

The Cost of Affordable Housing: What Drives It and How to Address It



bae urban economics

Commissioned by the San Diego Housing Commission

Who is BAE Urban Economics?

BAE Urban Economics, Inc. is an award-winning, national urban economics and real estate consultancy. Since 1986, we have completed more than 2,600 client engagements for public agencies, non-profit organizations, financial institutions, and real estate investors and developers. BAE's passion about the "triple bottom-line" of sustainable economics, equity, and environment makes us unique among urban economists.

BAE has 21 staff members in six offices, including the Bay Area, Sacramento, Southern California, Atlanta, Washington DC, and New York City.



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The City of San Diego's Commitment to Housing Affordability and Policy

- Issued via Executive Order by Mayor Gloria in 2023
- Available to certain project types, including 100 percent affordable housing projects and emergency shelters
- Expedites project review, not to exceed 30 business days, significantly speeding up the permitting process
- Assigns a Development Project Manager (DPM) to oversee each eligible project
- By August 2024, 27 projects with 2,834 units were built through program
 - Avg. a processing time of just seven days
 - 42% of income-restricted homes permitted in 2023
- Success of the policy led to a similar transit-oriented program, Complete Communities Now, in March 2024

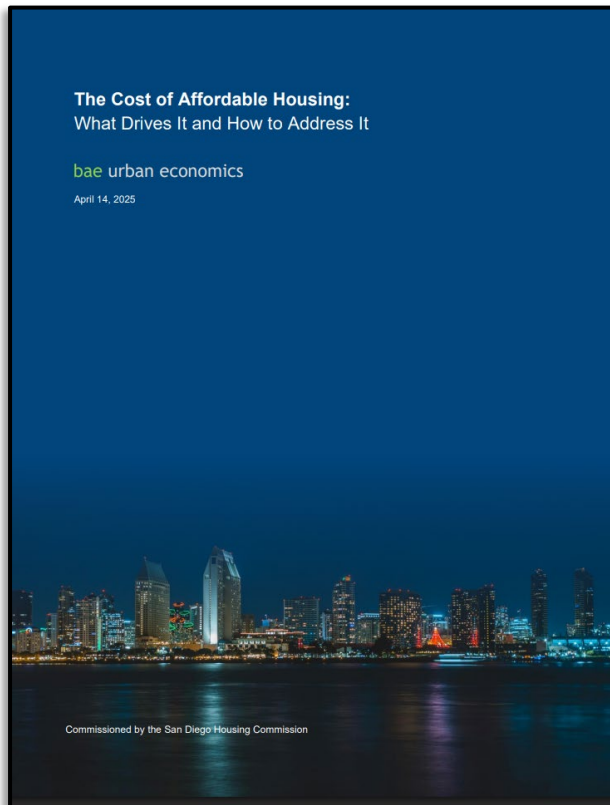


Study Purpose and Objective

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The primary goal of this study is to analyze the numerous elements that contribute to the rising costs of affordable housing development. By creating a detailed index of recent affordable housing developments, the study seeks to pinpoint the main drivers of cost increases.

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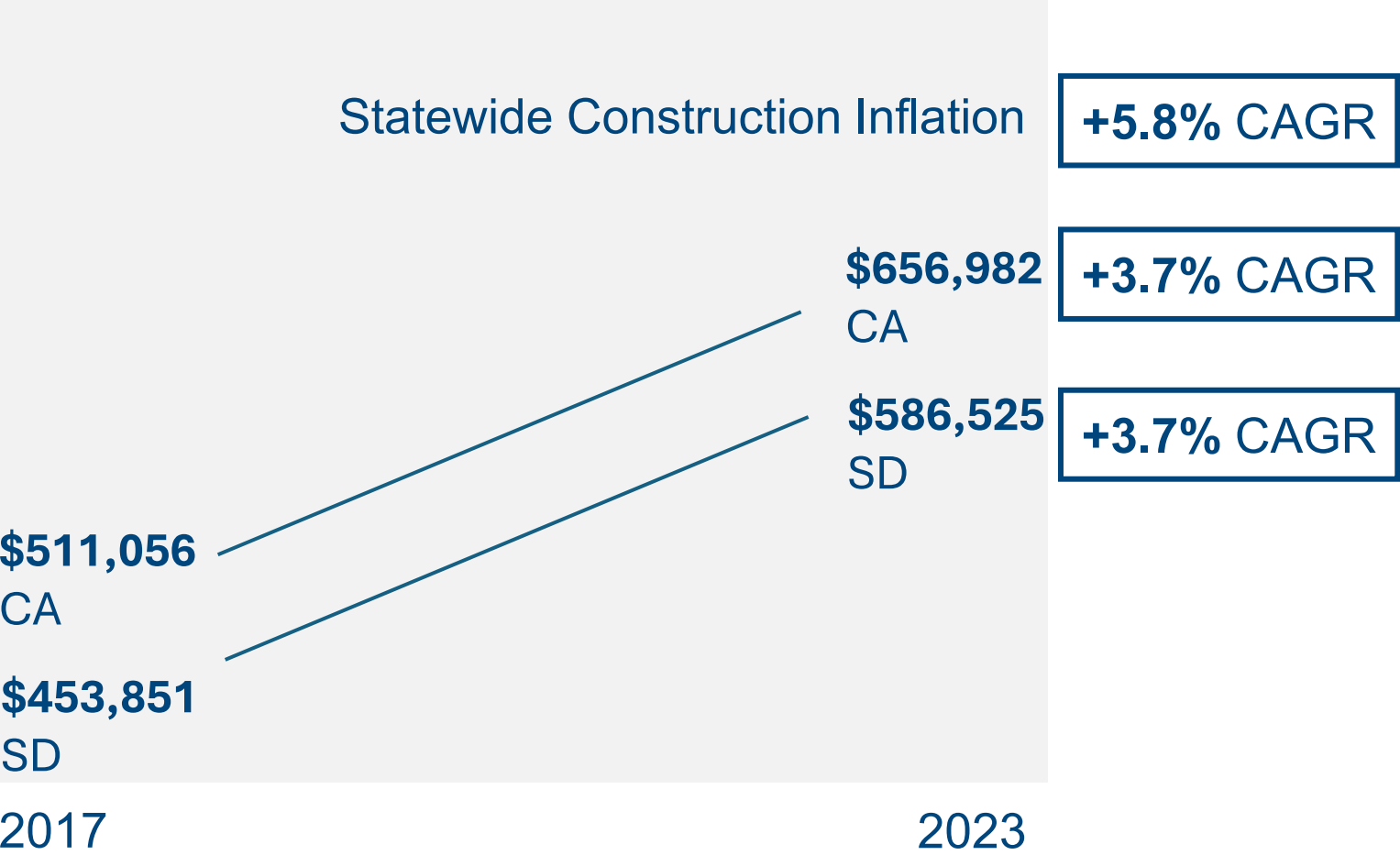
Where does the data come from?

The study is based on LIHTC application and Placed-in-Service (PIS) budgets procured from CTCAC for projects started or completed between 2020 and 2023 for San Diego and other cities, as well as interviews with the SD development community, and policy research from secondary sources. This includes:

- 391 application workbooks
 - 65 in San Diego
- 171 PIS workbooks
 - 30 in San Diego

Comparing Construction Cost Increases in San Diego to Statewide Increases

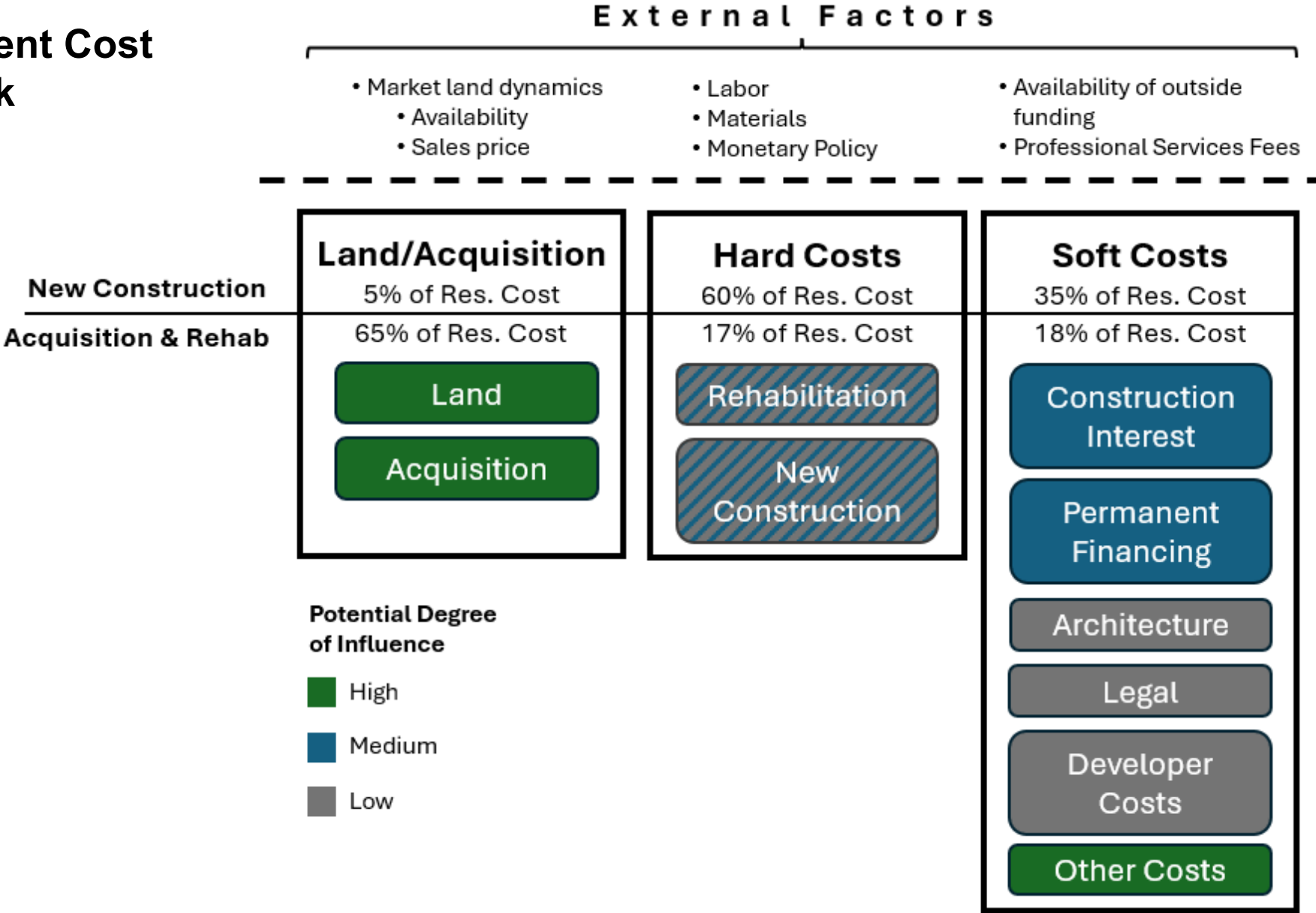
Residential Development Cost Per Unit



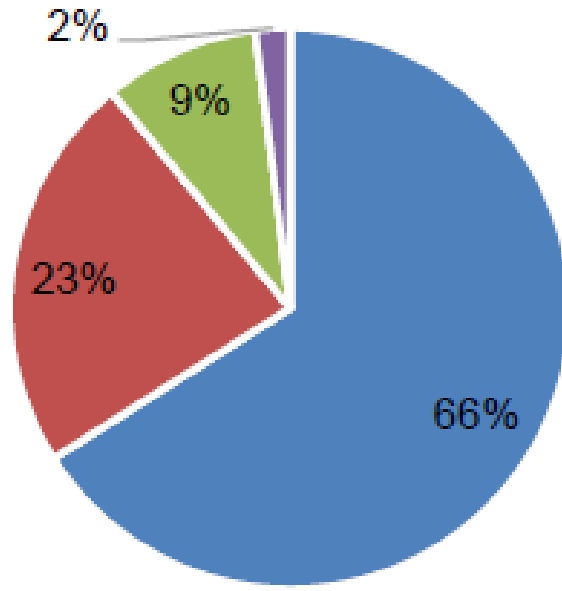
LIHTC projects in the study’s dataset show that the cost of construction per unit has been increasing at an annualized rate of 3.7 percent per year in both the City of San Diego and for all California peer cities.

This rate is lower than the statewide rate of construction inflation of 5.8 percent per year during the same period.

Development Cost Framework



Building Cost Index Components



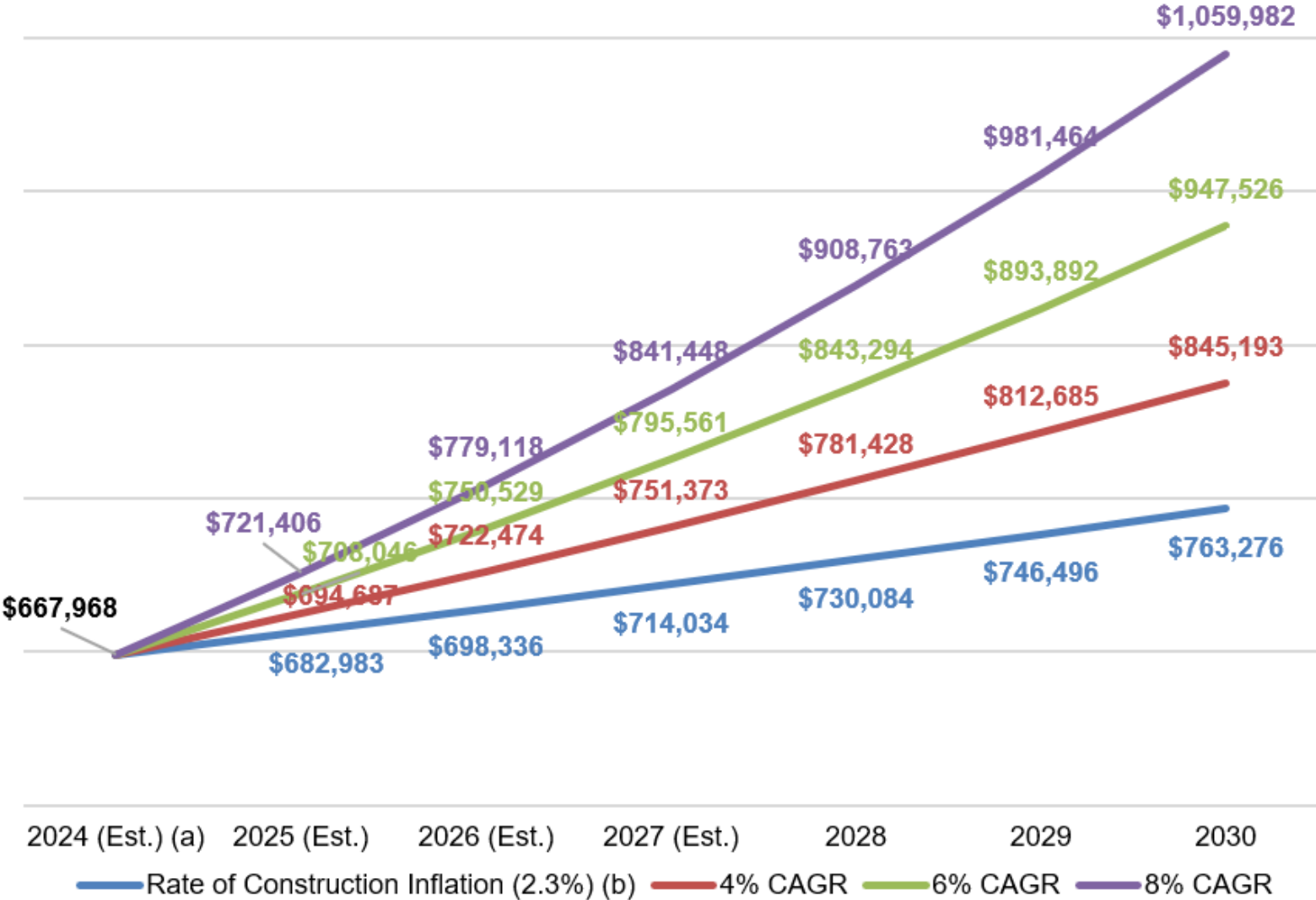
■ Skilled Labor ■ Steel ■ Lumber ■ Cement

Source: Engineering & News Report

The Building Cost Index, a common method of tracking construction cost inflation, is calculated using a basket of sources, of which two-thirds of costs are skilled labor and one-third is materials.

Cost Projection Scenarios

While the rate of construction inflation cannot be predicted with certainty, it can be reasonably expected that the average per unit cost of development will range anywhere from \$763,276 to over \$1 million per unit by 2030, with some projects costing less and some costing more.



Reasons for High Project Cost

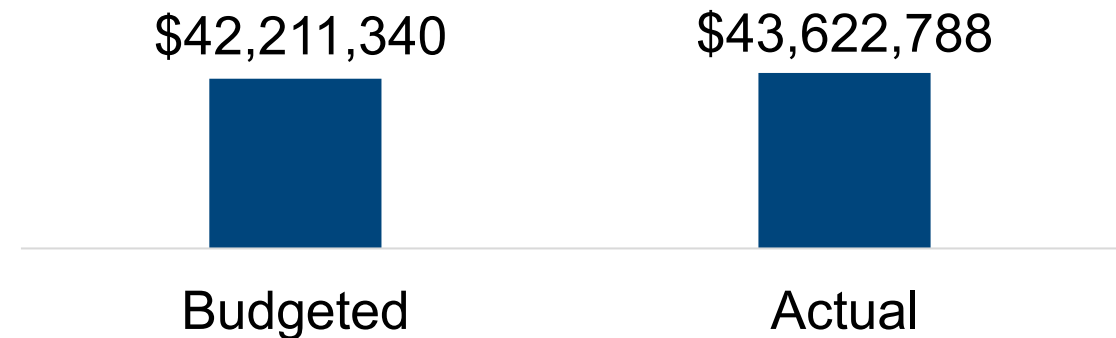
Projects in the City of San Diego with project costs greater than \$650,000 in development cost in application 2023 referred to the following reasons as causes of high project development costs:

Construction Type and Structure Requirements	Prevailing Wage/PLAs
Site Conditions and Environmental Mitigation	Escalating Material and Insurance Costs
Off-Site Requirements	Land Acquisition and Site Preparation

Why Build Affordable Housing Despite the Cost to Develop

Sustained affordability through 55-year covenants	Development costs are shared with private investors
Addresses homelessness crisis	Creates quality employment opportunities

Affordable Housing Budget, Application vs. Placed in Service



In the City of San Diego, LIHTC projects typically see residential development costs rise by just 3.3 percent from the application submittal to the placed-in-service phase.

Reasons for High Cost Overruns

Pandemic-related labor and material delays, extending construction timelines and leading to increased construction interest.

Pandemic-related labor and material inflation, leading to higher-than-expected project costs.

Unexpected design adjustments and additional construction or architecture fees.

Rising insurance costs, property taxes, and compliance with updated code requirements, adding substantial layers to the budget.

Cost Deep Dive: Skyline (f.k.a. Rancho Bernardo Transit Village)



- 99 affordable housing units, one manager's unit
- Neighborhood: Rancho Bernardo
- Developers: Affirmed Housing (for-profit) and Compass for Affordable Housing (nonprofit)
- Target Population: Large Family
- New construction
- Podium construction
- 4 percent LIHTC

Reasons Provided for High Cost

- Parking requirements: Must build 201 spaces (85 designated for MTS transit riders) requiring expensive two-story Type I concrete structure
- Complex construction: Five-story residential (Type III) built above parking structure
- Zoning compliance: Required to include 14,000 sq ft commercial office space shell
- Open space requirements: Large third-floor amenity area adds significant costs
- Labor costs: Project Labor Agreement and prevailing wage requirements increase expenses
- Construction market: Rising costs of materials and insurance
- Quality and compliance: ADA-accessible/adaptable features and high energy standards

Cost Deep Dive: Cuatro at City Heights



- 115 affordable housing units and two manager's units
- Neighborhood: City Heights
- Developer: Wakeland Housing and Development Corporation (nonprofit)
- Target Population: Large Family
- New construction across four scattered sites
- Type V wood-frame construction
- 4 percent LIHTC

Reasons Provided for High Cost

- Scattered site development across four urban infill parcels
- Environmental remediation: Parcels 1 and 2 require vapor barriers, sub-slab venting systems, Soil Management Plan, and Community Health and Safety Plan
- Soil contamination: Parcel 4 requires remediation of residual contaminated soil
- No land donation: Unlike many comparable projects that receive donated.

Key Recommendations



Pursue state legislation to **prioritize scheduling utilities inspections** and other services for affordable housing developments.

- Would shorten development times
- Requires coalition building and political strategy
- LADWP's Project Powerhouse shortened utilities review, engineering, and construction by 86%



Establish an **alternative land acquisition pipeline** to proactively acquire land to make available to affordable housing developers.

- Would increase number of development opportunities and eliminate land costs
- Requires philanthropic partners
- \$50 million Los Angeles County Land Bank Pilot with aim to acquire 5 to 15 properties



Pursue an **affordable housing bond voter measure** to establish a consistent funding source.

- SD Measure A and California Prop 5 failed to pass
- Challenges to getting supermajority
- Alternate strategy to develop a predevelopment philanthropic fund, such as the San Francisco Housing Accelerator Fund