolished and rental units are constructed on the same property and offered for rent or lease within five years of the date the rental unit that was the subject of the Notice of Intent to Withdraw was withdrawn from rent or lease, the owner may establish the initial rental rate for the newly constructed rental units. The provisions of the Rent Stabilization Ordinance, Section 151.00, et seq., and other provisions of this chapter shall apply to the newly constructed rental units."*

A 2017 modification to the RSO further requires that if an owner has demolished a building and did not comply with certain Ellis Act provisions, 100 percent of units in the new building are subject to the RSO, whether or not the five-year period has expired. This requirement is also detailed in section 151.28 of the LAMC:

> *"Notwithstanding any provision to the contrary contained herein, if rental units subject to the Rent Stabilization Ordinance were demolished subsequent to September 29, 2006, the effective date of these provisions, without complying with the requirements of Sections 151.22 through 151.28, then all replacement rental units constructed on the same property shall be deemed subject to the Rent Stabilization Ordinance, Section 151.00, et seq., and other provisions of this chapter."*

The 2017 modification provides an option for developers to opt out of RSO requirements by providing an affordability covenant for the higher of: (1) 20 percent of the newly constructed units at or below 80 percent of Area Median Income or for (2) the number of replacement units required. This requirement is also detailed in Section 151.28 of the LAMC:

> *"An owner who replaces the number of demolished rental units with a number of affordable housing units at least equal to the number of withdrawn rental units subject to the Rent Stabilization Ordinance on a one-for-one basis or at least 20% of the total number of newly constructed rental units, whichever is greater, may apply to the Department for an exemption of the newly constructed rental units from the provisions of the Rent Stabilization Ordinance."*

The cumulative effect of these requirements is that while there is a clear incentive to carefully comply with the Ellis Act procedural requirements, there is also an unintended incentive to vacate or demolish the building with existing units and leave the site unoccupied for a period of five years so that only the replacement unit requirements apply.

Generally, units must be replaced on a one for one basis. However, developers report that there are inconsistent applications by City officials about this requirement. In some cases, replacement units are calculated on a per-bedroom basis (i.e., if the rent-stabilized building had four 1-bedroom units, a developer could replace them based on the total number of bedrooms, such as with two 2-bedroom units). However, in other cases, an exact like-for-like unit replacement is required (i.e., a four-bedroom unit rent-stabilized unit removed must be replaced with a new deed-restricted four-bedroom unit).

The following notes present a set of challenges described by housing experts with existing RSO replacement requirements.

Challenges with Existing RSO Requirements

As described above, the City's replacement requirements are extensive and complicated to understand. While acknowledging the underlying affordable housing preservation purpose of the RSO requirements, many interviewees described challenges with their implementation, that also present barriers to another important City policy objective of increasing the supply of new housing overall. Other experts weighted in on logistical challenges and opportunities that LADCP should consider in achieving better alignment with the RSO intent. The primary issues discussed included:

1. RSO Replacement Requirements: Developers noted that HCIDLA's interpretation of the RSO, requiring that the entirety of a new multifamily project to the RSO when required by the Ellis Act replacement requirements within the RSO, was not a viable option to attract additional housing to RSO sites. Similarly, considering that no projects citywide (absent public subsidy or unusual circumstances) have provided 20 percent affordable units even with the most generous TOC or other incentives, the option to opt out of RSO requirements by providing 20 percent covenanted units does not appear to be viable.
2. Consistency Across Housing Programs: Developers utilizing the State Density Bonus program are required to replace existing units which were previously occupied by very low- or lower-income households or subject to local rent control when those units have been demolished or vacated prior to the Density Bonus application. The housing development must also meet the applicable Density Bonus affordable housing standards, including the replacement units. As a result of uncertainty about how to apply these standards when the income levels of prior residents are unknown, the Density Bonus Law establishes a rebuttable presumption for the income level of the replacement unit when the income level of the actual prior resident is unknown. But because the Density Bonus law also requires adherence to local rent control laws, the above-mentioned issues with the Ellis Act Notice of Intent to Withdraw come into play. Because developers find the Density Bonus replacement standards more feasible in terms of development economics, this has caused an unusual scenario where some owners vacate or demolish buildings, often leaving buildings in disrepair and wait for the five-year Ellis Act period to lapse so that only the Density Bonus replacement standards apply.
3. Like-for-Like Replacement: Experts across the housing spectrum report that the lack of flexibility in how to interpret the type of replacement unit required presents challenges, particularly for development projects targeted toward specific market segments (i.e., large family or micro-housing). Developers suggested that a per-bedroom replacement requirement was most feasible, and that administrative flexibility to determine whether a project meets the objectives of RSO replacement obligations was ideal to allow for innovative housing projects.
4. Right of Return: Some cities require "right of return," wherein residents of demolished rent-stabilized units are given the first right to reside in a newly constructed and covenanted replacement affordable unit (whether 100% affordable or mixed-income). Affordable housing experts generally agreed that flexibility was similarly essential to provide residents the opportunity to relocate more quickly to other units within a developer's portfolio, to accommodate residents whose incomes have changed over time, and to allow for certain types of projects (particularly 100% affordable large family or similar) that require somewhat higher incomes or have larger units and necessitate higher rents.

Conclusion: Developers and land use lawyers expressed concern about the challenges of existing RSO replacement requirements (although acknowledged that they were feasible under certain circumstances) and indicated a general reluctance to pursue redevelopment of housing sites subject to the RSO. If the policy direction is to support housing production through the densification/redevelopment of rent-stabilized buildings, it is likely that some streamlining of requirements should be considered before further modification to replacement requirements.

Feasibility of Changes to Replacement Requirements

As we understand it, in addition to clarifying the applicable replacement requirements, there is interest in strengthening TOC/Density Bonus replacement requirements by: 1) increasing the deed-restricted affordable replacement requirement from 69 percent of units to 100 percent of existing units (currently, the remaining 31 percent of replacement units can be market rate, subject to the requirements outlined in SB330 and Density Bonus); or 2) eliminating developers' ability to count replacement units towards their satisfaction of set-aside units for the purposes of meeting the State Density Bonus or TOC requirements. As we understand it, State Bill 330 (the Housing Crisis Act of 2019), which amended various procedural provisions of the State Planning & Zoning Law, including the State Density Bonus law, may require the City to count replacement units towards TOC or other density bonus requirements:

> *"Any protected units replaced pursuant to this subparagraph* ***shall be considered*** *in determining whether the housing development project satisfies the requirements of Section 65915 or a locally adopted requirement that requires, as a condition of the development of residential rental units, that the project provide a certain percentage of residential rental units affordable to, and occupied by, households with incomes that do not exceed the limits for moderate-income, lower income, very low income, or extremely low income households, as specified in Sections 50079.5, 50093, 50105, and 50106 of the Health and Safety Code." Calif. Govt.* Code Title 7, Division 1, Chapter 12, Section 66300 *(emphasis added)*.

Nevertheless, we tested the impact of different replacement unit requirements on two medium-density housing prototypes to determine the financial feasibility of the policy alternatives listed above. Both of these prototypes were developed for our analysis of Hollywood Community Plan (HCP) set-aside unit requirements and FAR bonuses, as further described in a separate memorandum also dated August 2, 2021. HR&A did not test a higher-density housing prototype in the HCP Regional Center. This is because our separate analysis found that these prototypes could not support TOC Tier 3 set-aside unit requirements, and as such any changes to replacement requirements exceeding TOC set-asides would also not be financially feasible.

The prototypes we tested are both assumed to be podium (wood frame/concrete) and have an FAR of 3.0, which would be achieved through the provision of TOC Tier 3 with 10 percent Extremely Low-Income (ELI) set-aside units and associated FAR bonus. Both prototypes are roughly six stories and include 90 total units, with nine of those units ELI set-aside units irrespective of replacement requirements. These prototypes are differentiated as follows:

1. **Small Housing Site (East HCP).** The first prototype utilizes market data for recently completed projects within the HCP along the commercial corridors roughly east of North Van Ness Avenue. For this analysis, we assumed that the site of this prototype included 15 existing units to be replaced. Our assumption is that the units to be replaced are not subject to the RSO, which would trigger separate requirements for rent-stabilization of new units. We further assumed for the purpose of

this analysis that 7 units are 1-bedroom units, 5 are studio units and 3 are 2-bedroom units and would be replaced like-for-like.

2. **Small Housing Site (West HCP).** The second prototype uses market data for recently completed projects within the HCP along the commercial corridors roughly west of North La Brea Avenue, which includes some projects within the City of West Hollywood. We assumed that the site of this prototype also included 15 existing units to be replaced. Our assumption is that the units to be replaced are not subject to the RSO, which would trigger separate requirements for rent-stabilization of new units We further assumed for the purpose of this analysis that 7 units are 1-bedroom units, 5 are studio units and 3 are 2-bedroom units and would be replaced like-for-like.

For each prototype, we tested the following sensitivity analyses:

1. **TOC Tier 3, with 10% ELI, No Replacement.** This prototype includes 9 ELI Units.
2. **TOC Tier 3, with 10% ELI, 69% Deed-Restriction Replacement.** This prototype includes 9 ELI units, of which all are assumed to be counted towards replacement requirements. The prototype also includes one additional VLI and one additional LI unit to meet the balance of existing replacement requirements.
3. **TOC Tier 3, with 10% ELI, 100% Deed-Restriction Replacement.** This prototype includes 9 ELI units, of which 9 would also be counted towards replacement requirements. The prototype also includes an additional 3 VLI and 3 LI units for a total of 15 replacement units.
4. **TOC Tier 3, with 10% ELI, Separate 69% Deed-Restriction Replacement.** This prototype includes 15 ELI units, of which 9 would be required to meet TOC Guidelines and 6 to meet replacement requirements. The prototype also includes three additional VLI and three additional LI units, consistent with existing replacement requirements.

Financial Feasibility Conclusions

Our financial feasibility conclusions are shown below. It should be noted that this analysis is highly sensitive to the existing number of units. A lower number of units may be more financially feasible than shown, while it is unlikely that most new projects could support replacement of a higher number of units.

East Housing Site. As shown in the table at right, Scenarios 2 and 3 *would be marginally feasible*, while Scenario 4 is *not feasible*. Marginally feasible indicates that the Residual Land Value (or RLV, as calculated and further described in our separate HCP memorandum) is greater than the base RLV without density bonus but does not exceed a 10 percent threshold we utilize to account for fluctuations in land values, rents, and construction costs over time.

Prototype 1 (East Housing Site) Feasibility Results

Set-Aside	Base/Max FAR	Feasible?
1. No Replacement (9 ELI – TOC only)	1.5/3.0	Yes
2. 69% Replacement (9 ELI, 1 VLI, 1 LI)	1.5/3.0	Marginal
3. 100% Replacement (9 ELI, 3 VLI, 3 LI)	1.5/3.0	Marginal
4. Separate 69% Replacement (15 ELI, 3 VLI, 3 LI)	1.5/3.0	No

West Housing Site. As shown in the table at right, Scenarios 2 and 3 *would be feasible*, while Scenario 4 is *not feasible*. This indicates that 100% replacement might be feasible in stronger market areas.

Prototype 1 (West Housing Site) Feasibility Results		
Set-Aside	Base/Max FAR	Feasible?
1. No Replacement (9 ELI – TOC only)	1.5/3.0	Yes
2. 69% Replacement (9 ELI, 1 VLI, 1 LI)	1.5/3.0	Yes
3. 100% Replacement (9 ELI, 3 VLI, 3 LI)	1.5/3.0	Yes
4. Separate 69% Replacement (15 ELI, 3 VLI, 3 LI)	1.5/3.0	No

<u>Conclusion</u>: *Feasibility of replacement requirements is highly sensitive to the number of existing units needing to be replaced. 100 percent deed-restriction replacement requirements generally have minor financial feasibility implications as compared to the existing 69 percent replacement requirement; this may be financially feasible in stronger market areas for podium projects but are unlikely to be feasible for weaker market areas or for high-rise prototypes where the number of units to be replaced exceeds TOC set-aside requirements. Requirements to count replacement units in addition to those required for TOC set-aside units are not financially feasible and may not be permitted due to language in SB 330.*

Attachment A: Appendix Tables for Prototype Results

HR&A Advisors, Inc.
Site 1 (East): RSO Replacement Alternatives
Residual Land Value Analysis

	Site #4 - Boulevards Small Site (East)				
	Base Scenario (FAR 1.5:1)	10% ELI (No RSO Replacement)	10% ELI, 68% RSO Replacement	10% ELI, 100% RSO Replacment	10% ELI, Separate RSO Replacement
Development Program					
Acreage	0.6	0.6	0.6	0.6	0.6
Height	44 ft.	64 ft.	64 ft.	64 ft.	64 ft.
Non-Parking Stories	3 stories	5 stories	5 stories	5 stories	5 stories
Parking Podium	1 stories	1 stories	1 stories	1 stories	1 stories
Residential Units	45	90	90	90	90
Market Rate	45	82	81	79	73
Affordable	0	8	9	11	17
Average Unit Size	667 SF	667 SF	667 SF	667 SF	667 SF
Construction Type					
Residential - Rental	Podium	Podium	Podium	Podium	Podium
Retail	Podium	Podium	Podium	Podium	Podium
Average Floorplate	15000 ft.	15000 ft.	15000 ft.	15000 ft.	15000 ft.
FAR	1.50	3.00	3.00	3.00	3.00
GBA	37,500 SF	75,000 SF	75,000 SF	75,000 SF	75,000 SF
Development Cost and Value					
Total Development Costs per GBA	$395	$361	$361	$360	$360
Capitalized Value per GBA	$637	$534	$514	$511	$483
Community Benefits					
Affordable Housing Levels					
Apartment - Level 1	Extremely Low (30%)	Extremely Low (30%)	Extremely Low (30%)	Extremely Low (30%)	Extremely Low (30%)
Apartment - Level 2	Extremely Low (30%)	Extremely Low (30%)	Very Low (50%)	Very Low (50%)	Very Low (50%)
Apartment - Level 3	Extremely Low (30%)	Extremely Low (30%)	Low (60%)	Low (60%)	Low (60%)
Affordable Housing Percentages					
Apartment - Level 1	0%	10%	10%	10%	16%
Apartment - Level 2	0%	0%	1%	3%	3%
Apartment - Level 3	0%	0%	1%	3%	3%
Affordable Housing Linkage Fee	Yes	No	No	No	No
Financial Returns					
RLV over Base Scenario		**27%**	**4%**	**1%**	**(30%)**
Residual Land Value	$5,466,952	$6,959,018	$5,674,030	$5,499,978	$3,803,135
RLV Per Acre	**$9,525,618**	**$12,125,392**	**$9,886,430**	**$9,583,161**	**$6,626,582**
Residual Land Value per SF of land	**$219**	**$278**	**$227**	**$220**	**$152**
Return on Cost	7.51%	6.81%	6.55%	6.52%	6.19%
Findings					
FAR over Base Scenario		**100%**	**100%**	**100%**	**100%**
Affordable Housing					
Housing Type 1		Extremely Low (30%)	Extremely Low (30%)	Extremely Low (30%)	Extremely Low (30%)
Housing Level 1		10%	10%	10%	16%
Housing Type 2			Very Low (50%)	Very Low (50%)	Very Low (50%)
Housing Level 2			1%	3%	3%
Housing Type 3			Low (60%)	Low (60%)	Low (60%)
Housing Level 3			1%	3%	3%
Affordable Units per FAR Increase		6.7%	8.0%	10.7%	14.7%
Feasible?	**Yes**	**Yes**	**Marginal**	**Marginal**	**No**

HR&A Advisors, Inc.
Site 2 (West): RSO Replacement Alternatives
Residual Land Value Analysis

	Site #5 - Boulevards Small Site (West)				
	Base Scenario (FAR 1.5:1)	10% ELI (No RSO Replacement)	10% ELI, 68% RSO Replacement	10% ELI, 100% RSO Replacment	10% ELI, Separate RSO Replacement
Development Program					
Acreage	0.6	0.6	0.6	0.6	0.6
Height	44 ft.	64 ft.	64 ft.	64 ft.	64 ft.
Non-Parking Stories	3 stories	5 stories	5 stories	5 stories	5 stories
Parking Podium	1 stories	1 stories	1 stories	1 stories	1 stories
Residential Units	45	90	90	90	90
Market Rate	45	82	81	79	73
Affordable	0	8	9	11	17
Average Unit Size	667 SF	667 SF	667 SF	667 SF	667 SF
Construction Type					
Residential - Rental	Podium	Podium	Podium	Podium	Podium
Retail	Podium	Podium	Podium	Podium	Podium
Average Floorplate	15000 ft.	15000 ft.	15000 ft.	15000 ft.	15000 ft.
FAR	1.50	3.00	3.00	3.00	3.00
GBA	37,500 SF	75,000 SF	75,000 SF	75,000 SF	75,000 SF
Development Cost and Value					
Total Development Costs per GBA	$395	$361	$361	$360	$360
Capitalized Value per GBA	$720	$606	$581	$576	$545
Community Benefits					
Affordable Housing Levels					
Apartment - Level 1	Extremely Low (30%)	Extremely Low (30%)	Extremely Low (30%)	Extremely Low (30%)	Extremely Low (30%)
Apartment - Level 2	Extremely Low (30%)	Extremely Low (30%)	Very Low (50%)	Very Low (50%)	Very Low (50%)
Apartment - Level 3	Extremely Low (30%)	Extremely Low (30%)	Low (60%)	Low (60%)	Low (60%)
Affordable Housing Percentages					
Apartment - Level 1	0%	10%	10%	10%	16%
Apartment - Level 2	0%	0%	1%	3%	3%
Apartment - Level 3	0%	0%	1%	3%	3%
Affordable Housing Linkage Fee	Yes	No	No	No	No
Financial Returns					
RLV over Base Scenario		**42%**	**22%**	**19%**	**(5%)**
Residual Land Value	$8,113,359	$11,530,928	$9,937,656	$9,660,449	$7,689,206
RLV Per Acre	**$14,136,716**	**$20,091,490**	**$17,315,371**	**$16,832,366**	**$13,397,673**
Residual Land Value per SF of land	**$325**	**$461**	**$398**	**$386**	**$308**
Return on Cost	8.46%	7.70%	7.39%	7.34%	6.95%
Findings					
FAR over Base Scenario		**100%**	**100%**	**100%**	**100%**
Affordable Housing					
Housing Type 1		Extremely Low (30%)	Extremely Low (30%)	Extremely Low (30%)	Extremely Low (30%)
Housing Level 1		10%	10%	10%	16%
Housing Type 2			Very Low (50%)	Very Low (50%)	Very Low (50%)
Housing Level 2			1%	3%	3%
Housing Type 3			Low (60%)	Low (60%)	Low (60%)
Housing Level 3			1%	3%	3%
Affordable Units per FAR Increase		6.7%	8.0%	10.7%	14.7%
Feasible?	**Yes**	**Yes**	**Yes**	**Yes**	**No**