



Good Neighbors

San Diego
Housing Commission

REPORT

DATE ISSUED: December 3, 2004

ITEM 104

REPORT NO.: HCR04-082
For the Agenda of December 10, 2004

SUBJECT: Update to Housing Impact Fees on Commercial Development

Issue: Should the Housing Commission recommend adjustments to the Housing Impact Fees for Commercial Development in response to updated information analyzed in a recent Nexus Study?

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 the most recent nexus study data in preparing amendments;
2. Adjust building type categories used in the fee schedule;
3. Focus on low income housing needs for people earning less than 80% of Area Median Income;
4. Base adjustments to the fee schedule on mitigating 15% of actual housing impacts;
5. Authorize the San Diego Housing Commission to approve variances for applicants if they meet the specified findings showing financial hardship or if the project is expected to create a low employee density.
6. Allow for exemption of office and manufacturing development proposals in redevelopment areas and Enterprise Zones.

Fiscal Impact: Depending on how the fee structure is amended, additional revenues of \$3M to \$10M more than the FY04 amount would accrue to the Housing Trust Fund. The recommended fee schedule would generate almost \$6 million more than currently is collected. Implementation of this recommendation would result in nominal costs to the Housing Commission and the City Attorney to prepare an ordinance amending the Municipal Code sections concerning Housing Impact Fees on Commercial Development.

Affordable Housing Impact: Any additional revenues would be deposited into the Housing Trust Fund and would be used to produce new affordable housing opportunities for targeted households. The recommended action would focus assistance on low income people.



BACKGROUND

In December 2002, the San Diego City Manager initiated an Affordable Housing Task Force made up of 20 experts from a wide variety of fields. The Task Force was charged with looking at San Diego's affordable housing crisis in a comprehensive manner and making recommendations for specific actions that the City Council could take to address the City's housing issues. Among its recommendations, published in June 2003, is a proposed combining of the Housing Impact Fee on Commercial Development to restore it to its original level. On October 1, 2003, the City Council's Land Use and Housing Committee considered the recommendation and directed staff to prepare an update to the 1989 Housing Impact Fee Nexus Study in anticipation of considering an adjustment to the fee.

In response to the Land Use and Housing Committee direction, the San Diego Housing Commission retained the consulting services of Keyser Marston Associates, Inc. (KMA) to perform an update to the Nexus Study. The Consultant has completed a comprehensive update to the Nexus Analysis, which is included as Attachment 1.

This report will provide background on the City's Housing Impact Fee, review the process for updating the Nexus Study and discuss various policy issues to consider in the Commission's deliberations.

DISCUSSION

Housing Impact Fees, otherwise known as linkage fees, are a means to mitigate the increased need for more affordable housing due to employment growth. The relationship between non-residential construction and the need for housing is widely accepted. Non-residential development typically results in new jobs. The additional jobs create a need for additional employee housing with the highest need being for housing that is affordable to lower income groups. Housing Impact Fees are assessed on non-residential development to mitigate for this increased need for affordable housing.

Cities throughout the United States have established Housing Impact Fees on non-residential development to mitigate for the increased need for affordable housing. The State of California, in particular, has numerous jurisdictions with commercial linkage fees. A survey of select California jurisdiction's linkage fee programs is found as Attachment 2. The survey shows that San Diego's fees are substantially lower than most comparable cities.

In California, fees on development are subject to two overlapping sets of legal requirements, constitutional requirements of nexus and "rough proportionality" under the U.S. Supreme Court cases of *Nollan v. California Coastal Commission* (1987) 483 U.S. 825 and *Dolan v. City of Tigard* (1994) 512 U.S. 374, and California's statutory requirements as embodied in AB 1600. The nexus analysis serves to establish the necessary legal relationships.

The City of San Diego's linkage fee was initially established through a nexus study performed in 1989. At that time, the fee levels were set at an amount equal to approximately 10% of the impact

on the 80% Area Median Income (AMI) level as shown by the study. In 1996, San Diego's linkage fee levels were cut in half. As a result, the current fee levels, which range from \$.27-\$1.06/SF based on development type, are substantially below the original nexus amounts.

The City of San Diego Housing Impact Fees on Commercial Development Ordinance ("Ordinance") is found at Chapter 9 Article 8 Division 6 of the City's Municipal Code. The current fee schedule is:

Type of Use	Fee Per Square Foot
Warehouse	\$0.27
Manufacturing	\$0.64
Retail	\$0.64
Hotel	\$0.64
Research and Development	\$0.80
Office	\$1.06

Linkage fees are deposited into the City of San Diego's Housing Trust Fund, which is administered by the San Diego Housing Commission ("Commission"). Annually, the City Council allocates Housing Trust Fund monies to a variety of eligible uses, including rental housing development and special needs housing. At each fiscal year end, an Annual Report is prepared to describe how the Housing Trust Fund monies were actually used.

Currently, linkage fees are the primary local source of revenue for the Housing Trust Fund. Over the years, some Transient Occupancy Tax dollars, land sale proceeds and Redevelopment Agency tax increment housing set-aside funds have been allocated to the Fund, and repayments of certain property rehabilitation loans have also contributed a small amount to the fund. Recently, the City earned a \$2 million commitment from the State to match the City's Housing Trust Fund revenues.

Housing Trust Fund monies are leveraged against outside affordable housing revenue sources, typically at a ratio of 8 dollars of outside money for each dollar from the Housing Trust Fund money. Since the linkage fee was adopted, it has produced a total of approximately \$38 million. The revenues have been leveraged to assist in the development, rehabilitation, or purchase of over 6,500 below-market rate units; and to support approximately 455 transitional housing beds annually. A summary of historical revenues is included as Attachment 3.

Update to the Housing Impact Fee Nexus Study

Although linkage fees could be adjusted based on the 1989 nexus analysis, an updated Housing Impact Fee Nexus Study provides more accurate and timely data on current market conditions. Trends in commercial development demand and the type of employment associated with commercial development have changed in the 15 years since the previous study was prepared. As a result of having an updated nexus study, decision-makers will be able to make better-informed decisions regarding potential adjustments to the Housing Impact Fees based on justifiable impacts by new employment development on the housing market .

Preparation of a nexus analysis entails a number of complicated steps, which are outlined in detail in the study (Attachment 1). However, the process can be summarized as follows. First, the nexus analysis provides estimates of the number of employees per square foot that work in identified building types. This number is also known as employment density. These estimates are based on average employment densities for typical activities. Once total employment density is established, the nexus analysis then identifies the proportion of employees that are associated with households of varying income levels by analyzing published data on the occupation of employees and their current compensation levels in San Diego. In every nonresidential building, a certain percent of the employees will be from lower income households. The percent will vary depending on the type of use. For example, office buildings have fewer workers from very low-income households than retail or hotelier operations.

The calculated density and proportion of lower income employees is ultimately translated into the amount of demand produced for affordable housing by each building type. This demand is used to calculate the housing impact fees by considering the gap that exists in the market between what households at the various income levels can afford for housing and the cost of market-rate housing.. It is evident in the new nexus study that assumptions regarding employment patterns, wage rates and housing costs have changed substantially since 1989.

As can be ascertained by the preceding description, the analysis makes a number of data assumptions in order to determine the nexus amounts. Wherever assumptions are used, the consultant has chosen conservative data, which would result in lower impacts than is probably the case. Nonetheless, even using conservative assumptions, justified fee amounts are still far above levels that would be practical for adoption.

In addition to simply updating the justifiable housing impact fee levels, the nexus study has been expanded to provide housing demand analysis for a broader range of income levels. The study updated the 1989 data associated with low and very-low income housing needs and also includes the housing needs of households in two additional income ranges: households with incomes between 80% and 120% of Area Median Income and households with incomes between 120% and 150% of Area Median Income (AMI). This expansion is a direct reflection of the increasing housing cost burden that is affecting larger segments of the City's workforce. In providing this broadened analysis, the nexus study will provide the City Council with increased discretion in using housing impact fee revenues to assist households within these broader income categories if desired.

Recommendation: That the new nexus study be used as the basis for updating the housing impact fees.

Alternative: Continue to use the 1989 Nexus Study as a basis for decision making.

Changes to Land Use/ Building Type Categories

The Nexus Analysis was prepared using a few different building types than were used in the 1989 study. As discussed above, market conditions have changed significantly since the original study was prepared. In updating the analysis, it was questionable as to whether the 1989 building definitions still appropriately reflect the market. Changes in the market have resulted in increasing

difficultly in the administration of the ordinance due to blurring distinctions between certain designated uses.

In consultation with industry representative and various City departments including Community and Economic Development, Development Services and Planning staff, Housing Commission staff worked with the Consultant to reclassify and redefine the building types. In addition, during the decade and a half since the linkage fee program was initiated a number of issues have been encountered in the administration of the housing impact fee. Many of these issues could be addressed through refinements in building type classifications.

The updated study expanded the number of building types from six to seven and shifted how some building uses would be categorized within the building types. Major changes include consideration of research and development uses as part of manufacturing, and creating separate categories for education and medical uses.

Current Land Use Categories	Proposed Land Use Categories
Office	Office
Retail	Retail
Hotel	Hotel
Manufacturing	Manufacturing
Warehouse	Warehouse
Research and Development	
	Medical
	Education

The Table above shows the proposed seven land use categories as: office, retail/entertainment, hotel, manufacturing, warehouse/storage, medical and educational. The 1989 nexus analysis was developed using six use categories: office, hotel, research and development, retail, manufacturing and warehouse.

The various City departmental representatives met with the consultant to consider new land use/building type categories and resolve issues identified with the current classifications. Reclassifying the building types was undertaken to achieve a number of goals, including:

- Increased fairness, due to solid basis of classification assignment;
- Increased ease of administration;
- Better guidance to the administrators by reducing the need for independent judgments where additional criteria would be helpful;
- Better internal consistency with other areas of the Municipal Code; and
- Closer compatibility of the housing fees and other fees, particularly traffic for which employment density is also key (as opposed to trip generation due to customers, etc.);
- Better classification of entire building rather than components of buildings.

In addition to development of new land use categories to achieve the above-referenced objectives, staff also recommends revising the methodology to calculating the square footage assessed to a particular building type. Currently if a 100,000 square foot building plan is submitted to the City with a proposal of 75,000 square feet of the building to serve as warehouse and 25,000 square feet as office space, the current calculation and fee assessment procedures would measure the size of each use and calculate the warehouse portion at \$.27/SF and the remaining office space would be calculated at \$1.06/SF.

In an effort to simplify the calculation process and provide developers with a clear understanding of what fee their project will be charged, staff is recommending a methodology that would allow for the predominant land use's fee structure be used for the entire building as long as the predominant use is at least 75% of the building's total square footage. Therefore, in the example above, the entire building would be charged the warehouse fee rather than a proportional assessment based upon actual square foot usage.

Recommendation: Approve the new building type categories and provide that buildings be assessed for the predominant use so long as the primary use constitutes at least 75% of the proposed development.

Alternative: Retain the current categories and continue to calculate the fee based on the square footage of the various component uses.

Who to Serve

Over the past 15 years, the San Diego housing and job markets have changed quite dramatically. No longer is San Diego heavily dependent upon the aerospace and military industries which in turn relied heavily upon federal and military spending. Today San Diego's economy is more diverse as it has developed and recruited more jobs in the high-tech manufacturing and biotech research fields. Visitor industry jobs have also grown. Furthermore, wage profiles within use categories and housing prices have changed markedly since the 1989 nexus study was prepared.

Therefore, using the new KMA Nexus Study as a background, the City's policy must first identify which income level is to be the focus of a housing impact mitigation program. As stated above, the newer nexus study not only looks at the housing impact for low income families earning below 80% AMI, it also considers the 120% and 150% AMI levels, often referred to as "workforce housing." Many home buying or rental assistance programs have been developed to assist low income families. Some redevelopment resources can address housing needs up to 120% AMI. But there are few if any programs to help meet workforce housing needs.

Because the linkage fee is an impact fee, the nexus amount is derived from specific economic analysis for particular income groups (e.g., the housing impact on low income households). Then fees are collected to mitigate the documented impact and can only be used for that purpose. So if the fee is established to mitigate housing impacts for low income people, then only low income persons can benefit from the fee revenue. If the fee were to be established to mitigate housing impacts for workforce households, then revenues could be used for programs to assist this underserved group as well.

However, if more income groups than the current low income beneficiaries are to benefit from linkage fee revenues, the dollar amount of the fee would have to be large enough to provide additional assistance to more people. Otherwise it would dilute assistance for low income groups currently being served. A large fee is unrealistic. Further, there was little policy support for expanding the Housing Trust Fund to create new workforce housing programs expressed in conversations with business and community groups.

Recommendation: Continue to assess the housing impact of new commercial development on low income households and use proceeds to assist this group.

Alternative: Base the assessment of the housing impact on the workforce earning up to 150% AMI and ensure that the first \$4 million collected be dedicated to low income housing programs, with funds in excess of \$4 million to be equally divided between those earning less than 80% AMI and those earning between 80% and 150% AMI.

Mitigation Level

After deciding at which AMI level to assess the housing impacts, the next decision is how much of the impact to mitigate with the fee. Policy makers may establish fees up to the maximum justifiable amounts (100% of the nexus study impact). This is not practical for two reasons. It offers no “safe harbor” protection against potential challenges to the nexus study and it produces a fee amount so significant as to discourage new development.

Policy makers could set the fee for all building types in the same proportion, such as 20% of the impact across all uses, or may set the fee for each building type independently, weighing policy considerations and market sensitivity for each type. Attachment 4 illustrates some different mitigation levels and AMI levels, and shows the amount of revenue the City could have expected to generate for each combination, based upon the square footage of building permits issued in the City during the 2003 calendar year.

In 1989, City Council determined that generally 10 percent of the nexus amount in each category was appropriate for housing impact fees. Adjustments were made to this general fee structure so that it yielded a targeted dollar amount, anticipated to be approximately \$12 million annually. In 1996, a task force empanelled by LU&H recommended that at least \$15 million per year be generated by the linkage fee. However, in response to a business recession, City Council instead cut the fees in half. Since then, non-residential development has been at a modest pace and exemptions have increased so that annually new revenues from linkage fees averaged less than \$2 million over the last three years:

	FY02	FY03	FY04
Revenues Collected	\$2.43M	\$1.6M	\$1.44

At the same time, development costs have risen and eroded the purchasing power of the Housing Trust Fund. Today, the same amount of housing opportunities as recommended by the 1996 task force would require substantially more than their recommended \$15 million.

Recommendation: That the impact fees be established based on 15% of the housing impact on low income households (Column 4 on Attachment 4). This would generate approximately \$8.7 million. In order to ease the affect of a sudden increase in the fees, especially for retail and hotel uses, consider limiting the increase of the fee by no more than 33% per year until the full amount is reached. It is also recommended that smaller projects (e.g., 5,000 square feet) be assessed half the fee amount because they typically operate on smaller margins. Lastly, it is recommended that an annual adjustment factor be applied, based on a recognized index, and that the fee amounts be reviewed at least every ten years.

Alternative: Several alternatives are available, including:

1. Selection of another column on Attachment 4;
2. Columns could be combined; for example, retail and hotels could be assessed based on column 3 – 10% at 80% AMI – with the rest of the uses assessed pursuant to column 4 – 15% at 80% AMI;
3. The fee schedule could be retained at the current level (approximately 5% of the 1989 impact for low income); or
4. The current fee schedule could be doubled as recommended by the Affordable Housing Task Force.

Variations and Exemptions

The Ordinance provides the Housing Commission with the authority to approve a variance to applicants, which could include a modification or exemption from fee payment, in cases of hardship or “low employee density” (i.e., the proposed project adds few or no jobs). Since the fees’ inception, the Commission has approved 52 variances (none for hardship, one for alternate compliance and the remainder due to the low employment density contained in the use).

Recommendation: Continue to authorize the Housing Commission to approve variances for applicants if they meet the specified findings showing financial hardship or if the project is expected to create a low employee density.

Special Treatment of Certain Geographic Areas

Many cities with linkage fee programs allow for differential treatment in specific areas such as redevelopment areas or enterprise/empowerment zones. The rationale is that these areas are designated as needing investment and therefore, special accommodations are made to encourage new economic development. In general, blanket exemptions for geographic areas are not recommended if strong redevelopment or reinvestment activity is already occurring there.

Currently, the Municipal Code allows for an exemption for one geographic area, the Southeast/Barrio Logan Enterprise Zone which was established by City Council Resolution R-

262864. In addition, the Resolution adopting the Metro Enterprise Zone (downtown from Little Italy eastward to roughly the 94 corridor) provided that non-residential development in the zone would be exempted from payment of the fee. The South Bay Enterprise Zone has also been exempted from payment of the fee. Between 1997 and 2003 a total of 78,760,115 square feet of Office, Retail, Hotel and Manufacturing have been exempted from this fee in the three Enterprise Zones. Had these zones been charged the fee, such floor area figures would have generated approximately \$58.5M.

Each of the Enterprise Zones is up for renewal within the next two to three years. If the Council were to remove the blanket exemption for all of the enterprise zones in the renewal documents, it could instead retain the option to review any commercial development located in a redevelopment project area or an Enterprise Zone on a case-by-case basis and accord selected projects special exemptions. Council could, for example, determine whether the proposed development offers significant economic development opportunities, which would be key to area revitalization plans and would be hampered by payment of the nexus fee. Based upon certain findings, the Council would have the authority to allow alternative compliance or exempt a specific project from the fee.

Another approach might provide an exemption for commercial development types with the least housing impacts (for example, offices have less impact for low income than do retail employers, and warehouses have an even lower impact) or could single out only certain building types that are likely to create better paying jobs (i.e., office and manufacturing). The blanket exemption could be lifted in all designated enterprise areas or just in the downtown area where a tremendous amount of redevelopment is occurring.

Recommendation: When renewing the Enterprise Zone designations and in redevelopment project areas, remove the blanket exemption from linkage fees but allow for a case-by-case exemption for manufacturing or office uses that provide significant employment opportunities.

Alternative: Two alternatives could be considered:

1. Only retain the housing impact fee exemption in the South Bay Enterprise Zone where investment has not yet gained momentum.
2. Retain the housing impact fee exemption in all areas except downtown.

CONCLUSION

The Nexus Study provides updated data regarding the nexus between employment in various types of buildings and the resulting housing demand for households that meet the criteria for a number of income categories. A summary of recommendations includes:

1. That the new nexus study be used as the basis for updating the housing impact fees.
2. Approve the new building type categories and provide that buildings be assessed for the predominant use so long as the primary use constitutes at least 75% of the proposed development.
3. Continue to assess the housing impact of new commercial development on low income households (80% AMI and lower) and use proceeds to assist this group.

4. That the impact fees be established based on 15% of the housing impact on low income households (Column 4 on Attachment 4). Consider limiting the increase of the fee for Retail and Hotel by no more than 33% per year until the full amount is reached. Smaller projects (e.g., 5,000 square feet) be assessed half the fee amount. An annual adjustment factor be applied, based on a recognized index, and that the fee amounts be reviewed at least every ten years.
5. Continue to authorize the Housing Commission to approve variances for applicants if they meet the specified findings showing financial hardship or if the project is expected to create a low employee density.
6. When renewing the Enterprise Zone designations and in redevelopment project areas, allow for a case-by-case exemption for manufacturing or office uses that provide significant employment opportunities.

Amendments to the Municipal Code will be drafted for future consideration to reflect any changes to the current housing impact fee structure that the policy makers may direct. If changes are to be made to the current Housing Impact Fee schedule, a determination will be needed regarding the effective date of those changes. New fees could be implemented on the effective date of an ordinance amending the Code or on a specific future date, such as July 1, 2005.

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. Jobs Housing Impact Fee Analysis (2004 Nexus Study)
2. Survey of Jobs Housing Linkage Fee Programs
3. Historical Annual Revenue Collected from Linkage Fees
4. Revenue Projections based on Various Fee Assessment Scenarios

ATTACHMENT 1

UNAVAILABLE ELECTRONICALLY

ATTACHMENT 2

UNAVAILABLE ELECTRONICALLY

HOUSING TRUST FUND REVENUE TO DATE								
	TOT	Linkage	Redevelopment	CDBG	Fay Ave. Sale	Rehabilitation	Total	
FY 91/92	3,070,884	6,211,014	-				9,281,898	
FY 93	-	1,899,406	3,238,765				5,138,171	
FY 94	-	1,432,139	-				1,432,139	
FY95		2,241,590	3,275,000				5,516,590	
FY96		2,885,181					2,885,181	
FY97		1,859,146					1,859,146	
FY98	115,000	3,282,811		254,243	2,275,468		5,927,522	
FY99		5,397,592		239,325			5,636,917	
FY00		4,953,463		152,321			5,105,784	
FY01		3,382,211		192,000			3,574,211	
FY02		2,424,763		430,613			2,855,376	
FY03		1,645,166					1,645,166	
FY04		1,448,329					1,448,329	
FY05		329,979					329,979	
							-	
Total Revenue	3,185,884	39,392,790	6,513,765	1,268,502	2,275,468	-	52,636,409	

Attachment 4

1	2	3	4	5	6	7	8
	Existing Fee Levels	Mitigation at 10% @ 80% AMI	Mitigation at 15% @ 80% AMI	Mitigation at 20% @ 80% AMI	Mitigation at 10% @ 120% AMI	Mitigation at 7% @ 150% AMI	Mitigation at 10% @ 150% AMI
Office	\$1.06	\$1.49	\$2.24	\$2.98	\$4.57	\$3.73	\$5.33
Hotel	\$0.64	\$2.95	\$4.43	\$5.90	\$3.68	\$2.66	\$3.79
Retail	\$0.64	\$3.75	\$5.63	\$7.51	\$5.46	\$3.98	\$5.69
Manufacturing	\$0.64	\$1.18	\$1.77	\$2.37	\$2.60	\$2.05	\$2.92
Warehouse	\$0.27	\$0.35	\$0.52	\$0.69	\$0.78	\$0.60	\$0.86
R & D	\$0.80	N/A	N/A	N/A	N/A	N/A	N/A
Education	N/A	\$0.66	\$0.99	\$1.32	\$1.61	\$1.32	\$1.89
Medical	N/A	\$1.85	\$2.78	\$3.70	\$4.14	\$3.26	\$4.65
REVENUE	\$2,789,700*	\$5,786,500†	\$8,682,900†	\$11,591,400†	\$11,496,000†	\$8,922,000†	\$12,729,400†
	* This figure reflects the amount collected in the 2003 Calendar Year						
	† These amounts are based upon 2003 Calendar Year square footage figures						