

Accessory Dwelling Units



EVERYTHING YOU NEED TO KNOW TO BUILD

Table of Contents

Everything to Know About Accessory Dwelling Units.....3

Are Accessory Dwelling Units Worth the Cost?.....6

Financing Options for Accessory Dwelling Units.....8

Should You Rent Your ADU Long-Term or Short-Term?.....10

About Good Life.....12

Everything to Know About Accessory Dwelling Units

The cost of building a home in San Diego has been rapidly increasing over the last decade. Because of this, some people are electing to build an accessory dwelling unit, or granny flat, on their property. These tiny, self-contained units are cheaper to build and cheaper for renters.

What is an Accessory Dwelling Unit?

Accessory dwelling units are a small, usually separate building on the lot of a single family home. They were nicknamed granny flats or mother-in-law units because many people began to use them to keep their aging parents and grandparents close. They have their own entrances, bathrooms, kitchens, and bedrooms. There is usually no access from the main house into the accessory unit.

Originally, these units allowed for families to be closer to each other. People still use them for grandparents and in-laws, but they have also been used for young adults after graduating college or high school.

Accessory units can be used as a source of rental income as well. Young professionals especially are looking to save money and don't yet need their own single-family home. A granny flat can provide them with their own space for a fraction of the cost.

Size, Required Permits, and Regulations

Granny flats are typically between 700-1,000 square feet. In San Diego, the maximum size allowed is 1,200 square feet and it cannot exceed 50% of the size of the primary home on the property. For example, if the main house is 2,000 square feet, the accessory home cannot exceed 1,000 square feet.

While most of these units are detached from the primary home, you can have an attached unit if you prefer. They will still require their own entrances and parking space, which can be a garage if necessary. However, if the unit is within ½ of public transportation, a designated parking space is not required.

You are required to have a building permit for your granny flat. This ensures that you are adhering to all building, zoning, and safety codes. Additionally, the unit cannot be sold separately from the primary residence. For more on the regulations of granny flats, check out the County of San Diego website.

The Cost of Building a Granny Flat

While the construction of a granny flat is less than building a home, it can still be a costly project. The average cost of building a granny flat from the ground up is roughly \$150,000. If you start with an existing structure, such as a shed or garage, the cost will be lower.

In addition to the cost of building, there are usually hefty development fees associated with breaking ground on a granny flat. Previously, fees could be anywhere from \$30,000 to \$40,000. Thankfully in 2018 the San Diego City Council reduced these fees by over \$10,000. Still, these fees can cost owners thousands of dollars on top of initial construction.

Benefits to Building an Accessory Dwelling Unit

In many cases, granny flats are initially built for family use. This allows for generational living. It can be used for grandparents, parents, or young adults that want to move back home for awhile. Having these units on the property can be a great alternative to expensive housing. You can avoid paying for assisted living for older members of the family or dorm living for the younger ones. People can use these units as guest housing, too. If you're someone that often has family and friends come to town, having a granny flat will save them time and money. Some families use their granny flats for their nannies so that they can always be close by.

Another great reason for building a granny flat is their rising popularity. More and more people are viewing these accessory dwelling units as a positive addition to a property. These units will likely rent quicker and add significant value to the home when you decide to sell it.

In most cities, you're able to rent out these units. This helps the housing demand in cities like San Diego and provides you with rental income. You can rent it out long-term, or if you're in a desirable area, you can rent it short term through companies like Airbnb (be sure to check your local laws on this).

Drawbacks to Building an Accessory Dwelling Unit

The main drawback of these units applies if you choose to rent it out. While you will be making extra cash, you'll also have tenants living mere feet away from your own home. This can be a drawback if you like having your privacy and quiet time. Tenants might be louder than you planned on or you might be too loud for them.

Having tenants in the accessory unit also means you become a part-time landlord. These units are subject to almost all the same issues as your own home, such as plumbing problems, insect infestations, and other basic maintenance issues. You'll be the one responsible for taking care of these problems in a timely manner.

Some property management companies won't take on any granny flats because of this potential problem. If the owner of the home is a mere 20 feet away, why would the tenant take the extra step of bringing issues to the property manager? This creates a negative triangle between the manager, the tenant, and the property owner.

Are Accessory Dwelling Units Worth the Cost?

Accessory dwelling units, also coined granny flats, are becoming more popular by the day. In San Diego, where housing is scarce, building a secondary unit can be a great idea. They provide you with additional income (should you choose to rent it out) and can greatly add to your home's resale value.

Because of the initial cost up front, some people aren't sure if constructing an entire new unit on their property will be worth it. While the cost per square foot may be higher on an ADU, the overall investment will be cheaper. If you don't have money for a new investment property, but are still looking to grow your existing Real Estate portfolio, ADU's are a great option.

The Cost to Build

Building a granny flat is significantly cheaper than building a single-family house. Average cost of a granny flat ranges from \$130,000 to \$180,000 from start to finish. This may be higher if you want more square-footage. This cost may be lower if you build on an existing structure, such as a garage or shed--ranging from \$60,000-\$100,000.

ADUs can be pricey to build because the cost per square foot is the same, but you need less material. This means you may not get as good of a deal when compared to building a larger, single family home.

However, you should take into account the value of the land. For instance, if the cost to build (per square foot) is \$250 but the land value in La Jolla is \$450, you're gaining property value. This will not only be great if you choose to rent the unit, but it will benefit you whenever you decide to sell.

Development Fees

Previously, this cost also included development and impact fees, which totalled close to \$14,000. Thankfully, last year, San Diego passed a 5-year plan to waive these fees. This means that for a short time, you can get your permit and not have to worry about paying thousands in extra fees on top of the initial cost. Since this waiver went into effect, the number of building permits issued for ADUs have increased.

This ruling applies to both the city of San Diego and outlying areas, such as Alpine, Julian, etc. For more information on these fees and permits, visit the City of San Diego website.

Potential Uses

The main reason to construct an ADU in San Diego is for the additional rental income. The housing crisis has hit our city hard and by adding an additional unit to your property, you can not only help yourself, but the population as well. The costs up front of building an ADU can be a bit steep, but the years of rental income can easily make up for it.

In some cases, an ADU can be used as a short term rental. This is very popular in cities like San Diego where people are on the hunt for inexpensive places to stay or places that are close to the beach.

People also use their ADUs for their family members or guests. This is why these structures were originally created. People wanted to be able to keep their parents close by without having them in the actual home.

Resale Value & ROI

Another benefit to building an ADU on your property is the potential resale value. Having a granny flat is a popular feature, especially in recent years. This allows you raise your asking price and be more competitive within the market. This is even more so the case if your home and ADU are in a desirable location or close to the beach.

ADUs can be a great return on investment as well. Let's say you build your ADU for around \$140,000. In San Diego, an average rent for this kind of unit is around \$1,800. Multiply that by 12 months and you'll be pocketing an extra \$20,000 per year!

Keep in mind, the big return will come over the span of many years. Building a granny flat has a large upfront cost, so if you can't swing that, it may not be the best investment for you. People typically see the biggest return over the span of 30+ years.

Tax Implications

When you build an ADU, your property will be assessed for tax purposes. If you haven't had your home assessed since the time of the initial purchase, don't worry. You'll do a blended assessment, which is where they will assess the new unit and add it to your current home value (plus the annual tax increase of 1-2%). If the home value was \$500,000 when purchased in 1999, it's new value would be roughly \$700,000. Then, you add the value of your newly-assessed granny flat--we'll say it's \$100,000. The total value of your property is now \$800,000.

You should note that while constructing and ADU has many benefits, you'll also be paying more in property taxes. This comes with the territory when expanding your portfolio. **Disclaimer: We recommend speaking with your CPA about anything tax-related, as we are not tax professionals.**

Financing Options for Accessory Dwelling Units

If you're considering building an accessory dwelling unit on your property, you might be wondering how to pay for it. While ADUs are cheaper to build than a regular single-family home, there's still a large upfront cost. There are a few options to choose from in regards to financing for accessory dwelling units.

Home Equity Line of Credit (HELOC)

A Home Equity Line of Credit is a popular option for those seeking to build an ADU. This form of loan sets up your current home as collateral. It borrows from the available equity in your home and has a variable interest rate, which can be beneficial when compared to other loans. However, you can only qualify for a HELOC if the amount you owe on your home is less than the value of the home.

Typically you can borrow up to 85% of the home's value with a HELOC. If you have a \$600,000 home with a \$200,000 balance on the mortgage, it would look something like this:

$$\$600,000 \times .85 = \$510,000$$

$$\$510,000 - \$200,000 = \$310,000, \text{ which would equal your max line of credit.}$$

Additionally, banks will review the usual information like your credit score and history, income, debts, etc. There are a few reasons you might not want to use this loan, depending on your circumstances. If you don't have a stable income, keeping up with the monthly payments might be a bigger challenge for you. There are also a few fees associated with applying for a HELOC, so your upfront cost may increase.

Cash Out Refinance

Another option is the cash-out refinance. This option takes your existing mortgage and replaces it with one that's value is more than your house. The difference can be used for things like home renovations or adding an ADU to the property. You still need to have equity built up in the home to utilize a cash-out refinance.

One benefit to this type of loan is that they have a lower interest rate than some of the other options, such as a HELOC or HEL. This is especially true if you purchased the home when mortgage rates were higher.

Mortgage interest payments are also tax deductible (unlike credit card interest). This means you can get a larger tax refund and reduce your taxable income.

Construction Loan

The other option is a construction loan. This loan differs from the others in that the project plan must be completed prior to receiving the loan. For instance, if you decide to add an ADU to the property, your home and future ADU will be assessed for value. If your property value starts at \$500,000 with just your home and then increases to \$750,000 after the ADU is built, that is the number the loan will be based on. You can typically get up to 95% of the newly assessed value.

While this loan might sound ideal, it's usually harder to get than the previously mentioned loans. There are more variables that come into play since the plans for the unit must be completed prior to approval. You also need to have a predicted budget and proof of how you will pay back the loan. On top of that, there are a few different types of construction loans depending on the project and time frame.

Should Your Accessory Dwelling Unit Be a Long-Term or Short-Term Rental?

Deciding to rent your accessory dwelling unit is a great decision. For long-term rentals, you aid the housing crisis and bring in consistent rental income. If you decide to go short-term, you provide tourists a great place to stay and bring in increased income seasonally. But which of these renting styles is right for you?

While short-term rentals can be very popular, they tend to be more involved and complicated than long-term rentals.

Frequency of Communication

If you rent your granny flat short-term on sites like AirBnb, you'll have to communicate with tenants and potential tenants more often. Airbnbs usually require more coordination because you have more turnover and more inquiries about the property. They might have questions before renting about rules and features of the home. During the brief tenancy they might have requests or problems you have to deal with.

On top of that, people are only staying for a few days to a couple weeks. This means that you'll be repeating that cycle much more often than you would for a long-term rental.

Long-term rentals will have significantly less communication required, especially if you hire a property management company. You'll communicate at the start of the tenancy, when maintenance is needed, and at their move-out. Leases typically last for at least a year, so you won't have to worry about repeating this process over and over in a short window of time.

Consistent Income

A benefit of using your home as a long-term rental is the consistent tenancy and income. Most rental property owners do one year leases, meaning you'll get consistent paychecks for 12 consecutive months. People often use this additional income for mortgage payments and to pay bills.

It's fairly easy to get instant traction when your home needs to be leased to new tenants as well. Landlords can easily post their rental on sites like Zillow and Craigslist and quickly receive applications and inquiries about the home. This is especially the case in cities like San Diego, where rentals are always in high demand.

On the contrary, renting the property short-term requires some rapport. When people search for rentals on sites like AirBnb, they look for homes with great reviews. It can take a lot of time to build that rapport and get enough reviews that you have consistent tourists and vacationers coming to stay in your home. In the meantime, you won't have that stable income that a long-term rental would provide.

The Housing Crisis

You probably hear a lot about the housing crisis if you live in San Diego. Plenty of people want to live here, but there aren't nearly enough affordable homes and apartments. Thankfully, granny flats are an easy way to help combat this.

By renting your granny flat, you're providing a cheaper alternative to an expensive apartment or condo. Many people are on the hunt for small units, particularly young professionals and couples. Renting your unit long-term can ease their struggles as well as yours.

As you probably guessed, renting your ADU short-term doesn't really help the housing problem. When you only rent to tourists, you aren't helping the population of San Diego. You're actually decreasing the supply because your home isn't on the long-term rental market, making it harder for residents to find what they need.

Different Regulations

There are different regulations and rules for short-term rentals. Cities are always attempting to pass new regulations to decrease the number of vacation rentals. This is especially the case if they are close to the beach. Carlsbad and Coronado already have their own restrictions on these rentals and it's only a matter of time before something passes in the City of San Diego. This means you might have to rent long-term anyway, or not rent your granny flat at all.

There are rules when it comes to renting a property long-term as well. These are mostly things like fair housing regulations and tenant laws that you should know. You should either study this information (check your neighborhood for any local landlord seminars) or consider hiring a property manager to handle your property for you.

About Good Life



Maximize your rental income, reduce your liability, and free up your time & energy with Good Life Property Management. We are the leading educator on all things property management in San Diego County. Rental property management is our passion. The Good Life team is guided by our core values--**be positive, be reliable, and be a go-giver**. We specialize in the management of single family homes, condos, and small apartment buildings, throughout San Diego County. Our years of experience, reputation for quality service and proven reliability are unmatched. You owe it to yourself to give us a call and see how we can help you today.

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About Our Owner

Steve Welty graduated from San Diego State University in 2005 with a degree in business management. Devoted to the customer experience, he started Good Life in 2013 with the intention of improving the lives of others. He is a member of SD-NARPM (National Association of Residential Property Managers) and currently holds his RMP (Residential Management Professional) designation. He is a member of CAR (Cal. Assoc. of Realtors) and SDAR (San Diego Assoc. of Realtors). He also hosts the [Good Life Property Management Podcast](#).

