



REPORT

TO: Honorable Mayor and Members of the City Council

DATE: For the Docket of August 6, 2002

REPORT NO.: CCR 02-002

SUBJECT: Inclusionary Housing

REFERENCE: Housing Commission Report 01-113 dated October 12, 2001, Workshop Regarding Balanced Communities Housing Program.
 Planning Commission Report 01-208 dated October 18, 2001, Balanced Communities Housing Program Joint Workshop with Housing Commission.
 Manager’s Report 01-095 dated October 31, 2001, Balanced Communities Housing Program.
 Housing Commission Report 02-028 dated April 17, 2002, Inclusionary Housing.

ISSUE: Should the City Council direct staff to proceed with the creation of an inclusionary housing ordinance as recommended by the Land Use and Housing Committee?

Recommendation: That the City Council adopt the recommendation of the Land Use and Housing Committee, as contained in this report; direct staff to proceed with the preparation of implementing ordinances and other documents to create an inclusionary housing program that requires 10% of new residential units be affordable to families at 65% (rental) and 100% (for-sale) of the Area Median Income (AMI); and return to Council for final consideration. See summary of recommended program in Attachment 1.

Fiscal Impact: In the event that the recommended action is approved, there will be nominal financial costs associated with the administration of future actions.

Affordable Housing Impact: The approval of this item would not directly impact the supply of affordable housing. However, in the event that the ordinances implementing the proposed program are ultimately adopted by the City Council, approximately 625-825 affordable units could be created each year (450-550 new units plus retaining requirements for 175-275 in the Future Urban Area), at current building rates.

Environmental Impact: This activity is exempt from CEQA pursuant to the State CEQA Guidelines Section 15262. In the event that City Council approves the recommended action, environmental review of the program would be initiated prior to returning to Council for final consideration.

Future Related Actions: If the recommended action is approved by the City Council, implementing documents would be prepared and returned for City Council consideration. It is anticipated that substantial review by community and interest groups as well as the Housing Commission and Planning Commission would be completed prior to returning to the City Council.

Other Recommendations: The San Diego Housing Commission and the Planning Commission have endorsed previous inclusionary housing recommendations. The Planning Commission is scheduled to consider the matter again on August 1, 2002.

BACKGROUND

In July of 2000, the San Diego City Council was asked to authorize submittal of the draft Housing Element Update to the State of California Department of Housing and Community Development for review prior to its adoption. At that time, the City Council adopted a resolution, which included direction to City and Housing Commission staffs to pursue several new housing policies, including direction to draft a "flexible inclusionary housing program on a citywide basis, with incentives to build affordable units." Since that time, the City's Housing Commission and Planning Department have been working diligently to fulfill the City Council's direction.

Early in the process, the Inclusionary Housing Working Group (IHWG) was formed to advise staff on a variety of issues surrounding the design and implementation of an inclusionary housing program for the City of San Diego. The IHWG was comprised of 21 individuals representing diverse perspectives and interests, including private and non-profit developers, financial institutions, and affordable housing advocates. Other interested parties regularly attended and participated in the meetings as well.

In addition to considering a wide range of policy-related issues, the IHWG spent a considerable amount of time analyzing the financial aspects of inclusionary housing. Keyser Marston Associates Inc. (KMA) was retained to act as a financial consultant for the program. KMA was tasked with determining the financial implications of an inclusionary set-aside and further determining the financial significance of potential benefits or incentives available to add economic benefit to developments.

After seven months of IHWG meetings, a proposal for a citywide inclusionary housing program was produced by staff. This proposal, called the "Balanced Communities Housing Program", was presented to the Housing and Planning Commissions, the Community Planners Committee, and the Land Use and Housing committee. After receiving comments from these groups, as well as extensive public input, it was determined that the program was not ideally suited for our city. It was too flexible and therefore unnecessarily complicated. In addition, Land Use and Housing committee members were concerned about the economic impacts that the program would have on development. At that time, staff received direction to continue discussions with select individuals

representing both the for-profit and non-profit residential development industry in order to address these issues.

In the ensuing months, parties representing all perspectives of the issue took more active roles in the design of the program by fashioning their own proposals. When the issue returned to the Land Use and Housing Committee on April 17th, 2002, eight formal proposals were presented, including two from the Building Industry Association, one from the Board of Realtors, one from a newly formed Housing Coalition, and two separate proposals from individual Council members. These proposals were in addition to the original “Balanced Communities Housing Program” and a new staff recommendation.

DISCUSSION

The unprecedented attention given to the issue of inclusionary housing since July of 2000 attests to the growing concern about our City’s severe lack of affordable housing. The diverse interests represented in the discussions demonstrate that the crisis that we are currently experiencing is far-reaching, affecting all sectors of our city. New graduates; senior citizens; single mothers; first-time homebuyers; employees in healthcare, biotech, tourism, service and other industries important to our healthy economy are all among those effected by our shortage of housing. As a result, diverse interests have come to realize the correlation between the availability of affordable housing and the quality of life of our residents, as well as the continued economic vitality of our city.

Many factors have contributed to the current undersupply of affordable housing. New housing development has not kept pace with job or population growth, resulting in housing costs that have increased at a much faster rate than incomes in the last decade. Currently, the median cost of housing far exceeds the affordability level for the median household. The median home price as of May 2002 is \$315,000, an increase of 18% over a year before. However, the region’s median income for a family of four of \$60,100 only qualifies them for a home that costs \$174,000. This divergence of income and home price leaves fewer than 25% of county residents with the ability to afford the median-priced home. Similar statistics exist for the rental market as well. The discrepancy has recently earned the City the unfortunate distinction of being named the 5th least affordable housing market in the nation by the National Association of Home Builders.

Families are dealing with the increases in housing costs by dangerously paying much higher portions of their incomes than is sustainable or by doubling up on occupancy. Worse, more frequent are the stories of families making choices between the basic needs of food and shelter.

Inclusionary Housing

Increasingly, local governments are finding that inclusionary housing programs are a successful tool in producing much needed affordable housing. This is because inclusionary housing programs foster the creation of a continuous and consistent supply of housing at below market prices. Affordable housing is produced as private developers reserve a specified percentage of new residential units for affordable housing.

In determining how to use inclusionary housing as a tool for creating affordable housing, each jurisdiction chooses from a wide variety of dynamic components in order to customize the program

to its market. Program elements such as the required number of units and affordability level, the allowance of offsite development or payment of in-lieu fees, developer incentives and thresholds vary greatly among the programs. Each of these elements must be taken into consideration in structuring a successful inclusionary housing program in order to tailor it to the individual market.

Programs typically attempt to address the housing needs of households earning less than median income, and especially low and very-low income households, as defined by the Department of Housing and Urban Development (HUD).

In general, it is expected that the cost of inclusionary housing would be shared among several parties: land seller, developer, City (through both monetary and non-monetary incentives), and consumer. For a more comprehensive discussion of the economic impacts of inclusionary housing, please see Attachment 2.

Inclusionary housing programs are not new or untested. Jurisdictions across the nation have proven to be successful in creating thousands of needed affordable homes through inclusionary housing programs. Jurisdictions enact inclusionary housing programs as an extension of cities' police powers to regulate land use, with the goal of assuring that limited supplies of developable land provides housing opportunities for all incomes.

In the State of California, inclusionary housing programs are widely implemented. There are currently well over 100 inclusionary housing programs adopted at the local level. Most recently, the cities of Pasadena, San Jose and San Francisco have passed inclusionary ordinances and the City of Los Angeles is currently considering a citywide program.

Also, the California state government has made a commitment to affordable housing by mandating an inclusionary housing requirement within Redevelopment Project areas. State redevelopment law set forth under the California Community Redevelopment Law (Health and Safety Code 33000) requires that at least 15% of new and rehabilitated housing units be affordable. Of the units provided, 60% can be affordable to families earning up to 120% of AMI and 40% must be affordable to those earning 50% or less of AMI. Within the City of San Diego, there are 15 redevelopment project areas.

Within the San Diego region, ten cities in San Diego County have adopted inclusionary housing programs, with Carlsbad and Chula Vista among the most productive. Furthermore, within the City of San Diego, there is a successful tradition of creating affordable housing through inclusionary housing. In addition to the Redevelopment Area inclusionary housing program, a program was established for the North City Future Urbanizing Area in 1992. The requirements of the program are detailed in the North City Future Urbanizing Area (NCFUA) Framework Plan. This document established a requirement for developers of residential projects North City Future Urbanizing Area to provide a set-aside of 20% for affordable housing at a level of 65% AMI. Subsequent subarea plans, development agreements, and subdivision maps have incorporated provisions of affordable housing in the project approvals. It is believed that the new affordable housing that is currently being constructed under this inclusionary housing program contributes significantly the overall quality of life in our city by creating affordable units close to a significant job center, thus creating an improved balance between jobs and affordable housing.

Goals for Citywide Inclusionary Housing

During the initial meetings of the IHWG, goals were established to guide the discussions and to assist in the development of a successful program:

- Balance housing needs with economic realities, acknowledging the difference between master planned communities and infill development;
- Provide a choice of affordable housing types and enhance homeownership opportunities;
- Further geographic and community balance through providing a range of housing opportunities throughout the city by specifically promoting further balance between jobs and housing;
- Be flexible, taking into account different housing types, development conditions and incentives; and
- Be easily understood, implemented and monitored.

It has become evident through the months of discussions that another integral goal would be to tailor a program that works most successfully within the unique market conditions found within the City of San Diego. It is clear from the diverse responses to the initial direction by the City Council in July of 2000 that this could be fulfilled in a variety of ways. A wide variety of dynamic components have been taken into consideration in structuring this inclusionary housing proposal. Each of the proposals that have been prepared to date has a unique approach in laying out a program. Program elements such as the treatment of the Future Urbanizing Area, the project size threshold, and the amount and availability of an in-lieu fee can vary greatly among programs. Each of the components of the recommended program has been heavily weighed and has been designed to complement the specific conditions that exist in our market.

RECOMMENDATION

On April 17th, 2002, the Land Use and Housing Committee unanimously approved components of an inclusionary housing program for the City of San Diego. A detailed description of the components is found below. A summary of the program is attached as Attachment 1.

Basic Requirements:

- 10 % of the units in a residential development would be set-aside at 65% AMI for rental units and at 100% AMI for for-sale units.

At the developer's discretion, inclusionary units could be constructed on the original development site or off the site within the same community planning area as the original site. On-site and off-site development of the affordable component are both welcomed, with no penalty for off-site development, yet it retains the balanced community goal of providing affordable housing near the market rate development.

The obligation would apply to any residential development of more than two units.

Rents would be restricted for 55 years. Individual purchasers would be allowed to resell, with financial recapture provisions.

Master Planned Areas:

- The current regulations found in the Future Urbanizing Area (FUA) would apply to any future large-scale, master-planned development, with the modification that 20% of new housing be affordable at *an average* of 65% AMI. Another distinction of the Master Planned inclusionary requirements would be to keep affordable for-sale units at restricted levels upon resale.

Redevelopment Project Areas:

- Program requirements would apply to all Redevelopment Project Areas. However, the Redevelopment Agency would be able to modify the citywide requirements for projects that are subject to an Agency agreement. The modification of requirements would be determined on a case-by-case basis for developments fulfilling other significant goals found in the applicable adopted redevelopment project area plan.

Incentives:

- A wide-range of developer incentives are currently being pursued. Processing time line commitments and expediting mechanisms are proposed in a concurrent report from the City Manager. A menu of incentives that are being pursued can be found in Attachment 3 and value of particular incentives is described in Attachments 5, 6, and 7.

Fee In Lieu of Affordable Housing:

- A fee could be paid in-lieu of constructing the inclusionary units, at the developer's option. The fee would be based on the square footage and would phase in over a three-year period as follows:

For projects of fewer than 10 units

- Year 1 \$.50 per square foot
- Year 2 \$.875 per square foot
- Year 3 \$1.25 per square foot

For projects of 10 or more units

- Year 1 \$1.00 per square foot
- Year 2 \$1.75 per square foot
- Year 3 \$2.50 per square foot

The in-lieu fee is an amount set based on 50% of the gap between the median priced home and the price of a home that a family earning median income can afford. As of February 2002 when the Department of Housing and Urban Development (HUD) published the Area Median Income, the median price of housing was \$274,000, while a family earning the median income could afford a home priced at \$174,000. The resulting gap is \$100,000.

The in-lieu fee has been structured as a fee assessed on a “per square foot” basis rather than a flat fee in order to encourage unit sizes that promote affordability. Based on the current average unit size of 2,000 square feet, the average fee assessed would be \$50,000 per affordable unit by the third year.

The in-lieu fee should be escalated annually after the third year under this established formula when HUD publishes updated Area Median Incomes.

The fee has been phased-in over a three-year period in order to ease the market adjustment to the new requirement.

Based on the current unit sizes, the average fee assessed would be \$50,000 per affordable unit by the third year. This would mean that the maximum impact to a project would be \$5,000 per total unit, with the potential for lesser impacts if the incentives are utilized. Economic topics related to inclusionary housing are discussed in further detail in Attachment 2.

It is estimated that this program would produce approximately 625-825 affordable units annually; 450-550 new affordable units plus 175-275 units anticipated in the Future Urban Area annually.

The program would be subject to periodic evaluation in order to assure its successful implementation over time.

Inclusionary as Part of a Comprehensive Solution

Unprecedented discussions about San Diego’s housing issues have taken place since the July 2000 City Council direction that staff create a proposal for an inclusionary housing program. Central to the discussions has been the shared motivation of all parties to help create a comprehensive set of policies to address the City’s critical shortage of affordable housing in order to sustain the City’s economic viability and quality of life. It is generally recognized that in order to reverse the current negative trends, it will be necessary to include a wide variety of tools including a multi-faceted policies and programs and broad-based revenue sources.

Creative solutions must be sought in all areas of government and private sector. Numerous studies have been completed in recent years to identify the factors contributing to the increasing cost of housing. Limited land supplies, construction defect litigation and regulatory constraints are most often cited. Oftentimes, the solutions are not within local control. Therefore, we must find creative ways of addressing the problems that are within the scope of local jurisdiction.

There are already many programs in place at the local level in both the public and private sectors. Within the public sector, programs administered by San Diego’s housing and redevelopment agencies successfully help to house tens of thousands of families. These programs include:

- First-time homebuyer assistance;
- New Construction or Acquisition and rehabilitation of rental housing;
- Preservation of existing SRO and other affordable units;
- Rehabilitation of existing affordable units;

- Rental assistance; and
- Funding of transitional and special purpose housing and emergency shelter facilities.

Despite the success of these programs, they alone are unable to create sufficient new affordable housing stock. Such housing must leverage public funds from the State and Federal governments, as well as local redevelopment tax increment and revenue generated for the Housing Trust Fund in order to create new affordable housing. Unfortunately, these funds are severely limited.

It is also recognized that a partnership between the public sector and private industry is imperative to find solutions to the critical shortage of affordable housing in order to sustain the economic and social well being of our City. The public sector plays a major part in contributing to the partnership, with policies regarding density, regulation and funding. Private industry can also contribute access to valuable land and expertise that are key to creating new housing stock. One technique to blend public and private resources to help solve our City's affordable housing crisis is through an inclusionary housing program. Inclusionary housing harnesses the resources, expertise, and creativity of the private building industry as one part of a comprehensive strategy for increasing the stock of affordable housing units.

Many other recommendations have been made as a part of the discussions on inclusionary housing that could be considered as part of a comprehensive package to address the affordable housing shortage.

One primary recommendation has been to consider additional revenue to augment San Diego's successful Housing Trust Fund. This action would fulfill further direction given by the City Council in the July 2000 meeting to pursue additional funding sources for Housing Trust Fund.

The Housing Trust Fund is an integral part of creating new affordable housing units. However, the only source of local funding is the commercial and industrial development housing impact fee, and the fee income alone is not sufficient. Attachment 4 reviews potential revenue sources that have been discussed.

It has also been recommended that a Blue Ribbon Committee be appointed to review potential funding sources and recommend a package of funding appropriate for the Housing Trust Fund to be considered along with infrastructure needs.

Next Steps

In the event that the City Council approves a citywide inclusionary housing program in concept today, there are many more steps that will need to be completed prior to the adoption of an ordinance. In the coming months, staff will prepare the ordinance and bring it to the public, Community Planners Committee, Housing Commission, and Planning Commission for review and comment. In addition, staff will prepare an initial environmental study for public review.

Concurrently, staff will continue to pursue the implementation of incentives as discussed in Attachment 3, including development processes, parking reductions, and modification to current water and sewer fee reductions to mirror the requirements of the inclusionary housing policy.

Due to the ever-growing need for affordable housing, staff hopes to complete this comprehensive process in an expedient and efficient manner and return for full City Council review within six to eight months.

CONCLUSION

The feasibility of implementing an inclusionary housing program in the City of San Diego has been the subject of substantial analysis since the initial City Council directive in July 2000. Based on information gathered during that period, staff is confident that an inclusionary housing program is an appropriate policy to contribute much needed new affordable housing stock without unduly burdening the development community or other homebuyers. At the same time, it has become increasingly apparent that revenues to the Housing Trust Fund should be augmented in order to enhance the ability of public and private entities to meet the critical housing need.

Respectfully Submitted,

Elizabeth C. Morris
Chief Executive Officer

Approved: P. Lamont Ewell
Assistant City Manager

S. Gail Goldberg, A.I.C.P.
Planning Director

Attachments:

1. Summary of Inclusionary Housing Program
2. Economic Impact of Inclusionary Housing
3. Menu of Potential Incentives
4. Menu of Potential Revenue Sources
5. Estimated Interest Savings on Land Cost from Expedited Processing
6. Impact of Density Bonus
7. Estimated Interest Savings from Fee Deferrals
8. News Articles