



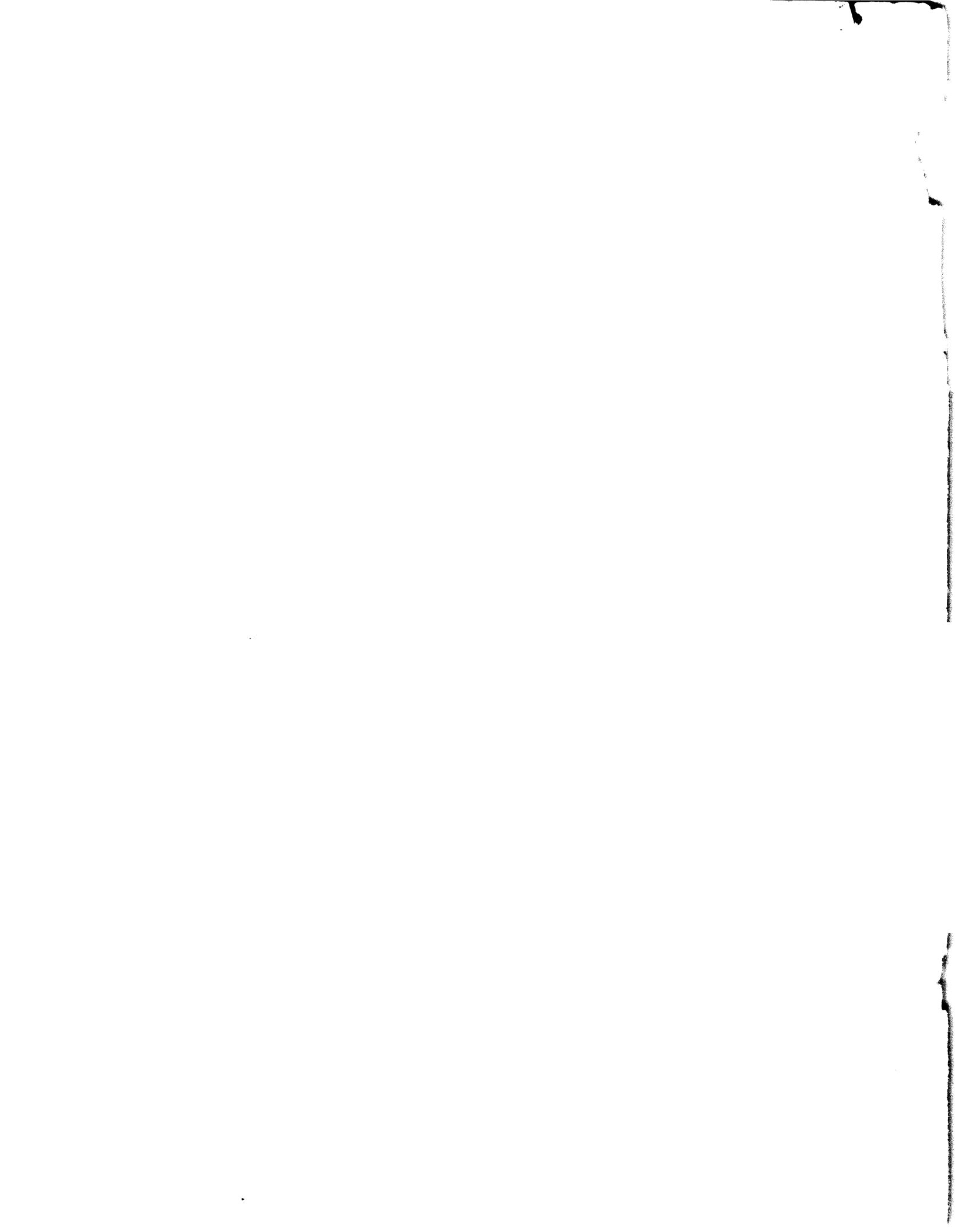
U.S. Department of Housing and Urban Development  
Office of Policy Development and Research

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# Granny Flats

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**An Assessment of  
Economic and  
Land Use Issues**



GRANNY FLATS: AN ASSESSMENT

OF ECONOMIC AND

LAND USE ISSUES

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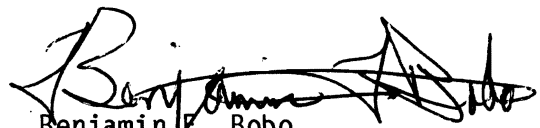
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## FOREWORD

In recent years, there has been increasing interest in alternative approaches for housing the elderly. Particular attention has been directed at the potential of placing small housing units for the elderly adjacent to existing single family homes. These units are generally known as "Granny Flats" or "ECHO housing" (Elder Cottage Housing Opportunities). Already, over 20 communities and the State of California have enacted legislation designed to accommodate this new housing concept. Interest has been stimulated by experience in the state of Victoria, Australia, where over 500 Granny Flats have been installed. However, localities in this country have had little practical experience with their use.

In order to provide further information on this housing alternative, the Office of Policy Development and Research prepared this report on two major issues: the economics, which must be attractive if Granny Flats are to become a viable housing alternative for the elderly; and the ability of Granny Flats to be accommodated within the framework of local regulations which govern the development and use of residential buildings.

It is important to emphasize that this study is not meant to be, nor can it be, a definitive assessment of this type of housing. However, it does provide a useful framework for local government officials to use in evaluating Granny Flats as alternatives to other housing arrangements for the elderly.



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## OVERVIEW

### Background

There has been increasing interest in the idea of using small housing units for the elderly placed adjacent to existing single family homes owned by their children or other family members. These units are generally known as "Granny Flats," but are sometimes referred to as "ECHO housing" (Elder Cottage Housing Opportunities). As distinguished from other types of accessory housing, the key characteristics of these units are that they: share the same lots as the existing single family houses, but are separate and detached structures; are intended for occupancy primarily by elderly relatives; and are meant to be removable structures which can be relocated to other sites. Since Granny Flats are intended to be easily removable, they are more likely to be modular/panelized units or mobile homes than conventionally-built structures.

The current interest in the United States has been stimulated by the experience in the State of Victoria, Australia where over 500 Granny Flats have been installed over the past several years. Most of these units are owned by the government and are financed and rented to occupants as part of the publicly subsidized housing programs. A number of these Granny Flats, which are built as panelized units, have been successfully moved for reuse at other sites.

In this country, the experience with Granny Flats has been much more limited. The Amish in Pennsylvania have utilized "Grossdawdy" and "Grossmutter" units for many years. The use of mobile homes in rural areas as detached, accessory housing is also a fairly common occurrence. Advocates of Granny Flats envision their use in suburban and urban areas where typical lot sizes are smaller and local regulations are generally more restrictive on the type, size, number, and placement of structures.

than in most rural areas. However, there is little practical experience in the United States with Granny Flats in more populated and developed areas. Only one producer specifically markets Granny Flats and it has sold only two units. Both of these units are located in fairly rural settings in Pennsylvania where there is already a long tradition of accessory units.

As a result, Granny Flats are currently more a potentially appealing concept than an available housing alternative for the elderly in the United States. Nevertheless, proponents of the Granny Flat concept cite several potential advantages which they feel point to a bright future for these units. From a social perspective, the separation of the unit from the existing single family house could provide for independence, yet the proximity of the two units could allow for close family interactions and support. For these reasons, Granny Flats may be more desirable than having the elderly reside in houses which are larger than they need, live in communities and projects specifically designed for senior citizens, or move to nursing homes.

From an economic perspective, it has been pointed out that there may be considerable savings in land and site development costs resulting from placing Granny Flats adjacent to existing houses where the land has already been acquired and major site improvements, primarily utility services, have been completed. Lastly, Granny Flats may be more politically acceptable at the local level than other types of accessory housing because they are intended for temporary occupancy and will not be viewed as permanently increasing the density of existing neighborhoods. By contrast, attached additions to houses, finishing out and converting basements into full apartments, or other types of accessory housing may be seen as more likely to become permanent rentals in predominantly single family, owner-occupied areas.

In addition to the increasing number of articles on the subject, over twenty localities and the State of California have passed legislation designed to accommodate Granny Flats and several proposals have been developed for demonstration projects. Given this level of interest, it is appropriate to take a more in-depth look at the major issues associated with Granny Flats. Two specific areas have been identified as key concerns and these are the focus of this paper. The first is the costs of Granny Flats, including the availability and terms of financing for these units. The economics of Granny Flats must be attractive to prospective purchasers and occupants if they are to become a viable housing alternative for the elderly. The second issue is the ability of Granny Flats to be accommodated within the framework of local regulations governing the development and use of residential dwellings. Unless these units can meet local regulations, with only reasonable modifications to these requirements, it is also unlikely that the potential market can be realized.

In light of the very limited experience with Granny Flats in the United States to-date, it is important to emphasize that this paper is not meant to be, nor can it be, a definitive or comprehensive assessment of this type of housing. This is particularly true with the discussion of economic issues where the prior work on the subject has focused on Australia and has presented only general cost information.

For this reason, the economic section of the paper is particularly important for the identification of the many cost items and financial considerations which have to be examined in assessing Granny Flats and not for the specific cost figures and estimates which are used. The economic section provides a framework

where more precise cost figures can be substituted when more data become available on Granny Flats.

Hopefully, the paper provides a basis for future analysts and local government officials to evaluate Granny Flats relative to other types of accessory housing or other forms of alternative housing arrangements for the elderly.

#### Summary of Economic Issues

The literature and limited experience to-date provide only general information on the costs of Granny Flats. This part of the paper begins by identifying the specific cost items associated with Granny Flats and develops cost estimates for each of these items. The items fall into three categories:

- a. Initial Costs - The amount required to purchase the unit and place it on site, including utility hook-ups;
- b. Carrying Costs - The monthly amounts necessary to cover financing for the unit as well as maintenance, property insurance, utilities and property taxes (if any); and
- c. Transfer/Relocation Costs - The costs involved in removing the unit when it becomes vacant, including site restoration.

The largest initial cost is for the unit itself. An \$18,000 F.O.B. factory price estimate is used for a one bedroom modular Granny Flat. The remaining "construction" related costs are for delivery, site preparation, installing the unit, and sales tax (if any); these costs will likely vary considerably depending on local prices for labor and materials and on individual site conditions.

The \$5,000 cost estimate for these items is meant to be representative and reflects minimal delivery charges and site problems; the actual costs could be significantly higher. This uncertainty can have a major impact on the economics of Granny Flats because these items must be treated as sunken costs which are tied to the initial site and have no value when the unit is transferred to another site. The total estimate of initial costs used in the paper is, therefore, \$23,000.

Two hypothetical cases are developed to illustrate the economic issues associated with Granny Flats. The first is analogous to single family homeownership where an adult family member owns the unit for purposes of providing housing for an elderly parent(s). The second is comparable to a scattered-site rental project where a non-profit group or local public agency owns the Granny Flats and rents them for occupancy by an elderly parent(s) on the property of an adult family member(s). For the rental case, \$22,000 is used as the total initial cost estimate because it is assumed that the sponsoring group is exempt from paying the sales tax.

In both cases, the largest carrying cost will be for the financing of the unit. The paper discusses the various ways in which Granny Flats might be financed and concludes that it is currently unclear as to what the availability, types, and terms of loans will be for these units. For analytic purposes, 100% financing for the total initial costs of the units is assumed. In the ownership case, two interest rates (12% and 16%) and two maturities (five and twenty years) are used for the basic loan terms. In the rental case, it is assumed that mortgage

revenue bonds would be used at their current 12% interest rate with a twenty year maturity. Estimates are then developed for the non-financial carrying costs of the units such as property insurance, utilities, etc.

Monthly carrying costs for the homeownership case range from \$353 (12%/20 year financing) to \$659 (16%/5 year financing) in the first year of ownership. These figures drop to \$250 to \$538, respectively, after consideration of potential income tax deductions for loan interest, property taxes and sales tax.

Monthly carrying costs are only one portion of the total costs of owning a Granny Flat. The other part consists of the costs incurred at the time of sale. Transfer costs include carrying charges during an assumed two month sales period, a broker's fee, removing the unit, restoring the site, and paying off the principal balance of the loan. These costs have to be subtracted from the resale price in order to estimate whether the owner realizes a net gain or loss. Although the resale value of Granny Flats is currently unknown, the paper assumes that the resale price of a one bedroom unit remains at its initial cost of approximately \$18,000 indefinitely.

Using this figure, the key variables which affect whether there is a net gain or loss are when the unit is sold and the maturity of the loan. If the unit is sold after one year, the owner incurs losses ranging from about \$4,000 (12%/5 year financing) to \$7,500 (16%/20 year financing). These time of sale losses result primarily from the fact that relatively little principal is paid off in the first year of a loan. After five years, there is about a \$6,700 loss in the 16%/20 year financing case and a \$15,500 gain in the 12%/5 year financing case. A gain occurs in the 12%/5 year financing case because the loan has been paid off. However, the owner also has been paying, on an after-tax basis, \$250 per month or \$3,000 per year more in carrying costs for five years.

The total monthly costs in the rental case, including utilities, range from \$407 to \$493 in the first year of occupancy. Both figures include an allowance for the costs of relocation and installation at subsequent sites when the units become vacant. The difference between the rental costs are based on assumptions about the turnover rate. If most occupants are elderly parents in the 62-65 age bracket where a Granny Flat is the preferred alternative among a variety of housing options, then the turnover rate should not be too high. For this case, a 10% per year turnover rate is used and this results in the \$407 per month rental. If most occupants are elderly parents over 75 where a Granny Flat is an alternative to a nursing home, then the turnover rate will be considerably higher. For this case, a 25% per year turnover rate is used and this results in the \$493 per month rental.

In summary, all of the above costs should be treated with extreme caution. They are based on very tentative assumptions and rough estimates, given the virtually non-existent data base on Granny Flats in the United States. The \$18,000 price for a one bedroom modular unit appears to be a reasonably good estimate of a Granny Flat. The \$5,000 estimate for delivery, site preparation, unit placement and finishing, and sales tax (if any) brings the total initial costs of a Granny Flat to \$23,000. These other "construction" related costs are meant to be representative and could vary considerably depending on local conditions. They are key variables in assessing the economics of Granny Flats because these items are sunken costs which have no value when the unit is moved. In fact, all of these "construction" related costs are incurred again when a Granny Flat is moved to another site.

The remaining cost assumptions and estimates necessary for a economic assessment of Granny Flats are more speculative than those used for the \$23,000 estimate for initial costs. The total costs of owning or renting a Granny Flat

will depend on such factors as the terms of the financing; the costs for maintenance, property insurance, property taxes, and utilities; the resale price and sales costs in the ownership case; and the turnover rate in the rental case. The paper has developed estimates for each of these items which appear to be appropriate. There is no way in which to determine whether they are accurate until, and if, a substantial number of Granny Flats are built. This uncertainty reflects the current status of Granny Flats as largely an appealing concept rather than a real choice available to consumers. This is not unlike prior innovations in the housing area at a comparable stage of development. If Granny Flats prove to be an attractive option to the elderly and their families, there is no reason why these units can not become more widely adopted than they have been to-date.

#### Summary of Land Use and Development Controls Issues

Granny Flats would not be permitted under most current local zoning and land use controls. However, while local ordinances can be changed, this action is not likely, by itself, to result in major growth and acceptance of this alternative form of housing. Over twenty communities have now enacted legislation to accommodate Granny Flats within their regulatory framework. Even so, this study failed to identify any Granny Flats yet built except for the often-cited two units in rural Lancaster County, Pennsylvania.

Adjustments clearly will be necessary in zoning and other land use laws to permit a second accessory unit on an existing single family lot. However, the terms and conditions upon which communities will accept these units remains undefined. As all the existing ordinances have been enacted in advance of actual demand, it is unclear whether the conditions and criteria in these statutes will effectively address the issues which communities will actually face when



confronted with requests to build units. Localities facing such a decision will have to carefully balance the potentially significant benefits to the elderly from Granny Flats with the equally legitimate concerns of other residents about increasing density, affecting the aesthetics, or having other impacts on the local community. It is currently possible only to discuss basic issues that have either already been identified or appear likely to arise as communities begin to address this housing option.

Any Granny Flat ordinance is likely to authorize these units only on a special permit/conditional use basis. A special permit is a device whereby the owner applies for the "privilege" of building to a specific use. The ordinance generally lists a series of conditions which the applicant must meet prior to award of the permit. The special permit has two distinct advantages for regulating Granny Flats. First, unlike other regulatory techniques, it gives the community the ability to review and control each application. And, second, the permit can be revoked if any of the required conditions are not met.

It will be the specific conditions imposed upon the Granny Flat applicant that will fashion the particular local ordinance. These conditions will reflect the priorities the community place upon issues such as density, property values, and aesthetics balanced against the need to provide additional housing opportunities for the elderly.

For the most part, a community's concerns fall into three areas: the nature of the applicant and the occupant; the type and size of the structure; and restrictions on the site. As to the first concern, only the owner of the land

will qualify for a permit to build a Granny Flat. On the otherhand, it is less clear who will be permitted to occupy a Granny Flat. Although a number of the existing statutes permit accessory units to be available to the broader universe of elderly or even to the general population, it can generally be expected that most communities will want to limit the permit only to those elderly persons in some way related to the occupant of the primary unit.

Second, the locality will also be concerned with the type and size of the unit. For the purpose of this report, a Granny Flat is a temporary, removable unit. Although, in larger suburban lots a mobile home might be most suitable for this purpose, many communities currently do not permit mobile homes within their jurisdictions. Thus, the locality could face a conflict between its desire to exclude mobile homes and its desire to be assured that a Granny Flat is, in fact, temporary. It may, therefore, insist that a unit, no matter what construction system is used, be installed in such a manner that it is relatively easy to remove.

A third and difficult issue facing a locality is deciding where in the community Granny Flats will even be considered. Analysis of a "typical" Granny Flat and representative lot sizes indicates that, generally, a unit can be placed on lots larger than 7,000 ft<sup>2</sup>. In addition to lot size, the width of side yards will be a limiting factor. If the Granny Flat is a mobile home or other three dimensional module then only large suburban lots with very wide side yards will be able to accommodate the unit. However, each situation is unique. Some larger lots will not be suitable while it is also possible that lots as small as 4,000-5,000 ft<sup>2</sup> could, in some instances, accommodate a small accessory unit.

The most significant issue facing a community is not whether or not a unit can "technically" fit on a particular lot size. Rather the key issue is whether the locality really wants to broadly permit, as a conditional use, Granny Flats in a full range of zones and densities within the community or, instead, prefers to relegate these units to only a few low density districts where they will have minimal physical impact. To date, only three of the twenty communities with Granny Flat ordinances appear to be willing to even consider Granny Flat applications for lots of 10,000 ft<sup>2</sup> or less. All the others seem to require at least a one acre minimum lot size or limit the units to rural/conservation districts. If these ordinances accurately reflect prevailing community attitudes, then Granny Flats will not develop into a major housing resource for the elderly.

In addition, communities will have to consider a number of other issues when fashioning special permit ordinances for Granny Flats, including methods to assure removal of the unit; restrictions on the total number of permits in an area; aesthetic controls; provisions for parking; and, private restrictions placed in deeds. How each issue is resolved will reflect a careful balancing of competing community interests.

Adjustments may also have to be made in other state and local laws. For example, state enabling legislation may have to be clarified to permit Granny Flats within local comprehensive plans, while local building codes may need adjustment to clearly authorize the hook-up of Granny Flats to existing public services.

These appear to be the major issues and areas of controversy which can be expected as more localities consider Granny Flat legislation. However, it is important to emphasize that the specific provisions of the existing ordinances may be an inadequate guide to how localities will react to Granny Flats when faced with the prospect of real units. At that time local governments will make the hard choices between competing interests and will enact legislation that reflects the needs and priorities in the community.

**PART ONE**

**ECONOMIC ISSUES**



## I. INTRODUCTION

The appeal and attractiveness of Granny Flats will be based in large part on the costs involved in providing this type of alternative housing opportunity for the elderly. The purpose of this paper is to look at the various economic issues, including the availability and terms of financing for these units, which have to be examined in estimating the costs of Granny Flats.

This task will be undertaken by developing hypothetical cases which specify the various cost items likely to be associated with Granny Flats and by making cost estimates for each of these items. Two base cases which reflect different forms of ownership for the Granny Flat are analyzed. The first is analogous to single family homeownership where an adult family member owns the unit for purposes of providing housing for an elderly parent(s). The second is comparable to a scattered-site rental project where a non-profit group or local public agency owns the units and rents them for occupancy by an elderly parent on the property of an adult family member(s). These two cases were selected because they are the ones most frequently cited in the literature\* and they seem to be reasonable choices to assess the major costs associated with Granny Flats.

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\* Some other options are described in the literature and have been raised in oral discussions with individuals interested in the Granny Flat concept. In terms of purchase, it has been suggested that the adult family member buys the unit and rents it out to an elderly parent or that the elderly parent buys the unit. Both options are potentially workable, but the same costs are involved and there are some trade-offs from the perspective of tax benefits.

In terms of the rental case, some individuals have suggested that a Granny Flat rental project might be attractive to profit-motivated investors. This is unlikely in the near future for two reasons. First, non-profit groups or public agencies have access to much more attractive sources of financing than profit-motivated investors. And second, profit-motivated investors will expect a very high rate of return to reflect the risks associated with a new and untested concept. For these reasons, the rents would also be higher than those projected in the subsequent analyses.

Literature references are included in Appendix A.

The development of these two hypothetical cases will serve to both illustrate and discuss the economic issues associated with Granny Flats. Since there is little practical experience with Granny Flats in this country, the analysis of these cases will also provide guidance about what is known about the economics of Granny Flats as well as to identify areas of uncertainty or where virtually no knowledge exists.

The discussion begins with a review of cost information appearing in the literature. Following this, specific cost items are identified for the ownership case and cost estimates are developed for each of these items. The cost estimates are then used to calculate monthly cash flows and total cost projections. Some variation is included for differences in financing terms (interest rates and maturities) and the length of ownership (i.e., occupancy by the elderly parent).

After discussing the first case, differences and additional cost items for the rental project case are described and new cost estimates, as appropriate, are developed. Pro forma cash flows are calculated to estimate the monthly rentals which a non-profit group or public agency would have to charge for the unit. A range of rentals is projected, depending on the length of tenure (i.e., frequency of relocating the unit) and whether the costs of siting and removing each individual unit are incorporated and pro-rated into the rents charged to all of the units in the project or charged directly to the occupant or his/her family.

The discussion of economic factors concludes with a summation of the economic issues and questions raised in the development and analysis of the hypothetical base cases.



## II. REVIEW OF THE LITERATURE

The literature provides only general information on the costs of Granny Flats.\* The most frequently cited cost advantage of Granny Flats is the savings in land and site development resulting from their placement on lots which already contain an existing house. To be realized, these potential savings must outweigh the initial costs of site placement (foundations and utility hook-ups) and the costs of removing and relocating Granny Flats.

Some cost data has been published, mostly from the Australian experience. The same basic cost information appears in literature published over a period of more than five years: \$13,000-\$14,000 in American dollars for the initial installation and \$5,000-\$5,500 for removing and reassembling the unit. These costs are based on Australian specifications, materials, and labor prices for a "panelized" unit, and are not directly transferable to the United States.

Of equal importance, the units are treated as part of Australia's subsidized housing programs and, therefore, no information is cited on total costs including financing and operating expenses. Consequently, the Australian experience is most useful for conceptual purposes and general guidance rather than as a basis for making direct cost comparisons.

In the United States, there is little practical experience to-date beyond the placement of mobile homes in rural areas as accessory, detached units. Housing Alternatives Unlimited Structures, a company in Santa Maria, California, has proposed manufacturing an "Elder-Haus" as a panelized unit. It has

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\*Literature references are included in Appendix A.

estimated the costs to be \$18,500 for the unit, \$3,000 for erecting the unit, and \$8,500 to dismantle and move the unit. Jonathan Stafford, a builder in Eugene, Oregon, was awarded a grant as part of HUD's "Building Value Into Housing 1981 Awards" program for the design of a Granny Flat. Mr. Stafford's submission includes cost estimates ranging from \$16,500 to \$18,505 for the construction and installation of a unit depending on whether it is conventionally built or is modular housing. This proposal provides only general estimates for financing and operating costs.

The only unit currently in production is the "Elder Cottage" marketed by the Coastal Colony Corporation of Lititz, Pennsylvania. The estimated cost of a one bedroom unit, as of April 1982, is \$17,000 plus a minimum of \$2,100 for delivery, site preparation, and installation in Lancaster County, Pennsylvania. To-date, only two "Elder Cottages" have been sold. Both of these units were paid for in cash and are located in rural, not urban or suburban, areas. Nevertheless, as the only unit actually in production, the Elder Cottage is the most reliable starting point for estimating the initial costs of a Granny Flat in the subsequent sections.

### III. COST ITEMS AND ESTIMATES: OWNERSHIP CASE

The costs of a Granny Flat to an owner fall into three major categories:

- a) Initial Costs - The amount required to purchase the unit and place it on site, including utility hook-ups;
- b) Carrying Costs - The monthly amounts necessary to cover financing for the unit as well as maintenance, property insurance, utilities and property taxes (if any); and
- c) Transfer Costs - The costs involved in selling the unit once it is vacant, including site restoration.

This section identifies the items which fall in to these categories and develops cost estimates for each. Cost items and cost estimates are summarized in Exhibit I. The cost estimates are used in the next section to calculate monthly cash flows and total cost projections involved in owning a Granny Flat.

#### Initial Costs

The largest initial cost item is for the unit itself. As noted previously, the cost estimate for the unit is based on the one bedroom Elder Cottage marketed by the Coastal Colony Corporation which had an April 1982 F.O.B. factory price quote of \$16,965.

For purposes of this paper, this price quote is adjusted upwards by 6.4% which brings the price of the unit to \$18,050 for a January 1983 delivery date. The adjustment reflects the change in the Coastal Colony Corporation's price quote between an equivalent nine month period from July 1981 to April 1982.

In addition, the paper assumes that a 5% sales tax, or \$903, is levied on the unit and that the sales tax is eligible for a deduction on the owner's income tax returns. The other cost associated with the purchase of the unit itself is the delivery charge to the site. The paper uses the Coastal Colony Corporation's minimal estimate of \$200 for this item.

The remaining initial costs involve preparing the site and setting up the unit. These costs could vary considerably depending upon local prices for materials and labor and, perhaps more importantly, difficult or unusual topographic features and locations of the utility lines. The cost estimates used in this paper should therefore be viewed as representative and reflecting minimal topographic or utility hook-up problems. The following specific cost estimates were developed by technical staff from HUD's Building Technology Division who reviewed the Coastal Colony Corporation's typical cost quotes for Lancaster County, Pennsylvania and made appropriate adjustments.

Site preparation estimates include \$300 for materials for a treated wood piling foundation and \$1,000 for the labor involved in installing the foundation and grading the site. Taking the unit off the delivery vehicle, placing and tying the unit onto the foundation, and attaching and finishing out the two modules which make up the one bedroom unit are estimated to cost \$500. An additional \$340 is included for the materials and labor involved in providing a ramp or steps for the unit.

The last major cost item in installing a unit is for utility hook-ups. Sewer service is assumed to be tied into the main service between the house and the street and to cost \$750. Water service (at \$500) and electrical service (at \$500) are assumed to be connected to the existing services on the house side of the main meters. Again, all the utility hook-up estimates assume minimum topographic problems for trench excavation and sufficient excess capacity in the house services and lines to handle the additional loads.

The estimate for the initial costs add up to \$18,953 for the unit (including sales tax) and \$4,090 for site preparation and setting up and finishing the unit, for a total of \$23,043, which is rounded off to \$23,000 in the subsequent analyses.

#### Carrying Costs

Some buyers may choose to pay cash for a Granny Flat. In this case, the carrying costs for the unit involve only property insurance, routine maintenance, utilities and property taxes (if any). However, \$23,000 is a significant outlay of cash and it is, therefore, likely that most buyers would prefer to obtain financing and pay for the unit over an extended period of time. In this case, the key question is on what basis will financing be available for Granny Flats?

A lender's initial question will be to ask whether a Granny Flat should be treated as real or personal property. As real property, Granny Flats would qualify for the longer maturities and lower interest rates associated with mortgage loans.

Granny Flats have several of the attributes of real property insofar as the wood piling foundation "technically" permanently attaches the unit to a specific site. On the other hand, the units are meant for temporary occupancy and by local law they would only be allowed on a site for a limited period of time and for a specific use.

If Granny Flats are treated as real property for financing purposes, they will be evaluated on the basis of their value, which is not necessarily identical to their initial costs. In other words, mortgage loans are made in relation to the value of the property offered as collateral, rather than its costs. A lender's principal concern here is the likelihood of recovering the principal balance of the loan through the sale of the property in the event of foreclosure. If the Granny Flat was the sole collateral for the loan, a lender would have to arrange for the removal of the unit. This could be a very tricky procedure since the unit is located on the homeowner's lot which is not collateral for the loan. In addition, there is currently no reliable basis on which a lender can estimate the resale price of a used Granny Flat. This problem would, of course, diminish if the market for Granny Flats, both new and used units, develops over time.

Even if a lender appraised the value of a Granny Flat to be equal to its costs, the loan amount would most likely be less than the cost of a unit. This is because mortgage loans are generally made on some fraction of the appraised value; i.e. the so-called loan-to-value ratio. This in part serves as protection to the lender in the event of default or foreclosure. Typically, loan-to-value

ratios are on the order of 80%-95%. When the ratio approaches 100%, the lender often requires a slightly higher interest rate, an additional payment for mortgage insurance, or both.\* The difference between the loan amount and the appraised value is the buyer's equity contribution in the form of a downpayment. For a \$23,000 Granny Flat, the downpayment would range from \$1,150-\$4,600 for an 80%-95% mortgage loan assuming the appraised value was equal to the initial costs. The downpayment would be proportionately greater if the appraised value was less than 100% of the costs. In addition, a lender might reduce the loan-to-value ratio considerably below 80% given the uncertain resale value of Granny Flats and the costs and potential difficulties involved with removing the unit from the owner's property.

Beyond the issue of value and loan amounts, a lender would have to carefully evaluate the maturity of the proposed loan. Since the Granny Flat is likely to be occupied for only a few years, a lender might not be willing to go beyond a five or ten year maturity. This could be a major concern in jurisdictions where special permits for continued occupancy are subject to review, and potential non-renewal, every two-to-three years. Shorter maturities increase the monthly carrying costs, although the loan would be paid off more quickly and the total interest costs over the life of the loan will be smaller.

A lender from a small commercial bank in Lancaster County, Pennsylvania suggested one alternative which would address a financial institution's concern with the maturity of the loan and a buyer's interest in spreading the payments over a longer period. He indicated that he might be willing to provide

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\* Lenders generally perceive that there are higher risks associated with new innovations in housing. As a result, a lender might charge a higher interest rate and require mortgage insurance for a Granny Flat even if the loan-to-value ratio is low.

a maturity of fifteen-to-twenty years, but would add a "call" provision whereby the balance of the loan is payable when the unit becomes vacant. In fact, a call provision upon vacancy might always be appropriate whenever a Granny Flat is financed as real property since the unit at that point is no longer legally permitted on the buyer's property.

From a lender's perspective, one possible objection to extending the term of the loan for a Granny Flat is that there may be a disincentive for the owner to pay off the loan once the unit is vacant. If the owner has considerable difficulty in selling the unit, it might be economically advantageous to default on the loan if the only collateral is the Granny Flat.

One alternative way in which to make use of the advantages of mortgage loan financing is for the owner to take a second loan based on the value of his/her house. This assumes that there is sufficient equity in the house through appreciation and/or paying down the principal balance of the first mortgage loan. In this case, the value of the main house serves as the collateral on the loan. This type of financing could cover 100% of the costs of a Granny Flat and repayment terms could extend to up to twenty years.

The other major way in which to finance Granny Flats is to treat them as personal property. Major consumer durables, such as cars, most mobile homes, and many home improvement loans, are financed in this way. In evaluating such loans, a lender's principal criterion is the credit-worthiness of the borrower even when the "chattel" or property is used as security. Personal property loans traditionally have higher interest rates and shorter maturities than mortgage loans. However, it may be easier to obtain financing for the entire cost of Granny Flat, assuming the borrower is sufficiently credit worthy, since the loan amount would not be determined by the appraised value of the property.



It is not within the scope of this paper to resolve the issue of whether Granny Flats will be financed as real or personal property or to discuss other potential financial/regulatory issues such as the reactions of first mortgage holders whose permission may be required to place a second mortgage loan on the main house. Many of these issues are not unique to Granny Flats and have been confronted by prior innovations in the housing area. These include condominium and cooperative forms of ownership and changes in construction techniques, such as mobile homes and manufactured housing. These issues will be resolved if a market for Granny Flats develops over time. Nevertheless, some assumptions about the financing of Granny Flats have to be made.

For purposes of this paper, it is assumed that the owner can obtain financing for 100% of the costs of a Granny Flat. This is equivalent to making use of a second loan secured by the value of the main house or some type of personal property loan. Maturities of five and twenty years are used. The five year period reflects typical terms for personal property loans, while the twenty year period is the generally used maximum term for second mortgage loans and loans insured through HUD's Title I programs. The use of these two periods also provide a range to show the impact of different maturities on monthly carrying costs. In both cases, it is assumed that a "call" provision requires that the loan is due when the unit becomes vacant and is sold. Finally, 16% and 12% are used for the interest rates on the loans. The 16% interest rate reflects the

October 1982 maximum allowable rate under HUD's Title I program and the 12% interest rate is used to illustrate the impact of lower rates on monthly carrying costs. No additional financing costs, such as points and other closing costs, are used in the analysis. These financing assumptions are fairly optimistic given the fact that Granny Flats have not yet really entered the marketplace and have not had to face the cautious posture lending institutions usually maintain initially towards new innovations.

The other carrying costs are meant to be representative and could vary considerably by locality. Property insurance is assumed to be \$10 per month, or about .5% of the total costs of the unit. Unless some type of local exception is granted, it is assumed that some form of real estate or personal property taxes will be levied on the unit. Property taxes, therefore, are assumed to be \$40 per month, or about 2% of the total costs. This figure is well within the range for property taxes charged in new suburban developments. A minimal \$10 per month expense is assumed for routine maintenance. Lastly, \$480 per year, or a monthly average of \$40, is assumed to cover utilities including space heating, domestic hot water, lighting and appliances. Cost inflation increases for these operating items are assumed to be 5% per year.

Income tax deductions for loan interest, property taxes, and the initial sales tax on the unit in the first year, reduce the total carrying costs. A 30% marginal income tax bracket is assumed for the subsequent analyses.

#### Transfer Costs

Once the Granny Flat is vacant, the owner will incur a number of costs in selling the unit. First, it is likely that it will take some time to find a

buyer and relocate the unit. For analytic purposes, it is assumed that the owner has to pay the carrying costs for the vacant unit for a two month period. Second, some assumptions have to be made about the resale value of the Granny Flat. Given the absence of data, any assumption should be treated with great caution. Looking at the Internal Revenue Service depreciation schedules for general guidance, the closest analogy is mobile homes which are considered to have a ten year life for tax purposes.\* Since Granny Flats have characteristics of both mobile homes and conventional single family houses, the paper assumes a more optimistic estimate than a ten year life. The sales price of the unit itself is assumed to decline 5% per year, but in future year dollars where the cost inflation rate is 5% per year. As a result, the resale price of a Granny Flat is always assumed to be the same as its estimated F.O.B. factory price in January, 1983 of \$18,050. It is important to emphasize that only the unit itself is assumed to have any resale value, the costs associated with sales tax, site improvements, and the installation of the unit are nonrecoverable expenses. These items are tied to the initial site and have no value which is transferable to a subsequent purchaser.

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\* Estimating the real economic life of a Granny Flat is a highly speculative exercise. The useful economic life of these units will be a key concern for initial and subsequent purchasers and lenders. A number of units have successfully been relocated in Australia and the Coastal Colony Corporation has moved a model unit several times over the last two years with no reported damage. The Coastal Colony unit is built to meet the BOCA code and, if it is well maintained and moved with care, presumably it should have a fairly long useful economic life.

Using mobile homes as a close analogy presents a number of problems, including the limited amount of research on the subject. The only available article indicates that there has been some appreciation for existing mobile homes over the last ten years. However, the appreciation rate is considerably less than the rate for site constructed houses and lower than the overall rate of inflation for the period. See: Larry R. Bauer "Up, Up and Away!", Manufactured Housing Dealer Magazine, December 1981.

It is also unclear as to how the sales process for Granny Flats would operate. It might be analogous to selling a car or other consumer durables, or given the large cost involved, it might come to resemble the process for selling single family homes. Given this uncertainty, a 6% fee for some sort of broker arrangement is also included as a transfer cost. Removing the unit from the site to the buyer's vehicle is assumed to be the same as the initial placement costs of \$500, increased by the 5% per year cost inflation factor. Finally, a \$500 cost (again increased by 5% per year) is used for the restoration of the site, including removing the foundation and stair/ramp, regrading the site, and capping off the utility hook-ups.

An example is useful to illustrate how the net proceeds of sale are calculated. It would cost an owner \$18,050 F.O.B. factory for a unit purchased in January 1983. Assuming that the unit is sold one year later, the net proceeds of sale are \$18,050 (the sales price) less \$1083 (broker's fee) less \$525 (unit removal costs in 1984 dollars) less \$525 (site restoration costs in 1984 dollars) less two months of carrying costs (which vary depending on the financing terms) = \$15,917 less two months of carrying costs. The net proceeds of sale are then assumed to pay off the principal balance on the loan. If the net proceeds of sale are not sufficient to pay off the loan, it is assumed that the owner has an out-of-pocket cash loss when the Granny Flat is sold.

These time of sales losses or gains have to be added to the monthly carrying costs in order to estimate the total costs of owning a Granny Flat.

## EXHIBIT I

SUMMARY OF COST ITEMS AND  
ESTIMATES : OWNERSHIP CASE

<u>ITEM</u>	<u>ESTIMATE</u>
<b>A. <u>Initial Costs</u></b>	
1. One Bedroom Modular Unit	\$18,050
2. Sales Tax (@ 5%)	\$ 903
3. Delivery of Unit	\$ 200
4. Site Preparation	
- Materials	\$ 300
- Labor	\$ 1,000
5. Unit Placement	\$ 500
6. Steps/Ramp and Railing	\$ 340
7. Utility Hook-Ups	
- Sewer	\$ 750
- Water	\$ 500
- Electricity	<u>\$ 500</u>
Total	\$23,043
<b>B. <u>Carrying Costs</u></b>	
1. Financing	
12%/20 years	\$ 253/month
16%/20 years	\$ 320/month
12%/ 5 years	\$ 512/month
16%/ 5 years	\$ 559/month
2. Property Insurance	\$ 10/month
3. Property Taxes	\$ 40/month
4. Routine Maintenance	\$ 10/month

- |                                   |             |
|-----------------------------------|-------------|
| 5. Utilities                      | \$ 40/month |
| 6. Cost Inflation Rate            | 5%/year     |
| 7. Marginal Income<br>Tax Bracket | 30%         |

C. Transfer Costs

- |                                                         |                                                                         |
|---------------------------------------------------------|-------------------------------------------------------------------------|
| 1. Resale Price                                         | \$ 18,050                                                               |
| 2. Broker's Fee (6% of the resale price)                | \$ 1,083                                                                |
| 3. Carrying Costs<br>during Sales Period                | Two month period, costs<br>depend on financing case<br>and year of sale |
| 4. Removal of Unit to Subsequent<br>Purchaser's Vehicle | \$500 in 1983 dollars                                                   |
| 5. Site Restoration                                     | \$500 in 1983 dollars                                                   |
| 6. Cost Inflation Rate                                  | 5%/year                                                                 |
| 7. Loan Balance                                         | Depends on financing<br>case and year of sale                           |

## IV. MONTHLY CASH FLOWS AND TOTAL COST PROJECTIONS: OWNERSHIP CASE

Monthly Cash Flows

Using the assumptions and estimates discussed above, monthly cash flows involved in owning a Granny Flat were calculated. Table I presents monthly cash flows for the 16%/20 year financing case for a ten year holding period. Total carrying costs are calculated on both a before tax basis (gross costs) and on an after tax basis (net costs). The costs are shown in future dollars which the owner would pay out rather than being discounted back into constant 1983 dollars.

Identical analyses were carried out for the three other financing cases. Table II summarizes the results of these analyses for selected years. The key variable which accounts for the large differences in initial carrying costs is the maturity of the loan. Twenty year maturities result in substantially lower initial cash flows because the costs of the Granny Flat are amortized over a longer period of time.

Cash flows are shown for Year 2 to illustrate the fact that the net costs rise more rapidly here than in the subsequent years because of the one-time deduction for sales tax in the first year. The Year 6 figures are included to show the steep drop in monthly carrying costs in the five year financing cases when the loan is paid off. Of course, it is important to note that the trade-off is that the homeowner had substantially higher carrying costs with a five year loan. Year 10 is used as the last column in Table II. A ten year period appears sufficient to highlight trends for both carrying costs and transfer costs.

TABLE I

MONTHLY CASH FLOWS  
(16%/20 Year Case)

<u>ITEM</u>	<u>YEAR 1</u>	<u>2</u>	<u>3</u>	<u>4</u>	<u>5</u>	<u>6</u>	<u>7</u>	<u>8</u>	<u>9</u>	<u>10</u>
Principal & Interest	\$320	\$320	\$320	\$320	\$320	\$320	\$320	\$320	\$320	\$320
Property Insurance	10	11	11	12	12	13	13	14	15	16
Property Taxes	40	42	44	46	49	51	54	56	59	62
Routine Maintenance	10	11	11	12	12	13	13	14	15	16
Utilities	40	42	44	46	49	51	54	56	59	62
Gross Costs	420	426	430	436	442	448	454	460	468	476
Income Tax Benefits	126*	104	103	103	103	102	101	100	98	97
Net Costs	\$294	\$322	\$327	\$333	\$339	\$346	\$353	\$360	\$370	\$379

\* Includes a \$903 deduction for sales tax in first year.



TABLE II

MONTHLY CASH FLOWS  
FOR SELECTED YEARS  
(Different Financing Cases)

<u>FINANCING CASE</u>	<u>YEAR 1</u>	<u>2</u>	<u>6</u>	<u>10</u>
<u>12%/20 YEARS</u>				
Gross Costs	\$353	\$359	\$381	\$409
Net Costs	\$250	\$279	\$303	\$336
<hr/>				
<u>16%/20 YEARS</u>				
Gross Costs	\$420	\$426	\$448	\$476
Net Costs	\$294	322	346	\$379
<hr/>				
<u>12%/5 YEARS</u>				
Gross Costs	\$612	\$618	\$128	\$156
Net Costs	\$513	\$553	\$113	\$137
<hr/>				
<u>16%/5 YEARS</u>				
Gross Costs	\$659	\$665	\$128	\$156
Net Costs	\$538	\$580	\$113	\$137

### Transfer Costs

The monthly cash flows only indicate one portion of the costs of owning a Granny Flat. The other part is the cost incurred at the time of sale. Exhibit II shows the calculation of the transfer costs for the 16%/20 year financing case. Table III summarizes the transfer costs involved in selling a Granny Flat in each of the financing cases. In all of these cases, the homeowner incurs substantial losses due to the transfer costs, ranging from \$3,979 to \$7,523, if the unit is occupied for only one year. The major reason for these losses is the fact that the site and installation costs do not have any resale value and must be viewed as sunken costs. The resale value of a Granny Flat would have to rise almost 20% in the first year in the best case (12%/5 year financing) before an owner would not have any out-of-pocket cash loss after paying off the balance of the loan. Of course, the loss could also be minimized if the loan amount was less than the total initial costs of the Granny Flat. However, in this case, the owner would lay out up-front cash in the form of a downpayment which would not be recouped if the unit was sold after one year.

Substantial out-of-pocket cash losses still occur when the unit is sold at the end of the fifth or tenth year where twenty year financing is used. Substantial gains are realized in the five year financing cases, but, as Table II shows, the owner has been paying about an additional \$250 per month or \$3,000 per year in net carrying costs in the first five years of ownership.

### Total Costs

Table IV brings together the net carrying costs and transfer costs and for purposes of comparison adds them together to arrive at an average monthly cost/per month of occupancy for different holding periods. These average monthly costs have been treated with caution because they are artificial constructs which do not reflect the timing of the cash flows. However, they do illustrate

## EXHIBIT II

CALCULATION OF TRANSFER COSTS FOR SELECTED YEARS  
(16%/20 Year Case)

<u>ITEM</u>	<u>YEAR 1</u>	<u>5</u>	<u>10</u>
Sales Price	\$18,050	\$18,050	\$18,050
LESS			
Broker's Fee	1,083	1,083	1,083
Net Carrying Costs during Sales Period	644	692	772
Removal of Unit	525	638	824
Site Restoration	525	638	825
Loan Balance*	<u>22,796</u>	<u>21,728</u>	<u>18,971</u>
Transfer Costs	\$ 7,523	\$ 6,729	\$ 4,405

\* The actual sale is assumed to occur two months after the unit becomes vacant. The loan balance is, therefore, calculated to reflect the two month sales period. For example, the loan balance after 14 months is used when the unit becomes vacant at the end of the first year.

TABLE III

TRANSFER COSTS  
FOR SELECTED YEARS  
(Different Financing Cases)

<u>FINANCING CASE</u>	<u>VACANT AT END OF YEAR</u>		
	<u>1</u>	<u>5</u>	<u>10</u>
12%/20 YEARS	\$7,293	5,931	2,844
16%/20 YEARS	\$7,523	6,729	4,405
12%/5 YEARS	\$3,979	(15,465)*	(15,053)
16%/5 YEARS	\$4,882	(15,465)	(15,053)

\* A number in parenthesis indicates that the owner does not incur any net transfer costs at the time of resale. A net gain occurs because the loan has been paid off before the unit is sold.

TABLE IV

AVERAGE MONTHLY COSTS FOR SELECTED HOLDING PERIODS  
(Different Financing Cases)

<u>FINANCING CASE</u>	<u>YEAR 1</u>	<u>5</u>	<u>10</u>
<u>12%/20 YEARS</u>			
Net Carrying Costs	\$ 3,000	\$16,776	\$35,880
Transfer Costs	<u>\$ 7,293</u>	<u>\$ 5,931</u>	<u>\$ 2,844</u>
Total Costs	\$ 10,293	\$22,707	\$38,724
Average Monthly Costs	\$ 857	\$ 378	\$ 323
<hr/>			
<u>16%/5 YEARS</u>			
Net Carry Costs	\$ 3,528	\$19,380	\$41,076
Transfer Costs	<u>\$ 7,523</u>	<u>\$ 6,729</u>	<u>\$ 4,405</u>
Total Costs	\$ 11,051	\$26,109	\$45,481
Average Monthly Costs	\$ 921	\$ 435	\$ 379
<hr/>			
<u>12%/5 YEARS</u>			
Net Carrying Costs	\$ 6,156	\$33,984	\$41,436
Transfer Costs	<u>\$ 3,979</u>	<u>(\$15,465)*</u>	<u>(\$15,053)</u>
Total Costs	\$10,135	\$18,519	\$26,383
Average Monthly Costs	\$ 845	\$ 309	\$ 220
<hr/>			
<u>16%/5 YEARS</u>			
Net Carrying Costs	\$6,456	\$35,952	\$43,404
Transfer Costs	<u>\$4,882</u>	<u>(\$15,465)</u>	<u>(\$15,053)</u>
Total Costs	\$11,338	\$20,487	\$28,351
Average Monthly Costs	\$ 945	\$ 341	\$ 236

\* A number in parenthesis indicates that the owner does not incur any net transfer costs at the time of resale.

three points. First, they again show the impact of the sunken costs of site preparation and installation. Average monthly costs for one year of tenure range from \$845 to \$945, while for five years or ten years of tenure the ranges are much lower; \$309 to \$435 and \$220 to \$379 respectively. Second, while the initial carrying costs are lower for the twenty year financing cases, over longer periods the average monthly costs become substantially lower for the five year financing cases. This reflects the higher amounts of interest costs (even after consideration of the tax benefits) for loans with longer maturities. And third, the total costs/average monthly costs for any holding period are much closer than might be concluded by looking at the differences in the carrying costs in Table II.

The analysis so far has been limited to the initial purchaser of a Granny Flat. The reasons for this focus are twofold. First, the economics must be attractive to an initial purchaser in order for the market to develop. And second, analyses involving subsequent purchasers are even more speculative than the projections used for the initial purchaser. However, it may be useful to look at one aspect of the economics relating to subsequent purchasers given the importance of the site, installation, and transfer costs in the above analyses. If, for example, a Granny Flat turns over fairly frequently, the total site, installation, and transfer costs are likely to be quite high in a period of a few years. This would offset the minimal land and site development cost advantages cited in the literature.

Exhibit III summarizes the total site, installation and transfer costs to the first three owners assuming that the unit turns over every three years. The cost assumptions are the same as those used previously, except that a \$500 cost (in

## EXHIBIT III

TOTAL COSTS ASSOCIATED WITH  
RELOCATING GRANNY FLATS  
(3 Year Turnover Case)

<u>ITEM</u>		<u>COST</u>
1. Broker Fees	Year 3	\$ 1,083
	Year 6	1,083
	Year 9	<u>1,083</u>
		\$ 3,249
2. Sales Tax*	Year 1	\$ 632
	Year 3	632
	Year 6	<u>632</u>
		\$ 1,896
3. Site/Installation Costs**	Year 1	\$ 4,090
	Year 3	4,735
	Year 6	<u>5,481</u>
		\$14,306
4. Unit Removal/Site Restoration Costs	Year 3	\$ 1,157
	Year 6	1,341
	Year 9	<u>1,551</u>
		\$ 4,049
5. Unit Refurbishment Costs	Year 3	\$ 579
	Year 6	<u>670</u>
		\$ 1,249
6. Carrying Costs during Sale Periods		Varies depending on financing case

Total= \$24,749 + Carrying Costs\*\*\*

\* Net costs after tax benefits.

\*\* Includes items A3-A7 in Exhibit I.

\*\*\* The minimum total carrying charges would be about \$2,000 if the three owners used 12%/20 year financing.

1983 dollars) is added for painting and other refurbishing items after the unit is sold. The \$24,749, plus carrying costs during the resale periods, in nine years indicate that the non-recoverable costs of temporary housing can be quite high. As will be seen in the subsequent sections these same cost items can have a major impact on the costs of Granny Flats as rental units.

In closing this section, it is important to note that the paper does not evaluate the economic attractiveness of owning a Granny Flat. Instead, the above analyses are intended to illustrate the likely costs of owning a Granny Flat based a series of cost assumptions and estimates. Potential purchasers will have to evaluate for themselves whether the likely costs are reasonable given their individual family situations.



## V. COST ITEMS AND ESTIMATES: RENTAL CASE

Renting Granny Flats to the elderly or their families is comparable to the way in which most units have been built and financed in Australia. In the American context, the literature has described this alternative as being operated through a local public agency or non-profit group. To-date, Rockville, Maryland, Lancaster County, Pennsylvania and a five county non-profit organization in rural Maryland\* have developed proposals for demonstration projects to test this overall concept. These proposals rely on grant funds to cover the capital costs of the Granny Flats. Further, only general information is provided in these proposals on operating cost estimates or the administrative structure necessary to carry out a scattered-site Granny Flat rental project.

As a result, cost projections for the rental case must also be based on some very tentative assumptions and cost estimates. With a few exceptions and additions, the same cost estimates which were developed for the ownership case are also used here.

### Initial and Carrying Costs

All of the initial cost estimates are the same, except that no sales tax is assumed because of the likely tax-exempt status of the sponsoring organization. This brings the initial costs down to \$22,140 which is rounded off to \$22,000 in the calculations of financing costs.

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\* Literature references are included in Appendix A.

It is possible that some cost savings may result from the purchase and installation of a large number of units. On the other hand, start-up expenses for legal, organizational and marketing purposes could also increase the initial cost of the units. Since the cost estimates are so tentative, the \$22,000 figure will be used.

The major carrying cost item will again be for the financing. It is assumed in this analysis that the Granny Flats will be financed through tax-exempt, local mortgage revenue bonds bearing a 12% interest rate and carrying a twenty year maturity.\* It should be noted that many localities have little or no experience in this area. Further, the underwriters of the bond issue will be concerned about the operating costs, turnover rates, and life expectancies of Granny Flats as these items relate to the income necessary to pay off the bonds.

Property taxes are eliminated because of the tax-exempt status of the sponsoring group. Maintenance is very difficult to estimate and will vary considerably, not only by geographic location, but by the managerial structure of the sponsoring group. In theory, scattered-

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\* The interest rate was developed by HUD's Office of State Agency and Bond Financed Programs based on current yields for multifamily projects using mortgage revenue bonds. These projects are usually financed with a forty year maturity. Given the newness of the Granny Flat concept and their unknown useful economic life, it was decided to use a twenty year maturity. In practical terms, the difference in monthly carrying charges is not very great. The monthly carrying charge for a \$22,000 unit is \$242 with a twenty year term as compared to a \$222 cost with a forty year term.

site projects can have very high maintenance costs because of down time in travel to individual sites and the potential time losses associated with storing material at a central location. These costs could be reduced somewhat if the sponsoring group did not have to hire a separate maintenance crew and facility, but could share these costs with another project. Having the elderly occupant's family undertake some of the routine maintenance would also result in savings. In any case, the routine maintenance costs would be higher than for the ownership case. A \$30 per unit/per month cost estimate will be used here. For a 100 unit project, this results in an annual budget of \$36,000 which is likely to be sufficient to cover 1-1.5 full-time maintenance staff, a maintenance van, materials, some central storage and shop facilities, and specialty contracts for major plumbing, electrical, and other repairs. Rental projects generally also include a contingency for replacement reserves. Using the generally accepted processing figure for HUD insured projects of 0.6% of the total structural costs, this works out to  $0.006 \times \$18,050 = \$108$  per year or about \$10 per unit/per month.

In addition to maintenance costs, some allowance has to be included for overall management and administration, involving marketing, rent collection, maintenance supervision, accounting, etc. A cost estimate of \$20 per unit per month is used which works out to \$24,000 per year for a 100 unit project.\* This would cover one staff person plus office facilities. Since the utilities are assumed to be hooked-up

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\*If the above staff and facility estimates for maintenance and management are reasonable, then the per unit/per month costs might be higher for a smaller project and potentially lower for a larger project.

on the homeowner's side of the meters, they are not included in the project costs, but are treated as direct charges separate from the rent for the unit. In other words, utilities are analogous to an apartment building with individual meters for each tenant.

#### Relocation Costs

Transfer costs in the rental case do not involve resale costs and paying off the balance of the loan. Instead, these items are really costs of relocating the unit when it is vacant. The key variable here is what proportion of units turn over each year and have to be removed, refurbished, marketed, and relocated to a new site. Since no data exist on this subject, a range of possible scenarios will be used. If most occupants are elderly parents in the 62-65 age bracket where a Granny Flat is the preferred alternative among a variety of housing options, then turnover should not be too high. For this case, a 10% per year turnover rate is used.\* If most occupants are elderly parents over 75, and where a Granny Flat is an alternative to a nursing home, then the turnover rate will be considerably higher. In the later case, a 25% per year turnover rate is used. No other allowances for vacancies due to the family moving to another location, the elderly parent remarrying and relocating, etc., are included in the analysis.

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\* Current estimates indicate that people in the 65-70 age category can on the average expect to live another sixteen years. This would imply a turnover rate of 6.25%. Given the high costs of relocating units and the strong possibility that turnover will differ somewhat each year, a sponsoring organization will likely try to build up a reserve by using a higher vacancy factor. As a result, a 10% turnover rate is used in this analysis.

Finally, the unit removal, site restoration, unit refurbishing, and unit relocation costs are the same as those used for the ownership case. Exhibit IV summarizes the cost items and estimates for the rental case.

## EXHIBIT IV

SUMMARY OF COST ITEMS AND  
ESTIMATES: RENTAL CASE\*

<u>ITEM</u>	<u>ESTIMATE</u>
<b>A. <u>Initial Costs**</u></b>	
1. One Bedroom Modular Unit	\$18,050
2. Site Preparation and Unit Placement	<u>\$ 4,090</u>
Total	\$22,140
<b>B. <u>Carrying Costs</u></b>	
1. Financing 12%/20 years	\$ 242/month
2. Property Insurance	\$ 10/month
3. Property Taxes	\$ 0 (local exemption)
4. Routine Maintenance	\$ 30/month
5. Replacement Reserves	\$ 10/month
6. Management/Administration	\$ 20/month
7. Utilities	\$ 40/month
8. Cost Inflation Rate	5%/year
<b>C. <u>Relocation Costs</u></b>	
1. Turnover Rate	10% per year 25% per year
2. Removal of Unit	\$ 500 in 1983 dollars

\* Cost estimates are on a per unit basis.

\*\* These costs are the same as Exhibit I, except that no sales tax is included.

3. Site Restoration	\$ 500 in 1983 dollars
4. Unit Refurbishment	\$ 500 in 1983 dollars
5. Unit Relocation and Installation at New Site	\$ 4,090 in 1983 dollars
6. Cost Inflation Rate	5%/year
7. Losses during Vacancies (100 unit project)	
- 10 units/year	20 months/year
- 25 units/year	50 months/year

## VI. MONTHLY CASH FLOWS: RENTAL CASE

There are, at least, two alternative ways in which a sponsoring organization could cover the costs of a rental project. First, all of the costs, including the expenses associated with turnover and the relocation of the unit, could be factored into the rents charged to tenants. Second, only the capital costs associated with the unit itself and the normal operating costs would be calculated into the rents, while the costs of site preparation, unit installation, and unit removal would be charged directly and separately to the tenant or his/her family.\*

Tables V\*\* and VI are five year pro-forma cash flows which show the rents a sponsoring organization has to charge when all the costs of a Granny Flat are factored into the rent. The first year rents range from \$367 to \$453 per month. The difference between the figures, of course, results from the turnover rate which is used. The higher rents for the 25% turnover case are due principally to the cost of removing and relocating the units rather than income losses during the two month vacancy period. The total monthly costs to the tenant are somewhat higher since utility costs are not included in the rent. The total monthly costs, including utilities, in the first year range from \$407 to \$493 and rise to \$443 to \$547 in the fifth year.

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\* This later option is similar to one variant of the Australian experience where individuals purchase the units, but the public agency guarantees to buy the unit at its market value when it becomes vacant.

\*\*All the tables for the rental case are calculated on a per unit basis.



MONTHLY CASH FLOWS  
(10% Turnover Rate, All Costs Case)

<u>ITEM</u>	<u>YEAR 1</u>	<u>2</u>	<u>3</u>	<u>4</u>	<u>5</u>
Principal & Interest	\$242	\$242	\$242	\$242	\$242
Property Insurance	10	11	11	12	13
Routine Maintenance	30	32	33	35	36
Replacement Reserves	10	11	11	12	13
Management/ Administration	20	21	22	23	24
Relocation/ Refurbishment	49	51	54	57	59
Rental Income Required	361	368	373	381	387
Allowance for Vacancies	6	6	6	6	7
<b>Rents*</b>	<b>\$367</b>	<b>\$374</b>	<b>\$379</b>	<b>\$387</b>	<b>\$394</b>

\* Utilities have to be added to calculate total monthly costs.

TABLE VI

MONTHLY CASH FLOWS  
(25% Turnover Rate, All Costs Case)

<u>ITEM</u>	<u>YEAR 1</u>	<u>2</u>	<u>3</u>	<u>4</u>	<u>5</u>
Principal & Interest	\$242	\$242	\$242	\$242	\$242
Property Insurance	10	11	11	12	13
Routine Maintenance	30	32	33	35	36
Replacement Reserve	10	11	11	12	13
Management / Administration	20	21	22	23	24
Relocation / Refurbishment	122	128	135	142	149
Rental Income Required	434	446	454	466	477
Allowance for Vacancies	19	19	20	20	21
Rents*	\$453	\$465	\$474	\$486	\$498

\* Utilities have to be added to calculate total monthly costs.

Tables VII and VIII are five year pro forma cash flows which show the rents when the costs associated with the unit installation and removal are paid directly by the tenant. The resulting rents in the first year range from \$273-\$280 per month, without utilities, which is substantially lower than the case where all the costs are factored into the rents. However, the tenant or his/her family would also have a cash outlay of \$4,090 for site preparation and the installation of the unit and \$1,000 for the removal of the unit and the restoration of site. Subsequent renters would also have an additional charge of \$500 for refurbishing the unit.

From the perspective of the sponsoring organization, it might prefer the later option of charging directly for site preparation and unit installation and removal since these large outlays could serve as an incentive to assure that the tenant remains in the unit. On the other hand, it may be more difficult to market the units under these conditions because of the large cash outlays. A tenant or his/her family is also likely to prefer to have all the costs factored into the rent to avoid the high cash outlays.

On an overall basis, it is difficult to evaluate the attractiveness of the rental case as compared to the ownership case because both analyses are very tentative and based on some highly speculative assumptions. However, it would appear that from the cost perspective,

TABLE VII

MONTHLY CASH FLOWS  
(10% Turnover Rate, Unit Costs Only Case)

<u>ITEM</u>	<u>YEAR 1</u>	<u>2</u>	<u>3</u>	<u>4</u>	<u>5</u>
Principal & Interest	\$198	\$198	\$198	\$198	\$198
Property Insurance	10	11	11	12	13
Routine Maintenance	30	32	33	35	36
Replacement Reserves	10	11	11	12	13
Management/ Administration	20	21	22	23	24
Rental Income Required	268	273	275	280	283
Allowance for Vacancies	5	5	5	5	5
Rents*	\$273	\$278	\$280	\$285	\$288

\* Utilities have to be added to calculate total monthly costs.

TABLE VIII

MONTHLY CASH FLOWS  
(25% Turnover Rate, Unit Costs Only Case)

<u>ITEM</u>	<u>YEAR 1</u>	<u>2</u>	<u>3</u>	<u>4</u>	<u>5</u>
Principal & Interest	\$198	\$198	\$198	\$198	\$198
Property Insurance	10	11	11	12	13
Routine Maintenance	30	32	33	35	36
Replacement Reserves	10	11	11	12	13
Management / Administration	20	21	22	23	24
Rental Income Required	268	273	275	280	283
Allowance for Vacancies	12	12	12	12	12
<b>Rents*</b>	<b>\$280</b>	<b>\$285</b>	<b>\$287</b>	<b>\$292</b>	<b>\$295</b>

\* Utilities have to be added to calculate total monthly costs.

the rental case has some major advantages. First, it is unclear as to what loan terms a owner could obtain from a financial institution. By comparison, a locality could use tax-exempt bonds to finance Granny Flats for a twenty year period at reduced interest rates. This mechanism also allows for lower monthly carrying costs for financing the capital costs of Granny Flats.

Second, substantial out-of-pocket cash losses can incur at the time of sale in the ownership case. This does not happen in the rental case where the turnover/relocation costs can be factored into the rental charges. Third, the monthly costs may often be comparable for the rental and ownership cases. For example, Table IV showed that the average costs to the owner over a five year holding period in the 16%/20 year case is \$435 per month. Adding utility costs to the rents in Tables V and VI result in average rental costs over a five year period of \$424 and \$519 per month respectively.

While the rental case may be more attractive, it should be reemphasized that only three proposals for rental projects have been put forward, and these demonstration initiatives would have relied on a 100% Federal writedown of the capital costs. To-date, no sponsoring organization has developed a proposal involving the various types of financing which are commonly used for conventional rental projects.

## VII. SUMMARY

The preceding sections have looked at the economic issues associated with Granny Flats by developing two hypothetical cases, one for owning the unit and the other for renting the unit from a non-profit group or local public agency. These cases highlight the various economic issues associated with Granny Flats.

First, there has been little experience in this country with Granny Flats. There is only one firm in the market and to-date only two units have been sold. Similarly, no proposal for a Granny Flat rental project has yet gone beyond the very conceptual stage. Nevertheless, the \$18,050 F.O.B. factory price for the only one bedroom unit in production appears to be a reasonably good estimate of the likely costs of a Granny Flat by itself.

The remaining initial costs for sales tax, delivery, site preparation, and installing the unit could vary considerably depending on local laws, local prices for labor and materials, and individual site conditions. The cost estimates used in this paper reflect minimal problems at the site, and actual costs could be significantly higher. This uncertainty can have a major impact on the economics of Granny Flats because these items are sunken costs which do not add to the resale value of the unit. If the costs are higher than estimated here, the owner will need a fairly long period of time to amortize these overhead items.

If the period of occupancy is also short, then the owner's total costs will be higher than estimated in this paper. The same problem exists in the rental case, and these added costs will be reflected in rents charged to the occupants or their families.

Second, it is unclear as to the availability and terms of financing for Granny Flats. If Granny Flats are treated as real property and financed with mortgage loans, financial institutions may lend significantly less than the actual cost of the unit, limit the maturity of the loan to a five or ten year period, and possibly increase the interest rate to reflect the perceived higher risks associated with any new innovation in housing. The result would be to increase the owner's upfront costs in the form of a downpayment and increase the owner's monthly carrying costs due to the shorter maturity and/or higher interest rate on the loan.

If Granny Flats are treated as personal property and financed with short-term loans similar to those available for home improvements, it is likely that the total capital costs of a Granny Flat could be financed, assuming that the borrower is sufficiently credit worthy. However, personal property loans traditionally have higher interest rates and shorter maturities than mortgage loans. It is also possible for an owner to take out a second loan on the primary house to finance the costs of a Granny Flat. Regardless of how Granny Flats are financed,



it can be expected that lenders will initially proceed cautiously in this area.

With respect to the rental case, financing may be less of a problem if a locality chooses to use mortgage revenue bonds. However, many localities have little or no experience in this area. Furthermore, the underwriters of the bond issue will have a number of concerns about the operating costs, turnover rates, and life expectancies of Granny Flats as these items relate to the income necessary to pay off the bonds.

Third, the non-financing carrying costs of Granny Flats used here, in both the ownership and rental cases, are, at best, rough estimates. In particular, the operating costs for the rental case could be quite high because of the scattered-site nature of the project. In addition, different turnover rates can have a major impact on the rental charges.

Last, it is difficult to estimate the total costs of a Granny Flat in the ownership case because the resale value of these units is currently unknown. The paper has assumed that the resale price of a one bedroom unit remains the same as its estimated initial cost of \$18,050. If units have a higher resale value, then the total costs to the initial owner are lower, but the converse also holds true. Since it is not possible to reliably predict the resale value for Granny Flats, this uncertainty may also act to deter some potential purchasers from buying the units.

On an overall basis, the fact that these major economic issues involve many uncertainties reflect the current status of Granny Flats as a potentially appealing concept rather than a viable housing alternative for the elderly. If the interest in Granny Flats grows and develops into a viable market, then the above issues will be addressed and many of the uncertainties will be resolved. This has occurred with many prior innovations in the housing area and there is no reason why a similar process will not apply to Granny Flats if they prove to be an attractive option to the elderly and their families.

PART TWO

LAND USE AND OTHER DEVELOPMENT CONTROLS



## I. BACKGROUND

All housing construction must conform to a complex regulatory system of local land use and other development controls. This system has, for the most part, developed without consideration of accommodating accessory residential structures or Granny Flats.\* Most urban/suburban residential land is dedicated to single family housing in which each lot has been zoned, platted, and developed to accommodate one individual structure/unit.\*\* As a result, a second unit on a lot is not a permitted use under most existing local zoning and related controls.

This study was undertaken to examine this basic legal reality. It explores the design and regulatory issues a community may want to look at in considering Granny Flats and suggests some possible legislative approaches that could be used to accommodate such units within the context of the existing regulatory environment.

Granny Flats have been discussed far more than they have been built. Historically, some accessory structure units were built in particular farming communities such as in the Amish country of Pennsylvania. Far more common is the use of mobile homes as a second unit in rural areas. These dwellings can now be seen in many rural areas serving a wide variety of occupants. The

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\* For this study any detached secondary unit will be referred to as an "accessory structure" while a Granny Flat is an accessory structure only for the use of the elderly.

\*\* Multi-family zones do permit more than one structure but these are generally large multi-lot sites.

study could, however, only identify one supplier of units specifically marketed as Granny Flats and it has, to date, sold only two units.\* As with mobile homes, these units are also located in rural areas.

It is important to note that this study has not been able to identify one example of a Granny Flat or other accessory residential structure in an urban/suburban area.\*\* Therefore, all assessments of both the concept and possible regulatory impediments still remain highly theoretical and speculative. It can, in fact, be argued that an analysis of regulatory impediments is currently premature. This argument would suggest that it is better to let communities fashion innovative solutions to actual rather than supposed regulatory impediments. However, advocates of Granny Flats argue that existing land use laws are having a "chilling effect" on further development of the concept. They argue that localities should act to encourage and anticipate demand.

While only two Granny Flats exist, over 20 communities have fashioned some sort of accessory housing ordinance and it appears that an increasing number of communities are now considering the option. A number of these early ordinances appear not to specifically address Granny Flats. Rather, they have been enacted as an attempt to recognize and regulate existing mobile homes by

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\* These are two units (Elder Cottages) built by the Coastal Colony Corporation of Lititz, Pennsylvania. It is these two units that have been cited and referred to in many newspapers and other publications as successful examples of Granny Flats.

\*\* This should be contrasted with the hundreds of thousands of accessory apartments, both legal and clandestine, which exist nationwide. Accessory apartments have had a long history in our housing markets. In recent years a number of communities have decided to legalize and regulate such apartments. See "Accessory Apartments" by Patrick H. Hare; a Planning Advisory Service Report published by the American Planning Association.

rural communities within existing zoning ordinances.\* However, there are a second group of ordinances, almost all in California, that specifically attempt to encourage accessory structures in an urban/suburban environment.\*\*

Given this limited legal and development experience with Granny Flats, this study does not propose a model ordinance. It does, however, discuss alternate methods by which a community may regulate Granny Flats and reviews some specific issues that will have to be addressed in fashioning a local ordinance. These issues have either already been<sup>u</sup><sub>n</sub> identified in recently enacted ordinances or appear likely to arise as other communities begin to consider this alternative housing option.

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\* For example, Rockingham, North Carolina; Frederick County, Maryland; and Tazewell County, Illinois

\*\* Eighteen communities with ordinances are located in California.

## II. METHOD OF REGULATION

The use of land is generally regulated through a comprehensive local zoning ordinance. Any legislation to allow Granny Flats will, therefore, take the form of a zoning amendment or modification. This can be handled in one of three ways: making accessory structures a permitted use; granting a variance for a specific project; or, establishing a special permit/conditional use approval process. The latter approach appears the most suitable for regulating Granny Flats.

### Permitted Use

Establishing districts or zones for designated permitted uses is the general method by which communities regulate the use of land. In each zone the owner of the land can build any of these permitted uses as a matter of right. Although the zone may contain certain standards and design minimums such as density, these are not judgmental conditions; i.e., generally there is no subsequent local administrative review and approval.

None of the existing ordinances on accessory structures have made Granny Flats a permitted use and it is highly unlikely that, for the foreseeable future, many communities will seriously consider this option. First, as a permitted use, all lots within the zone could, equally and as a matter of right, include a Granny Flat without further administrative review. Second, if a unit were built as a permitted use, the locality would have no easy method or mechanism to obtain removal of the unit. The full burden of monitoring use and seeking removal would fall upon the local government. To the extent a Granny Flat is not to be a permanent addition to the housing stock, but a temporary, relocatable unit tied to a particular class of occupant, the locality needs to be quickly made aware of



any changed conditions with the burden of notice placed upon the land owner.

### Variance

A variance is a common method by which a locality provides for flexibility in its zoning ordinance. A variance is an authorization by a local administrative body for the individual land owner to depart from the established zoning and to use the land in violation of the local ordinance. This study identified only one county that has used this approach in authorizing mobile homes as second units.\*

Although the use of variances permit the locality to effectively control the number and location of units, there are serious problems with this approach. First, once a variance is granted, it "runs with the land" to all subsequent owners, continuing as a matter of right. As with a permitted use, it would be extremely difficult to obtain subsequent removal of the accessory unit. Second, award of a variance generally requires a full administrative hearing. The applicant must show actual economic "hardship" in the use of the land prior to being awarded a variance. The variance process also provides neither guidance nor standards by which either the community or the applicant can assess the terms or conditions by which Granny Flats should be built.

### Special Permit/Conditional Use

The last alternative to regulating land use goes under various names: special use, special permit, conditional permit, etc. It is a common, long recognized device of land regulation whereby the owner applies for the "privilege" of building to a specific use. All but one of the existing ordinances use this approach.

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\* Kern County, California

The award of a special permit is not totally discretionary. Each local zoning ordinance, in addition to containing the previously discussed "permitted use" for designated zones, also provides for a series of conditional uses. Each zone may have its own conditional uses. The ordinance generally lists a series of specific conditions which must be met by the applicant prior to award of the permit for that designated conditional use. Upon evidence that the specific conditions have been or will be met, the landowner receives authorization, generally in the form of a permit, to proceed. Although the required conditions are set forth in the statute, they are often quite general and the locality has great latitude in approving permits.

The special permit device has two distinct advantages. First, it permits the community to individually review and control each application. It appears that this type of public review will be essential if localities are to consider seriously accessory structures. Second, a special use is a permit or personal privilege awarded to the individual landowner. It does not pass to subsequent owners and can be revoked if any required condition is not met. The "temporal" nature of a permit is particularly appropriate for Granny Flats where it is anticipated that the unit will be eventually removed.

Every locality has its own established procedures regarding application, review, and permit approval. The individual ordinance may require various certifications, hearings, notice to neighbors, submission of plans, etc. However, the locality may want to establish additional procedures to assure that, in fact, the unit will be used for its intended purpose after it is no longer needed by the original occupant. For example, the landowner may be tempted to convert the unit to personal use or to rent it out. To prevent this,

the locality may establish procedures to closely monitor and control subsequent use. Although there are a number of ways this can be done, the most effective approach would limit the permit to some time certain (1 or 2 years) requiring a permit renewal and recertification by the original applicant for continued use of the unit.

### III. CONDITIONS AND CRITERIA FOR THE SPECIAL PERMIT

The special permit appears to be the most suitable mechanism for regulating Granny Flats. The specific conditions which the locality imposes upon this permit will determine the nature and impact of the ordinance. There are, potentially, an unlimited number of conditions a community could demand. However, these concerns generally fall into three groupings: nature of the applicant and occupant; type and size of structure; and site restrictions.

#### Eligible Applicant and Occupant

As the special permit must "run" to that individual with accountability for the use of the land, only the owner of the land is a suitable permit applicant. However, the permit should be sufficiently broad so as not to prohibit alternative methods of ownership and financing of the secondary unit. In some cases the Granny Flat might be owned by the owner of the primary unit. However, it is possible that the elderly occupant may want to own the unit or, as discussed in Part I, rent the unit from a public or non-profit organization.

In any event, all public conditions regarding the unit and its removal must still be directed at the actual holder of the permit -- the owner of the land.\* Moreover, to the extent that the permit is awarded only to meet special family needs and the care of an elderly family member, the locality may want to limit the issuance of permits only to applicant/owners that live on the site.

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\* Banks may have major reservations financing units for elderly occupants or third party lessors if all legal control and disposal of the unit rests with the owner of the site rather than the potential debtor.

It is the identity of the intended occupant of the accessory unit, rather than the applicant, that may present the community with a series of difficult policy choices. When the Granny Flats concept was initiated in Australia, it was limited to aged parents or parents-in-law of the property owner. This was soon expanded to any aged relative or "friend" of the property owner and, even more recently, further extended to any retiree.

There are a number of individuals who advocate broad, general acceptance of accessory structures for many types of occupants. They view secondary units as permanent additions to the housing stock which should be built as a means of increasing the overall supply of "affordable housing." A number of the California ordinances, mentioned previously, appear to be a response to this philosophy.\*

Ordinances of this type, if actually used, could permanently alter the nature of the housing stock within a community. They present an entirely different set of sensitivities and legal and regulatory issues than ordinances permitting only Granny Flats. This study is limited only to the legal issues involved with Granny Flats.\*\*

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\* Monterey, California, authorizes, in designated districts, one additional rental unit for low-and moderate-income families. Martinez, California, authorizes a detached second unit if used exclusively for rental purposes and Carpinteria, California, permits affordable second units for low-and moderate-income families, particularly the elderly, students, and single-parent families. Note, however, that no units have, as yet, been built under these ordinances.

\*\* Much of this study could, however, be used to address accessory housing for the disabled. In fact, a number of the existing ordinances include the disabled. The justification of secondary housing that requires proximity to the primary dwelling would seem to apply equally to housing for the disabled as well as for the elderly.

A locality considering Granny Flat legislation will have to first decide whether the permits should be limited only to housing those elderly in some sort of "familial" relationship to the occupant of the primary residence or to a broader universe of elderly persons.\* Although some of the newer California ordinances are open to any elderly occupant, it seems likely that, at least initially, most communities will opt to restrict the program to occupants with family ties to the owner of the primary unit. One of the strongest justifications given for Granny Flats is that it offers a new option for proximate care with some physical separation between parent and child. This reasoning would not apply to a broader program. A community might be concerned that housing in an accessory structure that is offered to anyone beyond members of the immediate family could become permanent rather than temporary housing for the elderly.

It will be far easier for a locality to fashion a consensus in favor of Granny Flats if limited to family members. Nevertheless, the local government will still have to carefully draft the legislation to cover the intended beneficiaries. For example, the ordinance may limit the program only to the parents of the occupant of the primary unit.\*\* However, grandparents may also be desirable occupants as might be other close relatives.

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\* Note that California enacted legislation (S.B. 1160) amending state enabling legislation authorizing communities to permit second dwellings for any adult over the age of 60.

\*\* There is no reason the legislation should not also permit the elderly owner of a primary unit to move out into the Granny Flat, thereby "freeing" the main unit for children or grandchildren. However, some commentators have also suggested that local legislation should permit the elderly parent to continue living in the primary unit with the child or grandchild residing in the accessory unit. The latter would not be a Granny Flat and care should be taken in drafting legislation to address these two entirely different situations.

To avoid issues of this kind, some ordinances have been drafted to limit an accessory structure only to members of the "immediate family," either aged, disabled, or in some manner necessitating proximity to the primary unit.\* It is then left to the local administrative body to determine whether the intended occupant meets the criteria of the ordinance.

The ordinance will also have to establish a threshold age for occupancy. There is absolutely no consensus among existing ordinances on this subject. Some permit occupancy by persons as young as 55 years while most generally set a threshold of 60 or 65 years.\*\* In addition, almost all ordinances limit occupancy to no more than two adults.

#### Structure Type and Size

Much of the early discussions of Granny Flats have focused upon the type of building structure. As discussed earlier, the Australian type of temporary, panelized unit does not now exist in this country. Therefore, any unit that will be built in the immediate future will be some variant of an existing, available form of construction and will have certain distinct advantages and drawbacks.

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\* In some states restricting accessory units to members of the family may run afoul of state enabling or constitutional law. It is possible that it could be viewed as zoning illegally benefiting one particular class or group.

\*\* If an individual as young as 55 occupies a Granny Flat, it is entirely possible that the "temporary" unit might well be in place, in some instances, for over 30 years.

Some rural localities actually require that the accessory unit be a mobile home.\* Such a requirement provides an assurance to the community that the unit will be, in fact, temporary and easily removable. However, in most suburban/urban communities permitting mobile homes within existing neighborhoods would be totally unacceptable. In fact, a number of the existing Granny Flat ordinances mandate the unit meet the local building code, thereby effectively excluding mobile homes.\*\* Note that although all types of units are theoretically "removable," for a cost, a unit built to most local codes would generally not be considered temporary.

To the extent that a community initially agrees to permit accessory units only to meet the housing needs of particular individuals such as the elderly, they do not want permanent additions to the housing stock. The community will fear, with reason, that once such a unit is placed upon a lot the owner will, over time, seek to convert it to permanent use. Thus, communities will face a conflict between their desire to assure themselves that the unit is temporary and their desire to exclude mobile homes from their community.

As a solution the locality may want to emphasize the relative ease of removing the accessory structure irrespective of the construction system used. For example, the special permit might require that the unit be built, if at all possible, on piers or poles rather than on a continuous foundation or, if continuous, on a wood foundation. This should reduce the costs of removal and site restoration.

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\* See ordinances in Tazewell, California; Frederick, Maryland; and Rockingham, North Carolina.

\*\* See ordinance of Marin County, California, and Tuscon, Arizona.



Most communities will probably also want to establish a maximum limit on the size of the unit. Although the size of an accessory unit will be, to a great extent, dependent upon the size of the lot, the primary unit, and the rear yard, the locality will feel more confident with Granny Flats if it can be assured that all units will be small and suitable only for the intended beneficiaries. Looking at existing plans for Granny Flats, the available Lititz Pa. "Elder Cottage" offers a 508 ft.<sup>2</sup> one bedroom unit and 702 ft<sup>2</sup> two bedroom unit, while other proposals anticipate 480 ft<sup>2</sup> (20' x 24') to 640 ft<sup>2</sup> (20' x 32') houses.\*

The existing statutes vary widely on this issue of maximum house size. The California enabling legislation (S.B. 1160) establishes a 640 ft<sup>2</sup> maximum while other ordinances have limits as high as 800 ft<sup>2</sup> or even 900 ft<sup>2</sup>. \*\* One ordinance directs that the accessory unit cannot be larger than half the size of the primary unit.\*\*\* If the existing zoning ordinance also contains a minimum dwelling size for single family units, the accessory unit will have to be clearly exempted.

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\* See plans and specifications for the "Elder House" developed by Housing Alternatives Unlimited, a California company and the HUD BVIH award winner developed by Jonathan Stafford of Eugene, Oregon.

\*\* Claremont, California

\*\*\* Tucson, Arizona

### Site Considerations

For Granny Flats to become a widespread alternative for housing the elderly, two basic conditions regarding the availability of land must be present. First, there must be enough suitable and buildable land upon which units can be placed. Second, the locality must be willing to authorize these units, as a conditional use, in a sufficient number of locations and zones.

Exhibits IA-IC illustrate the potential of alternative configurations of Granny Flats on six typical suburban single family lots. Exhibit 1A illustrates the placement of the model "Elder Cottage" currently on the market; Exhibit IB uses the 24 x 24' panelized unit proposed in the HUD BVIH program; and Exhibit IC illustrates the placement of a 14' x 52' mobile home. Note that, generally, the Granny Flat can be placed on lots of 1/5 acre or more without difficulty. However, assuming that existing setback, side yard, and front yard requirements are maintained, some difficulties begin to emerge in lots of approximately 7,000 ft<sup>2</sup> or less. In the above example only the currently non-available 24' x 24' panelized unit could be placed on that particular 7,000 ft<sup>2</sup> lot.\* The currently available "Elder Cottage" would be too deep for the lot, while the mobile home, or any other three-dimensional module, could not be brought into the rear yard of this or, in fact, most smaller urban/suburban lots. A typical mobile home requires, at the very least, 12 feet or 14 feet side yards for access while most modules need at least 14 feet.

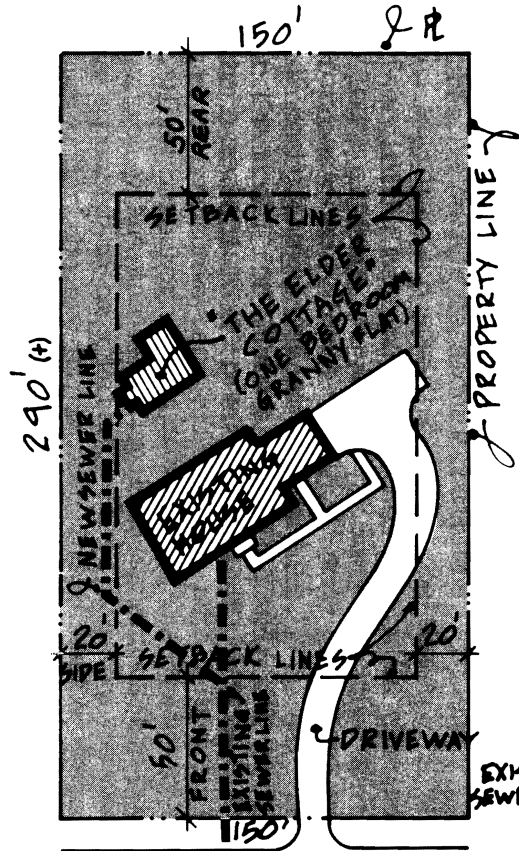
As long as Granny Flats need to be easily removable and relocatable then they will be, most probably, three-dimensional modules, either manufactured or mobile homes. In effect, this will result in limiting the concept to only

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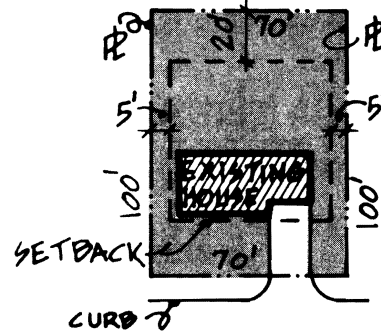
\* This analysis assumes a "typical" 70' x 100' lot, 20' front and rear yard requirements, 5' side yard, and a required 15' minimum fire clearance distance between structures.

# Exhibit-1A

SCALE 1" = 50'

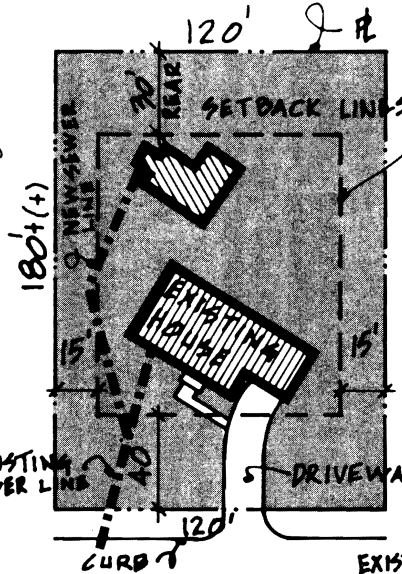


SITE PLAN  
1 ACRE LOT  
 (43,560 S.F.)



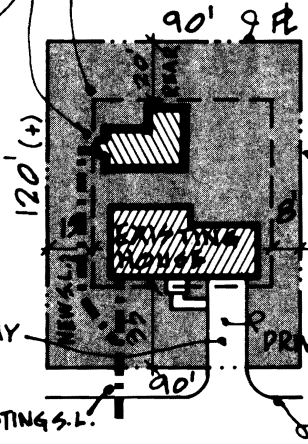
LOT TOO SMALL FOR THE ELDER COTTAGE (ONE BEDRM GRANNY FLAT)

1/6 ACRE  
 (7,000 S.F.)

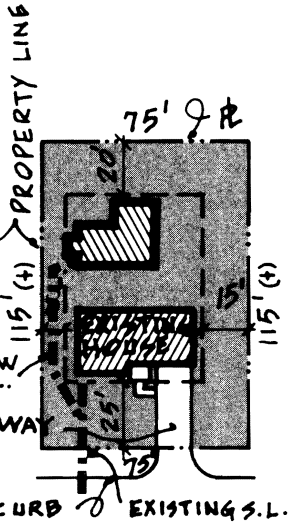


1/2 ACRE LOT  
 (21,780 S.F.)

SMALL LOTS



1/4 ACRE LOT  
 (10,890 S.F.)



1/5 ACRE LOT  
 (8,712 S.F.)

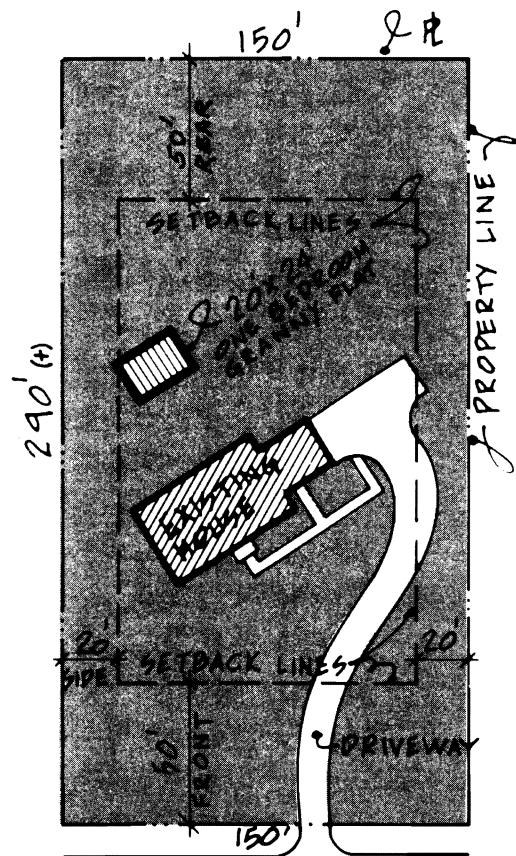
TYP. "LARGE LOT DEVELOPMENTS"

(W/DIFFERENT LOT SIZES & SETBACKS)

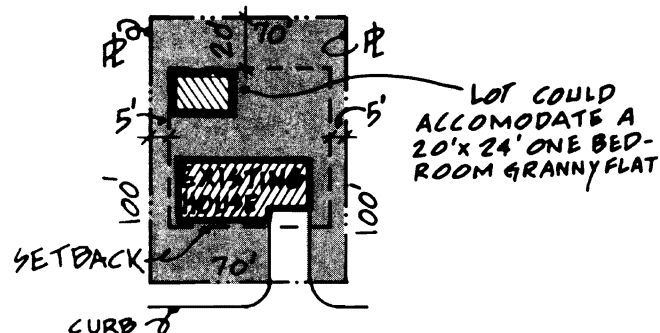
NOTE: S.L. = SEWER LINE

# Exhibit-1B

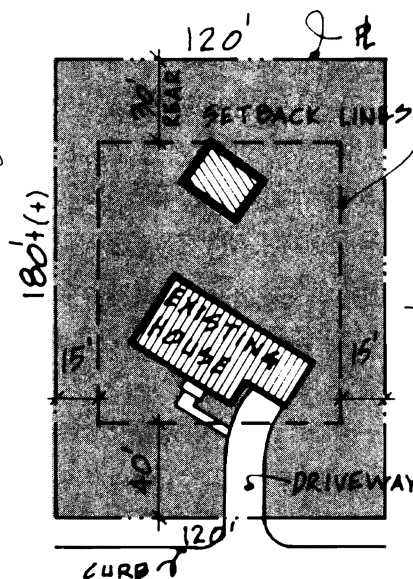
SCALE 1" = 50'



CURB  $\delta$  SITE PLAN  
1 ACRE LOT  
 (43,560 S.F.)

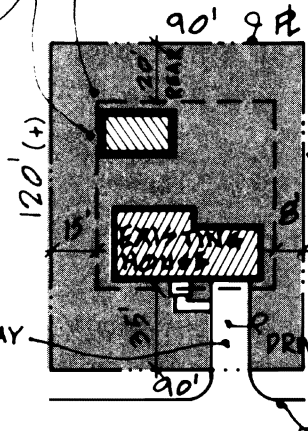


1/6 ACRE  
 (7000 S.F.)

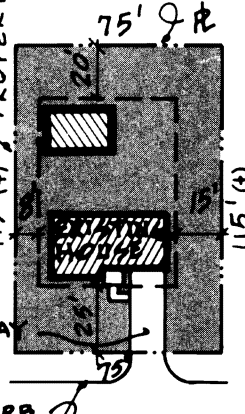


CURB  $\delta$  1/2 ACRE LOT  
 (21,780 S.F.)

## SMALL LOTS



CURB  $\delta$  1/4 ACRE LOT  
 (10,890 S.F.)

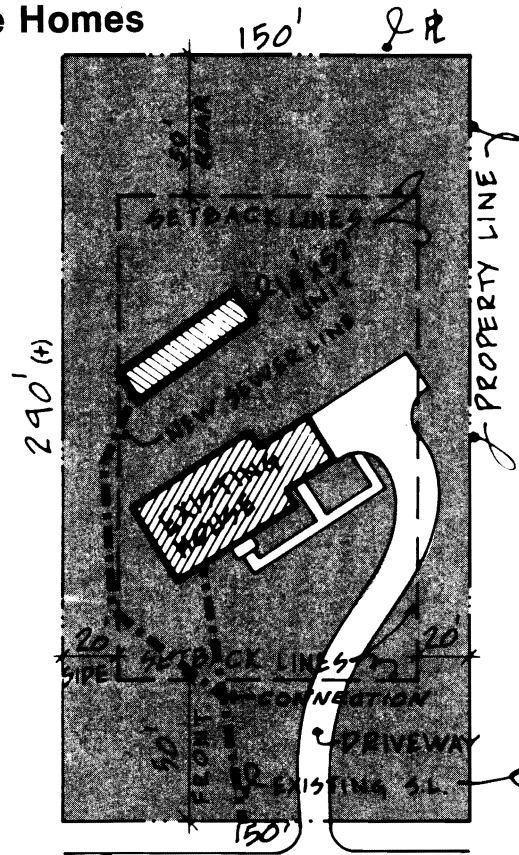


CURB  $\delta$  1/5 ACRE LOT  
 (8,712 S.F.)

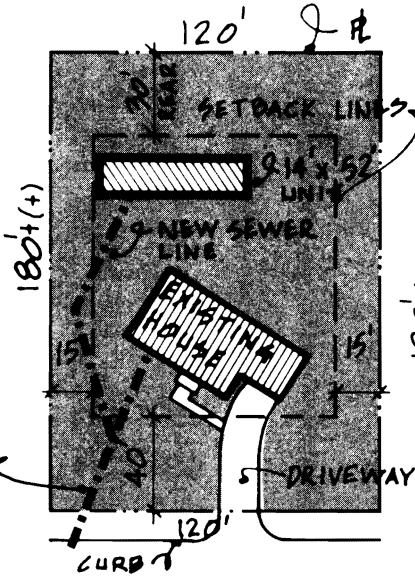
TYP. "LARGE LOT DEVELOPMENTS"  
 (W/DIFFERENT LOT SIZES & SETBACKS)

# Exhibit-1C Mobile Homes

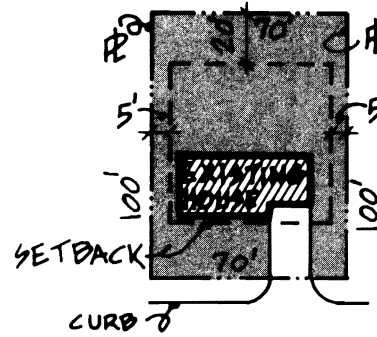
SCALE 1" = 50'



SITE PLAN  
1 ACRE LOT  
(43,560 S.F.)

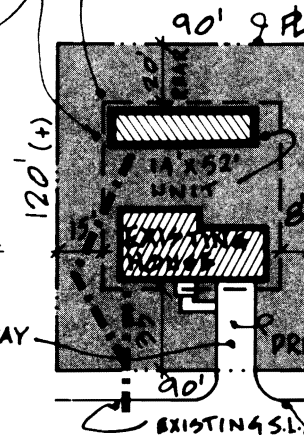


1/2 ACRE LOT  
(21,780 S.F.)

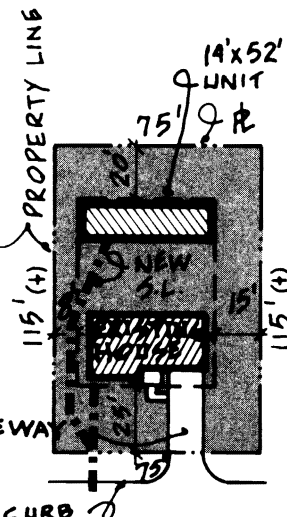


1/6 ACRE  
(7,000 S.F.)

## SMALL LOTS



1/4 ACRE LOT  
(10,890 S.F.)



1/5 ACRE LOT  
(8,712 S.F.)

- LOT TOO SMALL TO ACCOMMODATE MOBILE HOME.
- NOTES:
1. COULD BE DIFFICULT TO ACCOMMODATE ON 1/5 ACRE LOT.
  2. GRADE CONDITIONS ARE CRITICAL TO THIS TYPE SOLUTION.
  3. S.L. = SEWER LINE

TYP. "LARGE LOT DEVELOPMENTS"  
(W/DIFFERENT LOT SIZES & SETBACKS)

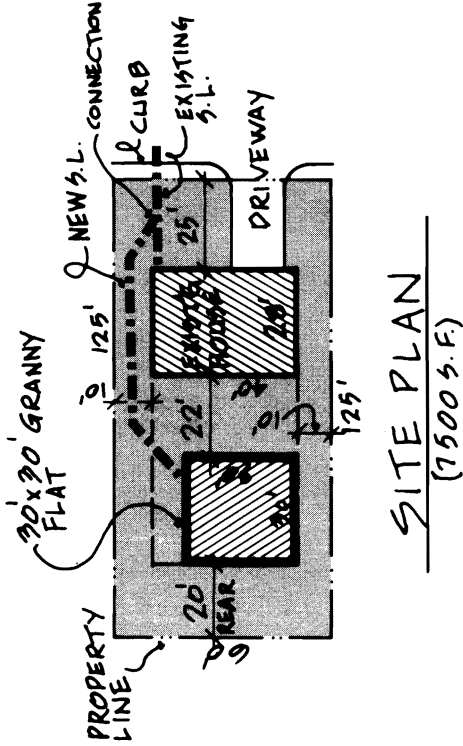
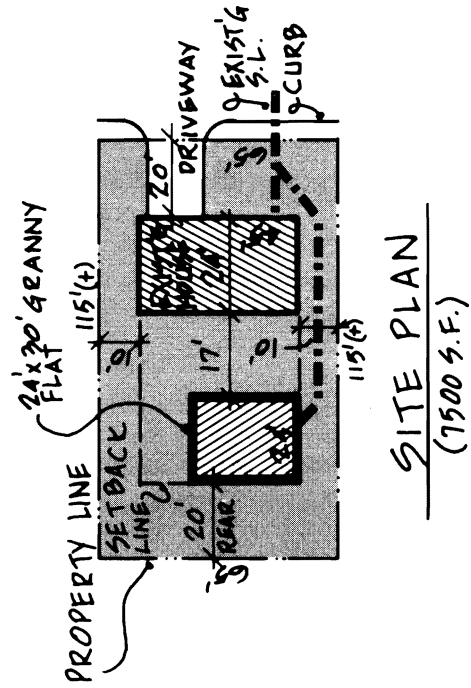
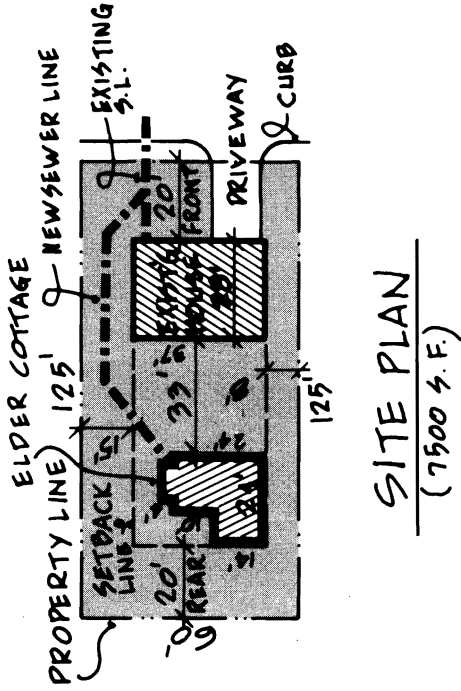
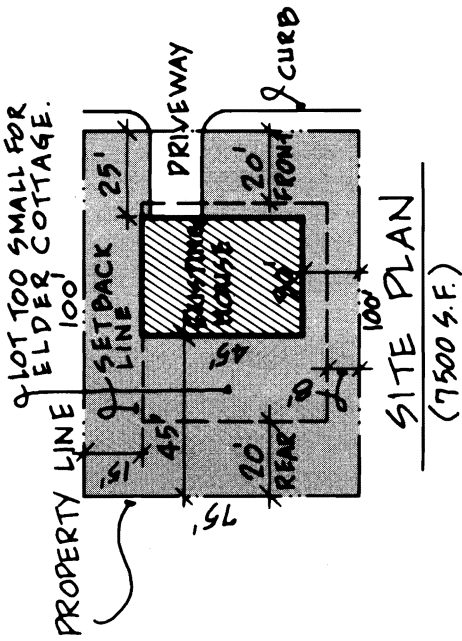
large suburban lots with very wide side yards which permit access for these modules. It is this problem as well as the more general problem of gaining acceptance for mobile homes in established residential communities that has lead proponents of Granny Flats to advocate as a solution demountable, panelized units. However, as discussed earlier, such units are presently not in the market place.

Each lot presents a unique situation. Much depends upon the lot configuration, the particular lot set back and side yard requirements and the clearances between buildings. Exhibit 2 illustrates this quite clearly. Notice that, depending on lot configuration, the Elder Cottage may or may not be capable of being placed on a 7,500 ft<sup>2</sup> lot. On the otherhand, Exhibit 2 also illustrates that it is theoretically possible, in some situations, to place a unit as large as 720 ft<sup>2</sup> or even 900 ft<sup>2</sup> on a lot of 7,500 ft<sup>2</sup>. However, these units would consume an extremely high percentage of the total available rear yard and, of course, would face severe access problems if the unit were to be a module.

Even larger lots might not be able to accommodate an accessory unit. If the rear yard slopes downward, it may be difficult to hook up to the existing sewage system without costly additional equipment. Utility easements may cut down on the available space in many otherwise suitable lots. On the otherhand, as Exhibit 3 illustrates, a small (400 ft<sup>2</sup>) accessory structure could, "theoretically," be placed on a some urban lots of 5,000 or even 4,000 ft. However, as with the 900 ft<sup>2</sup> unit on the 7,500 ft<sup>2</sup> lot, these units would take up a substantial portion of the rear yard, might be unacceptable to the community and would also have major access difficulties.

Exhibit-2

SCALE 1" = 40'

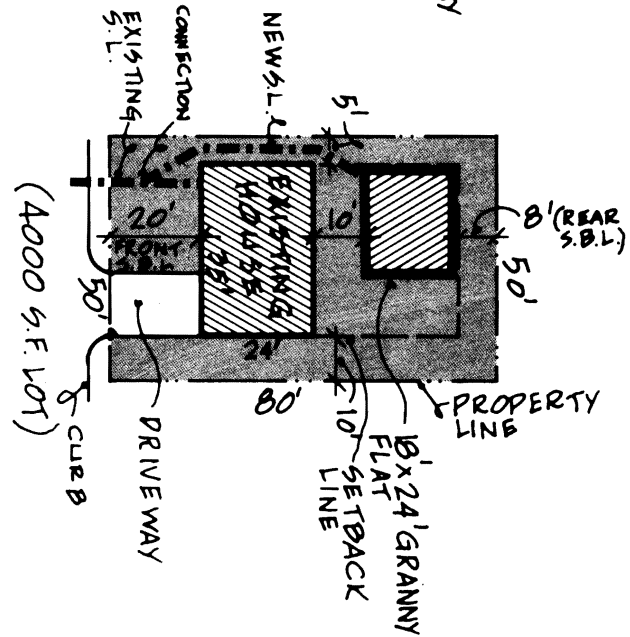
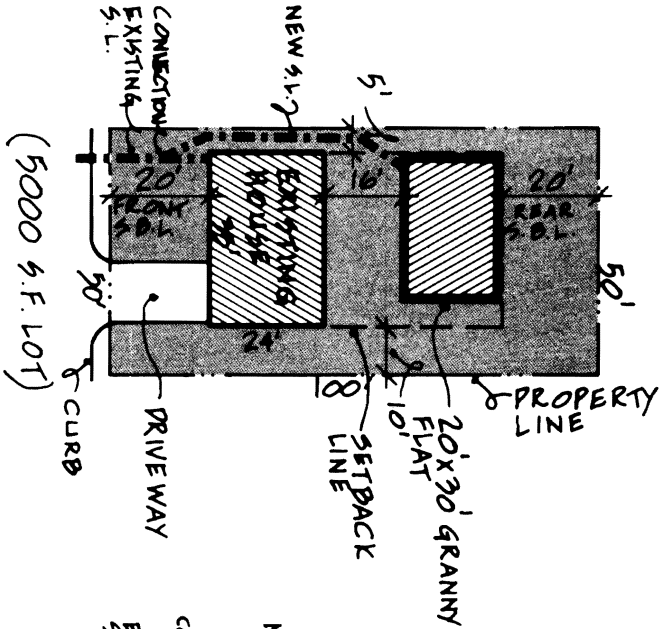


NOTES:  
1. S.F. = SQUARE FEET  
2. S.L. = SEWER LINE

EXAMPLE OF GRANNY FLATS  
ON 7500 S.F. LOTS

# Exhibit-3

SCALE 1" = 30'



NOTES:

1. S.L. = SEWER LINE
2. S.B.L. = SETBACK LINE

## EXAMPLES OF SMALL LOT DEVELOPMENTS



The number of suitable sites could be expanded if the locality was willing to modify existing rear and side yard requirements. All the present ordinances require that the accessory unit be placed within the pre-existing buildable envelope. Although a strong argument can be made in favor of adjusting these requirements for temporary units, to date no community has been willing to address this issue.

Although an accessory units may be capable of being built on a lot, it can be expected that most communities will limit the overall number of available sites. As exhibits 2 and 3 have shown, Granny Flats placed within existing set back and side yard requirements would consume an extremely large percentage of the total rear yard. Some of the ordinances address this issue through requirements on lot coverage and density. One locality requires that the accessory unit not take up more than 25% of the buildable rear yard.\* Under this formula it generally would be impossible to place a unit on any site smaller than 7,000 ft. Other communities add the square footage of the Granny Flat to that of the primary unit in computing maximum total lot coverage. Under many existing zoning ordinances, the added space of the Granny Flat would exceed total lot coverage requirements.

Finally, and most importantly, if the Granny Flats is to be a real rather than only a potential concept, they must be authorized in a sufficient number of density/use districts. To date the experience on this issue has been less than

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\* Tucson, Arizona

encouraging. The few communities that are willing to permit Granny Flats as a conditional use will, for the most part, consider them only in very low density or rural locations. Of all the ordinances reviewed, only three appear even willing to consider units in zones of 10,000 ft<sup>2</sup> or less.\* All the others appear to require a one acre minimum lot size and/or some sort of rural/conservation district designation. One community doubles the one acre minimum lot size if an accessory unit is to be built.

If these communities with existing ordinances accurately reflect prevailing attitudes elsewhere toward Granny Flats, then the potential for this type of housing will remain unrealized. Granny Flats cannot become a major alternative for housing the elderly if it is restricted only to the lowest density and rural districts. As more communities experiment with the concept, it is possible, however, that there will be an increased willingness to permit units in denser zones.

#### Other Conditions

The special permit provides the locality with great flexibility in fashioning conditions to meet local sensitivities. The following are some additional issues a locality may want to consider when developing Granny Flat legislation.

#### Removal of Unit

As has been discussed previously, many communities will fear that, over time, the Granny Flat will be converted to permanent use or, at best, the owner will fail to remove it after the intended occupancy is completed. Removal is costly and the owner may well resist or delay dismantling the unit.

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\* Tucson, Arizona; Santa Cruz and Carpinteria, California

The locality can address this concern in at least three ways.\* First, it can seek removal by directly enforcing its police power authority to direct removal under threat of civil or criminal penalty. However, this might well involve extensive litigation and is a time consuming, generally to be avoided, process. Second, the locality could impose a lien upon the property if the owner does not remove the unit. However, seeking restitution is also a cumbersome process. Finally, the locality could require that the owner post some sort of multi-year (e.g., 5 year) bond to cover the cost of removal, disposal, and site restoration if the owner otherwise refuses to pay these costs directly. Bonds of this sort should not be expensive and would reassure the community that the unit could be removed quickly and efficiently.

#### Restricting the Number of Units

A community may be concerned that, even with various conditions imposed upon the issuance of a permit, it will still be difficult to limit the number of Granny Flats. Of particular concern is the fear that the number of units will be concentrated in particular blocks or neighborhoods. In fact, if the standards in the ordinance are applied equally and objectively such a fear may be justified.

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\* Some ordinances also impose deed restrictions as a condition for the permit. However, it is unclear whether the locality can enforce these covenants. Generally, the law requires that only someone in the "chain of title" can enforce covenants. This does not apply to the locality approving the permit.

One approach that a community could try is adding a requirement for a finding, prior to the award of the permit, that the additional unit will not "unduly" burden existing public services such as water and sewer. Presumably, if too many units are in a particular community, the local government could find that the capacity to handle additional units has been reached.\* As an alternative, the ordinance could explicitly establish a maximum number of units that could be outstanding in a neighborhood or within the locality at any one period of time.

#### Aesthetic Considerations

A number of the existing ordinances require that the proposed unit, in some manner, architecturally relate to or be compatible with the primary unit, surrounding development, or larger neighborhood.\*\* A few even require formal design and site review.\*\*\* Although public architectural controls have often been criticized as inappropriate and costly public intrusions into private concerns, these additional units superimposed upon a pre-existing developed site and community could be visually disruptive and highly unattractive. Reasonably enforced architectural controls and site plan review would appear to be justifiable.\*\*\*\*

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\* Santa Cruz County, California limits accessory unit permits to no more than 30 per year of which no more than 10 can be constructed within the service area of any public water district.

\*\* See Claremont, Carpinteria, and Marin County, California.

\*\*\* See Martinez and Corte Madera, California.

\*\*\*\* Local architectural controls could also severely limit the ability to "recycle" accessory units from one neighborhood to another. Also, such provisions could restrict the number of units in the community as well as add to the cost of the unit.

### Neighborhood Review and Input

In many instances, there will be strong reactions, often negative, from neighbors to proposals to install Granny Flats. In reviewing a special permit application, it can be expected that the local government will usually consider the opinions of neighbors. This may take the form, as with a zoning variance, of a formal notice and review by neighbors.

The review power of neighbors has, in some cases, been strengthened even further. One ordinance requires that the accessory unit not be a "nuisance" to neighbors. In another, the applicant must submit written consent for the unit from all adjoining property owners before a permit can be issued.\*

### Parking

Most zoning ordinances have some sort of requirement for offstreet parking for each additional unit. If such a requirement were applied to a Granny Flat it could add a significant expense and, in many situations, would be physically impossible to accomplish.

A strong argument can be made that additional parking is unnecessary for Granny Flats. In many cases, the occupant, requiring proximity to the primary unit, will not have a car. Even if the occupant continues to have a car or has visitors with cars, the temporary nature of the structure would seem to justify either waiving or adjusting this parking requirement.

### "General" Review

Finally, some communities will feel that even with all of the above conditions, there still is need for a more generalized "escape" clause permitting the local administrative body wider latitude to consider other factors and to

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\* Martinez, California

impose additional conditions they could not foresee in the legislation prior to awarding of a permit.\* Some of the existing ordinances, therefore, add language permitting the local administrative body to consider "other relevant factors" or "other reasonable terms and conditions" prior to awarding of a permit.

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\* Some of the ordinances also require, as a condition of the issuance of the special permit, that the applicant obtain all appropriate water/sewer and building code approvals. Generally such language is not needed. Its inclusion in a land use ordinance could result in inconsistencies between the zoning ordinance and other development controls.

#### IV. OTHER RELATED LEGAL AND REGULATORY ISSUES

Amending the local zoning ordinance may, by itself, be insufficient for the removal of all legal and regulatory barriers. Prior to enacting any changes in the local zoning ordinance, the locality will also have to carefully consider existing State law. In some States adjustments may be necessary to State enabling legislation to permit the local government to authorize a second unit on an existing plot. Also, in some States, limiting the "benefits" of the accessory units only to the elderly or to members of the immediate family may be considered an improper use of zoning power. Each State presents a unique situation and a careful review of statutory and case law will be necessary.

Adjustments may also be necessary in other local building controls so as to accommodate Granny Flats. For example, some local codes may not permit the construction of housing on wooden piers or poles. Local water and sewer regulations may have to be clarified to permit the "hook up" of the accessory unit to the user side of the meter. If the primary house is using a septic tank, existing regulations might, unless adjusted, require a separate tank for the new unit. A whole series of local development controls of this type will have to be carefully reviewed to determine if Granny Flats can be accommodated.

Local property taxes may also be an issue. In most jurisdictions it can be expected that the Granny Flat will be taxed as real or personal property unless specifically excluded by legislation. It is unclear what standards a local tax assessor will use in assessing the temporary unit. As a public policy, a community might consider exempting the unit from local taxation.

Finally, in many communities there may be a land use issue far more serious than zoning. Many communities, particularly large, post World-War II suburban developments, are covered by extensive, detailed deed restrictions and covenants governing the nature, site development and use of buildings within the development. Generally more restrictive than public regulations, these deed restrictions give each and every owner within the subdivision some property "interest" in each other's lots in the development. This interest gives each property owner the right to prevent a violation of any covenant in the deed. In most of these communities, installation of a Granny Flat would violate the existing design and use restriction in these deeds. Because they are private agreements, it is extremely difficult for a public body to adjust deed restrictions.



## V. SUMMARY

This analysis examines those development controls, particularly zoning, that can affect or restrict implementation of the Granny Flat concept as a housing resource for the elderly. Because so few units have been built, the analysis can only identify potential, rather than real, issues that may be faced in converting what is, at present, only a housing idea into actual units.

It is interesting to note that in California, where almost twenty localities now have ordinances authorizing such units, not a single Granny Flat has yet been built. This suggests that removal of zoning and other regulatory barriers will not, by itself, immediately result in Granny Flats. However, this does not minimize the fact that significant legal barriers do exist. Clearly some adjustments will have to be made in many local zoning regulations to permit, under some conditions, a second unit on single family lots. However, beyond this generality, the specific terms and conditions that communities will choose to impose still remains undefined.

Few, except the most exuberant advocates, suggest that Granny Flats be a permitted use, with minimal controls, in the full range of density/use zones in a community. As an additional house, albeit small, imposed upon a pre-existing single family community, the Granny Flat will, in fact, increase density and be a physical intrusion that will have to be carefully regulated.

Although Granny Flats may have significant social and economic benefits to the elderly and their families, introduction of these units will have a physical and social "cost." The locality, in considering legislation, must

decide whether these potential benefits to the elderly outweigh equally legitimate claims, sensitivities, and values of other residents and interests in the community.

This assessment of competing interests by the locality will be most evident in the specific terms and conditions imposed by the local ordinance. As discussed previously, the existing set of ordinances, all enacted in anticipation of demand, are not fully hospitable to Granny Flats. Generally, the units can only be built in very low density districts and under the most strict site and design review procedures.

These ordinances have not been enacted in response to actual developmental pressures. It is still uncertain whether the conditions and criteria in these early statutes are, in fact, those that will be enacted when communities are confronted with the prospect of real units in large numbers. When that occurs local governments will really have to make a more realistic assessment of Granny Flats. Whether an ordinance resulting from that process will resemble those enacted to date is unclear. However, this analysis identifies what are believed to be most of the major issues and areas of controversy that will be dealt with in any such future legislation.

## APPENDICES



## Appendix A: Bibliography

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## Appendix B: Local Statutes and Ordinances

The study examined accessory housing ordinances from the following localities:

California

Arcata  
Belevedere  
Carpinteria  
Chula-Vista  
Claremont  
Imperial  
Kern County  
Madera County  
Marin County  
Martinez  
Monterey County  
Moraga  
San Anselmo  
Santa Cruz County  
Shasta County  
Tuolumne County

Arizona

Tuscon

Illinois

Tazewell County

Maryland

Frederick County

North Carolina

Rockingham

Pennsylvania

Lancaster County

Washington

King County

Wyoming

Hot Springs  
Thermopolis





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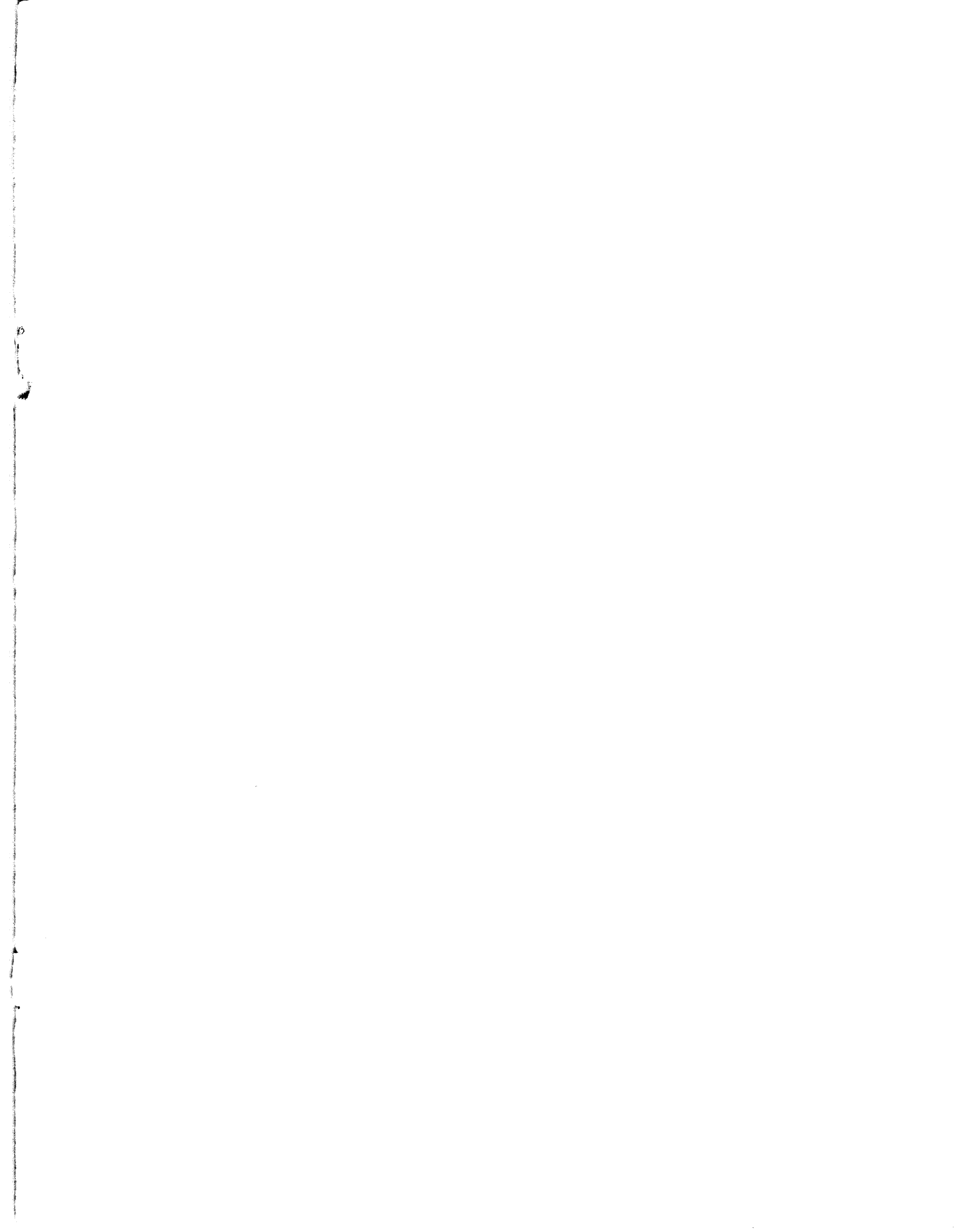
Ed Guion, Coastal Colony Corporation;

Paul Shepard, University of Maryland;

Beth Soldo, Georgetown University; and

Walter Stanley, Housing Alternatives Unlimited Structures.





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