MEMORANDUM

To: Elise Semonian, Director
San Anselmo Planning Department

May 4, 2017

From: Richard Berkson, Berkson Associates

RE: Economics of Accessory Dwelling Units – Preliminary Estimates

As you requested, I have prepared a preliminary analysis of the economics of an Accessory Dwelling Unit (ADU). An ordinance recently adopted by the Town includes provisions for the construction of ADUs, but currently the ordinance does not limit the rent that can be charged to a tenant of an ADU. The question you have asked is: "Will a homeowner have a financial incentive to convert an existing garage and create an ADU if the Town limits the rent to affordable levels?"

The example shown in this memorandum indicates that construction of an ADU could be economically viable even if its maximum rent were limited to a level affordable to a household of two earning 80% of Area Median Income (AMI).

Table 1 depicts estimated costs and revenues for the construction and leasing of an ADU. The annual net cash flow, after operating expenses, debt service, and income taxes, is about 8.1% of an estimated investment of $100,000. This return compares favorably to average, long-term stock market returns. To the extent that costs, revenues, or other financial assumptions differ, the returns will vary from those shown.

The ADU example assumes conversion of a garage or other interior unit. The actual costs will depend on the extent of plumbing and electrical work required, as well as improvements such as doors, windows, decks, and other structural changes, and possible parking-related costs. A new, detached ADU could require additional costs for new systems, unlike an interior unit that may connect to systems in the existing dwelling unit.

Table 1
Example of Costs and Returns: 1-Bedroom Interior Accessory Dwelling Unit

Item	Note	Amount
Investment		
Total Improvement Costs	(1)	**$100,000**
Return		
Rent (Household of 2, 80% AMI) $2,108 monthly	(2),(3)	$25,290
(less) Utility Allowance	(4)	(1,800)
(less) Vacancy	(5)	(2,529)
(less) Property Taxes	(6)	(1,200)
(less) Other Expenses	(7)	(2,000)
Net Operating Income (NOI)		**$17,761**
(less) Depreciation	(8)	($3,636)
(less) Interest	(9)	(5,000)
Net Taxable Income		**$9,125**
(less) Income Taxes	(10)	($3,194)
(less) principal	(11)	(1,505)
Net Cash Flow (NOI less income taxes and debt)	(12)	**$8,062**
Annual Return on Cost		
NOI less income taxes		14.6%
NOI less income taxes and interest		9.6%
Net Cash Flow (NOI less income taxes and debt)		8.1%

Source: Berkson Associates
(1) "Total Costs" include design, permits, utilities, furnishings, construction, etc.
(2) FY17 Marin County, Public Housing, Section 8 & CDBG Programs.
(3) Rent is limited to 30% of income (e.g., 80% of AMI).
(4) Assumes a share of utilities (water, electric/gas, trash, sewer) @$150 monthly.
(5) Vacancy rate of 10% is assumed.
(6) Avg. 1.20% includes tax overrides (ie, bonds) times 100% of total cost.
(7) Other Expenses @2.0% of 100.0% of total cost for insurance, maintenance, etc.
(8) Depreciation of 100.0% of total cost over 27.5 years.
(9) Interest @ rate of 5.0% assuming total cost is borrowed.
(10) Assumes marginal tax rate of 35.0%.
(11) Debt service payment of $6,505 annually on total cost for 30 years @ 5.0%.
(12) Net after income taxes and debt including principal and interest.
Does not deduct non-cash depreciation expense.