



Good Neighbors

San Diego
Housing Commission

REPORT

ITEM 108

DATE ISSUED: August 18, 2005

REPORT NO.: HCR05-82
For the Agenda of August 26, 2005

SUBJECT: Update to Housing Impact Fees on Commercial Development

Issue: Should the Housing Commission recommend adjustments to the recently adopted Housing Impact Fee schedule to allow for the fees to be indexed based upon an established performance measure, and develop some criteria for case-by-case fee waivers?

Recommendation: Direct staff to prepare an ordinance amending the Housing Impact Fees on Commercial Development (San Diego Municipal Code Chapter 9 Article 8 Division 6), as further described herein, including:

1. Use of the *Consumer Price Index* (CPI) as the source by which all linkage fees shall be indexed starting in year two of the newly adopted fee schedule;
2. Do not allow for any building types to have a blanket exemption from the linkage fee and continue to allow for case-by-case waivers approved by the City Council and based upon the guidelines described in Attachment 1.

Fiscal Impact: The allowance for certain waivers and/or exceptions from the linkage fee will decrease the total amount that could be collected into the Housing Trust Fund on a yearly basis. Conversely, indexing the fees will allow for yearly adjustments and will increase the fee amounts thus increasing the expected revenues into the Housing Trust Fund. Since the linkage fee is determinate on the amount of permitted commercial development in a given year, it is not possible at this time to accurately quantify the impact of these changes.

Affordable Housing Impact: Any additional revenues would be deposited into the Housing Trust Fund and would be used to produce new affordable housing opportunities targeting low income households.

BACKGROUND

On May 6, 2005 the San Diego Housing Commission adopted the updated Nexus Study issued by Keyser Marston and Associates (KMA). Along with the Nexus Study, the Commission also adopted an updated fee schedule for the different building types. Report HCR05-041 recommended



indexing the fees beginning in year two of the updated linkage fee structure. However, no suggestions were proffered regarding the preferred indexing methodology.

After receiving testimony, the Board of Commissioners directed staff to meet with the Chamber of Commerce, representatives from the various R&D companies and the City's Economic Development Department to address the following issues:

- Combining the R&D and Manufacturing uses into one category
- Selecting an appropriate indexing service to index new fees
- Determining if any uses should be exempt (e.g. R&D) and delineating criteria that would be used to waive the fee

On May 13, 2005 staff met with representatives from the Chamber of Commerce, BIA, BIOCUM, Qualcomm, Ligand Pharmaceuticals, GenProbe, and the City's Economic Development Department to discuss these three issues.

On July 8, 2005 the San Diego Housing Commission considered the aforementioned issues. The Board of Commissioners adopted staff's recommendation to combine R&D and Manufacturing uses into one category. The remaining two items were trailed until August 26, 2005 for further discussion.

DISCUSSION

Indexing the Fees

In staff's Report HCR05-062 (Attachment 1) it was suggested to index the fees to a recognized indexing source to provide a mechanism for the fees to increase over time congruent with the cost of inflation. At the July 8, 2005 Housing Commission Board meeting, the Commissioners agreed to the importance of indexing the fees, but did not identify the appropriate index to utilize.

The Commissioners also expressed the need for the chosen index to adequately represent the underlying cost of a home in San Diego. The Commissioners suggested selecting one of the listed indices for a trial period after which the index could be re-examined and a decision could be made as to that index's effectiveness. Finally, it was suggested that staff examine whether an alternate index exists that is published by the Construction Financial Management Association (CFMA).

Staff researched the Construction Industry Annual Financial Survey published by CFMA. The survey is not accessible to any entity that does not subscribe to the CFMA publication. The CFMA publication, which costs approximately \$400 per year, claims to provide aggregate data on the following issues:

- Techniques and practices, trends and forecasts
- Composite financial statements by contractor type, revenue, and geographic region
- Best-in-Class ratios and analysis for each contractor type
- A "Hot Topic" section covering a new issue every year

Staff did not purchase the CFMA Survey and recommends the Commission select one of the more broadly published and free indices as the preferred methodology for indexing the fees.

Because KMA has indicated the selected index should track the percentage change in disparity between the cost of housing (to the consumer) and median income level in San Diego, and because there is currently no published index that tracks only these two criteria, staff continues to recommend the CPI. Staff holds that the CPI more closely addresses the cost of a home for the consumer, as opposed to the *Engineering News Record* (ENR) which tracks the cost of construction to the development community.

Exemptions and Waivers

On May 6th, the Commissioners also asked staff to analyze the granting of exemptions and waivers. The Economic Development Department (EDD) drafted proposed criteria for a waiver which is included as Attachment 2. The business community has taken exception with some of the provisions drafted by EDD.

On July 6th, the Commissioners discussed the importance of not creating a system that places businesses at a competitive disadvantage with other industries. It was expressed that, irrespective of the criteria adopted, EDD and the City Council should work together to create incentive packages designed to recruit and retain businesses in San Diego and that such incentive packages should contemplate a complete waiver of the linkage fee.

Several Commissioners also expressed concern over the inclusion of the living wage requirement in the list of incentives. It should be reiterated that it is not envisioned that a project seeking a waiver must comply with *all* of the listed criteria; rather it is suggested that the decision makers *consider* the items listed when granting a waiver. Some projects may meet two or three of the listed criteria while other projects may meet five or six; in either case a waiver could be granted to the applicant.

Other Items for Discussion

Further discussions also centered around the two issues raised by the Land Use and Housing Committee on May 25, 2005: the inclusion of a grandfather clause and a phased payment schedule for the payment of the linkage fee. On July 8th the Commissioners expressed support for the concept of the grandfather clause and proposed a 50-50 phased payment alternative. This schedule would require half payment at the issuance of the building permit and the remaining half would be paid either at or after the issuance of the Certificate of Occupancy. It was mentioned that if a payment is required after it has left the overview of the City, then a punitive fee should be attached to the project or a lien should be recorded against the property. Housing Commission staff does not object to a grandfather clause or a phased payment schedule.

Alternatives:

1. Utilize the ENR as the preferred index. Staff is not recommending this index due to its lack of consideration for land costs and its failure to adequately track known cost increases in construction materials.
2. Adopt EDD's suggested criteria for waivers in their entirety or reject them in their entirety. Staff is not recommending either of these two courses of action. It is advisable that the Board establish a position on what criteria should be utilized so as to avoid unnecessary waivers in the future and the resulting loss of revenue into the Housing Trust Fund. Staff has tried to strike a balance between the City's desire to establish criteria for waivers with the business community's concerns over creating disincentives to the development and relocation of outside companies to San Diego.

Respectfully Submitted,

Approved By,

**Signature on File
With Original Document**

D. Todd Philips
Policy Advisor to the President and CEO

Elizabeth C. Morris
President and Chief Executive Officer

ATTACHMENTS:

1. Commission Report HCR05-062 (Report only)
2. Economic Development Department's Draft of Municipal Code Section 98.0618



Good Neighbors

San Diego
Housing Commission

REPORT

ITEM NO. 106

TO: The Chair and Members of the Housing Commission

DATE: June 29, 2005

REPORT NO.: HCR05-62
For the Agenda of July 8, 2005

SUBJECT: Update to Housing Impact Fees on Commercial Development

Issue: Should the Housing Commission recommend adjustments to the recently adopted Housing Impact Fee schedule to allow for a combined Research and Development and Manufacturing building category, index the fees based upon an established performance measure, and develop some criteria for the establishment of case-by-case waivers from the fee?

Recommendation: Direct staff to prepare an ordinance amending the Housing Impact Fees on Commercial Development (San Diego Municipal Code Chapter 9 Article 8 Division 6), as further described herein, including:

1. Allow all Research and Development building types to be charged the Manufacturing rate of \$1.18 per square foot;
2. Use the Consumer Price Index (CPI) as the source by which all linkage fees shall be indexed starting in year two of the newly adopted fee schedule;
3. Do not allow for any building types to have a blanket exemption from the linkage fee and still allow for a case-by-case waiver decided by the City Council and based upon the guidelines described below.

Fiscal Impact: Charging all Research and Development (R&D) building types the lower Manufacturing rate of \$1.18 rather than the higher Office rate of \$1.49 (that would have applied to some R&D uses) will impact the amount collected into the Housing Trust Fund by decreasing expected revenues. Additionally, the allowance for certain waivers and/or exceptions from the linkage fee will also decrease the total amount that could possibly be collected into the Housing Trust Fund on a yearly basis. Indexing the fees to the CPI will however allow for the fee to be adjusted on a yearly basis and will increase the fee amounts thus increasing the expected revenues into the Housing Trust Fund. Because the linkage fee is determinate on the amount of permitted commercial development in a given year, it is not possible at this time to accurately quantify how much of an impact any of these changes will create.

Affordable Housing Impact: Any additional revenues would be deposited into the Housing Trust Fund and would be used to produce new affordable housing opportunities focused on low income households.

BACKGROUND

On May 6, 2005 the San Diego Housing Commission adopted the updated Nexus Study issued by Keyser Marston and Associates (KMA). Along with the Nexus Study, the Commission also adopted an updated fee schedule for the different building types. At the May 6, 2005 hearing, representatives from the Chamber of Commerce and some of San Diego's leading Research and Development (R&D) companies including Qualcomm, BIOCUM and GenProbe all made statements that the R&D building type should be retained within the updated fee structure as a separately defined category. It was also asked of the Commission to consider exempting the R&D category type from having to pay the linkage fee altogether. Additionally, in staff's Report (HCR05-041) it was recommended to index the fees beginning in year two of the updated linkage fee structure, but no suggestions were proffered as to what indexing measure the fees should be tied.

After receiving testimony, the Board of Commissioners asked staff to meet with the Chamber of Commerce, the assembled representatives from the various R&D companies and the City's Economic Development Department to address the following issues:

- Combining the R&D and Manufacturing uses into one category
- Selecting an appropriate indexing service by which the new fees will be indexed
- Delineating any criteria that would be used to waive the fee and whether it is appropriate to exempt any uses such as R&D

On May 13, 2005 staff met with representatives from the Chamber of Commerce, the BIA, BIOCUM, Qualcomm, Ligand Pharmaceuticals, GenProbe, and the City's Economic Development Department to discuss these three issues.

On May 25, 2005 the Land Use and Housing (LU&H) Committee gave direction to staff to draft an ordinance that reflects the 15% mitigation level at 80% AMI. It is important to note: LU&H did not adopt the 15% fee level, but asked staff to prepare an ordinance with the 15% fee structure and provide the Committee with data on the 10% and 12.5% levels for further discussion.

On June 16, 2005 the San Diego Planning Commission approved all of staff's recommendations. Additionally, the Planning Commission accepted staff's definition and treatment of all R&D building types as discussed in the following section as well as utilizing the *Engineering News-Record* (ENR) to index the fees. Finally, the Planning Commission took positions in favor of allowing the linkage fee to be waived for mixed-use projects that have at least 50% of the project as residential; including a grandfathering clause in the new ordinance; and allowing for a phased payment of the fee that would be paid in two equal payments at building permit issuance and prior to the issuance of the Certificate of Occupancy.

DISCUSSION

Combining R&D with Manufacturing

The Housing Impact Fees are separated into various building types that signify the proposed use the developer has intended for the building. During the update for the Nexus Study, KMA was given advice and feedback from a number of sources to fold the R&D category into the Office and Manufacturing categories. The reasoning behind this directive was varied.

First, the R&D category was problematic for city staff processing the applications for new building construction. Based upon the development plans submitted by the developer, city staff would make educated guesses as to what type of industrial uses would be utilized in the proposed building (e.g. manufacturing, R&D, storage, etc.). This methodology relies heavily on the subjective standards of the various City employees reviewing the plans and can result in inconsistent determinations.

Secondly, the development plans for some R&D buildings look like plans submitted for office type uses. Based upon such plans it was suggested in the new Nexus Study that R&D facilities whose plans look like an office building would be charged the higher Office rate of \$1.49SF rather than the lower manufacturing rate of \$1.18SF. And those facilities that do have a manufacturing component would be charged the lower Manufacturing rate.

Lastly, it is a stated economic development goal of the City to retain and attract manufacturing jobs which includes the life sciences companies and other high-tech and biotech research companies, the lower Manufacturing rate should be applied to all R&D uses. Therefore in an effort to simplify matters and provide proper incentives, it is recommended that all R&D uses be charged the Manufacturing rate.

Indexing the Fees

In staff's Report HCR05-041 (Attachment 1) it was suggested to index the fees to a recognized indexing source to provide a mechanism for the fees to increase over time in congruence with the cost of inflation. It is broadly accepted that the fees should be indexed, but to what index the fees should be tied is under consideration. Representatives of the Building Industry Association (BIA) suggested the city should continue to utilize the Twenty Cities Indices, also known as the *Engineering News-Record* (ENR), cited in the 1990 Housing Trust Fund ordinance. As stated earlier, the Planning Commission also recommends the use of the ENR. Another alternative would be to use the Consumer Price Index (CPI). On May 25, 2005 the Land Use and Housing Committee (LU&H) suggested staff look into utilizing a third measure, that being a local economic performance measure.

Of the cities in California that have a linkage fee only five of them use an index to increase or decrease their fees. Of those five, four use the CPI while the last one ties theirs to residential construction costs (ENR). At the outset of this discussion, it is important to determine what the fee is trying to track by the utilization of an index. Is the interest in allowing the fee to grow in conjunction with the cost of home construction? Or is it more appropriate to try and track the cost of living in San Diego?

Discussions with KMA have indicated the appropriate measure the index should be tracking is the percentage change in disparity between the cost of housing and median income level in San Diego. Currently, there is not a published index that tracks only these two criteria. Furthermore, due to the complexity of trying to relate these two criteria to one another in an effort to provide an index to track the linkage fee, KMA has indicated that all other jurisdictions that index their fees utilize either CPI or ENR.

The CPI produces monthly data on changes in the prices paid by urban consumers for a representative basket of goods and services. It is noted that the cost of consumer products reflected in the CPI can and does fluctuate greatly from month to month and year to year. Alternatively, the ENR offers data on the price of construction equipment, labor and construction materials. This is a readily available, recognized index. However, it does not reflect land prices or housing affordability measures. Also, the ENR appears to lag noticeably behind known construction cost changes.

Finally, the University of San Diego publishes an Index of Leading Economic Indicators (ILEI) for San Diego County as compiled by Alan Gin, professor of Economics at USD. The ILEI tracks the percentage change among six different indicators ranging from local building permits issued, stock prices, consumer confidence and help wanted advertising in the *San Diego Union-Tribune*. Although the ILEI does give some indication as to local performance, it includes measures that are not relevant to commercial development or housing.

Staff recommends the use of the CPI. Staff recommends the CPI because it is the index that is closest to tracking the desired factors.

Exemptions and Waivers

The Commissioners also asked of staff to analyze the granting of exemptions and waivers. After discussions with interested parties, it was quickly realized that although an outright exemption was preferred by the R&D community, they agreed that as long as case-by-case waivers could be attained for specific projects then an outright exemption would not be pursued. As to the criteria that the waivers would be granted, the parties had divergent points of view.

The Economic Development Department (EDD) drafted a proposal (Attachment 2) whereby a waiver should be granted if the development's primary use is light manufacturing, warehouse, wholesale distribution, R&D or if it is within a Redevelopment Project Area and the developer agrees to pay at least 80% of the employees a living wage. As to R&D developments seeking a waiver, EDD further suggests the project must have an anticipated accessory use of either light manufacturing or an agreement to manufacture some of the products resulting from their R&D.

The business community took exception with some of the City's language and the requirements a development would have to meet in order to get a variance. Specifically, they argued against the requirement that some manufacturing need take place onsite or within the City of San Diego. They argued that due to several business-related pressures such requirements may prove infeasible for R&D companies. Additionally, the business community is seeking a waiver in cases where the R&D function(s) are providing advancement in the areas of science, technology and electronics and

where the development will not be accessible, in its entirety to the general public due to national security reasons.

Given the two points of view, staff recommends the following:

1. Do not allow for blanket exemptions for specific building types and allow for case-by-case consideration. Waiver of the fee should be the exception and not the rule;
2. Consider waivers if the anticipated primary use is light manufacturing, warehouse, wholesale distribution or R&D especially when such uses are located in Redevelopment Project Areas;
3. If the anticipated primary use is R&D, then some consideration should be given to whether light manufacturing shall be an accessory use on the premises or within an determinable area that has some reasonable positive impact on the surrounding economy;
4. Applicants for a waiver should provide their employees with a living wage;
5. Ultimate waiver authority on subjective waivers (e.g. R&D uses) should reside with the City Council while ministerial waivers (e.g. developments with low employment densities) should continue to be delegated to the Housing Commission;
6. Finally, if the proposed development is a mixed use project, then a method of alternative compliance should be devised that takes into account the level of housing affordability the overall project produces (e.g. if the residential component of the project builds in excess of the 10% inclusionary requirement, their impact on the 80% AMI housing market is mitigated onsite).

Other Items for Discussion

Since presenting this item to the Commission, staff has received other recommendation to the ordinance going forward. Staff felt it appropriate to allow for the Commissioners to discuss and consider taking positions on two items raised by LU&H on May 25, 2005.

Grandfather Clause – Part of LU&H's direction on May 25th also asked for inclusion within the ordinance of a grandfathering clause to allow for projects that have their financing in line and are currently in the pipeline at the City to be relieved of any dramatic increases to the fee structure that may be adopted. The question presented is: at what point in the development review process should the benefits of the one-time grandfathering be limited?

Discussions with the City Attorney's office indicate no established methodology for providing for a grandfathering clause with regards to new fee structures. Among the various alternatives would be to apply the new fee structure to any project without a Building Permit when the new fee is adopted, or do not apply the new fee structure to any projects that have had their development permit application already deemed complete when the new fee structure takes effect. It is suggested that the second approach be used.

It is also suggested that those projects which fall under a grandfather clause be given a timeframe by which their building permit must be pulled or else be subjected to the new fee structure. It is felt that this form of sun-setting the grace period would prevent developers from holding onto an approved development but not building it for many years—such a situation could result in projects unjustly benefiting from an inappropriately low linkage fee.

Phased Payment – LU&H also directed staff to look into allowing for a phased payment schedule for developers to pay their linkage fees. Because the fees will be dramatically increasing for certain uses it was felt that phasing the fee payment over three equal installments might provide a developer with a cash flow by which to pay the fee. The suggestion from LU&H was to allow for the first 1/3 payment at the time the building permit is issued for a project. The second 1/3 payment would be due at the issuance of the Certificate of Occupancy and the final 1/3 payment would be due two years after the Certificate of Occupancy is issued.

Development Services Department suggests that their concern with this methodology is that once the Certificate of Occupancy is issued, the City's control over the project and developer ceases. Trying to collect the final 1/3 payment two years after the developer has had their final dealing with the City might prove difficult to enforce. Standard procedure to use a performance bond would defeat the value of the deferral.

Alternative payment dates could be established if the Commission would prefer (e.g. 1/3 equal payments due at: development permit deemed complete status, building permit issuance and issuance of Certificate of Occupancy). As a further consideration, a phased payment option raises the issue of the time value of money. Depending on how the future years' payments are discounted, the phased payment option could adversely impact the Housing Trust Fund somewhat. While the value of this phased payment to the developer may be small, and enforcement complex, Housing Commission staff does not object to allowing for a phased payment schedule.

CONCLUSION

Direct staff to prepare an ordinance amending the Housing Impact Fees on Commercial Development (San Diego Municipal Code Chapter 9 Article 8 Division 6), reflecting the following changes:

1. Allow all Research and Development building types to be charged the Manufacturing rate of \$1.18 per square foot;
2. Use the Consumer Price Index as the source by which all linkage fees shall be indexed starting in year two of the newly adopted fee schedule;
3. Do not allow for any building types to have a blanket exemption from the linkage fee and still allow for a case-by-case waiver based on the aforementioned guidelines.

Respectfully Submitted,

Approved By,

**Signature on File
With Original Document**

D. Todd Philips
Policy Advisor to the President and CEO

Elizabeth C. Morris
President and CEO

ATTACHMENTS:

1. Commission Report HCR05-041 (Report only)
2. Economic Development Department's Draft of Municipal Code Section 98.0618
3. Fee Structure Recommendation

**City of San Diego Economic Development Department's
Proposed Linkage Fee Waiver Criteria**

[delete § 98.0608(a)(6)]

[repeal City Council Resolution R-286015]

§ 98.0618 Waiver or Reduction of Fee

In addition to variances granted pursuant to the provisions of Section 98.0615 and Section 98.0616 the City Manager may, at the sole discretion of the City Manager, waive or reduce any fees assessed pursuant to this Division if, in the determination of the City Manager, the non-residential development would convey an extraordinary public benefit to the City of San Diego. Following a full review and public hearing by the Housing Commission, the City Manager shall consider both the potential extraordinary public benefits which would result from the non-residential development, plus the potential impact on housing affordability which may result from the non-residential development, as the basis for the amount of the reduction, if any. The City Manager will be limited in this discretion to waive or reduce such fees on non-residential developments which meet any one of the following criteria:

- (a) the anticipated *primary use* of the non-residential development is *Light Manufacturing*; or
- (b) the anticipated *primary use* of the non-residential development is *Warehouse or Wholesale Distribution*; or
- (c) the anticipated *primary use* of the non-residential development is *Research & Development* and either of the following are true:
 - (1) *Light Manufacturing* is an anticipated *accessory use* on the same premises
 - (2) The applicant agrees in writing that at least some products resulting from *Research & Development* uses on these *premises* will be manufactured within the City of San Diego; or
- (d) the non-residential development is located within an adopted Redevelopment Project Area and is subject to a Disposition & Development Agreement (DDA) In addition the applicant must agree in writing that no less than 80% of the employees working within the non-residential development shall be paid a living wage as defined in Section 22.4105.

In the case of proposed industrial projects (a) through (c) above, the applicant must agree that the non-residential development will be used primarily for industrial purposes until and unless the fees which are to be waived are paid in an amount equal to the fee that would have been levied at the time building permits were pulled.