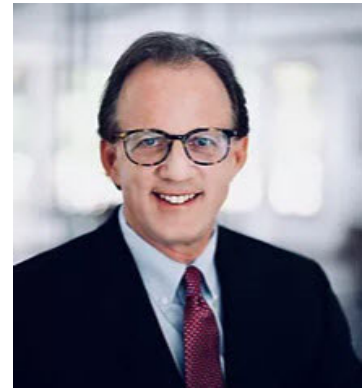


**“New life for ADUs: the potential creation of three income streams from a single family property”**



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Recent changes to Statewide rules concerning ADUs (Accessory Dwelling Units) and JADUs (Junior Accessory Dwelling Units), made in an attempt to address the growing lack of affordable housing in California, and signed into law by Governor Gavin Newsom, now provide real property owners with a unique opportunity to convert a single-family residential lot into income-producing property yielding as many as three separate streams of rental income.

Accessory Dwelling Unit (ADU) is defined as an attached or detached residential dwelling unit that provides permanent, complete, independent living facilities, including facilities for living, sleeping, food preparation and cooking, eating and sanitation, for one or more persons, on the same parcel as a primary dwelling. This classification also includes both an ADU (a free-standing structure) and a JADU (a structure attached to or part of an existing structure, as defined in Government Code Section 65852.22).

The recent legislative changes [notably AB 68, AB 587, AB 881 and SB 13] remove many of the former restrictions, impediments and impact fees that previously made conversion or construction of an accessory unit impractical or even legally impermissible. The law allows both an ADU and a JADU to be created on a single lot. The new law has also explicitly identified opportunities for ADUs/JADUs in multifamily buildings, including storage rooms, boiler rooms, etc., where building standards are met.

The former restrictions that have now been eliminated include:

1. Covered parking requirements: AB 68/AB 881 prohibit local agencies from requiring replacement of off-street parking when a "garage, carport or covered parking structure" is demolished or converted to construct the ADU. Parking requirements can now be satisfied by parking in the driveway;
2. Setback requirements/floor area ratio requirements: Both requirements have been eliminated under AB 68/AB 881;
3. Owner occupancy requirements: SB 13 provides, until Jan. 1, 2025, that cities may not condition approval of ADU building permit applications on the applicant being the "owner-applicant" of either the primary dwelling or the ADU;

4. Permit processing delays/Impact Fees: AB 68 requires local agencies to either approve or deny an ADU project within 60 days of receiving a complete building permit application. Municipally imposed “impact fees” have been eliminated for ADUs up to 750 sf, and are greatly reduced for larger ADUs;
5. Sale of separate ADUs: AB 587 provides that local agencies may now allow ADUs to be sold or conveyed separately from a primary residence if certain conditions are met. Prior law often prohibited ADUs from being sold or conveyed separately from the primary residence in which they are co-located. This hindered co-ownership models such as tenancies in common.
6. HOA prohibitions: AB 670 prevents homeowner associations from prohibiting ADUs or JADUs [note: similar to solar panels and ham radio towers, which cannot simply be prohibited by HOAs]. HOAs are allowed to have [properly created] rules setting minimum and maximum allowable sizes for ADU/JADUs, but cannot prohibit all ADU/JADUs.

As a result of these recent legislative changes, it is now possible and often feasible for property owners to construct both an ADU and a JADU on a given single family residential lot. With such construction (and permit issuance and final sign off) three rentable units can be created on a single property, all of which can be rented out, with no requirement that the owner occupy any of these units. It is important to note that other restrictions do exist concerning the creation of multiple rentable units on a single-family lot (such as the need for separate entrances, separate plumbing and separate electrical and water meters for each unit). Per AB 2299 and SB 1069 (effective January 1, 2017), it is prohibited for California cities to charge utility connection fees or capacity charges including water and sewer for ADUs which are a conversion of existing space.

A possible scenario for the potential creation of three rentable units on a single lot (which is already improved with a residence) could include:

- (a) The existing single-family home becomes rentable unit one;
- (b) The garage is converted to a JADU and becomes rentable unit two;
- (c) A free standing ADU is built on the lot and becomes rentable unit three.

Upon creation of these three rentable units (none of which are required to be occupied by the owner), and leasing to tenants, the property owner could have three rental income streams.

A typical investment scenario may contemplate acquisition of the property with a standard mortgage loan (or refinance of an existing mortgage), followed by a construction loan to build the detached ADU and convert a portion of the residence (such as the garage) into a JADU. Following the JADU conversion (or construction) and following construction of the ADU, the real property could be refinanced to pay off the construction loan. The refinance loan would then be supported by the increased improvement value of the property, and by the income producing capacity of the three rental units.

Overall, due diligence should be performed as to any given lot on which construction of an ADU or JADU is being considered, and the restrictions that will exist even with the above legislative changes. It also remains to be seen exactly to what degree municipalities attempt to push back against some or all of these changes, and whether new or additional fees and requirements are imposed by municipalities to address the loss of municipal revenue that will likely result. Assuming such pushback, it is possible that the courts may be asked to weigh in on disputes between municipalities and the State of California, and it may prove easier to legislate than to effectuate real change in the supply of affordable housing units.