

SANTA CRUZ COUNTY

ACCESSORY DWELLING UNIT FINANCING GUIDE

AUGUST 2017



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1 INTRODUCTION

1.1 Purpose of This Guide

The County of Santa Cruz is encouraging the creation of more Accessory Dwelling Units, or ADUs. As you may know, an ADU, also known as an “accessory unit,” “second unit,” “in-law unit,” or “granny flat,” is an additional smaller unit on the same property as an existing single family home. ADUs add housing to our community without the need to subdivide land to create new parcels. ADUs can be fit into existing neighborhoods, and ADU rents tend to be relatively affordable when compared to other rental units. Homeowners create accessory units by converting space within their existing homes; building home additions; converting existing accessory structures such as garages, sheds or workshops; building above garages or building new, detached structures. There are many options for you to consider.

The process of creating an ADU on your property may seem complicated, but it can be successfully completed by homeowners prepared with information and an understanding of the permit process. The purpose of this Guide is to inform and assist you by identifying questions any homeowner should ask as they undertake this process. This Guide focuses on the financial aspects of building and renting an ADU, and is meant to be used alongside other resources that assist with site design, building design, and permitting that are published by the County. Links to other sources of information are provided as well.

1.2 How to Use This Guide

This Guide is one of several sources of information developed by the County of Santa Cruz to help you design and build your ADU. Other resources provided by the County include the Santa Cruz County ADU *Design Book*, which illustrates different types, sizes, and configurations of ADUs on various property sizes, and the County's online financing tool, which can be used to explore the costs and pay back periods for building a unit on your property.

This Guide covers the following topics:

- Types of ADUs
- Typical Cost to Build an ADU
- Factor in the Fees: County and Special District Impact and Permit Fees
- Prototype ADUs and a Remodel Alternative
- Bringing It All Together: Looking at Total Estimated Cost
- How Property Owners Finance ADUs
- How Long Will it Take to Pay Off My ADU?
- Ongoing Costs of ADU Ownership
- ADUs as Rental Property

Additional information is found in two appendices:

- Case Stories of Owners Who Built ADUs
- Online Resources

2 MAKING A CHOICE: THE DIFFERENT TYPES OF ADUS

There are different kinds of ADUs. Deciding which approach is best for you will depend on many factors including the size of your lot, the size and layout of your existing home, the size and type of the unit you intend to build, where your property is located, and, of course, how much you can afford to spend.

- **Lot size** is important because not all lots will be large enough to build an additional detached structure, and the size of the ADU that is allowed by zoning depends in part on the size of your lot. More information on maximum allowable ADU sizes (which vary by type, lot size, and location within the County) is provided at the end of this section.
- The **size and layout of your existing home** is a factor, because converting existing space in a home to a separate unit is often the most cost effective ADU option. In addition, the existing home may determine the size of your ADU, whether attached or detached. This is not only because it determines what space is available for new building, but because FAR (Floor Area Ratio) and Lot Coverage — two measurements that describe the form of a building and how much space it takes up on the ground — are limited on each parcel. If you have a large home that takes up almost all the FAR and lot coverage that is allowed on your parcel, your ADU will have to be smaller to accommodate that. (The concepts of FAR and lot coverage are described and illustrated in the Santa Cruz County ADU *Design Book*).

The type and cost of your ADU will depend of where you live, the size of your property, and the configuration of your existing home.

- Your costs will be affected by **where you live** in the County because some fees, such as costs for water service and support of schools, vary by area. Some fees are charged based on the size of the unit or number of bedrooms. Knowing more about these fees may be helpful in making design choices that minimize fees. The different types of fees are explained later in this document. Lastly, rural properties may incur some costs related to septic systems and other aspects of rural living that urban properties will not face.

The companion *ADU Design Book* and the County Zoning Ordinance provide more information on the type of unit that makes most sense for your circumstances.

Brief descriptions of the types of ADUs that are most common in Santa Cruz County follow. Properties are unique, however, and other configurations may be possible. Detailed examples of the costs and opportunities of each type are given later in this Guide. The Santa Cruz County *ADU Design Book* also provides information on ADU types, size and design regulations.

CONVERTED SPACE WITHIN AN EXISTING HOUSE OR ACCESSORY STRUCTURE

Key Considerations:

- Likely the most affordable type of ADU.
- Suitable for lots that are too small to build an addition or a new structure.
- Can be created by modifying an extra bedroom or other unused room in a home to add a kitchen and exterior entrance.
- Can also be created within an existing accessory structure, such as a garage or workshop.
- Conversion ADUs are not charged sanitation connection fees or water connection unless located in the Soquel Creek Water District.
- May require providing parking elsewhere on the property when converting a garage.
- ADU floor area may not exceed 50 percent of living area of existing home (or 640 square feet), if located on a lot inside the Urban Service Line and if the lot is less 5,000 square feet. Larger ADUs may be built depending on location (within or outside the Urban Services Line) and lot size.
- Appropriate for a budget between \$30,000 (for the remodel alternative) and around \$150,000 for a conversion of an accessory structure. The wide range in cost reflects the variety of spaces that could be converted, from a master suite that would require minimal construction to a space that requires substantial remodeling. More information of how these costs are estimated is provided later in this Guide.



Conversions include (from top to bottom): basement apartments; attic apartments, the conversion of an attached garage; and the conversion of an existing detached accessory structure.

NEW SPACE BUILT ABOVE EXISTING GARAGE

Key Considerations:

- Garage setbacks from property lines need to be sufficient for fire safety.
- Maximum allowed height is 24 feet; maximum average height is 21 feet.
- Windows and entrance should be placed to maximize privacy for ADU occupant, primary home occupant, and neighbors.
- Recent examples have been built within a budget of about \$180,000.
- Building above an existing building minimizes impervious surface and uses the site efficiently.



This unit is built above an existing detached garage.

ADDITION TO EXISTING HOUSE

Key Considerations:

- Suitable for smaller lots that preclude a detached structure.
- Can be designed as a second story addition.
- Can be designed to ensure privacy for ADU occupant, primary home occupant, and neighbors.
- Can be designed to match existing home, including height.
- Not necessarily less expensive than detached construction, depending on design.



Additions may be on the second story (top) or the first (bottom).

NEW DETACHED BUILDING

Key Considerations:

- Starting “from scratch” provides the opportunity to design the building that suits your circumstances. There are online resources for design, including attractive ready-to-build plans. See Appendix B for more information.
- Maximum size in the Urban Services Line is 640 square feet or 10 percent of the lot area if the lot is under 5,000 square feet. In the rural area, detached units can be up to 1,200 square feet, depending on lot size.
- Cost will vary depending on size, location, and construction choices. The estimated cost for a new, 800 square foot structure with two bedrooms is approximately \$340,000 to \$380,000, depending on location within the County.



The permitted size and height of a new detached structure varies based on zone district.

SUMMARY OF ALLOWABLE ADU SIZES

The maximum allowable ADU size depends on the size of your lot, your location, and whether you are building a new structure or converting an existing one. Refer to the *ADU Design Book* and the County Zoning Ordinance for more details.

Table 2-1: ALLOWABLE ADU GROSS FLOOR AREA¹				
	Inside USL		Outside USL	
Property Size	New Construction	Conversion	New Construction	Conversion
Less than 5,000 sq. ft.	10% of parcel	50% of primary dwelling or 640 sq. ft, whichever is less	800 sq. ft.	50% of primary dwelling or 640 sq. ft, whichever is less
5,000 to 9,999 sq. ft.	640 sq. ft.	640 sq. ft.	800 sq. ft.	800 sq. ft.
10,000 sq. ft. to one acre	800 sq. ft.	800 sq. ft.	1,000 sq. ft.	1,000 sq. ft.
Greater than one acre	800 sq. ft.	800 sq. ft.	1,000 sq. ft.	1,200 sq. ft.

1. All new construction and conversions are permitted an additional 150 square feet or 30% of the converted space, whichever is less, for a maximum overall lot coverage of 42% or an overall FAR of 0.52 : 1.

3 COSTS PART 1: BUILDING AN ADU

3.1 Costs Overview

ADUs vary widely in terms of cost, complexity, and special requirements, but no matter the project, the costs fall into three general categories:

“Hard” Construction Costs include labor and materials to build the project. The contractor’s Overhead and Management (O&M) costs are usually included as a hard cost. Hard costs will vary depending on the type of construction, whether there is foundation work or site improvements necessary, and also on the type of finishes that are used, such as flooring materials, countertops, and fixtures. Generally, hard costs are the portion of the total cost that you will have the most ability to control with decisions about design and materials.

Improvements to meet fire safety requirements set by the local Fire District, such as improving the access to the site, or increased storage of water for firefighting are sometimes experienced as “hidden” hard costs. These costs are usually limited to rural areas where there are no hydrants, and vary by Fire District. Access improvements and other fire requirements are too individual to be reported in this Guide, and rural property owners are advised to consult with their Fire District early to learn about requirements for their parcel. In many cases requirements are minimal and do not overly cost burden the ADU. Note that fire sprinklers are no longer required in an ADU when the main house does not have sprinklers.

It is essential for owners with septic systems to consult early with County Environmental Health Services (EHS) about whether your current system is adequate to accommodate the increased flows from an ADU. Systems that date from the mid-1980s are likely to be constructed of materials that do not meet current standards, and systems may trigger a substantial

upgrade requirement. Note that regulations have been changed so that the one acre parcel minimum size for properties with septic systems no longer prevents construction of an ADU solely because of parcel size.

If repair or upgrade is required, depending on the location and existing capacity of the septic system, you may incur the following costs, which are based on common situations:

- Lower Cost Scenario: Minor repair needed. Minor repair application and an EHS clearance.
 - » Estimated cost: Permit fees are \$3,000, and the review fee adds an additional \$610, assuming it is a conventional minor repair. Repairs themselves typically run between \$2,000 - \$5,000.
- Medium Cost Scenario: Additional leach line needed to increase capacity. Requires an upgrade sewage disposal application and construction.
 - » Estimated cost: \$3,000 for application and up to \$10,000 for construction
- Higher Cost Scenario: Contract with a consultant to design and install an alternative septic system, which requires an alternative sewage disposal permit.
 - » Estimated cost: \$4,000 for permit and up to \$35,000-\$40,000 for consultant, equipment, and labor.

The actual cost to repair or upgrade septic systems will, of course, vary. These figures are provided for purposes of illustration only.

“Soft” Costs include design and studies or tests that may be required.

- All ADUs must meet the California Building Code. There is no requirement that a professional building designer or architect be involved in the project, however, many property owners do add budget for professional assistance. Consulting with a professional before you decide to proceed, though it adds cost, will assist with site planning and your overall understanding of the opportunities and constraints on your lot and of County regulations.
- You may have to hire a civil engineer if your project requires a new or upgraded foundation and soil report. Note that soil report waivers are available for projects that meet criteria that indicate a soil report is not necessary. Since many ADUs qualify for a waiver, you should consult with the Planning Department.
- In some situations, other tests and studies are required to meet health and safety and environmental codes. These range from testing your water pressure to geologic reports. Consider having a Pre-Development Site Review completed by the Planning Department to receive any requirements in advance, based on a site visit from the planners who review applications. Cost of this service is based on the number of hours of staff time.

County and Special District Fees can be a significant component of the cost of building an ADU, and they are dependent on both the design of the ADU (some

are based on size and number of bedrooms) and the location of the property. There are three types of fees:

- Fees that cover the cost of providing services to review your project and ensure that it is safe and doesn't harm the environment. Examples of this are fees for building plan review and construction inspection.
- Impact and Capital Improvement fees address the additional demand for services and impacts on infrastructure that result from new development. Examples of impact fees are school fees and affordable housing fees. Impact fees charged by the school and water district are typically the largest fees and are quite variable depending on the location of your parcel. These fees are used for facilities (such as new schools) and affordable housing.

Cost planning requires receiving an estimate of fees early in the process. The Planning Department will estimate fees based on building plans. When plans change, fees also change and therefore you may have to obtain a revised estimate when plans are modified. Fees are discussed in more detail in Section Four of this Guide.

3.2 Introducing Three Prototype ADUs and a “Remodel Alternative”

Three popular types of ADUs have been identified as example projects, in order to illustrate points about fees and other costs. The examples are introduced here and referred to throughout Guide. In addition, there is a fourth type of construction, called the “remodel alternative” in this report, which is the modification of existing space in a home, usually a bedroom or a master bedroom suite, to create an enhanced “rentable” space. The space has a mini kitchen, may have a separate bathroom and separate entrance, but is connected by a door to the main part of the house and is not a separate unit.

We have included this remodel alternative because it will serve many of the same needs as a full ADU without some of the costs. These remodel projects are sometimes called “Junior ADUs”, a term that was used in the State’s ADU legislation. This Guide avoids that term because it has a specific legal meaning that doesn’t always apply to the County’s ADU program. The idea of the remodel alternative is that it is “not quite a unit,” is less costly, and easier to build and permit. A Junior ADU and a remodel alternative are conceptually very similar, regardless of the terminology.

The four examples were located in different parts of the County to illustrate differences in fees and costs among Special Districts and between rural and urban locations. Again, individual properties have unique circumstances and your project is unlikely to perfectly match any one of the examples. There may be helpful information in each of the samples that will transfer to your situation.

Actual costs that have been incurred by homeowners who have developed ADUs are included in the “case stories” found in Appendix A.

ADU Prototype 1: Detached Unit

- Type: New, stand-alone structure
- Size: At least 800 square feet with two bedrooms
- Location of the example: Soquel area, Soquel Creek Water District
- School District: Pajaro Valley
- Fire District: Aptos/La Selva Beach
- Water District: Soquel Creek Water District
- Sewer District: Santa Cruz County Sanitation District

ADU Prototype 2: Garage Conversion

- Type: Garage conversion
- Size: 400 square feet, one bedroom
- Location of the example: Live Oak
- School District: Live Oak
- Fire District: Central Fire
- Water District: Santa Cruz City
- Sewer District: Santa Cruz County Sanitation District

ADU Prototype 3: New Unit above an Existing Garage

- Type: New construction above existing garage
- Size: 640 square feet, one bedroom
- Location of the example: Pajaro Valley, in Pajaro Unified School District
- School District: Pajaro Valley
- Fire District: Cal Fire/Pajaro Valley
- Water District: Watsonville City
- Sewer District: Freedom Sanitation District

Prototype 4: Remodel Alternative

- Type: Converted space inside the main home, with mini rather than full kitchen
- Size: 500 square feet, studio
- Location of the example: San Lorenzo Valley
- School District: San Lorenzo Valley
- Fire District: Boulder Creek
- Water District: San Lorenzo Valley Water District
- Sewer District: None

4 FACTORING IN THE FEES: COUNTY & SPECIAL DISTRICT FEES

Fees can be a significant part of the cost of your ADU, and well worth understanding in advance. The amount of the permitting, planning, and other fees varies with the characteristics of the project and strongly varies with the location of the property. As described in the previous section, fees are either fees for service, capital fees, or impact fees to mitigate the increased need for a particular service. Impact fees are set by the service provider, such as a water district or sanitation district, based on impact studies and in a public forum. Impact fees are typically the higher fees and vary the most by location. To the extent fees are based on size of the unit, number of bedrooms, or valuation, your design can influence the amount of fees.

Find out early which special districts your property is located in, so that you can factor in fees and costs.

4.1 County Fees

Planning and building permit fees are based on different aspects of your project. Fees may be based on the “valuation” of the project, size of the unit, or the number of bedrooms. In some cases, fees are fixed (“flat” rate per unit) regardless of other unit characteristics.

Find location-based information about your property, including special districts here:

[http://gis.co.santa-cruz.ca.us/
PublicGISWeb](http://gis.co.santa-cruz.ca.us/PublicGISWeb)

“Valuation” is an assumed value of the construction that is determined by the County, based on standard published values for particular types of construction. The values are reviewed annually. The valuation for determining permit fees is calculated by multiplying the size of the unit by the standard value that best fits the type of construction.

BASIS OF FEES

The Board of Supervisors sets the fees in order to ensure that the County is able to deliver the services the Planning Department is required to provide. The Planning Department collects and disperses fees for many agencies and Special Districts.

Fees insure that the County and Special Districts are able to provide necessary services.

1. Planning and Building Fees

- Plan Check Fee is based on valuation of project. This fee offsets staff time needed to ensure plans, engineering, and technical specifications meet building code requirements.
- Zoning Fee is \$742 per unit. This fee offsets the cost of staff time to ensure plans comply with the zoning code.
- Address Fee is \$33 per quarter hour of review time. Every unit in the County needs an address for fire safety and mail delivery. The Planning Department assigns and tracks addresses. The work to assign and track addresses typically takes one hour. Therefore, the typical property owner will pay \$145 for the address review.
- General Plan and Technology Fees is 10 percent of permit fees. The County is required by the State to develop and maintain a General Plan, sometimes referred to as the “land use constitution,” which requires ongoing effort. The Technology Fee provides aggregate resources to offset the cost of keeping up with rapidly changing technology needs.

2. Environmental Fees

The County is responsible for ensuring that any development is assessed for its impact on safety and the physical environment. These reviews protect county natural resources including streams, wetlands, and biodiversity. New development—even of a small structure like an ADU—has the potential to impact these resources by creating more stormwater runoff, soil erosion, and loss of habitat. These fees are not charged for a remodel alternative, because it is conversion of part of a structure that already exists rather than creation of new development.

- Review of a Soils Report by a County Engineer is \$1,573 per unit.
- Environmental Plan Check Fee is \$576 per unit, for a structure greater than or equal to 640 square feet, and \$398 for units less than 640 square feet.
- Building Inspection Fee (for environmental impacts) is \$350 per unit. This inspection is needed for the purpose of ensuring compliance with plans and safe building practices.

3. Fees associated with Public Works: Drainage, Sanitation, Water, Roadway, Roadside, and Transportation Improvements

The Department of Public Works is responsible for County infrastructure such as roads, sidewalks, drainage facilities, and sanitation facilities, as well as provision of services, such as sanitation and water in certain locations. Your cost will be a mix of fees for plan review, connection fees, and per fixture fees charged to supply services.

- Road Engineering Review is \$433 per unit. This fee is charged for any new residential unit and for any new bedroom additions. It offsets staff time needed to ensure that there is adequate roadway right of way for travel and utilities along your property.
- Drainage Assessment is \$970 per unit. This fee pays for a Drainage Engineer to assess the impact of your project on the surrounding areas. For example, the development of an ADU may increase the amount of impervious area. Paying attention to drainage before the structure is built can avoid later flooding issues, both on site and in the surrounding areas.
- Sanitation Connection fee: The Department of Public Works oversees several sanitation districts and county service areas (CSAs) within the county, including the Davenport, Freedom, Boulder Creek, Rolling Woods and Santa Cruz County districts. Connection fees range from \$1,135 to \$4,000 per unit, depending on the District. This fee is not charged for conversion ADUs in the Santa Cruz County Sanitation District, which includes the majority of the urban area with the greatest potential for ADUs. Sanitation fees only apply to areas with sewer systems.
- In addition, roadside and transportation improvement fees of \$3,000 per unit for each improvement are charged in four planning areas in the County: Aptos, Live Oak, Pajaro Valley, and Soquel. These fees are intended to address transportation and road impacts from new developments. There are a few areas in each of these planning areas in which these fees do not apply. You should check with the Department of Public Works to understand if your property's location would trigger the payment of these fees.

4. County Impact Fees

- Parkland Fees are \$1,000 per bedroom.
- Child Care Fees are \$109 per bedroom, and contribute to a child care facility fund administered by the Human Services Department.
- Affordable Housing Impact Fee is \$2.00 per square foot for rental units, unless they are deed restricted as affordable housing. These fees contribute to the Affordable Housing Fund that is used to create affordable housing.

Table 4-1 provides an estimate for County Fees for the four construction prototypes included in this Guide (fees are current as of June 2017).

Since fees are subject to change, the amounts included in this table are only illustrations of the potential fee structure for a particular ADU.

For additional information on Planning and Building fees and a spreadsheet that can help you estimate your own fees visit

www.sccoplanning.com/PlanningHome/BuildingSafety/FeesBuildingPermitFeeEstimateWorksheet.aspx

Find Service and Capital Improvement Fees information online:

www.dpw.co.santa-cruz.ca.us/Portals/19/pdfs/feebook.pdf

Table 4-1: ESTIMATED COUNTY FEES FOR PROTOTYPES					
Fee Title	Basis for Fee	PROTOTYPE 1	PROTOTYPE 2	PROTOTYPE 3	PROTOTYPE 4
		<i>New Detached Structure (800 sq. ft., with Two Bedrooms) Soquel Area</i>	<i>Accessory Structure Conversion (400 sq. ft., One Bedroom)</i>	<i>New Unit Above a Garage (640 sq. ft., One Bedroom) Pajaro Valley</i>	<i>Remodel Alternative, Conversion (500 sq. ft.)¹ San Lorenzo Valley</i>
		DFee Amount			
Processing	Valuation	\$1,815	\$965	\$1,587	\$574
Building Plan Check	Valuation	\$1,615	\$965	\$1,412	\$511
Permit Fee	Valuation	\$1,630	\$900	\$1,425	\$515
Soil Report	Flat Fee	\$1,573	\$1,573	\$1,573	\$0
Environmental Plan Check	Flat Fee	\$576	\$398	\$576	\$0
Environmental Inspections	Flat Fee	\$350	\$350	\$350	\$0
Address review	Based on Time at \$33 per quarter hour ²	\$145	\$145	\$145	\$145
Zoning review	Flat Fee	\$742	\$742	\$742	\$307
Road Review	Flat Fee	\$433	\$433	\$433	\$0
Drainage Review	Flat Fee	\$970	\$0	\$970	\$0
Roadside Improvements	Flat Fee	\$3,000	\$3,000	\$3,000	\$0
Transportation Improvements	Flat Fee	\$3,000	\$3,000	\$3,000	\$0
Park Dedication Fees	Flat Fee/ per bedroom	\$2,000	\$1,000	\$1,000	\$0
Childcare Fees	Flat Fee/ per bedroom	\$218	\$109	\$109	\$0
Affordable Housing Impact Fee	\$2.00 per sq. ft.	\$1,600	\$0	\$1,280	\$0
General Plan & Technology ³	10% of Permit Fees ³	\$687	\$446	\$624	\$205
Total		\$20,353	\$14,026	\$18,226	\$2,257

Notes:

1. If a bedroom is added then Roadside Improvements, Transportation Improvements, Park Dedication, and Childcare fees also apply.

2. Address review typically takes a full hour.

3. Permit fees used to calculate the General Plan and Technology Fee include Processing, Building Plan Check, Permit Fee, Environmental Plan Check, Environmental Inspections, Address Review, and Zoning Review.

Source: Santa Cruz County, 2017

4.2 Special District Fees

In addition to County Fees, property owners in Santa Cruz County pay fees to outside agencies when the property is located within a special district that has been formed to provide a specific service. These special districts include the local school district, fire protection district, water district, drainage/flood control district, and sanitation district. Every property is in a school district, but some properties that have private wells and/or individual septic sewer systems will not be in a water or sanitation district. See the ADU Issues and Options Study (2017) for additional information on special districts. You can find out what special districts apply to your property by consulting County maps that are available online. Please see the section in Appendix B, Locations of Special Districts, for details.

4.3 Water District Fees

In many cases, water district fees are a determining factor in whether an ADU is economically feasible. Water district fees in particular vary widely depending on which water district serves your property. Water service fees are complex, sometimes including costs to install a required meter, meter drop charges, installation charges, and costs to participate in conservation/mitigation programs. Table 4-2 provides estimates of the fees for typical size ADUs in each water district.

Table 4-2: WATER DISTRICTS' CONNECTION FEES AND OTHER CHARGES

Water District	Estimated Connection Fee by Size of ADU			
	400 sq. ft.	640 sq. ft.	800 sq. ft.	1,200 sq. ft.
Central Water District ¹	N/A	N/A	N/A	N/A
Davenport County Sanitation District – Water only – Sewer Service has its own Connection Fee ²	\$3,000	\$3,000	\$3,000	\$3,000
Pajaro Valley Water Management Agency ³	N/A	N/A	N/A	N/A
San Lorenzo Water District ⁴	\$5,056	\$5,056	\$5,056	\$5,056
Santa Cruz City ²	\$7,434	\$7,434	\$7,434	\$7,434
Scotts Valley Water District	\$20,485	\$20,485	\$20,485	\$20,485
Soquel Creek Water District ⁵	\$33,253	\$43,018	\$46,098	\$46,098
Watsonville City ²	\$2,326	\$2,326	\$2,326	\$2,326

Notes:

1. No connection fee required for an ADU. If fire service is needed, ADU has to pay construction cost for adding "detector meter", but there are no additional connection charges.

2. Connection fees waived for ADUs that are contained entirely within the existing house or if ADU is a conversion of an accessory structure.

3. Each connection, including an ADU, pays an annual fee of \$92 for well use but there is no initial connection fee.

4. Includes charges of \$4,966 for a 5/8" meter connection and \$90 for a 5/8" meter drop. Fee does not include required \$2,500 installation deposit. A new meter is not required in every case. If an additional meter is required, additional installation costs of \$12,000-\$15,000 would apply.

5. Includes fees for Water Demand Offset, water capacity, application, meter drop charge, and construction inspection deposit. Fee shown reflects \$13,500 in service installation costs to add a separate meter for which a customer must hire a contractor. These installation costs were estimated by Soquel Creek at \$12,000-\$15,000.

4.4 Other Special District Fees

There are additional Special District fees that affect costs of constructing ADUs. These include School District fees, Fire Protection District fees, and connection fees for Sanitation Districts as shown in Tables 4-3, 4-4, and 4-5. Information on these additional fees is provided below. School impact fees and wastewater connection fees are higher than Fire District fees. School District fees are not charged on ADUs that are smaller than 500 square feet. Sanitation Connection fees are a flat fee charged per unit, regardless of size or number of bedrooms. For more discussion of Special District fees, see the ADU Issues and Options Study, Chapter 6.

Portions of the county are also within the County Flood Control and Water Conservation District. When a property is within Zone 5, 6, or 8 of the Flood Control District there are charges associated with drainage management, including \$1.23 per square foot of new impervious area. This is likely to come into play only for new structures and additions, but not for ADUs created by conversions or internal remodeling.

Table 4-3: SCHOOL DISTRICTS – RESIDENTIAL IMPACT FEE COMPARISON

School District	Fee/ Sq. Ft.	ADU Fee (Unit)			
		<500 Sq.Ft.	640 Sq.Ft.	800 Sq.Ft.	1,200 Sq.Ft.
Unified School Districts					
Aromas-San Juan	N/A	\$0			
Pajaro Valley	\$5.02	\$0	\$3,213	\$4,016	\$6,024
San Lorenzo Valley	\$2.63	\$0	\$1,683	\$2,104	\$3,156
Scotts Valley	\$2.43	\$0	\$1,555	\$1,944	\$2,916
Elementary School Districts					
Bonny Doon Union	N/A	\$0			
Happy Valley	N/A	\$0			
Lakeside Joint Union	N/A	\$0			
Live Oak	N/A	\$0	N/A	N/A	N/A
Loma Prieta Joint Union	\$3.20	\$0	\$2,048	\$2,560	\$3,840
Mountain	\$0.94	\$0	\$602	\$752	\$1,128
Pacific ¹	\$1.74	\$0	\$1,114	\$1,392	\$2,088
Santa Cruz City	N/A	\$0			
Soquel Union	N/A	\$0			
High School Districts					
Los Gatos - Saratoga Union	\$3.36	\$0	\$2,150	\$2,688	\$4,032
Santa Cruz City ¹	\$1.74	\$0	\$1,114	\$1,392	\$2,088

Source: Communications with individual school districts, March-May 2017.

Table 4-4: FIRE PROTECTION DISTRICTS – FEE COMPARISON

Fire Protection District	Plan Check (Fee/Sq.Ft.)	Sprinkler	Extinguisher	Total ADU Fees/Unit				
				400 Sq.Ft.	640 Sq.Ft.	800 Sq.Ft.	1,200 Sq.Ft.	
Aptos/La Selva Beach	\$0.30	\$270	N/A	\$337	\$727	\$799	\$847	\$967
Aromas Tri-County	\$0.53	N/A	N/A	N/A	\$212	\$339	\$424	\$636
Ben Lomond	\$0.40	N/A	N/A	N/A	\$160	\$256	\$320	\$480
Boulder Creek	\$1.00	N/A	N/A	N/A	\$400	\$640	\$800	\$1,200
Branciforte	\$0.40	\$330	N/A	N/A	\$490	\$586	\$650	\$810
Cal Fire	\$0.42	N/A	N/A	N/A	\$168	\$269	\$336	\$504
Central1	\$0.25	\$115	\$175	\$90	\$480	\$540	\$580	\$680
Felton	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Pajaro Valley	\$0.42	N/A	N/A	N/A	\$168	\$269	\$336	\$504
Scotts Valley	\$0.20	\$110	\$275	\$275	\$740	\$788	\$820	\$900
Zayante	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A

Note:

1. Central also charges \$5 per extinguisher head and \$5 per alarm device.

Source: Communications with individual fire protection districts, March-April 2017.

Table 4-5: SEWER DISTRICTS – CONNECTION FEE COMPARISON

Sanitation District (SD)/CSA	Connection Fee
Boulder Creek (CSA) ¹	\$1,135
Davenport (SD) ^{1,2}	\$3,000
Freedom District (SD) ¹	\$4,000
Rolling Woods (CSA) ¹	\$2,000
Salsipuedes (SD) ³	N/A
Santa Cruz County (SD) ¹	\$3,000

Note:

1. Connection fees for all sanitation districts and CSA overseen by DPW will be waived for ADUs contained entirely within the existing space of a single family residence or accessory structure.

2. Davenport Sanitation provides water and sewer service, each with separate connection fee.

3. Not managed by DPW.

Source: Santa Cruz County Department of Public Works, Service and Capital Improvement Fees, July 2016

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5 COSTS PART 2: BRINGING IT ALL TOGETHER

The estimate of total cost will include hard costs, soft costs, County fees, and Special District fees. Table 5-1 provides information on current costs for the four prototypes. The costs are summarized in seven categories: construction costs, contractor overhead (which is based on the construction costs), additional costs to prepare the site (which may not be needed depending on lot characteristics), soft costs which are the studies and plans that may be needed and are prepared by professionals, the County and Special District Fees which are required, and for one example, an estimate for minor septic upgrade.

The information on total costs is provided to indicate “approximate” costs, which can vary from property to property and by locations within the county. Converting an existing building is the least expensive way to add an ADU to your property, and the County issues the most permits for converted garages. Recent changes in County regulations make it easier to accomplish this kind of version as well.

Table 5-1: 2017 ESTIMATED COSTS FOR THREE EXAMPLE ADUS AND A REMODEL ALTERNATIVE*				
	PROTOTYPE 1 <i>New Detached Structure (800 sq. ft., with Two Bedrooms)</i>	PROTOTYPE 2 <i>Accessory Structure Conversion (400 sq. ft., One Bedroom)</i>	PROTOTYPE 3 <i>New Unit Above a Garage (640 sq. ft., One Bedroom)</i>	PROTOTYPE 4 <i>Remodel Alternative, Conversion (500 sq. ft. studio)</i>
Location	Soquel Area	Live Oak	Pajaro Valley	San Lorenzo Valley
Applicable Special Districts				
School District	Pajaro Valley	Live Oak	Pajaro Valley	San Lorenzo Valley
Fire District	Aptos/La Selva Beach	Central	Cal Fire/ Pajaro Valley	Boulder Creek
Water District	Soquel Creek District	Santa Cruz City	Watsonville City	San Lorenzo Valley
Sewer District	Santa Cruz County (SD)	Santa Cruz County (SD)	Freedom District (SD)	None
Hard Costs				
Construction Costs	\$200,000	\$66,700	\$90,000	\$15,000
Contractor Overhead	\$33,000	\$13,005	\$16,500	\$2,250
Potential Additional Costs (Site preparation including parking and drainage work)	\$20,000	\$20,000	\$20,000	NA
Minor Septic Upgrade	\$0	\$0	\$3,610	\$0
Soft Costs				
Soft Costs (Design, Engineering Survey, and Soils Report where Relevant) ¹	\$52,600	\$21,941	\$27,300	\$2,588
Fees				
County Fees	\$20,353	\$14,026	\$18,226	\$2,257
Special District Fees ²	\$53,961	\$480	\$5,808	\$6,771
Total	\$379,914	\$136,152	\$181,443	\$28,866

Note:

1. Soft costs include \$2,000 for a site survey, engineering costs which are 5% of total costs that include the construction costs, potential site costs, and contractor overhead, and architecture/planning fees which are 15% of total costs.

2. Assumed Special Districts for each prototype:

* The “remodel alternative” is the modification of existing space in a home, usually a bedroom or a master bedroom suite, to create an enhanced “rentable” space. The space has a mini kitchen, may have a separate bathroom and separate entrance, but is connected by a door to the main part of the house and is not a separate unit. We have included this remodel alternative because it will serve many of the same needs as a full ADU without some of the costs.

COSTS: KEY TAKEAWAYS

The stand-alone, detached structure is the most expensive way to add an ADU to your property. The example provided here is in the Soquel Creek Water District, where water service connection fees and the Water Demand Offset Fee (a mitigation fee charged to address over drafted groundwater basins experiencing seawater intrusion), contribute substantially to the cost. If the new structure was located in the Scott's Valley water district, which services a portion of the unincorporated county, total cost would be approximately \$355,000, and if located in the San Lorenzo Valley, total costs would be approximately \$340,000.

The least expensive option is the remodel alternative. All six cost components for the remodel alternative are much lower, particularly construction (and related soft costs) than for the other three examples. While the conversion of an accessory building has lower costs in the example provided than building above a garage, in part this is explained by the size of the unit that was used. On a cost per square foot, building above a garage in this case is actually less expensive, and the owner would have over 50 percent more space. If the existing garage were to require significant foundation or other improvements in order to support the second story unit, this might not hold true.

The highest cost components are for construction and soft costs. Since soft costs include design and planning, it is possible to reduce these costs if you are able to undertake more of the work yourself. Also, there could be some ways in which you could lower construction costs by doing some of the work yourself as well. You could also consider placing a factory-built unit on your site. This option allows you to choose the unit that best suits your needs, and most provide many choices for finishes and final look of the unit. This approach may save money and complexity, because your design decisions are narrowed to address the impacts of siting the unit. See Appendix B for further information. It really depends on what your skills are and what you are comfortable with doing on your own.

Regarding the actual costs to you if you were to add an ADU, **it is important to remember that there are some costs you can control and others on which you have no influence.** For example, County and Special District Fees are outside your ability to reduce, but construction and soft costs could be.

A note on property taxes: Many homeowners have the concern that constructing an ADU will trigger a re-assessment of the base value of their property for the purpose of collecting property tax. While constructing an ADU will incrementally increase the value of your property, the corresponding amount of increased value is simply added to the tax that was assessed before the improvement. The base value of the property is not reassessed, and any tax advantages that exist, for example from long ownership with no reassessment, does not change.

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6 ADU FINANCING

Homeowners choose to build ADUs for a number of reasons ranging from providing housing for a family member to planning for retirement by creating an income stream that helps them afford their housing costs when they are no longer working. Among the issues that a homeowner interested in creating an ADU on their property must consider is the question of paying for the unit: how much is needed, where the money will come from, and if the unit is intended for other than personal use, how long it will take to recover the cost of building the unit and create cash flow.

Once you are comfortable that you understand the cost of constructing or legalizing an ADU, it is time to consider where you will get the money to take on the project. Do you have cash you can use—either short term (while you are building the unit) or long term—or will you need to borrow the funds? For many homeowners, ADUs will be built with a combination of cash and financing.

In the current lending market, the primary sources of financing to build ADUs have been either through a mortgage that covers the cost of both the ADU and the primary house, or through the use of a second loan that is used to construct the unit. Both of these approaches assume that the homeowner has a positive credit history and the ability to make payments. Homeowners must also have the ability to cover unanticipated expenses. The approaches to financing can be summarized as one of the following four strategies:

- **Initial Mortgage** (when purchasing primary home). An initial mortgage would cover a property that already has an ADU. It does not typically cover the cost of both the home acquisition and the cost to build a new ADU. A new homeowner interested in creating an ADU would need to access other funds to pay for the ADU costs.

- **Home Equity Line of Credit.** Once an owner has lived in the house and built up home equity, then it is possible to use a Home Equity Line of Credit, also referred to as a HELOC.
- **Refinancing.** A third option for those owners who also have equity in the home (or whose home has appreciated in value since it was originally financed), is to refinance the house to cover the ADU construction costs and use these funds to build the ADU.
- **Construct ADU with Cash and then Refinance the Property.** As a variation on the above, some homeowners may decide to take advantage of low mortgage interest rates by using personal savings to construct the unit and then refinance the property once it is complete.

Of the 60 respondents to the County's online survey who built ADUs, over half used personal savings and about 42 percent used a HELOC. Fewer than 10 percent refinanced by taking out a new loan from a bank.

ASSESSING YOUR FINANCING OPTIONS

Whether you are working with your lender to refinance an existing mortgage to cover the costs of construction or to take out a new loan to cover construction costs, the following requirements are likely to apply. Also keep in mind that many lenders will prefer to be in the "first" position when making a loan and consequently will want to retire an existing loan before providing additional funds for ADU construction. Banks will differentiate between a new "first mortgage" and a "second mortgage" (which includes a HELOC). A refinance of the property generally means that the existing first mortgage is paid off and replaced with new financing. Whatever new financing structure is proposed, banks are using the following criteria to review loan applications:

- You need to have a good credit history with no recent history of foreclosures or bankruptcy (usually defined as seven years).
- Your total debt to income ratio should not exceed 45 percent for all debt.
- Most conventional lenders will generally not include potential of rental income when calculating income to qualify for a loan, although Bay Federal Credit Union is developing a loan product that would take into account future rental income and incentivize use of rental subsidy.
- The loan to value ratio should not exceed 70 percent (meaning the total debt on the property can't be more than 70 percent of the appraised value).¹
- Lenders prefer that you have some liquidity in order to qualify for the lowest interest rate – for example, while this is not typical, one bank said they look for approximately \$25,000 in savings.
- Appraisals are required for a new HELOC or a new mortgage that covers the existing mortgage and construction costs. These appraisals are based on the current house value and the construction costs of building the ADU.

1. If you take out a construction loan that also covers the existing loan and then refinance when the unit is completed, the loan to value ratio can be higher – for example 80 percent.

- A contingency amount needs to be included in the loan balance – generally five percent for soft costs and ten percent for construction costs to protect the borrower and the lender against cost over-runs.
- Lending for unpermitted ADUs is similar to new construction provided the unit has not been “red tagged” for code violations.

There are several differences between a conventional cash-out refinance versus a Home Equity Line of Credit (HELOC) or Second Loan:

- The interest rates between the two loans differ. The home equity loan is likely to have a higher interest rate and is also more likely to be a variable rate.
- There may be higher upfront costs to obtain financing for a new first mortgage. In addition to paying for an appraisal, the borrower pays loan fees, title and escrow costs. Also, some lenders may require the owner to re-finance after a year, assuming the ADU is completed. The refinancing adds additional costs.²
- If a borrower is able to qualify for a home equity loan, the main expense would be the appraisal and bank fees. The borrower must notify the financial institution that holds the first mortgage about the pending home equity loan to pay for construction work on the property. Most HELOCs last for ten years.
- A HELOC or second loan is likely to have a shorter term than the typical thirty years for a first mortgage. Because it has to be repaid more quickly, the monthly payment will be higher than if it is rolled into a new first mortgage.

Some ADUs are built with new first mortgages and not home equity loans. In these cases, property owners accessed funds to pay for the ADU construction and then refinanced to take-out or recover these funds when the unit is built.

SUMMARY OF FINANCING OPTIONS

Home Equity Line of Credit (HELOC)

- Requirements: Appraisal and payment of bank fees.
- Noticing requirements: If you have a first mortgage, you need to notify the financial institution that holds the first mortgage that you are taking out a HELOC.
- Cost: Likely to have a higher interest rate and a variable interest rate; in other words, if interest rates increase in the residential lending market, the interest rate on the HELOC will also increase.
- Term: Most HELOCs last for ten years. The monthly payments may be higher for a HELOC, because the principal borrowed needs to be paid back over a shorter period of time. For example, a HELOC repayment could be on a ten-year schedule, whereas a new first mortgage could be based on a thirty-year repayment schedule.

2. Some lenders encourage the owner to submit an application to “pre-qualify” for the permanent financing that will be needed once a year has passed and the ADU is completed.

- Qualifications: In order to qualify for this type of loan, most lenders require the borrower to have a minimum Loan to Value ratio (LTV) of 70 percent.

Refinancing/New First Mortgage

- Requirements: Requires an appraisal, Title Search, and payment of bank fees (including escrow fees).³
- Cost: The cost of refinancing a new first mortgage may be more expensive, since it includes title and escrow costs.
- Term: A new first mortgage can last for thirty years.
- Qualifications: One lender who participated in the County’s process requires that you re-finance the loan a second time once the ADU is completed. In this situation, you may wish to find out about these additional costs in advance of deciding whether to use this type of mortgage, since these costs do add up. This refinancing could occur within a year assuming that the ADU is completed.

To learn more about the current costs for a HELOC or refinancing your existing mortgage, contact the lender that originally issued your loan, or contact another local lender and discuss existing debt and income.

It is very important to work with a reputable lender. While the financial crisis of 2007/2008 is over, there are still sub-prime lenders operating in California and nationally. While their lending terms may seem attractive, loans provided through these institutions may end up costing the homeowner more in the long run.⁴

There is no “right” financing choice for owners wishing to add an ADU. Qualifying for either type of loans will depend on your household income, your existing debt (including credit card and auto purchase debt), how much of your existing mortgage has been paid off, and the appreciation in the value of your home.

A good way to evaluate your options is to talk to one of the local lenders identified at the end of this Guide. These lenders are supportive of homeowners wishing to add ADUs to their properties.

Shop around — local lenders are also concerned about the housing shortage and are looking for ways to help.

3. Escrow fees may include the costs of producing loan documents, title insurance, notary costs and recording and escrow fees.

4. One example would be a “teaser” interest rate loan offered to lower-income borrowers, which is a loan that will require refinancing after a few years. These lenders tell borrowers that they should be able to refinance their loans before interest rate increases would occur. This method of loaning is considered risky, as default rates are high.

Read more: Teaser Loan <http://www.investopedia.com/terms/t/teaser-loan.asp#ixzz4nIQHTEeV>

5. As used in this report, the term “affordable housing” means housing that does not cost more than 30 percent of the gross monthly income for households with incomes that do not exceed 120% of the County median income. Monthly housing costs include both rent and utility costs for rental housing. The County median income was \$87,700 for a family of four in 2016. See http://www.hcd.ca.gov/policy-research/docs/2016non_heraincomerentsloanlimits.pdf

Lower-income households are divided into four income categories as follows:

- Extremely Low Income—less than or equal to 30 percent of the County median income;
- Very Low Income—between 31 percent and 50 percent of the County median income;
- Low Income —between 51 percent and 80 percent of the County median income; and,
- Moderate Income—between 81 percent and 120 percent of the County median Income.

COUNTY LOANS AND SUBSIDIES TO ASSIST CONSTRUCTION THAT RESULTS IN AFFORDABLE UNITS

The County is developing two loan programs that can create affordable rental opportunities through construction of ADUs. Homeowners interested in either of these programs should contact the County's Housing Section.

County ADU Loan Program

Funding has been set aside for a pilot ADU Loan Program that would provide a low interest, deferred and forgivable loan to homeowners willing to commit to renting an ADU to a low income household at a rent that is affordable. The loan can be subordinated to a HELOC or second mortgage and may be particularly helpful to homeowners who want to build an ADU but do not have substantial equity in their homes.

Loan Terms

Maximum loan amount:	\$40,000
Interest rate:	Three percent (3%) simple interest
Term:	20-years
Loan Forgiven:	Loan is forgiven at the end of the 20-year term
Opt-Out Provision:	County rent restrictions will be released prior to the 20-year term of the loan with payment of the principal plus accumulated interest.
Security:	Loan and rent restriction agreement are secured by a deed of trust recorded against the property.
Tenant Income Limits:	County assisted ADUs can only be rented to "lower income households" at affordable rents as defined in the Santa Cruz County Affordable Housing Guidelines.

Table 6-1: 2017 LOWER INCOME DEFINITION ADJUSTED BY HOUSEHOLD SIZE

Household Size	1	2	3	4	5
Income Limit (80% of median)	\$56,500	\$64,550	\$72,600	\$80,650	\$87,150

For more information on renting your ADU, refer to Chapter 7.

Maximum Rents: The rent that homeowners can charge for a deed restricted unit is the County’s Lower Income Rent as defined annually in the Affordable Housing Guidelines. This rent is calculated to be affordable at 60 percent of the Area Median Income. Owners have the option of renting an affordable ADU to a tenant who holds a Housing Choice Voucher or other subsidy at the Fair Market Rent (FMR) that is defined annually by the federal Department of Housing and Urban Development (HUD). Renting the unit to a tenant with rent subsidy allows the tenant to pay one-third of their income for rent with the difference made up by subsidy source, which in most cases is HUD.

Table 6-2: 2017 MAXIMUM RENTS FOR LOWER INCOME UNITS

Unit Size	Lower Income Rents	HUD Fair Market Rent
Studio	\$913	\$1,275
1 Bedroom	\$1,044	\$1,512
2 Bedrooms	\$1,305	\$1,931

My House My Home

The County is developing a program in partnership with Habitat for Humanity Monterey Bay and Senior Network Services to expand its ADU construction program targeting low income homeowners. The goal of the program, which is called My House My Home, is to build ADUs on the properties of low income senior homeowners to provide additional income and adjustable living accommodations to help them age in place.

The County program would provide an \$80,000 loan to a qualifying senior homeowner. The loan would be due and payable in 30 years at a 3 percent interest rate. The loan would be matched on a dollar for dollar basis by Habitat and Senior Network Services will provide case management assistance to the homeowner. The County Housing Program will certify eligibility and monitor compliance annually.

6.1 Ongoing Costs of Ownership

Constructing an ADU is a significant investment. When thinking about creating an ADU, remember that there are ongoing costs of ownership after the unit is built, including:

- Monthly costs of paying back the ADU loan or new first mortgage, if savings are not used to pay for the ADU. The County’s online financing tool can help you calculate how long it will take you to pay off your loan given the rent you are charging.
- Potential increase in property taxes
- Ongoing maintenance and repair of the ADU and occasional capital improvements
- Additional utility costs

These additional costs may be partially or fully offset by rental income, which is discussed in the next section.

Table 6-3: EXAMPLES OF PAY-BACK CALCULATIONS

ADU Cost	New Structure (800 sq. ft., with Two Bedrooms)	Accessory Structure Conversion (400 sq. ft., One Bedroom)	Above Garage (640 sq. ft., One Bedroom)	Remodel Alternative (500 sq. ft.)
Total Unit Cost (Rounded Values)	\$380,000	\$136,000	\$181,000	\$29,000
Annual Pay off Assumptions				
Annual ADU Loan Payments - See the mortgage tool on the County’s website or use an online mortgage calculator to determine annual payments. ¹	\$37,231	\$13,619	\$17,832	\$2,841
Monthly ADU Loan Payments	\$3,103	\$1,135	\$1,486	\$237
Annual Rent Revenue - HUD FMR Subsidized Rent (i.e. Section 8 Housing Choice Voucher Program) ²	\$23,172	\$18,144	\$18,144	\$15,300
Monthly rent assuming HUD’s Fair Market Rent for the Unit	\$1,931	\$1,512	\$1,512	\$1,512
Number of years to pay off loan under loan payments and rental income assumed here. ³	24	11	15	3

Notes:

1. This example assumes an interest rate of 5.25%, and a 15-year loan term. Principal and interest are included in payments.
2. Monthly rents are multiplied by 12 to determine annual rental revenue.
3. Total annual mortgage payments are divided by annual rent revenues to estimate pay-back period.

UNDERSTANDING THE PAY-BACK PERIOD OF YOUR ADU

A pay-back period is the amount of time it takes a borrower to pay off a loan. The net income (cash flow) from the ADU can be used to help pay the mortgage costs for the loan you needed to build it. Once the loan is paid off, the cash flow from your ADU can be used for other purposes.

Your need for cash flow may influence the type of unit you decide to build. For example, a two-bedroom unit will generate higher rents than would a one-bedroom unit or a studio, but it will cost more to build.

If personal funds are available to reduce the pay-back period, you could decide either to reduce the loan size or to pay the loan off sooner. This reduces the amount you spend on mortgage interest.

Finally, you could consider using the County's ADU loan program to reduce the size of the loan required to build. This will also reduce your mortgage payments.

As you consider the pay-back period for your ADU, the variable factors are:

- **The amount of the loan you are considering.** The amount could change depending on whether you use savings or tap the County's ADU Loan Program
- **The interest rate.** Understanding the impact of the interest rate banks charge will help you evaluate loan products offered by various lenders.
- **The term of the loan.** Most HELOCs are due in 10 years. Does this work for you? Talk to your lender about your options.
- **The payment.** For many ADU owners the payment will be limited to the rental income received from the ADU tenant. You can also consider whether you can afford to pay more than the monthly rent amount in order to help pay down the loan more quickly.

There are many tools available to assess these "moving parts," including online tools and loan tables that are built into many software packages. The County has developed an online tool available at: <http://sccoplanning.com/PlanningHome/SustainabilityPlanning/AccessoryDwellingUnits.aspx>.

Table 6-1 uses the Prototype models to illustrate the pay-back period of an ADU loan assuming the full cost of ADU construction was financed. The intention here is to show comparative payoff periods considering similar financing assumptions, including FMR rents, interest rates, and modern construction costs.

The fastest pay-back period would be for the remodel alternative, and the longest would be for the ADU built as a new structure, which would take 24 years to pay back the loan. The loan for a new structure could be paid off in a shorter time frame, if you reduce the loan amount by providing a down payment. For example, if the owner who builds a new structure is able to afford a 40 percent down payment, the pay-back period based on HUD FMR rents could be as short as 15 years.

INCREASE IN PROPERTY TAXES

If you add an ADU to your property, the County Assessor's office will reassess the value of your property. The increase in assessed value is not related to costs paid but to the value added. For example, in the case of the owner undertaking construction, this would result in lower costs, but the value would be the same as if a contractor undertakes the work. Typically, appraisers working for the County determine the increase in assessed value resulting from an ADU based on plans submitted for Building Permits, but the appraiser may choose to visit the property as well.

You can expect an incremental increase in your property tax because the ADU will increase the value of your property. The base value of the land and existing improvements remains unchanged, and an increment representing the change in property value because of the new ADU will be added. (See your Property Tax bill for information on the current assessed value of your property.) There is no "one size fits all" in calculating this increase in value, since there are multiple factors that determine the assessed value. These factors may include the shape of the property, unit size, type of design or the quality of finishes. Whatever the amount of the increase, any tax benefit you currently have, for example from owning the property for many years, will be preserved.

The State Board of Equalization (BOE) Website provides quick estimates about how much the ADU will add to assessed value of a property and explains how the ADU value is assessed. ADUs are considered Modern Single Family Homes in the BOE Guide. Depending on construction characteristics, costs per square foot can be calculated and will define the increase in assessed value due to the ADU. Keep in mind that the BOE uses statewide valuations and costs in Santa Cruz County may be higher. (See the website link and directions at the end of this Guide to help estimate the increase in assessed value due to the new ADU.)

ONGOING OPERATING COSTS

In most cases the loan payment will be the largest monthly expense for the ADU. Other potential costs to consider are property insurance, increased cost for trash and recycling pick up. Utility and maintenance costs are other issues to consider and are discussed below.

Maintenance, Repair and Capital Improvement Costs of Your ADU

As with any home, the ADU will require on-going maintenance. This could range from fixing or repairing an appliance to occasional major improvements. Major repairs and improvements occur infrequently but can be costly, such as roof replacement, re-siding, or driveway repair. Many landlords set aside funds monthly in anticipation of these costs. Note that some of the costs of operating the ADU may be tax deductible.

Understanding Utility Costs

As you are planning your ADU, consider how the cost of utilities will change with increased usage. Units constructed under CALGreen—the California Building Code—will be very energy efficient and utility costs can be shared with the tenant by devising a split of the utility bills or by installing a separate meter, or sub-meter.

Calculation of Income Taxes on Rental Income

It is important to maintain records of revenues and expenses (including a pro-rated share of property taxes) to come up with a net income figure that is added to your income tax return. An IRS form for supplemental income and losses from other sources, such as rental property. (Schedule E to Form 1040). One of the advantages of owning rental property is that it is possible to depreciate the “value” of the property by following a defined depreciation schedule provided by the IRS, which creates a significant tax benefit. Consider setting up your rental unit with a tax professional or utilizing online tax preparation software.

7 ADUS AS RENTAL PROPERTY

Rental income is the reason that many property owners build ADUs. In the survey conducted for the County's 2017 ADU Study, of the Santa Cruz County homeowners who either built an ADU or purchased a home with an existing ADU, almost half said that rental income was an important consideration. In addition, this same survey showed that rental income is the primary motivation for over half of homeowners who are interested in adding ADUs to their properties. Before considering using your ADU as a rental unit, you may wish to know more about the costs and benefits of owning a rental unit. ADUs can be used for long-term rental income, but cannot be used as short-term or vacation rentals.

7.1 Deciding to Rent Your ADU

Santa Cruz County code requires properties that include an ADU to be owner occupied and, as stated above, you cannot rent out your ADU as a short-term rental (for a period of less than 30 days, i.e. on Airbnb). There are financial benefits and personal benefits to renting out your unit, but not everyone is ready to be a landlord. Think about whether you want to have a tenant on your property.

DO YOU WANT TO BE A LANDLORD?

Being a landlord for a renter of an ADU on your property is different from owning and operating other types of rental properties. In many ways it is more similar to deciding to have a roommate. Renting your ADU means you are sharing your property with another person who has tenancy rights, and the right to expect quiet enjoyment of the home for which they are paying rent. Additionally, as a landlord you are subject to all of the same

Use a legally enforceable lease to clearly establish your rights and responsibilities as a landlord, as well as those of your tenant

requirements under local, State and federal law, such as non-discrimination and the requirement to give notice of changes to the lease.

It is advisable to spell out your expectations through a legally enforceable lease. The lease is the opportunity to consider the issues that will make sharing your property work for you – for example, will you allow your tenant to smoke in the unit? If not, be sure that the lease agreement states that very clearly. Do you expect your tenant to help out with maintaining the landscaping around the unit? Spell it out in the lease. What are your expectations for guests? Where will the tenant park? You should expect to inspect the unit once a year to be sure everything is in working order, such as the smoke alarm--be sure the lease makes it clear you will do this and how you will give notice to the tenant when you will enter the unit. There are many resources (See Appendix B) available to get an up to date, legally enforceable list of typical lease conditions to consider.

A lease establishes your rights and responsibilities as a landlord, as well as what you can expect from your tenant. The California Department of Consumer Affairs website provides information about leases and other landlord/tenant responsibilities. Most tenants and landlords that share property are able to manage their relationship without legal input, but if you are concerned about your responsibilities, you may consider consulting with a property attorney.

Here is a list of many of the items typically included in leases:

- Term of lease (month to month or a specific date, such as one year, with termination date specified)
- Amount of rent
- Security deposit and terms for return of deposit
- List of payments of move-in costs
- Late charges
- Availability of parking and storage
- Designation of who pays for utilities
- Check list to show condition of unit at move-in
- Maintenance responsibilities (landlord's and tenant's)
- Alterations and repairs that should not be undertaken by tenant
- Inventory of keys
- Tenant's obligations when vacating property

SELECTING TENANTS

Deciding to rent out a unit on your property is an opportunity to augment your income and help out with your own housing cost and provide badly needed housing. The County's ADU Survey indicated that some ADU landlords negotiate other neighborly assistance with their tenants such pet-sitting, child care assistance, gardening and helping you with the property, or taking the trash cans to the street.

When selecting tenants, it is very important that you adhere to the federal Fair Housing laws that apply. The Fannie Mae Landlord Guide provides more information on these important rules. Also, California has additional Fair Housing Rules that can be downloaded at <https://www.dfeh.ca.gov/housing/>.

SETTING RENT LEVELS

What is the “right” rent you should charge for your ADU? You might start by finding out what the current market is charging. Sources of information on current rents include Craigslist and the UC Santa Cruz Housing Department. (Links provided in Appendix.) These resources can give you some idea of the market but there are other factors to consider. How much income do you need in order to cover your costs and pay down debt? Do you want or expect your tenant to help out on the property?

Setting a reasonable rent can help to reduce tenant turnover. The stability of a long-term tenant saves you money, both because you do not need to “prepare” the unit frequently for a new tenant and because you will not lose rental income while you search for a new tenant.

7.2 Benefits of Renting an ADU

There are both public and private benefits for owners renting out their ADUs. From the County’s viewpoint, homeowners providing ADUs as rental units expand the housing supply. ADUs may also be more affordable than other types of rental units.

The major benefit to most property owners is the increased income. This rental income can augment your income or help you repay the loan you took out to build the unit. The County has developed an online resource to help with your consideration. In the situation where household help is needed, for example, a nanny for child care or assistance with household chores, a homeowner with an ADU can offer to rent the unit to the helper at a reduced rent in exchange for the services needed.

In fact, in response to one of the online survey questions, of the respondents interested in developing an ADU, almost three-quarters responded that they were interested in developing “separate living space for a household member or family care employee, such as an adult child, elder family member, live-in aide, or nanny.”

ADVANTAGES OF RENTING AN ADU AT A BELOW MARKET RENT

Housing Choice Voucher Program

There are advantages of renting out the ADU to a tenant participating in a housing subsidy program, although the rent may be below market level. A below market rate rental amount is defined by the Housing Authority of Santa Cruz County under the Federal Housing Choice Voucher Program (often referred to as “Section 8,” although there are other programs).

See Section 6 above for information on understanding this pay-back period.

Secondly, the rent difference between a below market rate (BMR) rent and a market rate rent is not as large as might be expected. The Housing Authority determines the level of annual rent increases which are intended to reflect market trends.

In 2017, differences between BMR rents and market rate rents is smallest for studio units and higher for two-bedroom units. Table 7-1 shows a comparison of the Voucher Program rents with the rents advertised by the UCSC Housing Office in 2017.

Table 7-1: COMPARISON OF BELOW MARKET RENTS WITH MARKET RATE RENTS (MAY 2017)			
UCSC Housing Office, Current Listings (May 2017)	Studio	One Bedroom	Two Bedrooms
Apartments	\$1,400	\$1,840	\$2,560
Houses	NA	\$1,980	\$2,860
Averages (Apartments and Houses)	\$1,400	\$1,910	\$2,710
Below Market Rate Rents - BMR (March 2017)	\$1,275	\$1,512	\$1,931
Rent Difference	\$125	\$398	\$779
Percentage Difference Between BMR Rents and May 2017 UCSC Housing Office Listings for Apartments and Houses	9%	18%	25%

The way the housing subsidy program works, is that first, The Housing Authority approves a household for the Housing Choice Voucher Program. Then, the household who has obtained the voucher is responsible for finding a unit that will rent to them. The final decision of whether the tenant with a voucher will move into the unit is a mutual decision between the potential tenant and the landlord.

APPENDIX A: EXAMPLES OF OWNERS WHO HAVE BUILT ADUS

In early 2017, Santa Cruz County conducted an online survey about ADUs. This was a voluntary survey that was advertised in the community. Property owners who had ADUs, owners who built ADUs, and those interested in building ADUs were encouraged to participate. Professionals who have built or designed ADUs were also encouraged to participate. The experiences and recommendations of these property owners are provided in a separate report entitled “Santa Cruz County ADU Study Summary of Online Survey Results” and is available at: <http://sccoplanning.com/PlanningHome/SustainabilityPlanning/AccessoryDwellingUnits.aspx>. The survey information was very useful in understanding property owners’ motivations and experiences in building their ADUs.

Following are the stories of three different ADU builders who shared their experiences with the County. The names of these owners have been changed since the survey was confidential. Case study information presented in this Appendix has not been verified. Also, since these units were built in the past, the cost information reflects time of construction and is not current. The County is grateful for all of the participants in the online survey and the many people who attended public meetings, focus groups and otherwise helped to improve the County’s ADU program and create badly needed housing in our community.

SEPARATE ADU STRUCTURE

Stuart lives in an urban area of Aptos. He built a new detached ADU in 2013. It is 612 square feet and includes one bedroom and one bathroom. He has owned the property for four years and built the ADU within the first year. The lot size is 11,800 square feet or just under one-quarter of an acre.

Stuart lives in the primary unit. He built the ADU unit as a separate living space for his son. He rents the unit to his son for a “very reduced rent.” “I purchased this large lot with the intention of building the ADU for my disabled 40-year-old son.”

Stuart designed and built the ADU. From start (obtaining permits) to finish (construction completed), the process took about one year.

The total cost for the ADU in 2013 was \$220,000 and was financed through personal savings. These costs included permitting costs (\$17,337), utility connections (\$24,607), Central Fire fees (\$4,317) and the remaining amount of \$178,000 was for labor, materials and other additional costs. The only permit Stuart obtained was the building permit. Stuart mentioned that “I built this unit myself, but the cost of permits was extravagant. I built a higher quality project than many, but of the total cost of \$220,000, there were \$46,261 in permit costs. The majority of this was paid to SCWD (\$24,607). The new changes in regulations should take care of some of the problems I had with permitting.”

“I have no idea how much the ADU has increased my property values. Values have gone up a fair amount since I built it, but I didn’t build it to make money. I built it for family.”

DETACHED GARAGE CONVERSION

Connie has lived in her home located in urban Live Oak for the past twenty years. Her house is located on a lot that is about 8,000 square feet.

Connie built her ADU after owning her house for less than five years. Rental income was the primary reason she created the ADU.

“When I purchased the property, I was married. The original plan was to convert the structure legally with my ex-husband doing the construction work. Instead, after the divorce, I lived in the unfinished space and later converted the unit with the help of a general contractor.”

Her ADU is a detached garage conversion and is 525 square feet size. Connie’s ADU is a one bedroom, one bathroom unit. Parking for her tenant is not a problem, since her tenant has room to park the car on the lot and does not need to park on the street. Her current renter has lived in the ADU for almost five years and is a senior citizen. Connie knew the current tenant before. There is no formal lease contract.

“Today, I rent it to a senior citizen on a very fixed income for less than half its

market value. Next year, I plan to return to school to make a career change and live in the ADU myself, so that I can earn more income from the property by renting out the main house. I will finance my schooling, in part, by rent from the main house.”

Rent paid by her tenant consists of a combination of cash rent (\$750/month) and help provided by the tenant to Connie (minimal cooking, gardening, and housekeeping). Utilities are included in the rent and cost \$115/month. There have been no rent adjustments for the five years that the tenant has lived in the unit. Connie originally set the rent based on what the tenant could afford.

Connie designed her ADU with help from a contractor. The contractor built the unit. She did not apply for permits. According to Connie, “I investigated permits and couldn’t afford them. I wish I’d found a way to finance the permits.”

The total cost for the construction work was \$25,000 in 2001. Connie used a home equity line of credit (HELOC) and borrowed the maximum amount that she could afford, based on the equity in her home and her income. The potential rental income from the ADU was not considered when she applied for the loan.

“At the time I borrowed the money, the \$25,000 for building and finishing of the unit was all I could afford. The permitting fees and required plans and setback variance all felt overwhelming and impossible. If it was happening today, I’d be able to borrow the necessary money from my parents. At the time, however, they were still working and trying to retire and very concerned about finances.” (The permitting fees were approximately \$18,000, with another \$3,000 to \$5,000 to hire an architect to do the necessary drawings.)

Connie is interested in incentives that would allow her to get permits for the unit and make it fully legal. Receiving incentives in exchange for an affordable rent requirement would be an acceptable tradeoff, since she already rents out the unit at a below market rent level. “The only incentive I want is to be able to legalize it quickly, easily, and affordably. I would be deeply appreciative of an efficient and affordable way to legalize my situation. It was stressful to have the fees and process feel overwhelming when I built the unit. I would very much appreciate a clearly defined, efficient way to navigate through a fairly priced amnesty program.”

ADU ABOVE GARAGE

Melinda, age 67, lives in Soquel in a rural area. Her site is over one acre in size. She has lived in the house for 40 years and built the ADU after living in the house for more than 10 years. Her ADU is located above her garage and is 650 square feet in size. The unit consists of one bedroom and one bathroom.

The ADU was designed by her spouse, a contractor, who also built the unit. “My husband drew and submitted the plans through a planning consultant.”

The total costs were \$113,500 (in the late 1990s/early 2000s), of which \$4,000 was for design, \$12,000 was spent on labor, \$25,000 was spent on materials,

\$24,000 for permits, \$1,500 for utility connections, \$2,000 for the planning consultant who helped with the plans cost, and \$45,000 for remaining costs. She remembers that the Fire Department and Planning Department gave conflicting instructions and it was costly to meet the Fire Department requirements.

Marilyn and her husband paid for the costs of building the ADU by subdividing and selling a portion of the property. The proceeds from the sale of the land were sufficient to pay all the costs.

Marilyn lives in the primary residence; Marilyn's mother had lived in the ADU but recently died. "We built the ADU for my aging mother. My husband completed the work himself, as he was a licensed contractor. Yet, there were still challenges and expenses involved in coordinating the requirements of the Fire Department and Planning Department, which made the project more difficult than we had hoped. Ultimately, we were able to resolve the issues and finish the unit."

After Marilyn's mother died, the unit needed some renovation. So Marilyn left it vacant briefly, but she decided that she could use the rental income. She has also thought about living in the ADU herself and renting out the primary house, which could increase her income even more.

Recently, the first tenant moved in. The tenant holds a Section 8 Voucher.⁶ Marilyn is renting the unit at the HUD reimbursed Fair Market Rent of \$1,512 per month. "The young woman (my new tenant) cried with relief when she heard the rent. I simply cannot bring myself to charge a high market rate rent. I don't know what you can do about getting others to feel strange about collecting insanely high rents. Most landlords will charge what the market will bear."

6. The Housing Choice Voucher Program (or Section 8) is the federal government's major program for assisting very low-income households and individuals. The participant is free to choose any housing that meets the requirements of the program. Housing choice vouchers are administered locally by public housing agencies, such as the Santa Cruz County Housing Authority. A housing subsidy is paid to the landlord directly by the Housing Authority on behalf of the participating household.

APPENDIX B: ONLINE RESOURCES

GENERAL GUIDANCE AND REGULATIONS

ADU Statewide Guidance and Regulations

California Department of Housing and Community Development, Where Foundations Begin

Accessory Dwelling Unit Memorandum (December 2016)

<http://www.hcd.ca.gov/policy-research/docs/2016-12-12-ADU-TA-Memo.docx.pdf>

Guidance from Santa Cruz County

ADU Design Book and How-To Guide – **URL to be added**

County Zoning Ordinance – www.codepublishing.com/CA/SantaCruzCounty/

FEES AND RELATED COSTS

Santa Cruz County Department of Public Works, Service and Capital Improvement Fees

<http://www.dpw.co.santa-cruz.ca.us/Portals/19/pdfs/feebook.pdf>

Calculating Costs of Installing Separate PG&E Meters

<https://www.pge.com/mybusiness/customerservice/otherrequests/newconstruction/projectcosts/index.shtml>

Calculating Costs of Water Connections to ADUs in the Soquel Creek Water District

<http://www.soquelcreekwater.org/residential/new-accessory-dwelling-unit-water-service>

Locations of Special Districts

Interactive Special District Maps:

- Water District Map: Type in an address or place into search bar at the top right. The map will automatically zoom to the location and display the corresponding water district. (<https://www.arcgis.com/home/webmap/viewer.html?webmap=e07763e2553b4340b96835348bd46986>)
- Flood Control (<http://gis.co.santa-cruz.ca.us/publicgisweb/>)
- Road Maintenance (<http://gis.co.santa-cruz.ca.us/publicgisweb/>)

Find Special District by Location on Santa Cruz County website (<http://gis.co.santa-cruz.ca.us/publicgisweb/>):

Click the right-pointing arrow at the top left to reveal a side menu. Scroll down in the menu to find “Special Districts” and select one or more special districts. The district boundaries will draw over the map.

Select the drop-down box at the top left under “Select Search Type” and change to “Address.” Enter an address in the textbox to the right under “Enter Search Value.” The map will zoom to the location. Zoom out to see which district contains the location.

Districts Available:

- Flood Control
- Road Maintenance
- Fire
- Water
- Sanitation

Special District PDF Maps

- Fire Districts (<http://www.santacruzlafco.org/maps/225-03FireOverview.pdf>)
- Sanitation Districts:
 - » Santa Cruz County (mid-county) (http://gis.co.santa-cruz.ca.us/map_gallery/pdfs/Map%20Gallery/Jurisdictional%20Boundaries/Sanitation%20Districts/Santa%20Cruz%20Sanitation%20District.pdf)
 - » Salsipuedes (http://gis.co.santa-cruz.ca.us/map_gallery/pdfs/Map%20Gallery/Jurisdictional%20Boundaries/Sanitation%20

- Districts/Salsipuedes%20Sanitary%20District.pdf)
- » Freedom (http://gis.co.santa-cruz.ca.us/map_gallery/pdfs/Map%20Gallery/Jurisdictional%20Boundaries/Sanitation%20Districts/Freedom%20Sanitation%20District.pdf)
- » Davenport (http://gis.co.santa-cruz.ca.us/map_gallery/pdfs/Map%20Gallery/Jurisdictional%20Boundaries/Sanitation%20Districts/Davenport%20Sanitation%20District.pdf)
- School Districts) (http://gis.co.santa-cruz.ca.us/Map_Gallery/pdfs/Map%20Gallery/Administrative%20Boundaries/School%20Districts/County%20Wide%20Districts.pdf)

FINANCING AND LENDING INFORMATION

Lenders

These websites can provide updated information on interest rates and other lending information. Also included here are local lenders (Santa Cruz County Bank, Lighthouse Bank, and Bay Federal Credit Union).

<https://www.wellsfargo.com/mortgage/rates/> is a good source for current interest rates.

https://www.sccountybank.com/realestate_lending.cfm

<https://www.lighthousebank.net/Home/tabid/2188/Default.aspx> (links to telephone numbers to use)

<https://www.bayfed.com/products-services/Loan-FAQ/heloc-information>

Mortgage Calculator

<https://www.zillow.com/mortgage-calculator/>

Calculating Increase in Assessed Property Value

<http://www.boe.ca.gov/>

Click the tab for Forms & Pubs, then click Property Taxes. Click on Publications, then look for Other Documents, and click on Assessor's Handbook. Select AH 531, Residential Building Costs. Click on the latest date shown. Go to Section 531.21.

You may also paste the following link into your browser:

<http://www.boe.ca.gov/proptaxes/pdf/ah53117.pdf>

LANDLORD AND RENTAL INFORMATION

Landlord Advice for New Landlords

Becoming a Landlord: Rewards, Risks, and Responsibilities (Fannie Mae 2008)

<https://www.fanniemae.com/content/tool/landlord-guidance.pdf>

Consumer Publications - Landlord/Tenant - California Department of Consumer Affairs

<http://www.dca.ca.gov/publications/landlordbook/index.shtml>

California Association of Realtors Lease Template Tool

<https://eforms.com/rental/ca/california-association-of-realtors-c-a-r-lease-agreement-template/>

Sources for Current Rent Data

UC Santa Cruz Housing Office

<http://communityrentals.ucsc.edu> – this link shows current listings.

<https://communityrentals.ucsc.edu/cost/index.html> - This link summarizes an entire year of rental listings

Craigslist for Rentals in Santa Cruz County

<https://sfbay.craigslist.org/search/scz/apa?availabilityMode=0>

Santa Cruz County Housing Authority Website (Below Market Rents, also Known as Affordable Rents)

https://hacosantacruz.org/pdf/Pymt%20Std,%20Util%20Allow,%20Inc%20Limits/sc_pmt_standards.pdf

MANUFACTURED/PREFAB HOME AND STOCK BUILDING PLAN RESOURCES

Ohana Kit Homes: <http://www.hawaiiadu.com/>

Yamada homes: <http://www.yamadahomes.com/>

GJ Gardner Homes: <http://www.gjgardner.com/san-luis-obispo-county-home-builders/granny-flats.aspx>

Cutting Edge Homes: <https://www.cuttingedgehomes.net>

California Precut Homes: <http://www.caprecut.com/floorplans/1-story-homes-600-2-000-ft.html>

HousePlans.com: <https://www.houseplans.com/collection/themed-granny-units>

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