

Reaching California's ADU Potential: Progress to Date and the Need for ADU Finance

Karen Chapple, Faculty Director, Center for Community Innovation

David Garcia, Policy Director, Turner Center for Housing Innovation

Eric Valchuis, Graduate Student Researcher

Julian Tucker, Graduate Student Researcher

Executive Summary

Following a series of legislative changes, the permitting and construction of accessory dwelling units (ADUs) in California has increased significantly in recent years. Between 2018 and 2019, permits increased from almost 6,000 to almost 16,000. During that same period, ADU completions more than tripled from 2,000 to almost 7,000. This activity is concentrated in the state's major population centers— Los Angeles, San Diego, and the San Francisco Bay Area— but other areas of the state are also experiencing meaningful increases in ADU development. Most of this activity is taking place in areas with high home values and rents, though there is regional variation. In particular, ADU development in Los Angeles is more likely in low resource areas.

To build upon the early success of ADU legislation, more financial tools are needed to facilitate greater ADU development amongst low to moderate income homeowners who do not have access to cash savings and cannot leverage home equity. To that end, we

recommend that the federal government create an ADU-specific construction lending programs. Similarly, California could also lead on this issue by creating a program to assist homeowners in qualifying for ADU construction loans.

Introduction

California is in the midst of a dire housing crisis due in part to decades of underbuilding. As a result, the cost of housing remains out of reach for many, and the gap between the state's existing housing stock and what is needed to satisfy demand continues to grow. This calls for a broad, innovative set of strategies to close the supply gap. ADUs are one form of relatively low-cost housing that can help improve the housing landscape. In recent years, California lawmakers have passed numerous pieces of legislation that have loosened restrictions on constructing ADUs, resulting in a proliferation of ADUs statewide. A recent study confirmed that existing state ADU legislation has created market-feasible potential to build close to 1.5 million new housing units.¹

In this brief, we show that California has experienced rapid growth in ADU permitting and construction, particularly in its major metropolitan areas. In high-wealth areas, ADU construction is providing new housing supply, and in lower-income areas, new ADUs are helping to reduce overcrowding, provide new rental income, and build home equity. Despite this growth, challenges in scaling ADU development remain. Specifically, homeowners often find it difficult to obtain financing to build their ADUs, as banks have been slow to design appropriate types of loans while construction costs continue to escalate. This can pose a particular barrier for lower-income households who are less likely to have the assets needed to fund the construction of an ADU. Indeed, we find that although ADUs tend to be built in areas with higher home values, they are built in many different types of neighborhoods; almost 3,800 ADUs were completed statewide in 2018 and 2019 in higher resource areas in terms of access to opportunity, compared with over 5,000 ADUs built in lower resource areas.² In the San Francisco Bay Area and San Diego, ADUs are disproportionately built in higher resource neighborhoods. Los Angeles County leads the state in ADU construction within lower resource areas, likely in part due to higher homeownership rates and lower construction costs there compared with the Bay Area.

To see broader expansion of ADUs across the state, new and improved financial tools are needed to support ADU development, especially in lower-income areas within high-cost regions. Thus, this brief provides background information on recent ADU legislation in California and the limitations of existing financial mechanisms in facilitating the construction of ADUs. We demonstrate that recent ADU production is not distributed equally across communities of varying types in California. Finally, we conclude with recommendations on how to improve ADU financing options, specifically for lower- and moderate-income households.

Background

California has recently passed several bills to enable more ADU production. Among the earliest of these statewide laws was SB 1069, which was passed in 2016 and requires cities to adopt ADU ordinances that adhere

to state-level guidelines, such as requiring ministerial approval of ADUs, limiting parking requirements, and other key changes. This bill's passage had a significant impact on ADU production across many municipalities. The number of ADUs permitted across California's largest metro areas increased from 654 in 2016 to 3,126 in 2017, and Los Angeles experienced a particularly large increase (from just 80 permits in 2016 to 1,980 in 2017).³ 2019 saw three key bills—AB 68, AB 881, and AB 670—passed to address additional barriers to development and continue the momentum for ADU and junior ADU (JADU) production.⁴ These reforms took cues from cities in the Cascadia region (Portland, Seattle and Vancouver) that have eliminated restrictive zoning provisions, waived impact fees, and implemented additional mortgage- or government-sponsored loan products, all of which have spurred significant growth in ADUs.⁵

However, despite this legislative progress, constructing an ADU in California remains prohibitively expensive for many. An analysis of ADU construction data suggests that the average ADU cost in California is \$167,000, though the cost varies by region and the size/quality of the ADU.⁶ In Los Angeles, the average cost estimate is \$148,000 while the average cost in the Bay Area is \$237,000, a gap that is driven largely by differences in labor costs between the two regions. In fact, ADU construction costs in the Bay Area can exceed \$800 per square foot, equaling \$400,000 for a 500 square foot ADU.

Options to finance the significant expense of an ADU remain limited. This is an issue for households wanting to build an ADU, as they are often motivated to add an additional housing unit for financial reasons. According to a survey of ADU owners in Portland, OR, obtaining supplemental income was the biggest motivating factor in their decision to build an ADU, and obtaining financing, paying for construction, and permitting fees were their most common obstacles. Most funded their ADU developments with either cash, a home equity line of credit, or cash-out refinancing. Many owners reported needing to use multiple sources of financing, which indicates a lack of mainstream financial products available to assist them in ADU construction.⁷

Table 1. ADU Financing Methods and Homeowners Best Served

Financing Method	Who is best served by this method?
Existing Cash Savings or Support	Owners with sufficient cash saved outside the value of their home or who have cash support from family and friends, and do not wish to take on debt.
Cash-Out Refinance Loan	Owners with significant home equity who are refinancing to take advantage of lower interest rates or to extend the length of their repayment term.
Home Equity Loan or Home Equity Line of Credit (HELOC)	Owners with significant home equity who do not want to refinance with higher interest rates. When interest rates are high, taking out a smaller second mortgage through a HELOC may make more sense than refinancing the first mortgage at a higher rate.
Renovation Loan	Owners with high income but without significant home equity, buyers looking to purchase “fixer-uppers,” or those who wish to leverage financing without liquidating savings.

Source: Adapted from UC Berkeley Center for Community Innovation, 2017.

Previous Termer Center research on ADU owners in Cascadia similarly demonstrated that most ADUs are built to create extra income or provide housing for a close family member or helper. This study found that a majority of ADUs are used for long-term housing solutions, and in some cases the additional rental income would allow individuals to purchase their entire property. Zoning reforms and an owner’s ability to obtain cash were the top factors cited in decisions to build, a finding that supports legislative efforts to facilitate ADU development and financing.⁸

Unfortunately, few loan products exist to finance ADU construction, and those that are available often do not go far enough in assisting property owners to build them. Traditional loan products are not designed for ADU financing, as most lenders are unwilling to expose themselves to additional risk. The mainstream tools currently available are a cash-out refinancing, a home equity loan or line of credit (HELOC), or renovation

financing. Cash-out refinancing and home equity loans let a homeowner tap into the existing equity of their home. However, Government-Sponsored Enterprises (GSEs) limit these loans to only part of the equity that an owner has on their home. The resulting amount is often not enough to fully finance an ADU, especially when the homeowner already has a mortgage on their property. In the current financial climate, private bank lenders tend to be unwilling to lend beyond these established benchmarks and only make exceptions for very high-net worth borrowers or those with pristine credit scores, further restricting the usefulness of these loan products. The third option, renovation financing, is limited by the length of time of the construction project and the area where the project occurs. Therefore, an ADU project timeframe that is too narrow or in a location with few or no ADUs does not provide an adequate benchmark for lending.⁹ Table 1 outlines the conditions under which each financing option is most ideal for homeowners.

Table 2. Households by Income and Equity in Comparing Existing Mortgage Products

	High-Income	Low-Income
High Home Equity	Cash-Out Refinance or Home Equity Loan/HELOC	Special FHA, Reverse Mortgage, or Fannie Mae Loan Products
Low Home Equity	Renovation Loan	Cash Savings and Personal Resources

Level of Difficulty Finding and Qualifying for Loan Products:

Least Difficult



Most Difficult

Source: Adapted from UC Berkeley Center for Community Innovation, 2017.

In addition to these limitations, the existing array of financial products is incompatible with ADUs because they solely take into account the current value of a property and prevent owners from borrowing against the expected rental income that an ADU will generate.¹⁰ There are some tightly-constrained exceptions to this rule related to GSE construction loans. For the most part, however, this standard stems from longstanding and outdated perceptions of properties with ADUs. Institutions like Fannie Mae, Freddie Mac, and the U.S. Department of Housing & Urban Development (HUD) continue to drive lenders and appraisers to assess ADUs in very conservative ways that do not account for their income generation potential.¹¹ Additional structural issues prevent large-scale lending for ADUs. The smaller size of these types of loans compared with traditional home loans means that they are more costly for lenders. Private lenders are also unwilling to create new loan products specifically designed for ADUs without assurance that they will be insured or backed by GSEs.¹² This makes it nearly impossible for owners to receive the proper capital necessary to fully finance their prospective ADU projects. Many must resort

to cobbling together a variety of funding sources or using cash savings to finance an ADU on their own, making ADUs less accessible for many lower-income owners who could stand to benefit the most from a supplemental stream of rental income. Lower-income households with and without significant amounts of home equity are the most underserved by traditional mortgage lending when attempting to finance an ADU, despite the fact that these households could gain meaningful resources through an ADU's supplemental rental income (Table 2).

In response to growing interest and demand for ADUs, various jurisdictions across California are providing creative financing options. For example, Los Angeles has piloted two programs to promote ADUs. The [Backyard Homes Project](#) provides ADU construction loans for homeowners that rent them to low-income Housing Choice Voucher recipients for at least five years after completion. The program is coordinated by LA Más, a nonprofit design group, and includes support from local community development financial institutions and larger corporate lenders. Similarly, the [Second](#)

[Dwelling Unit \(Accessory Dwelling Unit\) Pilot Program](#) aims to provide housing for homeless people in Los Angeles through direct subsidies toward building new ADUs or preserving unpermitted ADUs. Santa Cruz County offers an [ADU Forgivable Loan Program](#) that provides loans of up to \$40,000 to homeowners who rent an ADU to a low-income household at an affordable rent for up to 20 years. The loan is forgiven after 20 years if the ADU has been rented with the low-income restriction for the entire 20-year term. The [My House My Home Program](#) is a partnership between Habitat for Humanity Monterey Bay, the City of Santa Cruz, Santa Cruz County, and Senior Network Services that helps build and renovate affordable ADUs for low-income senior homeowners in the area. The City of Napa's [Junior Unit Initiative Program](#) provides homeowners with technical assistance and up to \$50,000 of below-market forgivable financing for converting or creating a JADU and renting it to a low-income tenant at an affordable rate. The Silicon Valley Housing Trust sponsors the [Small Homes, Big Impact](#) initiative, which provides a three-year construction loan at a competitive rate. Eligible expenses include hard and soft costs, and any ADU built using these funds is subject to a two-year minimum affordability restriction (tenant must have income below 120% AMI). In addition, the California Department of Housing and Community Development (HCD)'s CalHome program helps low- and very low-income homeowners fund ADUs.

Municipalities outside of California have also attempted to facilitate ADU construction by offering creative financing options. In Brooklyn, NY, the NYC Department of Housing Preservation and Development and the Cypress Hills Local Development Corporation have partnered to launch the [Basement Apartment Conversion Pilot Program](#), which provides homeowners living in the Cypress Hills/East New York community with low-interest, no-interest, or forgivable loans and technical assistance to convert their basements into safe apartment-style JADUs that can be rented for supplemental income. In Boston, the city government set aside \$650,000 to create an [ADU Loan Program](#) to promote construction of ADUs based on the success of a previous pilot initiative. The program grants no-interest loans of up to \$30,000.

A number of private firms on the West Coast have also begun specializing in ADU lending or construction. Companies like Dweller, United Dwelling, and Rent the Backyard help homeowners build an ADU with no upfront cost to the homeowner. The companies retain ownership of the unit and a portion of the rent received. Equity-sharing companies provide another financing option by purchasing a portion of the equity of an owner's home. The owner can then use the proceeds to build an ADU.

While more municipalities and private firms are recognizing the new market for ADUs, the aforementioned programs are limited in scope and do not address the overall dearth of ADU financing options. Specifically, programs highlighted in this section rely on small amounts of public and private funding relative to what is needed to create large-scale ADU feasibility. The aforementioned Brooklyn pilot program was capped at serving 40 local households. The Los Angeles Second Dwelling Unit Pilot Program only provided funding to build or preserve a maximum of six ADUs. Although it assists lower-income households with ADU financing, the CalHome program has only one funding stream focused on ADUs for the entire state.

Thus, not surprisingly, a 2020 survey by the Center for Community Innovation found that among California jurisdictions, lack of financing is now the number one barrier to more widespread ADU construction—almost twice as influential as physical site limitations and lack of desire or awareness among homeowners.¹³ Financial barriers are particularly daunting in San Francisco Bay Area and Inland Empire jurisdictions.¹⁴

Methodology

To analyze recent growth trends in ADU production in California, we compiled data from HCD's Annual Production Reports for 2018 and 2019, which include statistics from California jurisdictions on permitted and completed ADUs (i.e., those with a certificate of occupancy). We then linked this data to parcel-, tract- and zip code-level characteristics from multiple sources. We used tax assessor datasets of California's 12.5 million parcels to draw out data on the physical characteristics of parcels (e.g., lot size and built area),

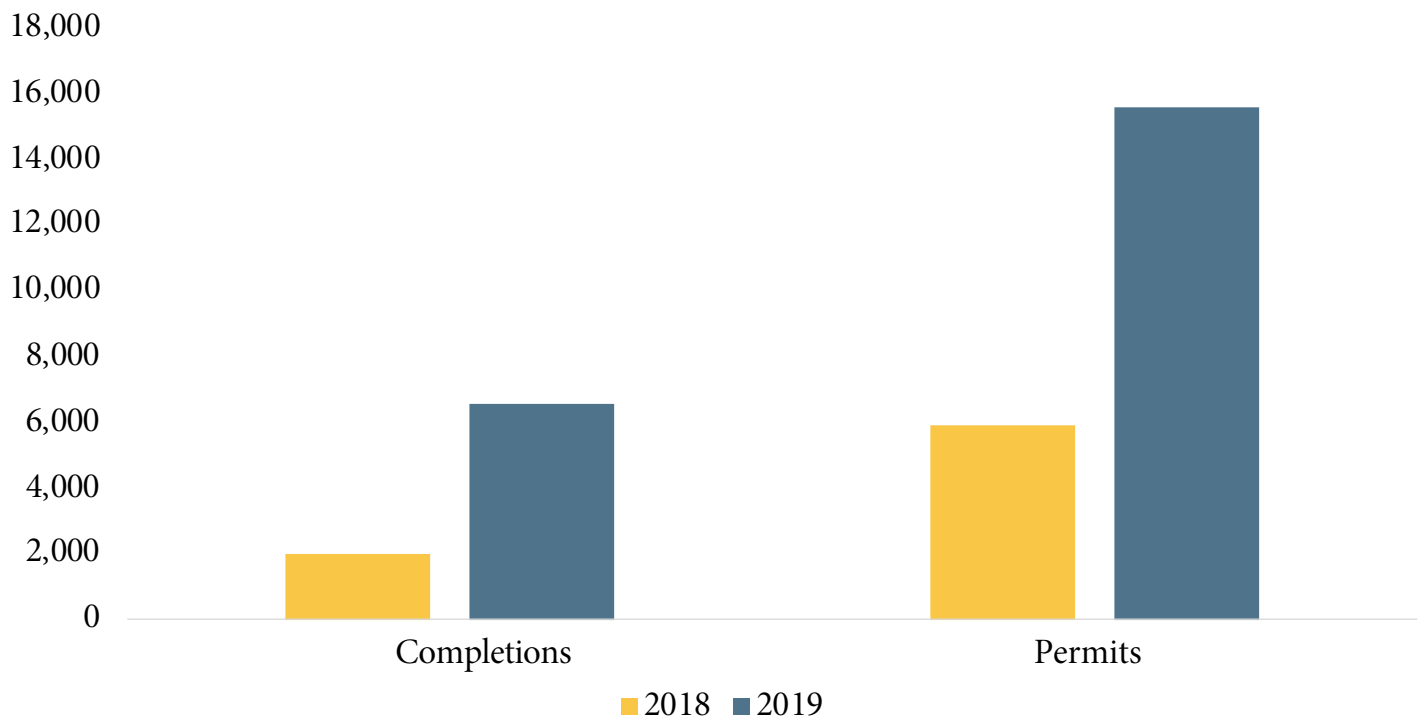
the characteristics of homeowners (e.g., corporate versus individual), and the years since sale. From the American Community Survey (ACS), we linked data on race and ethnicity, income and rent, household structure, and tenure type. For the ACS data, we eliminated all unreliable data (i.e., data with a large margin of error). We then added home values from the Zillow Home Value Index, employment information from the Longitudinal Employer-Household Dynamics program (LEHD), and distance to transit from the US Environmental Protection Agency (EPA)’s Smart Location dataset. To identify low and high resource areas, we relied on the TCAC Opportunity Area maps, which use a compound indicator based on many of the same economic characteristics, but also including data on education and health.

Findings

ADU permits and completions have increased significantly in recent years.

ADU construction in California has surged with the passage of new legislation. Jurisdictions went from issuing 5,911 permits in 2018 to 15,571 in 2019. Although ADU completions tend to lag behind permits due to construction timelines and the time it takes a homeowner to secure financing, these completions more than tripled from 1,984 to 6,668 over this period (Figure 1). The highest producing counties are Los Angeles, Santa Clara, and San Diego, though ADU production has also spread to the Inland Empire, the greater Sacramento region, the Central Coast, and other areas (Figure 2). Comparing progress year-over-year in the state’s major cities and regions, Figure 3 reveals continued growth, with Los Angeles producing the largest number of units.

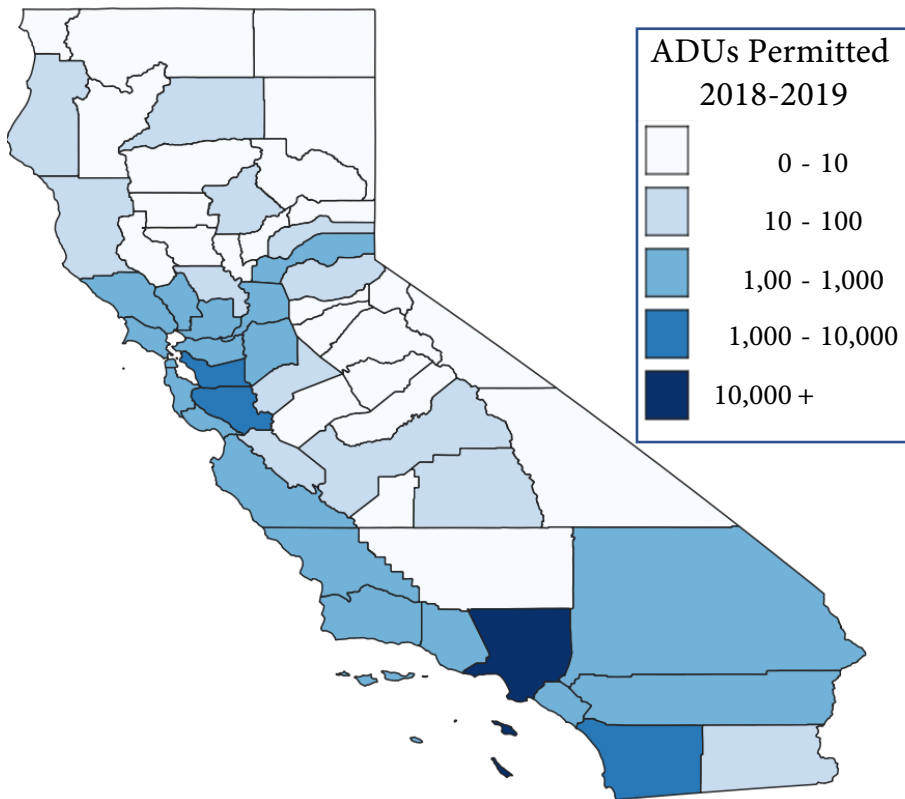
Figure 1. ADU Permits and Completions in California, 2018 and 2019



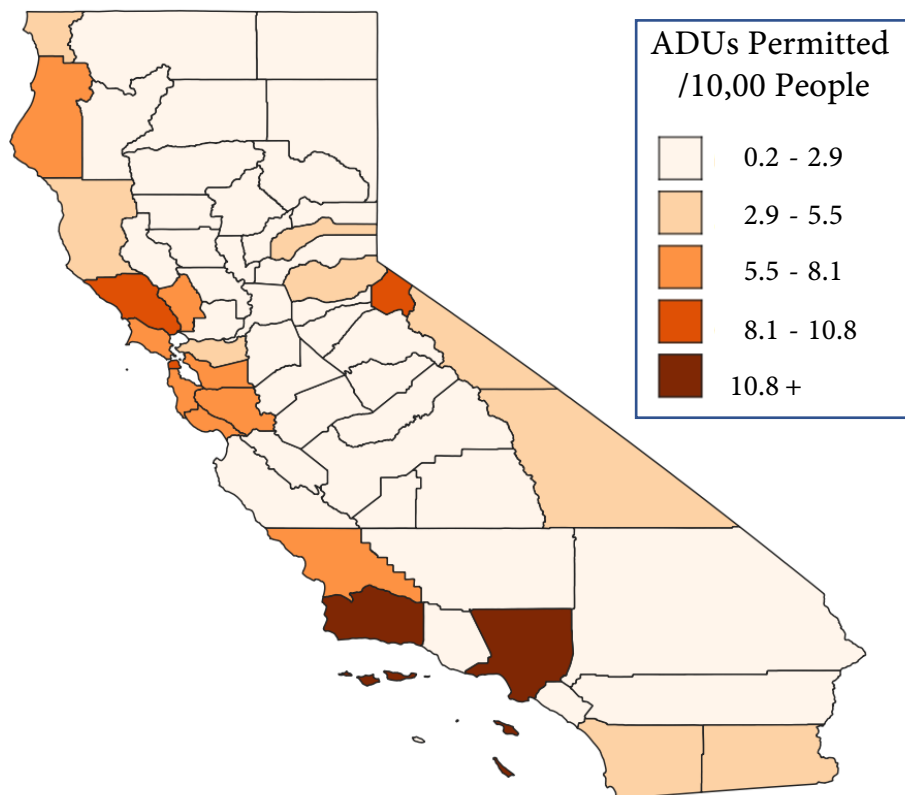
Source: Calculated by the authors from Annual Production Report data (California Department of Housing and Community Development).

Figure 2. ADUs Permitted in 2018 and 2019 by County

ADU Permits - Counties (2018-2019)



ADU Permits / 10,000 People - Counties (2018-2019)

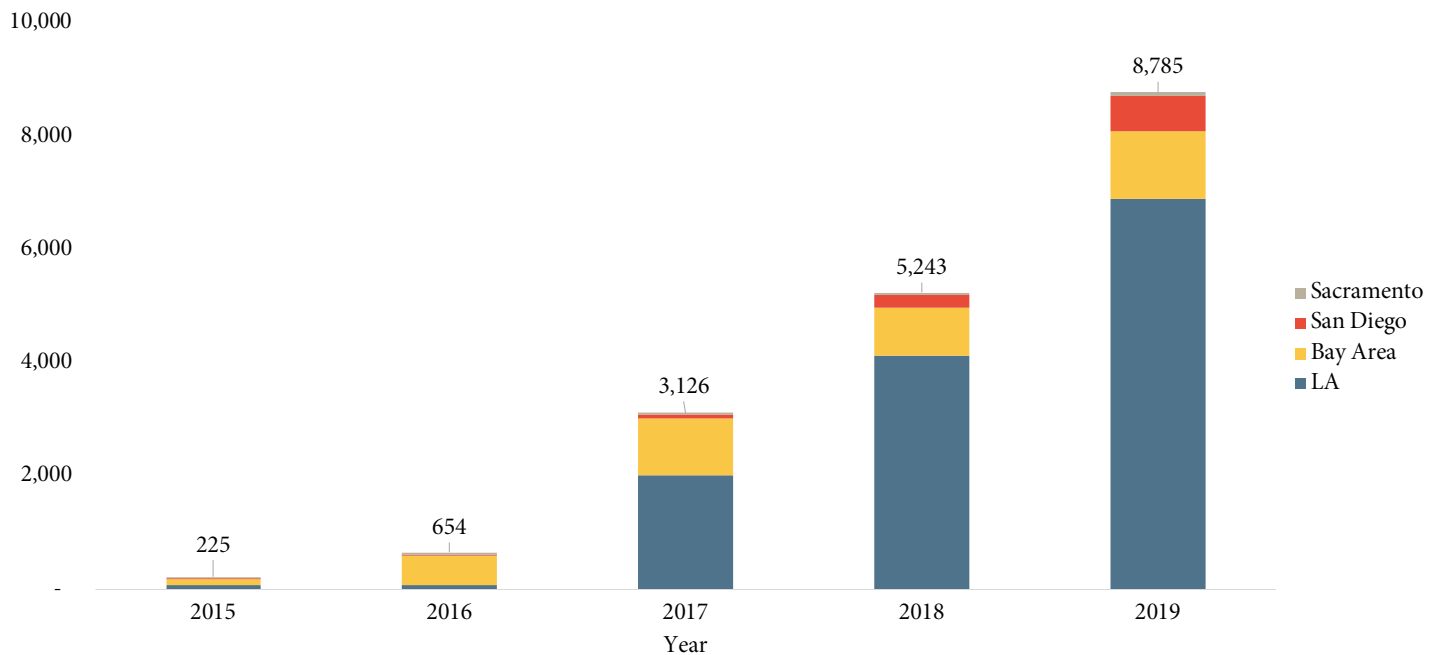


Source: Calculated by the authors from Annual Production Report data (California Department of Housing and Community Development) and 2018 American Community Survey data (U.S. Bureau of the Census).

While overall ADU growth is significant, there is an imbalance in who is building ADUs and where ADUs are built. Specifically, property owners living in more affluent areas are more likely not only to obtain ADU permits, but also to complete their ADU building projects. The following figures examine permitting and completions relative to share (quartile) of the California parcels to reveal where a disproportionate share of ADU activity has taken place. Figure 4 shows that in neighborhoods (census tracts) in the lowest quartile of median income for the state, ADU permitting and completions have lagged, while the highest quartile has seen a disproportionate share of permitting and completions. Looking at neighborhoods by home value,

the differences are much more dramatic. As shown in Figure 5, which compares property owners by quartile of home value across the state, just two percent of property owners in the lowest quartile have permitted or completed ADUs, compared with about 40 percent in the top two quartiles (or neighborhoods with above-median home values). These patterns vary by region across the state. Figure 6 shows the concentration of ADU permitting and construction in California's high-cost coastal regions. Figure 7 reveals that most of the Bay Area's ADU activity has been taking place in high-cost zip codes, while Figure 8 shows that in Southern California, some lower-cost zip codes have seen significant permitting and construction as well.

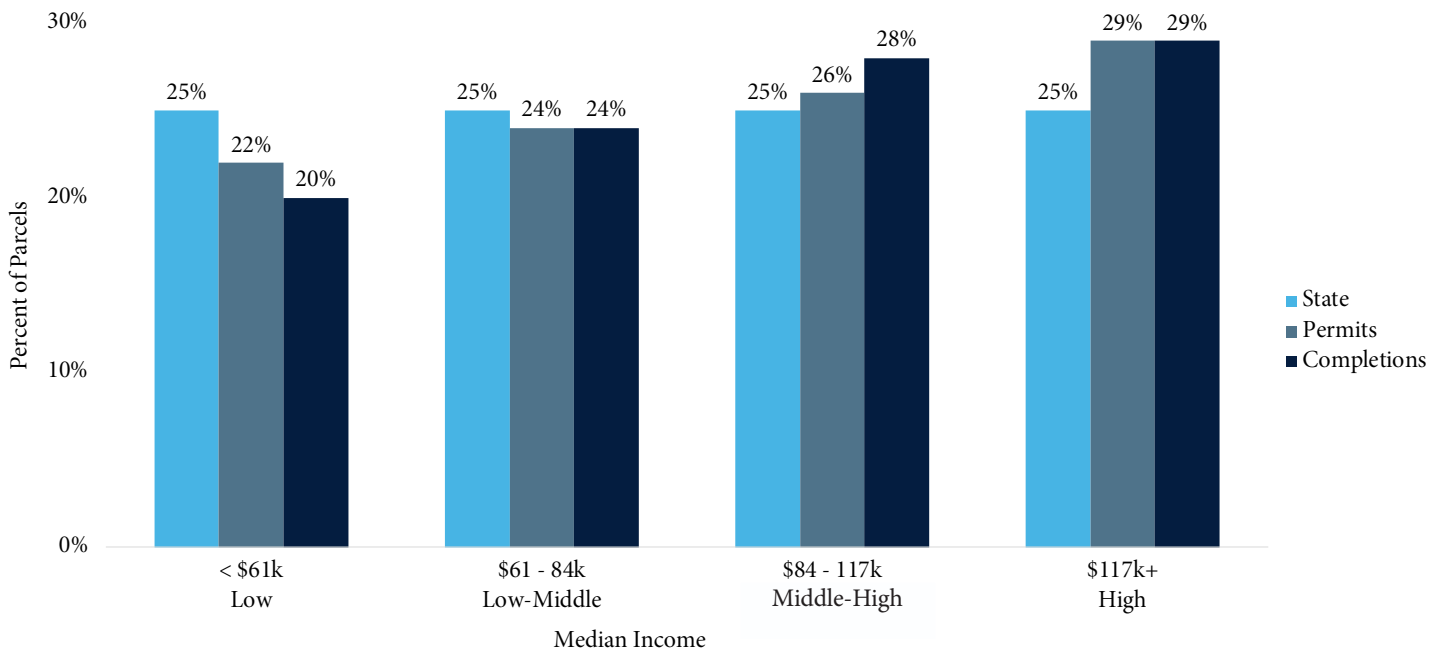
Figure 3. ADUs Permitted in California's Major Metropolitan Regions, 2015-2019



Sources: 2015-2017 data: [“ADU Update: Early Lessons and Impacts of California’s State and Local Policy Changes”](#).

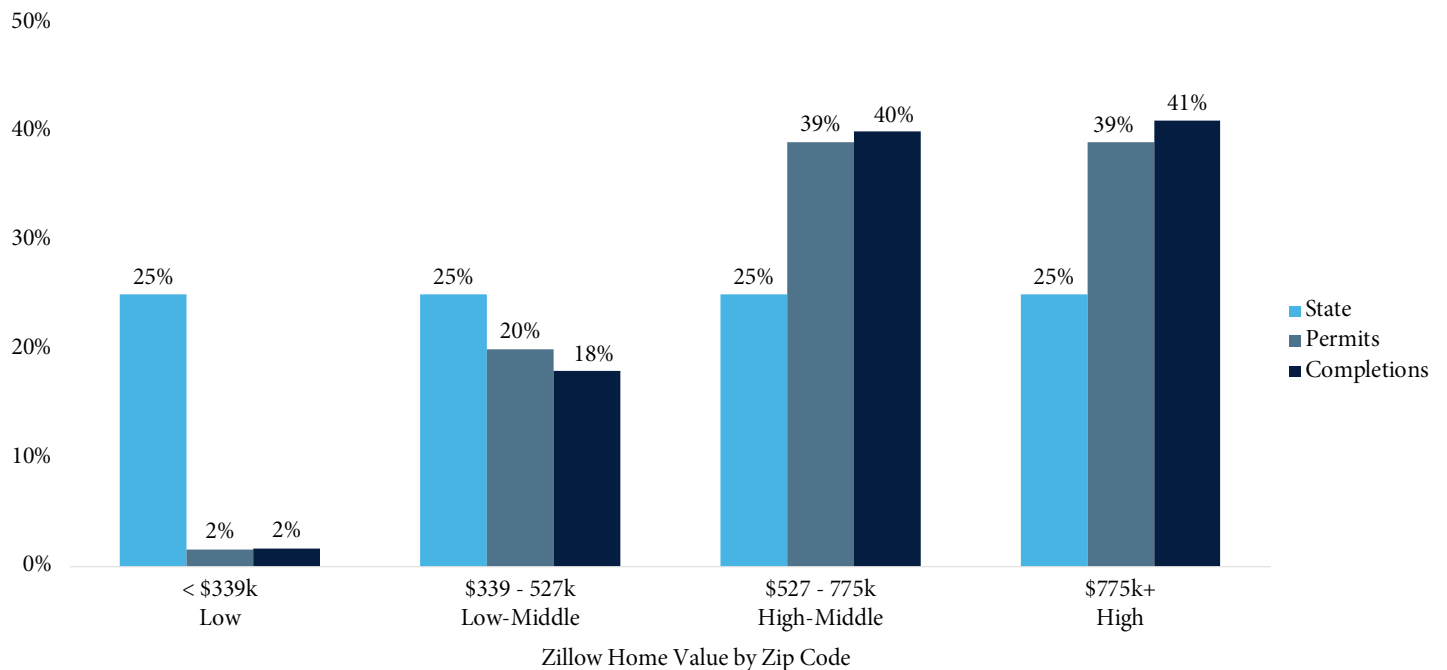
2018-2019 data: Calculated by the authors from Annual Production Report data (California Department of Housing and Community Development). Note: “LA” includes the cities of Los Angeles and Long Beach. “Bay Area” includes the cities of San Jose, Oakland, and San Francisco. “Sacramento” and “San Diego” include their namesake cities only.

Figure 4. ADU Permits and Completions by Tract Median Income Quartile



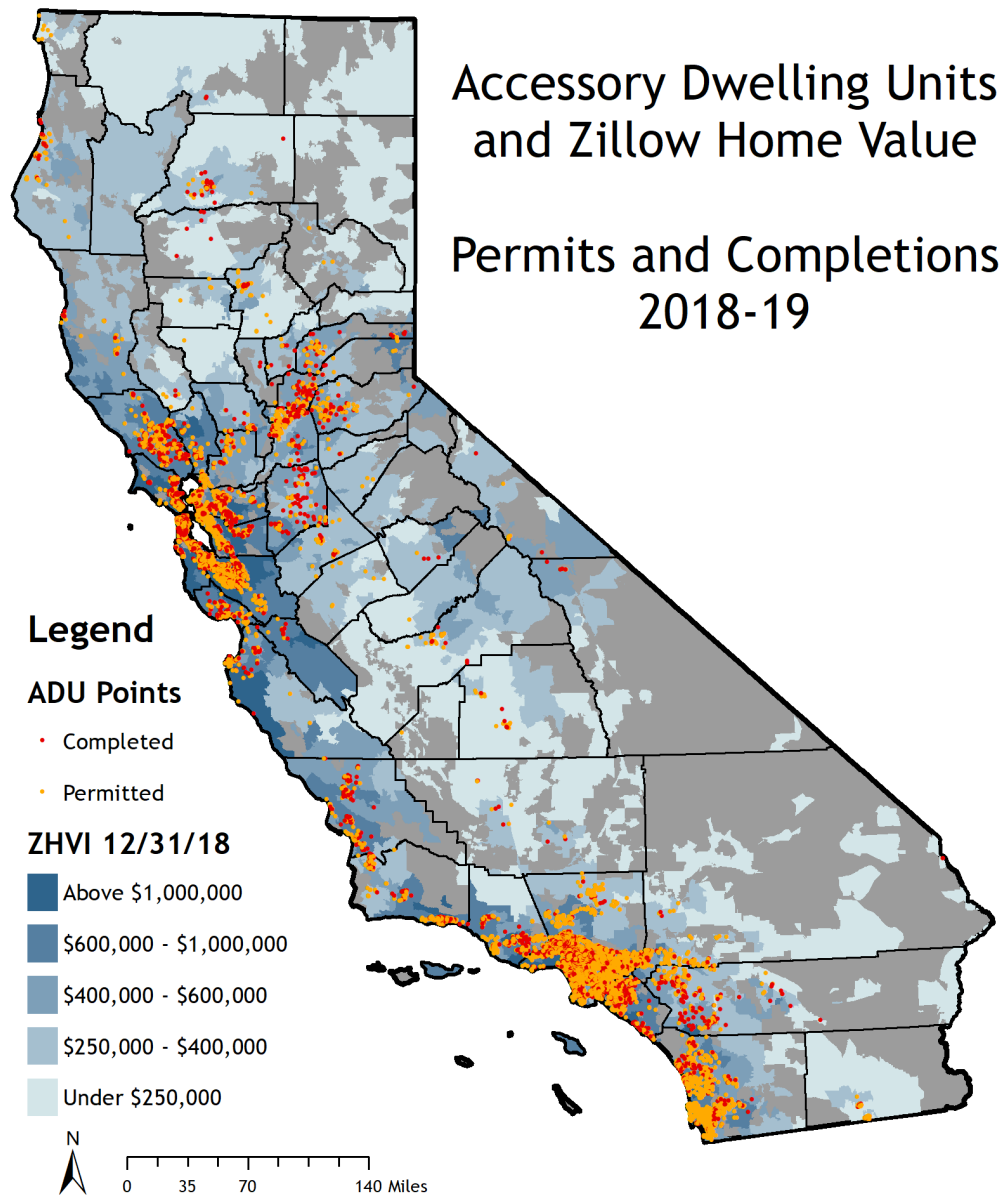
Source: Calculated by the authors from Annual Production Report data (California Department of Housing and Community Development) and 2014-18 American Community Survey data (U.S. Bureau of the Census).

Figure 5. ADU Permitting and Completions by Home Values in Zip Code



Source: Calculated by the authors from Annual Production Report data (California Department of Housing and Community Development) and Zillow Home Value Index data.

Figure 6. ADU Permits and Completions with Zillow Home Value by Zip Code



**Figure 7. ADU Permits and Completions with Zillow Home Value:
San Francisco Bay Area**

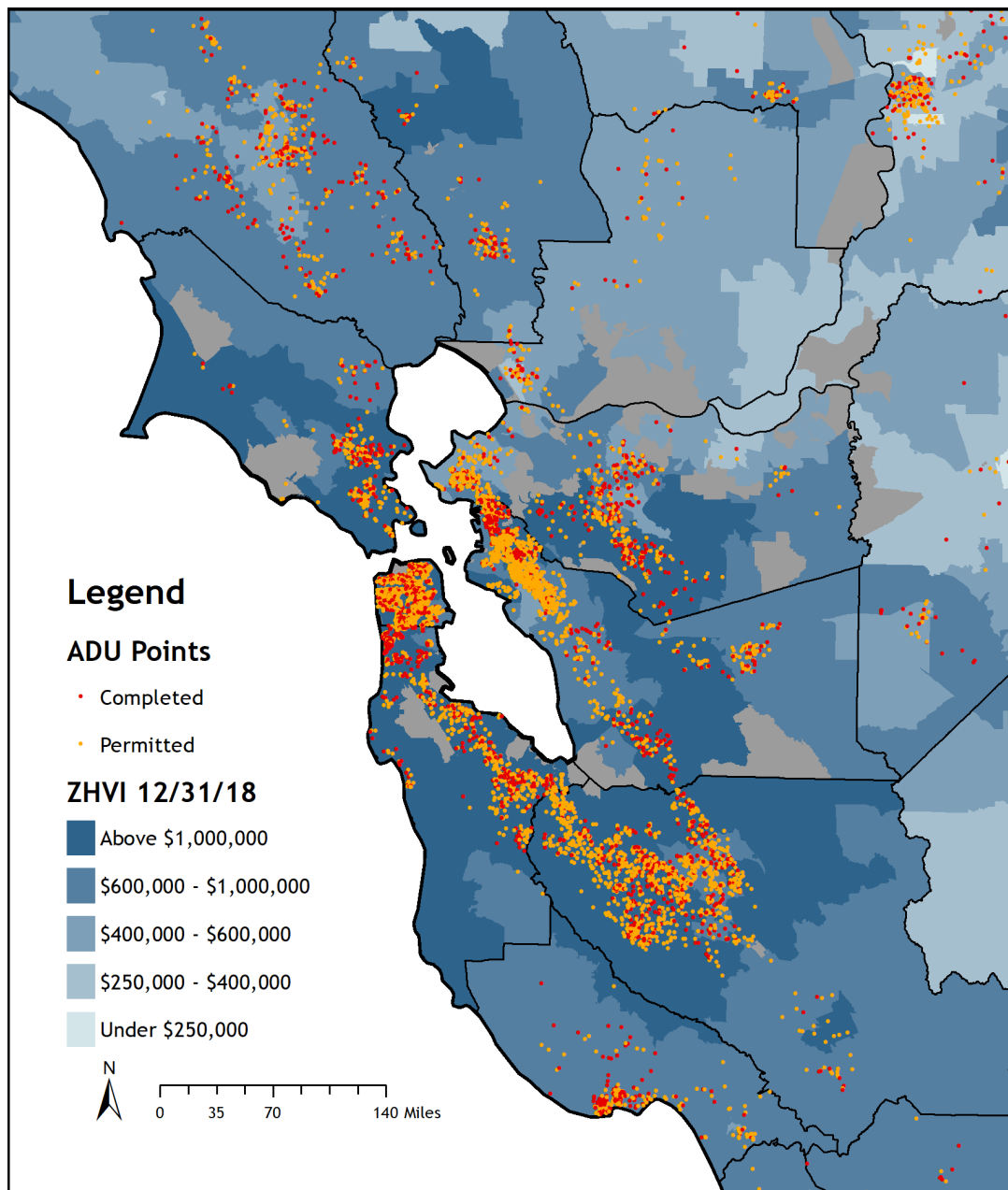
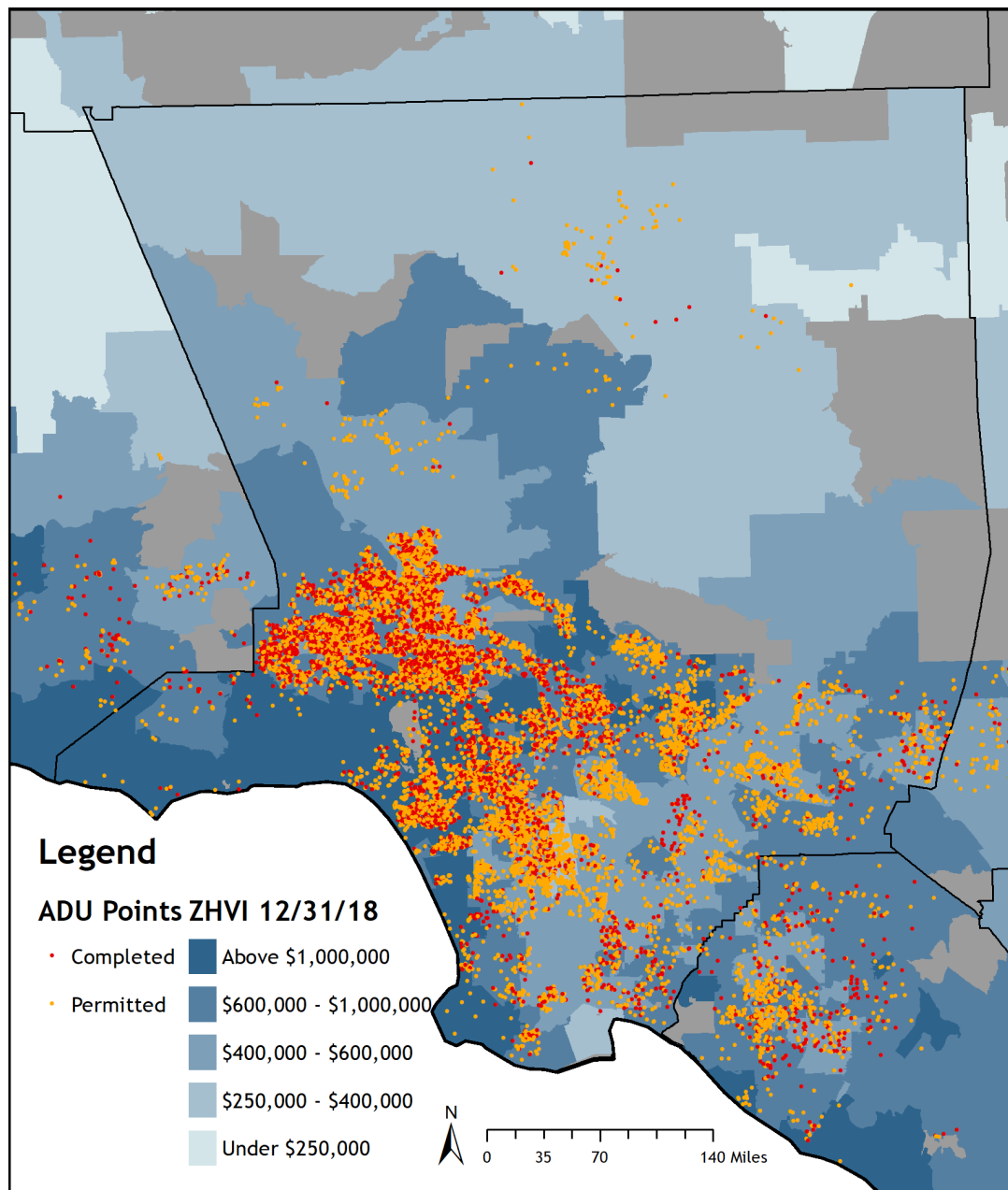


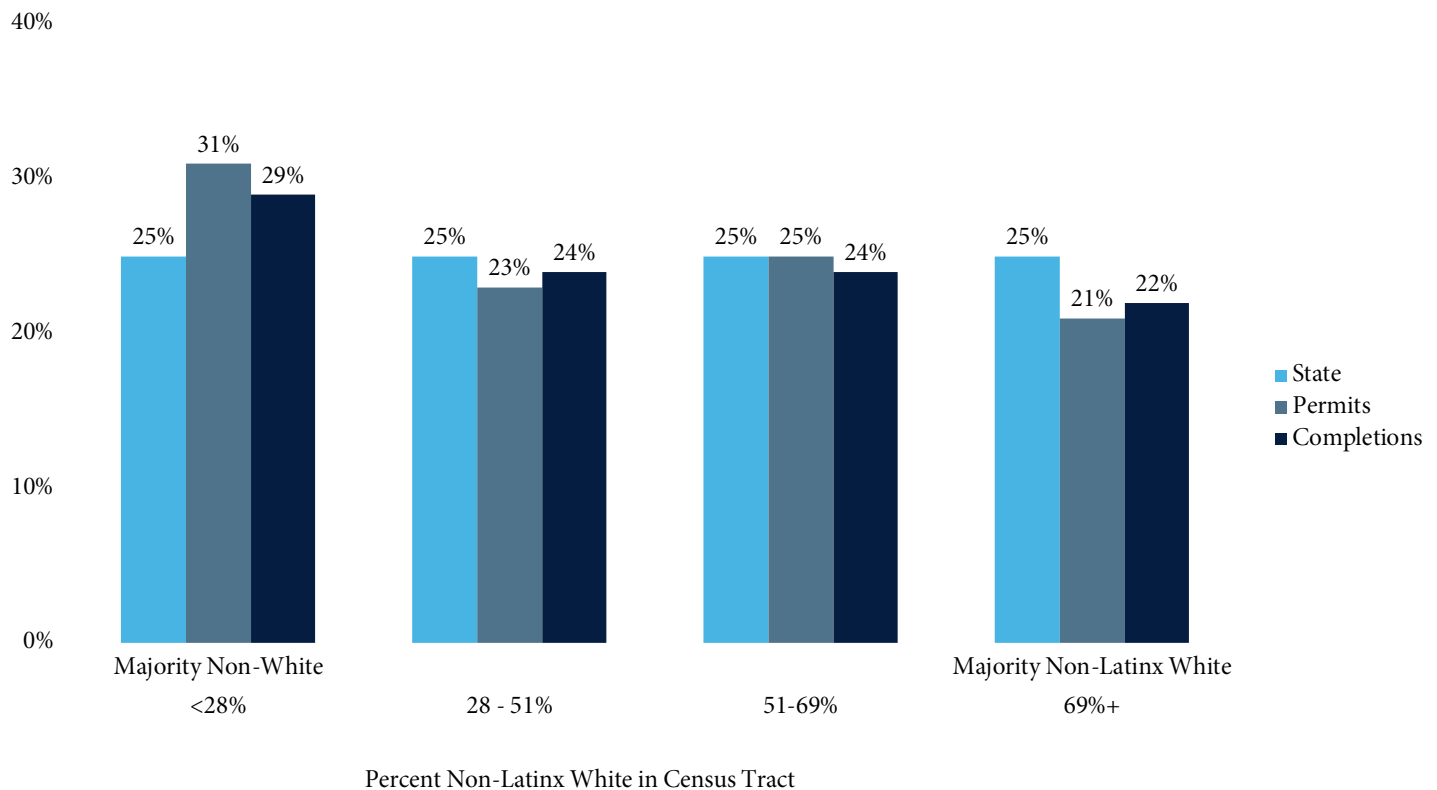
Figure 8. ADU Permits and Completions with Zillow Home Value: Southern California



Exploring other variables presents a more nuanced picture. In particular, neighborhoods with ADU permitting are diverse in terms of race and ethnicity. Looking at ADU patterns by tract share of non-Latinx Whites, Figure 9 shows that majority non-White areas are disproportionately likely to permit and complete ADUs. This finding is perhaps not surprising given how ADU production in Los Angeles, California's most diverse region, dominates the rest of the state. Looking at ADU patterns by tract median rent quartile, Figure 10 confirms that ADU permitting and completions have lagged in the neighborhoods in the lowest quartile of median rent for the state, but shows that the two middle quartiles have outperformed the highest quartile in ADU production.

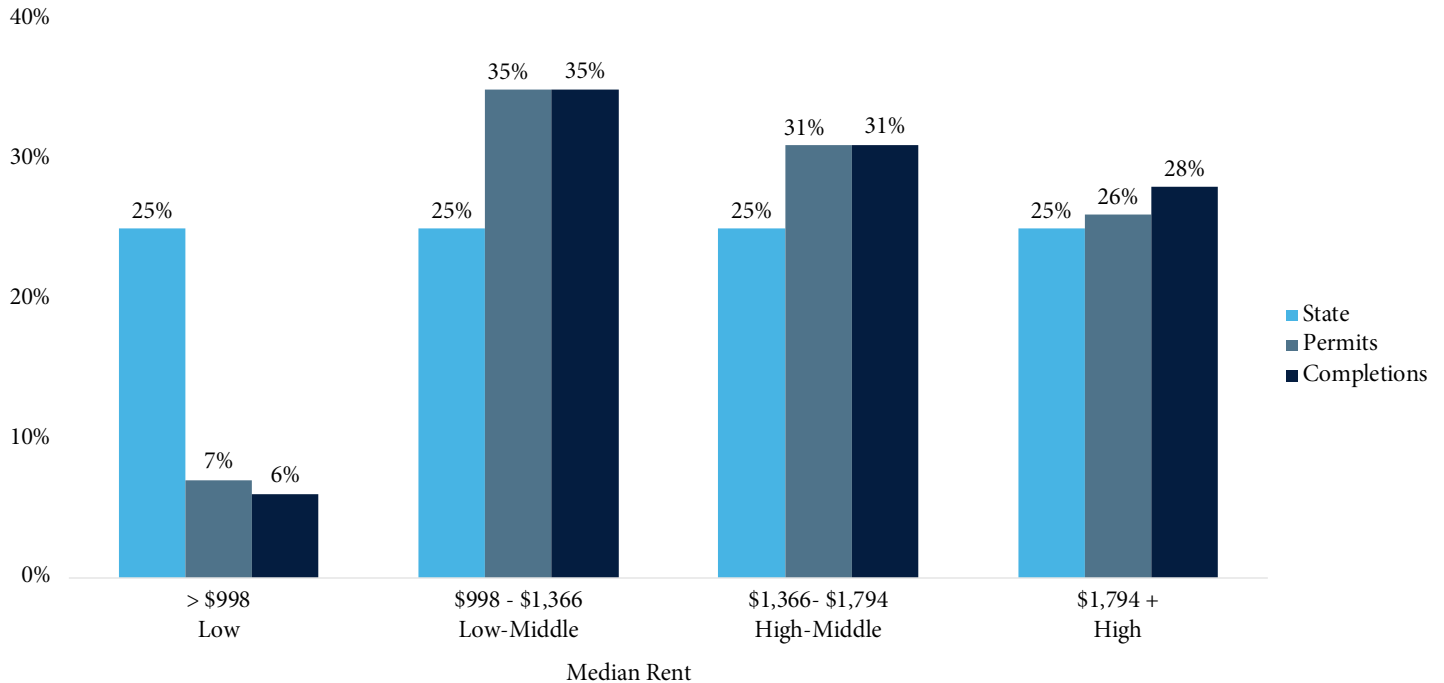
Mapping ADU permits and completions against the TCAC opportunity areas provides another way to analyze ADU production in relation to income and racial inequality. As Figure 11 shows, Los Angeles and Orange County experience most of their building in low resource areas, while moderate and higher resource areas see most ADU construction in other regions. In other words, though all types of communities are embracing ADUs, exclusive areas in Southern California are less likely to produce ADUs, while elsewhere, low resource areas lag behind. These low resource areas in regions like the Bay Area and San Diego are the areas where homeowners are most likely to require assistance in procuring ADU finance.

Figure 9. ADU Permits and Completions by Tract Share of Non-Latinx Whites



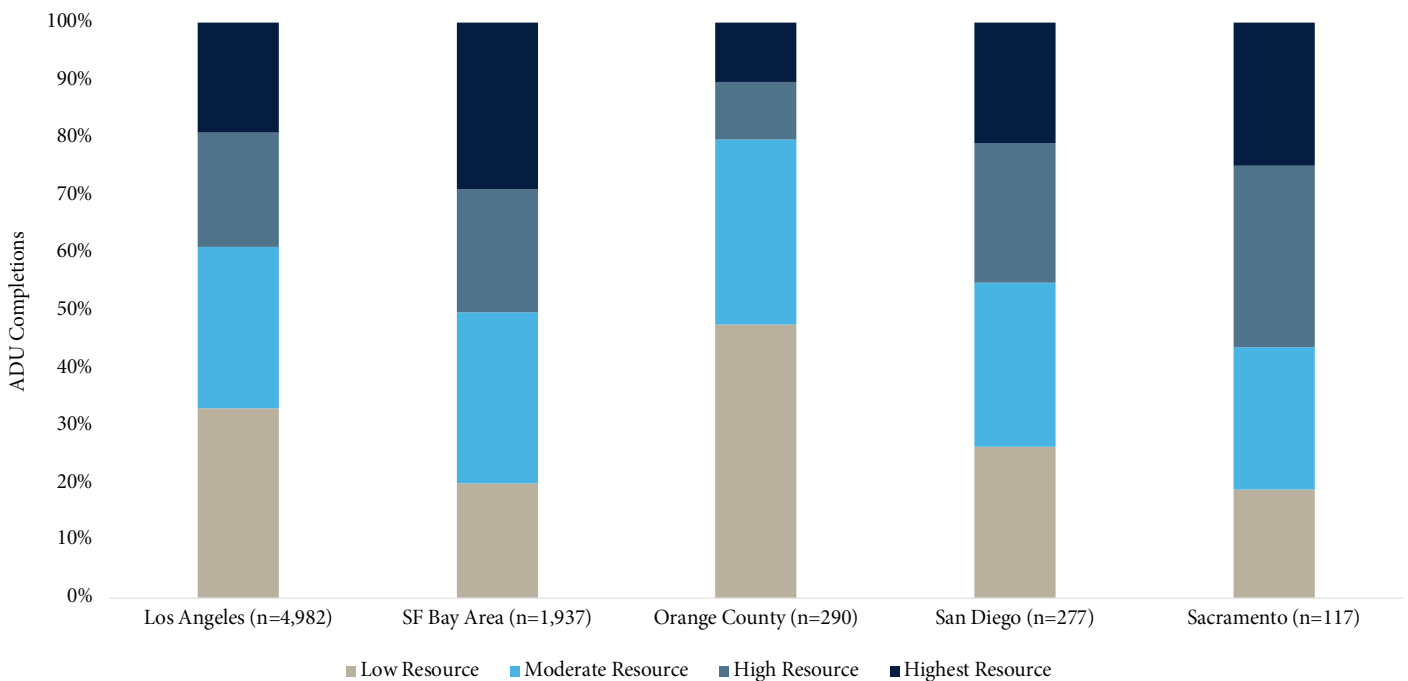
Source: Calculated by the authors from Annual Production Report data (California Department of Housing and Community Development) and 2014-18 American Community Survey data (U.S. Bureau of the Census).

Figure 10. ADU Permits and Completions by Tract Median Rent Quartile



Source: Calculated by the authors from Annual Production Report data (California Department of Housing and Community Development) and 2014-18 American Community Survey data (U.S. Bureau of the Census).

Figure 11. ADU Completions by Resource Level and Region



Source: Calculated by the authors from Annual Production Report data (California Department of Housing and Community Development) and TCAC/HCD Opportunity Area Maps downloaded from: <https://www.treasurer.ca.gov/ctcac/opportunity.asp>. “Low Resource” includes “Low Resource” and “High Segregation and Poverty” designations. “Moderate Resource” includes “Moderate Resource” and “Moderate Resource (Rapidly Changing)” designations.

Who is permitting and building ADUs in California?

Data on individual property characteristics and ownership shed light on the specific conditions under which ADUs are being built. The median lot size for ADUs in California is 6,930 square feet, and most ADUs (about 80 percent) are built on lots ranging from 3,000 to 14,000 square feet. Just five percent of completions are on lots less than 3,000 square feet. Likewise, most ADUs are completed on lots in the medium range in terms of the ratio of existing built square footage to lot size (floor area ratio). The median ADU is built on a lot with a ratio of floor area to lot size of just 20 percent, and just 17 percent of ADUs have been completed on lots with either a very low or high floor area ratio. Homeowners who permit and construct ADUs are disproportionately likely to have bought their property in the last five years, and long-term homeowners (owning for more than ten years) are slightly less likely to build them. In general, properties held by individuals, rather than companies, are disproportionately more likely to permit and construct ADUs; although some 17 percent of residential property in the state is owned by companies and organizations, they construct eight percent of ADUs.

To examine which property owners are more likely to build an ADU while controlling for other factors, we ran logit regression models predicting the likelihood of a parcel obtaining an ADU permit or completion. Table 3 displays the results for several regions and the state, showing the direction of the effect only where variables were significant.¹⁵ Because Los Angeles produces most of the state's ADUs (in part because of lower construction costs), it has more significant results that dominate the overall picture in California.¹⁶ The table clarifies that the response to the new ADU regulations has varied widely across the state. Homeowners in high home value areas across the state are more likely to construct ADUs, but those in lower-income, lower-rent areas are also more likely to build (with the exception of the Bay Area). The other significant variables in the Los Angeles case reveal further nuance; here, neighborhoods with higher proportions of non-Latinx White, Latinx, and/or Black populations are all more likely to build ADUs, controlling for all else, as are those with high overcrowding (people per room), smaller lots, and more

recently purchased homes. In the Bay Area and San Diego, only the non-Latinx White variable is consistently significant and positive. In San Diego, homeowners with smaller lots are more likely to build ADUs, but in contrast to Los Angeles, the likelihood is greater when there are fewer people per room. Overall in California, ADU production is occurring in diverse, transit-accessible neighborhoods where a greater share of homeowners still have a mortgage, and specific properties are more likely to gain an ADU if owned by a homeowner than by a company. A separate regression reveals that ADU permitting and construction in Los Angeles, similar to the state, is less likely in high resource areas and more likely in low resource areas. Meanwhile, in the Bay Area, high resource areas are both permitting and building ADUs, while low resource areas are slower to actually complete ADU construction.

These findings have important implications for how California should approach ADU finance. Although there is some variation across California, in general, areas with higher home values see more ADU production, suggesting that high home equity is enabling many to build. In many cases, it seems that homeowners are building within the first few years after they acquire the home and/or building while they have a mortgage, suggesting that financing may be easier in conjunction with a new home purchase and mortgage. The surge in ADU production is led by homeowners, not companies. Institutions seeking to finance ADUs should note that the sweet spot for building seems to be medium-size lots with significant existing built square footage. Though a great variety of Los Angelenos are finding a way to build ADUs, homeowners building in the Bay Area and San Diego tend to live in higher-opportunity areas. This suggests a particular need for ADU finance for low- and moderate-income homeowners in these regions.

Recommendations

To increase low- and moderate-income homeowners' access to ADUs, better financing tools and increased homeowner education are necessary.

Today, Fannie Mae, Freddie Mac, and the Federal Housing Administration (FHA) are responsible for the large majority of the mortgages for 1-4 unit structures.

Table 3. Analyzing the Factors behind Permitting and Building ADUs in 2018 and 2019

Variable Type	Los Angeles County		SF Bay Area		Capital Region	
	Permits	Completions	Permits	Completions	Permits	Completions
Property						
Homeowner as resident	+	+				
Company owned	-	-	-	-		
Lot square footage	-	-			+	+
Years owned	-	-	-			
Neighborhood						
Population density	-	-	+			
Transit accessibility	+	+	+			
Average household size	-	-	-	-		
Median age of residents	+	+	+	+		
Number of jobs	-		-		-	-
Median family income	-	-	+	-		
Median rent	-		-		-	-
Home value	+	+	+	+		
Percent non-Latinx White residents	+	+	+	+		
Percent Black residents	+	+	+			
Percent Latinx residents	+	+	+			
Percent of homes with a mortgage	+	+				
Average people per room	+	+				

Table 3 Cont.

Variable Type	San Diego County		California	
	Permits	Completions	Permits	Completions
Property				
Homeowner as resident			+	+
Company owned			-	-
Lot square footage	-	-	-	
Years owned			-	-
Neighborhood				
Population density	-		+	+
Transit accessibility	N/A	N/A	+	+
Average household size		+	-	-
Median age of residents		-	+	+
Number of jobs	-		-	-
Median family income		-	-	-
Median rent	-		-	
Home value	+		+	+
Percent non-Latinx White residents		+	+	+
Percent Black residents		-	+	+
Percent Latinx residents			+	+
Percent of homes with a mortgage			+	+
Average people per room		-	+	+

Note: If the coefficient for a given independent variable is greater than zero, meaning that the independent variable has a positive effect on the dependent variable, a (+) is shown above. If the coefficient is negative, then a (-) is shown.

Dataset includes California's 10.1 million residential parcels, excluding other types. Two logistic regressions are performed for each region—one with a dependent variable of whether or not each parcel has obtained a permit to build an ADU ("Permits") and another with a dependent variable of whether or not each parcel has obtained a certificate of occupancy ("Completions"). Independent variables with a p-value of less than 0.05 are deemed non-significant and are not included in the table above. Data on transit accessibility is not available for San Diego.

Homeownership purchase and refinance has remained relatively healthy during the recent economic downturn due to the Federal Reserve Bank's unprecedented infusion of capital into the mortgage markets, enabling historically low interest rates. Yet, absent a homeowner being able to document an existing ADU with a year or more of rental income, current government-backed mortgage programs do not allow underwriting against unrealized rents. In the context of some very limited pilots, Fannie Mae has offered to waive their requirement for in-place ADU tenants in exchange for a variety of fairly onerous risk-mitigants, including third-party corporate guarantees and/or professional property management. Expanding these kinds of waivers—or enabling ADU-specific construction lending programs—will require leadership from Fannie and Freddie's regulator, the Federal Housing Finance Agency (FHFA), which has typically focused on restraining the scope of Fannie and Freddie's innovation. And while HUD Secretary Ben Carson has publicly expressed interest in making FHA's programs work better for ADUs, little has materialized to date in terms of substantive reforms to existing programs. This needs to become a priority, either for a new administration or for a new HUD Secretary and FHFA Regulator.

Absent changes at the federal level, the state of California can also lead on this issue. To do so, we recommend that the state consider providing support or incentives for ADU construction financing provided by private lenders, which could act as a bridge to GSE refinance products. For example, this could mean creating a financial product through the California Housing Finance Agency (CalHFA) and/or local housing finance agencies to cover a portion of losses to private lenders resulting from default, prior to a homeowner refinancing into a Fannie Mae, Freddie Mac, or FHA product.

California policymakers are actively exploring other financing options. [AB 69](#) by Assemblymember Phil Ting would create the Help Homeowners Add New Housing Program to assist homeowners in qualifying for loans to construct additional housing units on their property, including ADUs and JADUs. However, few details have been incorporated into the bill and subsequent legislation and/or funding from the state legislature to expand the initiative may be required in future years.

In addition to the availability of financial tools, ADU adoption is also predicated on homeowners' understanding of the resources available to them to facilitate their application, design, and construction. However, lower- and moderate-income homeowners may be less likely than their wealthier counterparts to have knowledge of how to make the process work to their advantage. Public interest campaigns to educate homeowners about the advantages of investing in ADUs could help address this knowledge gap. Local jurisdictions can also advertise their ADU programs and make their zoning and permitting processes more user-friendly. To that end, we recommend that both local jurisdictions and regional governments take advantage of recent state-level housing technical assistance funding to stand up local homeowner education and outreach programs, and to help overhaul their ADU websites and streamline their permit processing. These ADU programs should also be incorporated into city and county sixth-cycle Housing Elements as explicit strategies to overcome existing housing constraints and ensure sufficient zoned sites to achieve state-mandated targets for new housing under the Regional Housing Needs Allocation (RHNA) process.

In addition to creating new financial tools specifically for ADUs, allowing for single-family parcels to be split in order to sell a newly constructed ADU would also help facilitate more ADU development. By creating a separate parcel entirely for new ADUs, a prospective resident of that ADU could purchase the lot with or without the improvements and secure conventional financing via a home construction or purchase loan, and take advantage of historically low interest rates to do so. [SB 1120](#) currently proposes to allow for ministerial single-family lot splits for the purpose of facilitating up to two newly constructed units on existing single-family parcels. However, as we have noted [here](#), the bill's uptake may be significantly constrained by its deference to local design and zoning guidelines. Moreover, the success of this legislation will also likely hinge on the degree of public awareness of this new law and the degree to which it is embraced by city officials and housing advocates.

Endnotes

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14. Ibid.
15. Note that because of the unreliability of race/ethnicity data for most regions outside of Los Angeles, these variables are not significant.
16. Valchuis, 2020. Ibid.

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