SENATE COMMITTEE ON LOCAL GOVERNMENT
Senator María Elena Durazo, Chair
2025 - 2026 Regular

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HOUSING DEVELOPMENT: DENSITY BONUSES: RENT

Prohibits land improved with an operating hotel or motel from being valued for purposes of setting ground rent under an existing lease based on residential density or density bonuses.

Background

Real estate appraisals. A real estate appraisal is the best estimate of market value of a property. Appraisals generally value property as though it were being put to its most profitable use, given probable legal, physical, and financial constraints, known as the "highest and best use." The Board of Equalization, which standardizes procedures for county assessors, specifies that the use must be:

- *Legally permissible.* The highest and best use must be a use that is allowed by government. The property tax appraiser must consider the effect that any enforceable government restrictions, such as zoning regulations, have on the value of property;
- *Physically possible.* The highest and best use depends on physical factors. The proposed or existing use must fit the size, shape, topography, and other specific characteristics associated with the parcel or location;
- *Financially feasible.* The highest and best use must not be too speculative. There must be a demand for the use in the market that will generate and sustain sufficient income to cover the costs of construction, to have enough money for maintenance during the economic life of the property, and to provide both a return of and a return on the investment. This can include costs to maintain or improve the remaining economic life. All uses that produce a positive return are regarded as financially feasible; and
- *Maximally productive.* The highest and best use must be the most productive use. Of all the financially feasible uses, the one that produces the highest residual land value (yields the highest net return to the investor) is the highest and best use. For example, if it is physically possible, legally permissible, and financially feasible to construct an apartment complex, an office building, and a restaurant on a particular parcel, but the office building would yield the highest value to the real property, then the office building is considered the maximally productive use.

In general, the proposed use that an appraiser determines would yield the highest and best use from a particular real property must pass all four criteria, or the proposed use (either the current use or an alternate use) cannot be considered the highest and best use of the real property.

Appraisal standards. In 1989, Congress adopted the Federal Financial Institutions Reform, Recovery and Enforcement Act (FIRREA), which required states to license and certify real estate appraisers who appraise property for federally-related transactions, as a result of the savings and loan disaster in the 1980s. The FIRREA, and rules promulgated pursuant to that act, required that real estate appraisals be performed in accordance with the generally accepted uniform standards as promulgated by the Appraisal Standards Board (ASB) of the Appraisal Foundation.

In response to the federal mandate, the California Legislature enacted the Real Estate Appraisers Licensing and Certification Law in 1990, which established the Office of Real Estate Appraisers, which today is the Bureau of Real Estate Appraisers (Bureau) under the jurisdiction of the Department of Consumer Affairs (AB 527, Hannigan). The Bureau licenses appraisers as education and standards are determined at the federal level. The Bureau is required to implement real property appraiser licensing and certification requirements that are no less stringent than those issued by the ASB. The ASB established Uniform Standards of Professional Appraisal Practice (USPAP), which was adopted by Congress in 1989 as a method to ensure a high level of integrity and public trust in federally-related appraisal practices.

The USPAP contains standards for all types of appraisal services, including real estate, personal property, business and mass appraisals. The USPAP is updated every two years. State law requires licensed appraisers in California to abide by USPAP standards, regardless of whether they are federally-related or not.

Ground leases. When a property owner wants to derive value from their property without constructing or owning improvements themselves, they can enter into a ground lease where they rent out the land ("ground") to another entity who will construct, own, and operate the improvements on that property. Ownership of the improvements reverts to the landowner at the end of the lease. Ground leases can last 50 to 99 years, with periodic rent reset adjustments, but the landowners and business operators often renegotiate the terms and rents in the leases periodically. As part of the renegotiations, the landowner and business operator may use appraisers to value the property, and those valuations can inform the creation or increases in rents.

Density bonus law. The state's density bonus law grants certain benefits to developers who build affordable units in order to encourage greater affordable housing production. Density bonus law requires cities and counties to grant a density bonus when an applicant for a housing development of five or more units seeks and agrees to construct a project that will contain at least one of the following:

- 10% of the total housing units reserved for lower income households;
- 5% of the total units for very low-income households;
- A senior citizen housing development or mobile home park;
- 10% of the total units in a common interest development for moderate-income households;
- 10% of the total units for transitional foster youth, disabled veterans, or homeless persons; or
- 20% of the total units for lower income students in a student housing development.

If a project meets one of these conditions, the city or county must allow an increase in density on a sliding scale from 20% to 50% over the otherwise maximum allowable residential density under the applicable zoning ordinance and land use element of the general plan, depending on the percentage of affordable units.

Incentives, concessions, waivers, and other benefits. Density bonus law also grants "incentives or concessions" that can be used to modify development policies that add costs or reduce the number of units that a developer can build on a site. Incentives and concessions can vary widely based on the individual projects, but examples can include waivers of zoning codes, reduced parking requirements, approval for mixed-use zoning, or other reductions of other regulatory requirements on development. The number of incentives or concessions a project may be eligible for is based on the percentage of affordable units contained in the project and other project characteristics, up to a maximum of five.

Density bonus law also allows "waivers" of any development standards that physically prevent the developer from constructing a project at the density allowed to the project, along with the incentives or concessions, under density bonus law. Finally, density bonus law reduces or eliminates the parking that can be required in connection with a project.

The Sandbourne hotel. The Sandbourne is a boutique hotel operated by Marriott in Santa Monica near the Santa Monica Pier. The land the Sandbourne sits on is subject to a ground lease with periodic resets based on the appraised fair market value of the land on a five-year cycle. The most recent rent reset occurred in 2020, where the valuation of the property included the potential for the property to be redeveloped using density bonus law, which led to increased lease payments. UNITE HERE Local 11, which represents the 100 workers at the hotel, indicates that the valuation for the land increased from about $35 million in 2015 to $62 million in 2020, after the potential for density bonus law was included in the appraisal, jeopardizing the operations of the hotel and the jobs of the workers employed there.

UNITE HERE International and UNITE HERE Local 11 want the Legislature to prohibit the use of residential density, including any benefits available under density bonus law, in the calculation of ground rent for hotels.

Proposed Law

Assembly Bill 2181 prohibits, notwithstanding any other provision of density bonus law, land improved with an operating hotel or motel from being valued by the landowner, for purposes of calculating a ground rent under an existing lease, based on residential density or density bonuses, unless those density increases are entitled and vested as of the valuation date. The bill provides that it doesn't alter the requirements for obtaining a density bonus.

Comments

1. Purpose of the bill. According to the author, "California's hospitality industry is one of the state's largest employers, supporting good paying union jobs and contributing to our local communities. AB 2181 protects those jobs by addressing an unintended consequence of California's density bonus law, which was enacted to incentivize the development of more affordable housing. Current law creates uncertainty during ground lease appraisals by allowing property owners to utilize density bonuses that hypothetically may be available to a property to inflate the land value when ground lease rents are reset. This speculation can artificially inflate land valuations, dramatically inflate ground lease payments, and threaten the economic viability of existing hotels and dependent hospitality jobs. When operating costs increase because of speculative appraisals rather than real market conditions, hospitality workers whose livelihoods depend on these businesses are harmed. AB 2181 simply clarifies that hypothetical density bonuses cannot be used to value operating hotels for ground lease resets unless those

development rights have actually been approved and vested. It preserves the intent of California's density bonus law, ensures fair and predictable property valuations, and helps protect California hotels and the thousands of hospitality jobs they support."

2. Square peg, round hole. Appraisals have been grounded in the highest and best use of a property for decades. AB 2181 changes the rules for appraisals of properties with hotels such that they can't include residential density or density bonus as part of the calculation of the value if an appraisal is going to be used for a ground lease. This is a significant departure from usual practice: it excludes one of the major uses of property—residential—which could depress a valuation subject to the bill below what the property is likely to receive on the open market. This could make the appraisal less accurate. AB 2181 makes this change by amending density bonus law rather than the usual channels for making changes to appraisals: the USPAP process, where the implications of the change could be weighed by professionals. To the extent that AB 2181 addresses a problem with the way appraisals are conducted, the Committee may wish to consider whether amending density bonus law is the appropriate way to make its changes.

3. Gut and amend. As introduced, AB 2181 required the Governor to ensure a diverse composition of commissioners for the Public Utilities Commission. The June 11th amendments deleted the contents of the bill and inserted the current provisions related to appraisals.

4. Incoming! The Senate Rules Committee has ordered a double-referral of AB 2181: first to the Committee on Housing, which will hear the bill at its June 30th hearing, and second to the Committee on Local Government.

Assembly Actions

Prior votes not relevant to the current version of the bill.

Support and Opposition (6/26/26)

Support: Unite Here International Union, Afl-cio (Co-Sponsor)
Unite Here Local 11 (Co-Sponsor)
California Federation of Labor Unions, Afl-cio

Opposition: None Submitted

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