



REPORT

DATE ISSUED: April 7, 2003

ITEM 102

REPORT NO.: HCR03-030
For the Agenda of April 11, 2003

SUBJECT: City of San Diego Inclusionary Housing Program

ISSUE: Should the Housing Commission recommend that the City Council adopt the documents implementing the Inclusionary Housing Program?

RECOMMEND:

Recommend that the Housing Commission make recommendation to the City Council to:

1. Consider the policy questions outlined in the report and adopt the Inclusionary Housing Ordinance (Attachment 1).
2. Approve Negative Declaration No. 42-0939 (Attachment 5).
3. Approve amendments to the Housing Trust Fund Ordinance to expand the program to include new revenues produced through the Inclusionary Housing Program (Attachment 3).
4. Recommend adoption of the Inclusionary Housing Fund Annual Plan (Attachment 4).

Fiscal Impact: Recommendation 1 would result in costs associated with the implementation and administration of the program within the Development Services Department, Facilities Finance Department, and the San Diego Housing Commission. Departmental costs vary in impact and most would be recouped through administrative and other fees. It is estimated that the program will produce approximately \$7.5 million of revenue in the first year from the collection of in-lieu fees that can be used for the production of affordable housing.

Affordable Housing Impact: By its third year of implementation, it is estimated that this program would directly and indirectly result in the creation of 450 to 550 new affordable housing units annually based on existing market conditions.



Environmental Impact: Negative Declaration No. 42-0939 has been prepared in accordance with State CEQA Guidelines. It has been determined that no significant impacts would result from the adoption of the Inclusionary Housing Ordinance.

Future Related Actions: This Ordinance and other implementing documents will be presented to the Community Planners Committee on April 22, the Planning Commission on April 24, CCDC Board Committees on April 30, and the City Council on May 6. The Program will require Coastal Commission approval to be enacted in coastal areas.

BACKGROUND

On August 6, 2002, the San Diego City Council adopted a concept for an inclusionary housing program for the City of San Diego. The City Council gave direction to staff to integrate the following elements into an Inclusionary Housing Ordinance and return to Council for its full adoption:

- 10 % of all new housing would be set aside as affordable housing at 65% Area Median Income (AMI) for rental units and at 100% AMI for for-sale units.
- Inclusionary units can be provided on the same site as the market-rate development (on-site) or on a secondary site within the same Community Planning Area (off-site).
- For-sale units targeted for households earning at or below 150% AMI would be exempt from requirements the above requirements. Units must have 2 or more bedrooms to qualify.
- A fee could be paid in lieu of providing affordable housing, at the developer's option. The fee would be charged on a "per square foot" basis on the area of the entire project. This fee would be phased in over a three year period as follows:
 - For Projects of 10 or more units
 - Year 1- \$1.00/ Square Foot
 - Year 2- \$1.75/ Square Foot
 - Year 3- \$2.50/ Square Foot
 - For Projects of less than 10 units
 - Year 1- \$.50/ Square Foot
 - Year 2- \$.875/ Square Foot
 - Year 3- \$1.25/ Square Foot
- All program requirements would apply to projects of two or more units.
- Within the Future Urbanizing Area, current regulations would remain in effect, with the modification that 20% of new housing be affordable at *an average* of 65% AMI.
- A wide range of developer incentives would be pursued. Processing timeline commitments and expediting mechanisms would be in place at the time of implementation.
- Rents would be restricted for 55 years. Individual purchasers would be allowed to resell, with financial recapture provisions.
- The program would be subject to periodic evaluation.

DISCUSSION

Since August 6, staff from the San Diego Housing Commission and Planning Department have been working closely with the City Attorney's Office, Development Services Department; Redevelopment Agency, including CCDC and SEDC; and Community and Economic Development to craft a document that fully reflects the direction given by the City Council. In addition, staff has been working to complete the necessary environmental review and documentation and prepare complementary implementing documents for the inclusionary housing program.

While clear direction was provided by the City Council on the broad framework of the program, it was necessary for staff to make numerous determinations on specific elements of the ordinance that could substantially affect the essence and effectiveness of the program. In addition to fulfilling Council direction, two other objectives served as the basis for staff decision-making in these areas: 1) to ensure that the overall goals of the inclusionary housing program as outlined in Attachment 3 were attained through the policy decisions and; 2) to ensure that the program could be efficiently and effectively implemented upon its adoption.

The following is a discussion of the most significant policy decisions that were addressed in drafting the Ordinance:

Applicability

The proposed Ordinance would apply the requirements of the program to all *development*, as defined within the Municipal Code. This broad definition includes both condo conversion and rehabilitation of existing structures in addition to new construction. Council direction was interpreted to apply solely to the provision of new housing units. As a result, condo conversion and rehabilitation have been exempted from the application of the proposed Ordinance.

Time of Applicability

Standard City policy applies new development regulations to projects that have not received a building permit or otherwise have some vesting rights. Absent alternative direction, the proposed Inclusionary Housing Program would apply to any new residential development that had not received a building permit or vesting rights at the time of Ordinance adoption.

Concern has been expressed that some projects may have special circumstances that would render them economically infeasible in the event that the inclusionary housing requirements were imposed at this time. Council adopted-elements of the program included several mechanisms for addressing these extenuating conditions. These included a structure for the phase in of the in-lieu fee over a three-year period to ensure a smooth market adjustment period.

A provision was included in the August 6 Council direction for a modification or waiver of the inclusionary requirements for projects located with Redevelopment Project Areas, as discussed further below. Similar provisions for modification and waiver of the requirements have been extended to developments throughout the City for projects that meet specified hardship findings.

Despite these mitigating factors, City Council may consider applying the regulations at some other stage of the development process, for example, to all projects for which the application for development has been deemed to be complete or may consider “grandfathering” a special class of projects.

Modifications and Waivers

As discussed above, Council direction included a provision to allow for modification or waiver of the inclusionary requirements for specific projects located within Redevelopment Project Areas. Under this provision, program requirements would apply to development within Redevelopment Project Areas; however, the Redevelopment Agency would be able to modify the citywide requirements for a project that is subject to an Agency agreement. The modification of requirements would be determined on a case-by-case basis if a development fulfills other significant goals found in the applicable adopted Redevelopment Agency Five-Year Plan. In these situations, it is anticipated that the Redevelopment Agency would have invested significant tax-increment monies in the project and the additional requirements of inclusionary housing would render the project infeasible or would require an undue amount of public subsidy. It is anticipated that the Centre City Development Corporation will request a waiver under this provision of the inclusionary housing requirements for the Entrada Apartments located in East Village for which a loan and Development and Disposition Agreement have been approved.

Construction of Units Off-Site

The August 6 Council motion specified that inclusionary housing units could be constructed on a different site from the original site as long as the affordable housing units remain within the same Community Planning Area (CPA). The proposed Ordinance includes a provision that would enable developers to go outside of the CPA under specific hardship conditions through variance procedures. There may be situations, especially in the small CPAs or in the largely developed urban areas where it is infeasible to develop within the CPA. This could be due to the lack of developable or redevelopable land within the CPA. It is recommended that approval for the modification of program requirements be considered through a Process 3 Variance with findings that the alternative site meets community and economic balance and/or transit orientation goals.

For-Sale Housing Exemption

During the public discussion leading to the adoption of the framework of the program, some concern was expressed that the units produced by this inclusionary housing program would

not sufficiently serve the segment of the market made up of moderate-income working families. Construction defect litigation has significantly hampered the market's ability to produce moderately priced for-sale housing. Last year, State legislation was passed that will begin to remedy the detrimental effects of a decade of litigation. Absent the litigation, it is believed that the market should be able to produce housing for this segment of the market. In an effort to give an incentive for the production of moderately priced for-sale housing, the City Council adopted a provision to exempt this type of housing from the inclusionary housing program. For-sale units, affordable to, and sold to, households at or below 150% AMI (approximately \$90,000 for a family of four) will be exempted from the inclusionary housing requirements. In order to be eligible for the exemption the units would be required to have at least two bedrooms and the units must be sold to households that do not own any other residential property. There are no long-term affordability restrictions on these units.

Fractional Units

In calculating the number of affordable units that a developer is required to provide, a fraction of a unit may result. In these cases, a developer may choose to pay a prorated fee in-lieu of the partial unit. While the construction of affordable units by the developer rather than payment of an in-lieu fee is determined to be a more desirable and beneficial outcome of the program requirements, the requirement that the developer round up to a higher number may be a deterrent to the construction of the units. The proposed Ordinance allows a payment of an in-lieu fee for any fraction of a unit (1/10 -9/10). However, the City Council may wish to consider only allowing a prorated in-lieu fee up to .5 of a unit and require that a developer provide an additional unit above this fraction.

Shared Equity

The City Council specified that buyers of for-sale units constructed under the Inclusionary Housing Program would be required to return a share of the equity earned in the sale of the unit at the time the unit was resold. By requiring that buyers share equity in below market rate housing, it gives the buyer an incentive to remain in the unit for a longer period of time and provides a mechanism for the City to reinvest in affordable housing over time. Currently, the San Diego Housing Commission administers two shared-equity programs for homebuyers in the City of San Diego. Based on the experience of administering these programs, the program has been structured to recapture the original price differential and provide a lower level of equity to the buyers in the early stages of ownership with a 15-year period of "buy-in" for the buyer. All revenues collected by the City through the share in equity would be deposited into the Inclusionary Housing Fund and would be used to produce new affordable housing opportunities.

Large-Scale Development

Inclusionary housing has been applied in the North City Future Urbanizing Area (NCFUA) for several years. Development in this area is characterized by a larger than average parcels of land which provides the developer a significant amount of flexibility in the type and

amount of housing produced. In considering the framework for the citywide program, the regulations in the north city area were adapted for smaller developments in more urban portions of the City covered by the proposed inclusionary program discussed herein. The percent of affordable housing is relaxed (from 20 percent affordable in the NCFUA to 10 percent citywide) and payment of a fee in lieu of providing housing is allowed in the urban version. However, some have questioned as to whether large scale developments that are not located in the NCFUA bear more resemblance to that area than to infill situations and suggested that regulations for this type of development more closely match that of the NCFUA. For this reason, Council might wish to consider some modifications to the citywide inclusionary requirements for non-FUA large-scale developments, in order to ensure that affordable housing is included in these highly flexible land development opportunities. One way to accomplish this would be to limit the payment of an in-lieu fee for projects over a designated threshold, such as 400 residential units. This approach would address the policy goal of maximizing the number of affordable units constructed and ensure that the development of larger land parcels serves residents at a range of incomes.

Inclusionary Housing Fund

Two types of revenue will be produced by the Inclusionary Housing Program; in-lieu fees and monies from the share in equity for for-sale inclusionary housing units. Currently, the City of San Diego has a tested and successful model for the collection and allocation of housing funds in place with the Housing Trust Fund (HTF). However, there is a desire to account for the use of in-lieu fee income and to meet different housing goals than is currently utilized in conjunction with the HTF. Therefore, it is recommended that a new type of fund be created called the Inclusionary Housing Fund. Monies from the Fund would be used to help meet the housing needs of very low, low, and moderate income households with the emphasis being on the production of new affordable housing units. As is the case for the HTF, the Fund would be administered by the San Diego Housing Commission and it would propose a strategy for the expenditure of the monies to the City Council annually. Specific expenditures would be subject to existing policies and authority levels. Attachment 3 proposes amendments to the Housing Trust Fund Ordinance to include this program and Attachment 4 provides a draft of the Inclusionary Housing Fund Annual Plan.

Progress Reporting

In order to ensure that the Inclusionary Housing Program remains a viable and successful means for producing affordable housing, it will be important to revisit elements of the program on a regular basis. Program components such as the level of affordability and percent of set-aside should be assessed to ensure that the program is producing the type and number of units that will be most beneficial to the City. Staff recommends that the Program be comprehensively reviewed in conjunction with the reporting in association with the Housing Element update every five years.

Comprehensive Approach

Implementation of the Inclusionary Housing Program is not intended as a sole solution to our current shortage of affordable housing stock. Rather, it is meant to be a component of a comprehensive package of programs and policies that will work to increase and maintain the affordable housing stock. For this reason, staff has been working to ensure that the program be implemented as a component of a multi-faceted, comprehensive set of policies and programs to address the housing crisis. Since August, several significant steps have been made towards developing a comprehensive strategy for affordable housing.

In November, voters passed a \$2.1B bond to fund affordable housing programs. The City is working to ensure that we receive an equitable share of these funds and to develop strategies to ensure that the funds are maximized locally.

In December, the City Manager initiated the Affordable Housing Task Force. The Task Force is charged with looking at our affordable housing crisis in a comprehensive manner and making recommendations for specific actions the City Council can take address the City's housing issues. The Task Force is made up of 20 experts from a wide variety of fields. The Task Force is expected to have its final recommendations prepared by June of this year. The Task Force has organized itself into four committees discussing the following issues:

- Committee 1 - Goals for housing production;
- Committee 2 - Development, Regulations, and Incentives;
- Committee 3 - Financing and Revenue; and
- Committee 4 - Homeowners, renters, and preservation issues.

In January, the City released the first Notice of Funding Availability from the "collaborative affordable housing finance strategy". The strategy will leverage redevelopment tax increment monies to create \$55M to finance affordable housing projects. The effort is a collaboration of the Redevelopment Agency (the City Redevelopment Division housed in the Community and Economic Development Department, Centre City Development Corporation, and Southeastern Economic Development Corporation) and the San Diego Housing Commission.

Also in January, state law expanding the use of the density bonus became effective. New provisions of this law allow for a density bonus when developers construct for-sale housing at 100% AMI. This new provision is complementary to the inclusionary policy. An update to the Municipal Code to reflect these changes in state law is in process at this time.

On a 5-1 vote, the Affordable/In-fill Housing Expedite Program was approved by the City Council's Land Use and Housing Committee. Adoption of this program allows for expedited permit processing for all projects that develop inclusionary housing units. The Program provides reduced project-processing times in the development review process for both discretionary and ministerial projects by utilizing dedicated staff, established processing timelines, and accountability in the permitting process.

CONCLUSION

Stakeholders, Council members, and staff alike have been working diligently for nearly two years to bring forward a citywide inclusionary housing program for adoption. The housing conditions that initiated the discussions regarding inclusionary housing have continued to worsen in the months since the concept for the program was passed by the City Council. The need for such a program is has become increasingly important during those months. The program will make a significant impact on the crisis that we are currently facing by contributing a continuous and consistent supply of new affordable housing.

Respectfully Submitted,

Signature on File with Original Document

Elizabeth C. Morris
Chief Executive Officer

Attachments:

1. Draft Inclusionary Housing Program Ordinance
2. Inclusionary Housing Background Information
3. Draft amendments to the Housing Trust Fund Ordinance
4. Draft Inclusionary Housing Annual Plan
5. Negative Declaration No. 42-0939*

*Distribution of this attachment is limited. A copy is available for review at the Housing Commission's office at 1625 Newton Avenue or at the office of the City Clerk located at 202 "C" Street, 2nd Floor.