SOUTH TUCSON CLINIC & DIAGNOSTIC
SMALL GROUP SUMMARY & NEXT STEPS

Project: South Tucson, Arizona – Implementation Clinic & Code Diagnostic

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This general findings summary memo identifies key gaps in knowledge, tools, processes, and relationships in South Tucson, AZ with respect to its real estate environment that could impede small-scale, incremental development. It outlines key takeaways from a research of existing regulations, stakeholder input gathered in a series of Small Focus Group Meetings, and a Regulatory Review Analysis.

Project Overview

The Incremental Development Alliance (Inc Dev), a national non-profit, has been retained by the Pima County Planning Department to diagnose and identify obstacles to small-scale and incremental real estate development in South Tucson, Arizona.

Members of the Incremental Development Alliance Faculty gave presentations late 2020 and early 2021 on topics relating to small-scale development. These included an introductory lecture, a Dirty Dozen lecture, and Step Buildings lecture. The purpose of these lectures was to describe the project but also educate interested parties on the philosophy and application of small-scale development for their community.

In addition, Small Group meetings were held to speak with and solicit feedback from stakeholders closely associated with real estate development, property management, finance, business, and the local development regulatory framework. Alliance faculty spoke with more than 20 individuals including members of the local development review boards, real estate developers, housing providers (both for-profit and non-profit).

Concurrent with these lectures and interviews, the Alliance faculty performed research of previous studies, current zoning standards, permitting fees, property tax structure, and current market trends. This information will be particularly useful in informing the subsequent phase of engagement. That involves modelling a handful of most promising building types (both physically and financially) in yet-to-be locations to better understand any opportunities or challenges to local small-scale development.

Comments and topics that are both outside of this project scope and the influence of both the Incremental Development Alliance and the local municipality have also been captured and noted as such. They include construction labor shortages, high construction costs, and depressed incomes.

Small Group Discussions Key Takeaways

When considering what small-scale real estate strategies can contribute to local goals in South Tucson, several topics emerged from our conversations during the Small Group conversations. They are summarized below, grouped by categories of stakeholder observations and experiences along with funding, development, and zoning opportunities and challenges.

Overall, we found a strong respect for, and knowledge of, local history and culture. Where there are related local goals or aspirations (be they public or from private sector individuals) it would be helpful to articulate where and which small-scale development approaches can implement those goals. This memo highlights some structural and regulatory conditions that have almost invisible effects on some of those aims. Understanding them can better enable local stakeholders to employ small-scale strategies.

The region's rapid growth often creates new pressures on long standing residents and businesses, especially property affordability. Such pressures can also provide opportunities but the grounds for change must be prepared to bring about local benefits. Incremental real estate strategies can contribute to economic resiliency of both households and certain kinds of businesses. Local wealth building and economic opportunity are also possible, as are increased housing choice, housing configurations and diversity of changing neighborhoods and places in South Tucson.

While local government administrators try to find ways to "yes," when regulations (knowingly or unknowingly) create conditions that run counter to goals or aspirations, they are candidates to be changed to better align with allied efforts and policies toward desired outcomes.

There is an acknowledgment that some things will need to change to accommodate issues and opportunities stemming from broader forces such as changing demographics and their real estate needs compared to existing residential formats, configurations, and housing supply. Better understanding of the effect of local policies and regulations can enable a better understanding of what is (and what is not) able to be influenced as broader forces impact South Tucson.

Lower incomes and property values coupled with a labor shortage and high construction costs create additional development challenges requiring creative solutions. Fortunately, there are local resources available to aid in closing some of these cost gaps.

South Tucson is not alone in these challenges. They are shared by many communities nationwide experiencing almost identical development challenges. Wages across the nation have not kept pace with housing costs that have been rising over the last decade or more. During the Great Recession, many established contractors were put out of work and never returned to the construction workforce. This and fewer young people going into the trades have contributed to a skilled labor shortage. In recent years, materials costs have been escalating as well. Causes include market disruptions (such as regional fires, periodic natural disasters and subsequent rebuilding, tariff policies, and other global shifts in demand (e.g., China). More recently, the global pandemic has constrained outputs of material supplies causing backorders and material costs, (especially lumber) to skyrocket.

Following are recorded comments from the individual Small Group discussions:

Community Needs and Desires

- Folks are skeptical of change. Would like to show community examples of communities that have done incremental development and help people believe in change.
- The deep history and culture in South Tucson is its strength. We need to protect but also accommodate change.

Development Opportunities and Challenges

- South Tucson incomes are low.
- Achievable rents are not able to support property maintenance costs.
- There are many houses in disrepair and need significant work. Some likely need to be replaced.
- Local zoning standards are a borrowed ordinance from Tucson, is antiquated but staff will work with you to overcome challenges.
- SB1 zone allows MF but is restricted by closest zone – needed staff help with that. Zoning needs an overhaul.
- REO rehab with ADUs, wanted to split a lot but could not so we dropped that project.
- Building types: fee-simple townhomes, tiny homes. Mobile vendors: open-air concept.
- Encumbered title issues make it difficult to use public funding or bank capital – Title Clinics to help clear up.
- The owner info on lots is often incorrect.
- Property hoarders/slumlords.
- If something is deemed vacant or blighted, increased taxes.
- Local banks? Access to capital thru national funding partner – raise money to capture expenses (Primavera) LIHTC = 50 units or more. Growth Partners CDFI – focused on WOC in disinvested census tracts.
- Retail rates are all over the place based on the age of building: 1,000sf on 4th St = $12psf/year for older buildings– up to $20psf/year for newer buildings.
- Residential rates? Historically $1psf, hard to build to $1.75 now – folks think this amount is gouging – typically 850-1,600sf units. New construction is now pushing $2psf.

- Smaller the unit, the higher per square foot rent. Rent growth is projected to be the highest in the nation.
- SBA is looking to grow an owner-occupied portfolio. SBA will accept as little as 15% down, amortized over 30 years. Also, lower DSCR. Can rent out 49% + recognize outside investors.
- Recommended working with local bankers, not large banks.
- Construction costs = MF now over $200 psf.
- Young people need live/work units – Does SR2 Tucson zoning fit section 419 Live/Work of the IBC? *This could be a prototype for spot testing.*
- Brownfields are an issue.
- Sell as condos? – will condo arrangements work in this market? Financing condos is more difficult.
- The local median income of South Tucson is 47% of Area Median – need layers of financial support.
- It was recommended to talk with Foothills Bank

Commercial Tenant Conversation

- A roadblock to development are legacy residents that sit on their land as absentee owners.
- Commercial properties that come to the market are expensive.
- South 4th is primarily restaurants
- Want to keep arts & culture alive - host popups - need additional space - space is limited - no building that would be able to house other artists - lots of buildings in disrepair.
- Buildings available are enormous - need smaller space - Greyhound park is a large facility - owned by absentee owner - derelict racetrack opportunity for the destination - the owner is asking $13M for the property.
- Some hotels facing I-10 present opportunities for new uses.
- Inquiries weekly looking for space. Priced out from central locations. Potential tenants are used to paying under $1,000/mo. Looking for workspace opportunities. Coffee roasters/suppliers - vacant buildings and buildings in disrepair stand in the way - car mechanic shops require costly environmental cleanup. Latinx & indigenous folks want to keep local identity and culture.
- Live/work space would be great.
- Commercial kitchen space - commissary for food trucks.

- ACUs would work well on South 4th.

Funding Opportunities and Challenges

- Habitat is open to creative ideas and has done some projects that do not fit the broader Habitat mold.
- Community Investment Corporation (CIC) could be flexible to look at supportive positions on non-traditional loans, PRIs, etc.
- A local bank iterated that mortgage products still needed to meet standard underwriting. There did not seem to be much flexibility on that. However, CIC might be able to play a mitigating role.

Zoning Opportunities and Challenges

- City officials are helpful.
- Rules are administered at the town level - people enforcing rules are willing to look at alternate options to get to the result.

Regulatory Review Key Findings

Keeping in mind the comments from the Small Group discussions around zoning, the Incremental Development Alliance team conducted a review of current zoning standards coupled with an existing parcel analysis to identify opportunities or challenges to implementing small-scale development.

The zones analyzed include:
SR1 - Single-Family Residential District
SR2 - Duplex Multi-family Residential District
SB1 - Retail Local District
SB2A - Local Retail Center District

What we found were suburban development standards and a single-family bias that limit a wide range of development type options that can meet the needs of the market today. So, while comments from the Small Group mention historicity and culture as a value, the current zoning standards promote development types out of sync with this. As it stands currently, most of the residential parcels promote single-family only and, commercial development requiring multiple variances and review by discretionary bodies to gain approval for most types of development or redevelopment. Fortunately, City officials and review boards are said to be helpful in finding ways to meet compliance.

Future Spot Testing will allow the team to test fit unit types that are both desired and in demand to identify opportunities for adjustments in the regulatory framework.

SR1 - Single-Family Residential District

South Tucson's SR1 zone is the largest zone, spanning nearly 25% of the city's geography but making up 75% of its residential zones. Of the 974 lots in this zone, 92% are 8,000 square feet in size or smaller. Most are between 6,000 and 8,000 square feet, indicating a history of generally fine-grained, compact platting patterns used during the time South Tucson was originally built.

Based on the current minimum lot size standard for redevelopment of 6,500 square feet, 20% of these lots are nonconforming. This means it is not legal to build what was built when South Tucson was founded on 20% of the lots in this zone today. This bears more investigation.

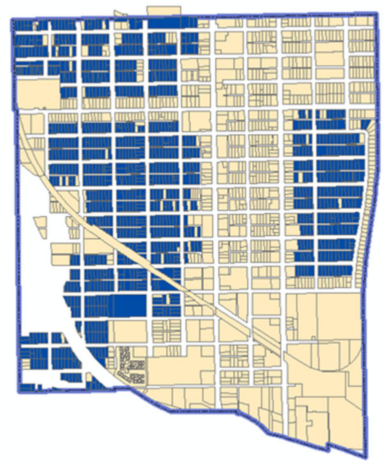

Figure 1: SR1 Zoning location map

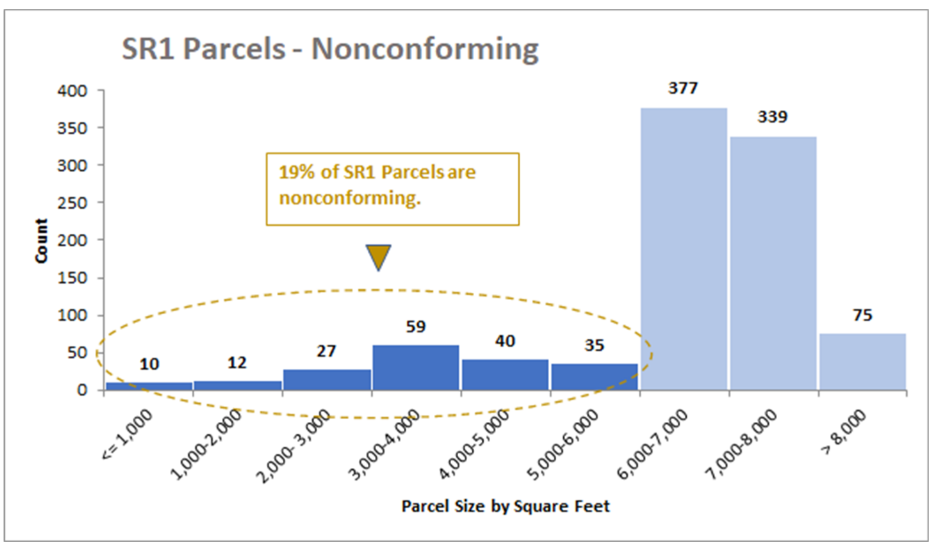

Figure 2: SR1 Parcel histogram and non-conforming lots

So many non-conforming lots also represent a potentially large constraint when considering possible solutions to the problems related to the condition of local housing stock. A recent report identified 43% of local housing to be in fair condition and needing some work, 21% of homes were in poor condition, needing substantial work; and 9% of homes likely requiring complete replacement since the necessary repairs outweigh the value of the home.

The current minimum lot size requirements limit redevelopment potential on these lots. This is likely to result in existing small houses will be bought, demolished, and replaced with even larger single-family homes sold at a price point well beyond what the median household will be able to afford.

A rough, but general rule-of-thumb is that it takes about four times the acquisition price to build a new building to cover the demolition, new construction materials, labor, permitting, taxes, fees, and a return on investment. That means, more square feet of new building are needed than the original structure to spread that cost.

The result of limited redevelopment options is two-fold, either a larger, more expensive building or simply allowing the original structure to further spiral downward in deferred maintenance and upkeep to eventual tax or mortgage foreclosure. In the case of foreclosure, the government or bank that comes into ownership will eventually sell and (because the same cost conditions apply) a new, larger building gets built. There is a definable role of local zoning policy in this dynamic that could be further understood and there are potential solutions for existing property owners and small-scale redevelopers that could generate different outcomes. This requires a more detailed understanding of the related issues and opportunities. Doing nothing and leaving current policies in place will continue to generate one or both outcomes described above.

Enabling small-scale development for such "infill" scenarios has benefits to the public sector as well. Infill redevelopment at this scale does not require new capital expenditures, or additional repair and maintenance cost liabilities that development on the urban edge requires (even if a large developer "pays to build roads, sewer and other utilities," local governments almost always assume the long-term liability for maintaining and replacing them after their useful life of about 30-40 years).

SR2 - Duplex Multi-family Residential District

South Tucson's SR2 zone is the primary location for multi-unit buildings (anything more than a single-family house). It covers only 7%of the city area and a little less than a quarter (22%) of all residentially zoned land. Of the 247 lots in this zone, 73% are the same average size as most of the SR-1 zoned lots, between 6,000 to 8,000 square feet in size or smaller.

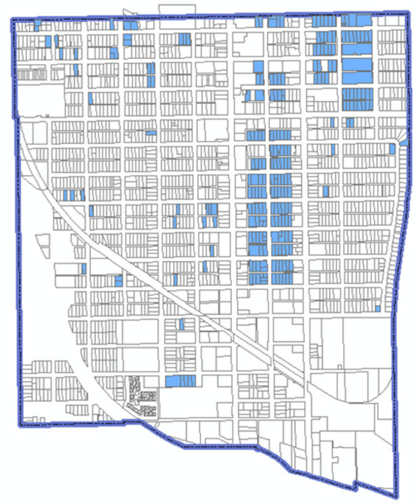

Figure 3: SR2 Zoning location map

That means almost all the residentially zone land in South Tucson has lots whose size would allow a variety of residential building types (from single-family to 6 or even greater number of housing units) but like with the SR1 regulations, the minimum lot size required to develop new units on these properties constrains what is possible to build there, regardless of what would fit. In this case, 3,000 square feet of lot area is needed for every unit of housing allowed to be built on a property. A duplex building cannot be done in this zone on any properties less than 6,000 square feet. This means 14% of the properties in SR2 zone are, on paper, allowed to build multi-family but functionally, because of their size, cannot meet the addition per unit minimum requirement. These properties are effectively single family only though they are located in a multi-family zone.

So, with SR1 and a decent portion of SR2 being single-family only, there are limited opportunities to respond to multi-unit market demand. Housing choice, even housing availability, (because many rental units are at lower prices than single family homes even if

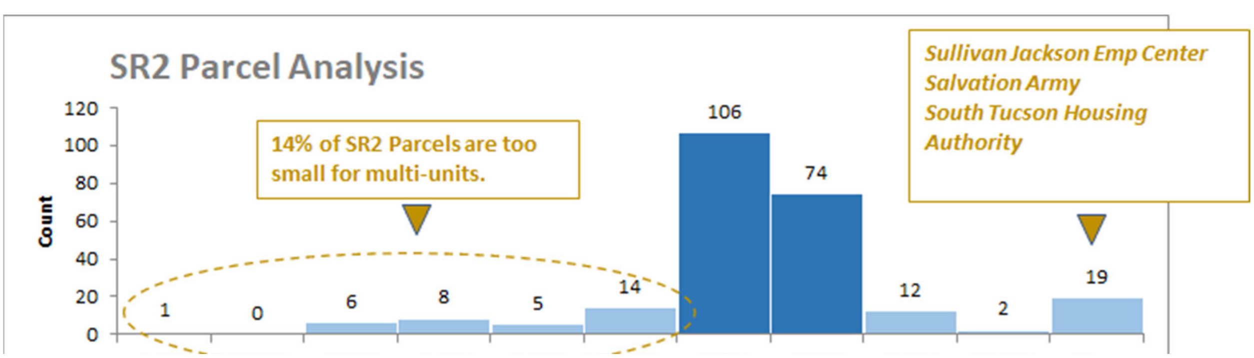

Figure 4: SR2 Parcel analysis identifies a number of lots unable to accommodate multi-unit development due to minimum square feet per unit requirements

those homes are for rent) become severely constrained as a result of the way local zoning regulations are written.

Another finding is that side setback standards (the distance a building must be from the side property line) in the SR2 zone is twice for multi-unit buildings than single-family dwelling buildings of the same height. Such regulations often presume that more density means much larger buildings but examples in South Tucson, and nationwide, show two-four units on a property do not create buildings that are necessarily twice the height and width of a single-family building. Many duplexes and other multifamily buildings are not readily discernible from the sidewalk as much different than the one family building next door. Often, one must count either electric meters or mailboxes to even notice that the building is multi-unit. Rather than a protection against double and triple sized buildings next door, the double set back requirements simply preclude legally building a duplex or triplex on an average sized lot at all.

Figure 5: This diagram illustrates the range of housing types that, while multi-unit are compatible in height and width to large single-family houses

There is an opportunity to review such regulations, understand their unintended effects, and re-calibrate them to allow local real estate development to better meet locally prioritized needs (such as housing choice, affordability, income and other diversity, economic opportunity, wealth-building and more).

SB1 - Retail Local District

The 350 lots of the SB1 zone come in a wide range of lot sizes with the median size of 7,092 square feet. 79% are less than 11,000 square feet, a reasonable lot size for small-scale commercial opportunities.

The East 29th Street corridor is primarily zoned SB1 and contains the highest concentration of very small lots. With a new Bus Rapid Transit Line being implemented, much of the current planning focus may focus on South 6th Avenue, but East 29th Street could also become an area of focus for entrepreneurial and bootstrapped small-scale commercial development.

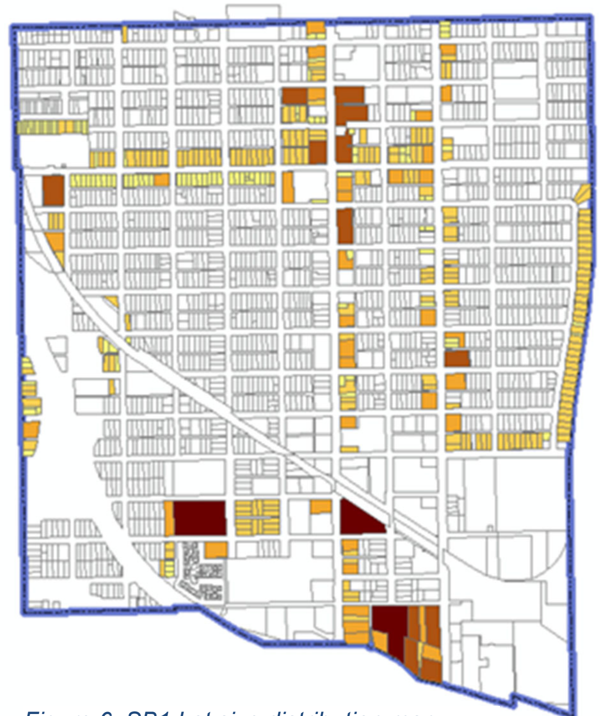

Figure 6: SB1 Lot size distribution map

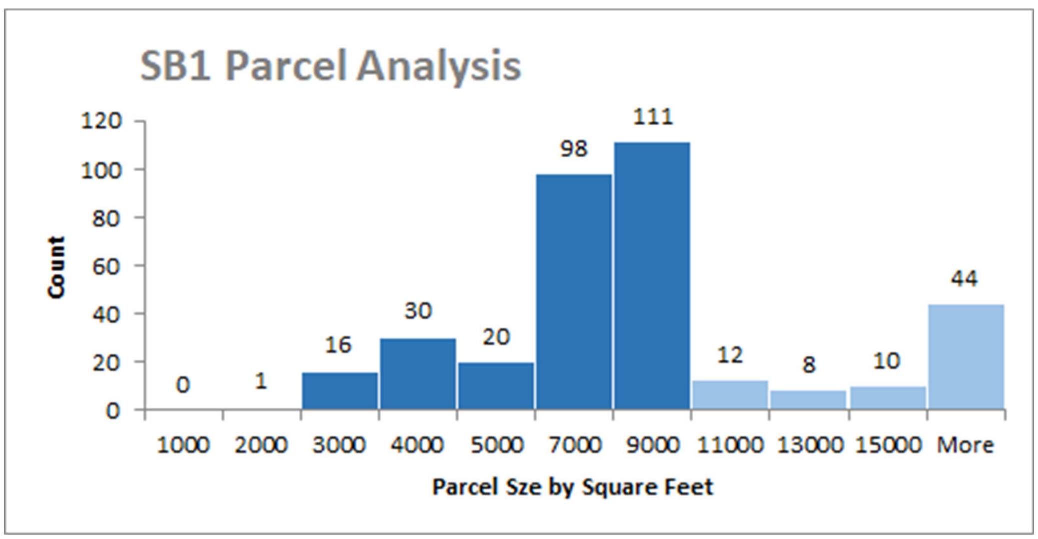

Figure 7: SB1 Parcel analysis demonstrates two size cohorts, medium size at 5,000-10,000 square feet and large >15,000 square feet

SB2A - Local Retail Center District

As it relates to parcel size, the SB2A Zone has a dumbbell effect with a significant concentration of medium size lots but also a large number of very large lots over 15,000 square feet. Generally, the very large lots can be found toward the southern end of town, where smaller lots are found north.

Many of the very large lots in this zone are developed but some contain either underutilized or vacant structures lending themselves to redevelopment over others based on their existing conditions, location, and ownership. Longer-term, incremental strategies that break these singularly large spaces into much smaller and varied spaces could be employed to redevelop.

Contemporary manufacturing does not necessarily equate to noxious noises and fumes. The manufacturing standards in this zone should be revisited to respond to these changes and the demand for small, affordable maker spaces close to where workers live.

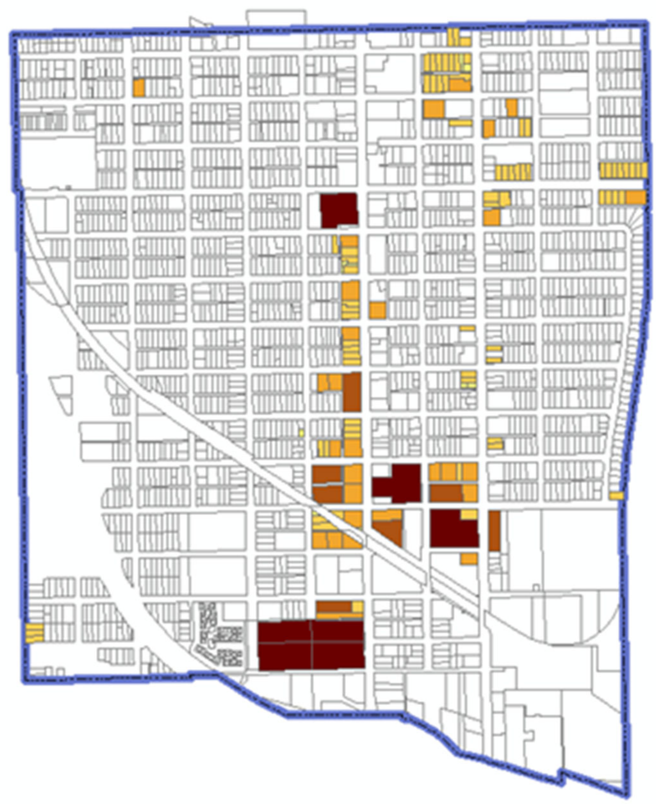

Figure 8: SB2A Lot size distribution map

Accessory Dwelling Units – (ADUs)

Conversations with City Planners indicate that ADUs are allowed but the zoning standards surrounding their construction are unclear to the Inc Dev Faculty team. No one in our Developers/Builders Small Group Discussion had attempted or planned to attempt building an ADU. It would be interesting to know what the cost to build such structures is and the resulting rents to help local understanding of whether and for what kinds of people an ADU might be beneficial.

In general, ADUs as a building option should be promoted and clearly defined in any future zoning code updates. The benefits of ADUs are many and reasonably well researched. A recent report from the AARP, *The ABCs of ADUs*, outlines many reasons why creating or living in an ADU responds to a variety of living arrangements and individual needs. General experience nationwide suggested some reasons why ADUs are created, and by whom:

- **EMPTY NESTERS** can build an ADU and move into it, then rent out the main house for supplemental income or make it available to their adult children.
- **FAMILIES WITH YOUNG CHILDREN** can use an ADU as housing for a nanny or au pair or even a grandparent or two, who can then help raise their grandkids and be assisted themselves as they age.
- **INDIVIDUALS IN NEED OF CARE** can reside in an ADU to be near family members, or they can use the ADU to house a live-in aide. (In fact, ADUs can be an affordable and more comforting alternative to an assisted-living facility or nursing home.)
- **HOME BUYERS** can look forward to the rental income from an ADU to help pay their mortgage or finance home improvements, especially in expensive housing markets.
- **HOME-BASED WORKERS** can use an ADU as their office or workshop.
- **HOMEOWNERS** can use an ADU for guests or as housing for friends or loved ones who:
    - are not yet financially independent, such as new high school or college graduates
    - need temporary housing due to an emergency or while renovating their own home
    - have disabilities but can live independently if family reside nearby

Further, we feel it is important to share commonly found local rules to be aware of that discourage the development of ADUs:

- ADU-specific regulations that do not also apply to primary dwellings (e.g., owner-occupancy requirements)
- complex design compatibility criteria and approval steps
- off-street parking requirements beyond those required for the primary dwelling
- restrictions that limit ADUs to certain geographic areas, particular zoning categories or to large lots
- caps on square footage relative to the primary house that make it easy to add an ADU to a large home but hard or impossible to add one to a small home

Alley Density

One item for consideration that came up during the Regulatory Review meeting was the idea of allowing additional density on the alley. Aesthetically pleasing and functioning examples were shared where this approach was historically implemented in Tucson. They consisted of a single unit (like an ADU). Some even had up to four attached units. This is an approach that has historic precedent and given the traditional block structure of South Tucson, is worth further exploration. Some American cities even have examples approaching apartment density on alleys.

Contemporary leading urban planners like Andres Duany promote this idea by declaring that, *"Alleys are richer, more flexible, and more subject to creative social interpretation than the frontage street. They will play an ever-greater part in the future of New Urbanism."*

While thought and coordination will need to be put toward parking, trash, and utilities, this approach could be especially useful in finding space for new homes while retaining the existing homes at the front of the lot meaning that from the street much of the neighborhood will appear largely unchanged, outside of facelifts and rehabs.

Figure 9: Image via Google Streetview showing Tucson example of homes fronting an alley

Figure 10: Image of the Soulard neighborhood in St. Louis with circle highlighting small apartment on alley. Via Google Maps

Exploring Live-Work for South Tucson

Live-work building types come in a variety of configurations with various implications. The following explores these to aid in additional understanding of this unit type for South Tucson. Much of the research provided here is via Thomas Dolan, an architect and national expert in live-work building types.

Echoing what we heard from our Commercial Tenants Small Group discussion, the ProBuilder.com website also believes there is pent up demand for this building type:

During the current pandemic, the ability to run a business or work from home has taken on even more significance as people have struggled to discover a secluded nook or cranny at home where they can find a moment of privacy to join a video conference.

Although nobody really knows the long-term effects, there seems to be little doubt that work patterns will change for many of us. The slow-paced development of live/work projects is likely to accelerate now that the concept has been tried and proven to be successful for many workers.

In our conversations with various groups, we have heard the need for small, but quality commercial space. The users and tenants of this type of space include local artists and makers. We also heard that the stated preferred rent level is around $1,000 per month, a rate unlikely to be offered in new commercial retail centers due to the investment return requirements of large, syndicated capital.

Outlined below are some best practices and practical advice when configuring live-work spaces, including how they can be thought of in terms of intensity and spatial arrangement.

Recommended Best Practices:

- Configure live/work townhouses (if in townhouse format) so that the ground floor space can be rented separately from the upper stories.
- The building type offers tremendous flexibility which can be significantly compromised by hardwiring the live/work as a single unit.

Live-Work Types by Intensity:

- Home Occupation (home office)
- Live-Work (working space is secondary to residential activities)
- Work-Live (residence is secondary to work activities)

Live-Work Types by Proximity:

- Live-With (residential mezzanine over large workspace)
- Live-Near (two physically separated space within a building)
- Live-Nearby (work activities take place in an accessory building)

Cohort Housing is in this family of live-work types and may present an opportunity to potentially explore in the subsequent Spot Testing phase. Cohort Housing is defined as being occupied by a group whose prior relationships have led them to choose to live and work near one another. Financing this arrangement would require a condo purchase agreement unless developed purely as rental of both the housing and work spaces.

Off-Street Parking Requirements

Parking and lot coverage limitations will be tested in the subsequent Spot Testing phase. With current high construction costs, it may prove that more units are required to amortize the construction costs to keep the sales and rental rates lower for the end-user tenant. It is likely that adding additional square footage will compete for space with current off-street parking requirements. Any tuck-under or underground parking strategies range from $15,000 - $40,000 per space, so keeping parking on the surface will likely be the suggested strategy in order to restrain unnecessary development costs.

Where to Start?

The question of where new small-scale development can begin often comes up. South Tucson grew up around its commercial corridors. Different building types present different opportunities as to where they might first be feasible. Larger commercial and mixed-use developments are likely to be found in areas of high visibility on the primary corridors, smaller opportunistic development types will be found outside of these primary corridors but do not necessarily require empty lots.

Other, often overlooked opportunities, exist in the following types of properties:

- Vacant lots (as stated)
- Underutilized surface parking lots
- Double lots which can be split
- Backyards (ADUs - Accessory Dwelling Units)
- Renovations of underused space in large structures
- Fronts of homes (ACUs - Accessory Commercial Units)

Figure 11: Example of coffee shop live-work Accessory Commercial Unit (ACU)

By Right vs. By Local Discretionary Approval Process

At its best, a well calibrated regulatory system is clear in what it wants to see resulting in the landscape and promotes it by making the pathway to realizing it as easy as possible. Not every aspect or possibility can be predicted or enforced by a regulatory system. For those exceptions, a discretionary approval process is best suited to deal with such complexity or ambiguity. A signal to whether a local code is calibrated to local conditions is the number of variances required each year. If variances are required for a majority of cases, that's a good sign the regulations could be further calibrated and these scenarios be considered as candidates for allowing by-right.

A local government's zoning code can be a clear signal to the market as to what kinds of building types and configurations are most desired and where. Speed to realization can be a cost-free way to incentivize the private sector to build more of what the community has decided it wants. With development, time is literally money. Interest rates of construction loans compound daily, so with every day required by an approval process the cost of the project increases. These potentially avoidable costs add to those already identified cost escalations that are beyond local control (labor shortages, materials price increases, etc.)

All development assumes a certain period of time for approvals. Worse than cost, however, is uncertainty. A developer will endure the cost of approvals if there is a general assumption that the process will play out reasonably within expectations. If a developer is unsure a certain approval will come at all, however, that can cause the project to seek a location with less uncertainty. Across the country, we see this force pushing new development beyond existing developed areas into greenfields with far fewer restrictions and uncertainty. Making legal (and easy) the desired types of development in already developed areas is one competitive factor to capture your fair share of economic growth. It is also one that is completely within the local government's control.

By-right development standards mean the standards are clearly articulated by local government. If the property owner meets that bar that the community helped set, approval is automatic or, "by-right." The best standards effectively incorporate community aspirations and desires and codify them. If a community is clear about what it wants, that clarity can be converted into the conditions for automatic approvals. Where there is variation, ambiguity, or other need for discretionary intervention, a variance or other process is the appropriate track.

The analyses in this project aim to help reveal the most impactful changes to local regulation to enable local goals to be met through small-scale, incremental development. Making as many as practical "by-right" will increase the chances of attracting the development the community wants.

Next Step Implications for Spot Testing of Market Study

It is important that emerging small developers respond to the realities of current market demands. The market study provided by Sharon Woods of LandUse USA indicates that there is demand for the creation of new residential units. This includes single-family detached housing, but also attached single-family unit types with a private entrance. This suggests an opportunity to Spot Test with a townhome format in the next phase of the project, particularly when attempting to hit the lower end of the in-demand sale price points that range from $150,000 to $400,000.

While demand for ownership types is somewhat limited, there is additional opportunity to provide rental opportunities. The market study identified up to 360 new and existing renters could potentially migrate into and within the city each year for the next five years. One focus of the project's next phase will be to identify residential unit types that attempt to meet the renter target market's tolerance range of $400 up to $1,400 per month, with the vast majority demand in the range of $850 or less.