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San Diego
Housing Commission

- ♦ 1625 Newton Avenue
- ♦ San Diego, California 92113-1038
- ♦ 619/231 9400
- ♦ FAX: 619/544 9193
- ♦ www.sdhc.net

REPORT

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ITEM 105

REPORT NO.: HCR03-072
For the Agenda of September 12, 2003

SUBJECT: Residential Hotel Work Plan Workshop

SUMMARY

After a presentation by staff on the Residential Hotel Work Plan proposed by the Residential Hotel Working Group, it is recommended that the Commissioners discuss the Plan and provide input to staff for preparation of a report for the Land Use and Housing Committee's September 17, 2003 meeting.

BACKGROUND

Single Room Occupancy Hotels (SRO) or Residential Hotels provide some of the City's most affordable housing inventory. Traditionally, this housing stock has served the most vulnerable and lowest income of our City's residents, including those on a fixed income such as seniors and disabled individuals. Although SROs continue to serve these populations, the City of San Diego's continued housing shortage has resulted in a shift in the demographics living in SROs. The shortage of housing meeting the needs of low-income individuals has been impacted hardest by the pent-up housing demand throughout the San Diego region. As a result, a recent survey showed a high percentage of students and working individuals living in SRO units.

The City of San Diego has had some form of SRO regulations on the books since 1977. However, it was not until 1985 that the regulations took a form similar to those that the City administers today. The ordinance has been amended several times since that date, most recently in 2000. However, the primary features of the ordinance have remained consistent. The most significant of these features are the requirements that residential hotel rooms be replaced upon conversion or demolition and a requirement to provide relocation assistance to tenants residing within the property upon its conversion, demolition, or rehabilitation.



The legal environment within which residential hotels are regulated have changed in recent years and continue to change with currently pending litigation and state legislation. Recent legal interpretations of SRO ordinances have prompted a reexamination of the existing Municipal Code provisions governing the loss of SRO rooms. As a result, a number of modifications to the Ordinance were proposed in December 2002 in the form of an Emergency Ordinance. Although the ordinance was not approved, the need to amend the City's regulations remains urgent.

In consideration of the current economic environment and worsening deficiency of low-income housing, it has become apparent that simply amending the existing SRO regulations will not be sufficient to ensure a sufficient stock of SRO rooms. For that reason, Housing Commission and City staffs recently convened a Residential Hotel Working Group to discuss the development of a comprehensive work plan to address the need for both construction and preservation of Residential Hotels. Working Group participants represent many different interests in the SRO discussion, including community representatives, for-profit and non-profit developers, advocates, social service providers, and homeless service providers. Staff from many City departments and agencies, including the Housing Commission, Centre City Development Corporation, Development Services, Planning Department, City Attorney, and the Water Department, provided support for the meetings. The Working Group is scheduled to conclude its work on September 9, 2003. This report serves as a preview to the recommendations that will be presented to the Land Use and Housing Committee on September 17, 2003.

DISCUSSION

The proposed Residential Hotel work plan proposes a three-pronged approach to providing safe, sanitary, and stable housing for populations living in SRO Hotels. The plan would include an aggressive new construction program coupled with targeted rehabilitation of existing SRO housing stock and sufficient relocation assistance for tenants displaced from SROs to ensure their successful, long-term relocation to new affordable housing. Despite differing opinions on the issues surrounding SROs, the Working Group has found consensus on most of the recommendations found in this report.

Implementing the work plan will necessitate numerous amendments to the City's Municipal Code. In order to be most effective, all elements of the work plan should be adopted concurrently. The Residential Hotel Work Plan and the proposed amendments to the Municipal Code are described further below. A summary of the recommendations is in Attachment 1.

Residential Hotel Inventory and Definition

It is recommended that the ordinance establish a clear mechanism for measuring and setting goals. In order to accomplish this, it will be necessary to establish a base inventory of existing

residential hotels so that future progress can be measured against today's inventory level. Although the City has performed a number surveys to establish an inventory in the past, these surveys contain conflicting information and are outdated. It is recommended that a new survey be performed.

One method recommended for establishing the base inventory would utilize the City of San Diego's Transient Occupancy Tax (TOT) records. The TOT ordinance, found in Chapter 3, Article 5, Division 1 of the San Diego Municipal Code, allows exemptions from the tax under two applicable circumstances: "when the Transient has exercised Occupancy or was entitled to Occupancy for one month or more;" or "when the total space rental charge...in a Hotel is twenty-five dollars (\$25.00) a day or less". These exemptions provide a direct correlation to the identification of Residential Hotels. Residential hotels typically serve low-income, non-transient persons. If commercial properties have been exempted from a substantial portion of their TOT obligation, it is likely that they are renting their rooms for purposes of long-term occupancy and/or at rates affordable to low-income persons. It is recommended that hotels that have been exempted from one-third or more of their TOT obligation be subject to further review by the Housing Commission upon their application to convert, rehabilitate, or demolish the property. In order to avoid any anomalies in this methodology, staff would recommend a further check before determining the final inventory. Property owners would be notified of their inclusion on the list. They would be given an opportunity to dispute their inclusion and provide sufficient justification for being removed from the list within a limited period of time. An example of justification may include an extended stay hotel catering to out-of-town executives that provides long-term occupancy but at rates unaffordable to low-income persons.

The base inventory established through this process is recommended to serve as a threshold for purposes of monitoring, setting goals, and to trigger some regulatory requirements. Goals should be reflected in the City's Housing Element and other policy documents. In order to ensure that the threshold reflects the growing population and need for affordable housing, a formula could be established so that the threshold gradually increases over time.

Over time the inventory is expected to increase through the construction of new Residential Hotel housing stock. The construction of new units would be closely monitored and counted to track the progress towards goals. Furthermore, in the event that the total stock of Residential Hotel Rooms falls below the threshold in any given year, further regulation of the stock could be triggered as described further below.

The definition of a Residential Hotel Room is of equal or greater importance as that of a Residential Hotel. While the established inventory of Residential Hotels will serve as a pool of properties that should receive further review, all regulation will be tied to the Residential Hotel Room. The definition of a SRO room or Residential Hotel Room should acknowledge that the stock traditionally serves as a primary residence for low-income, single-person households. As such, the length of tenancy would exceed 30-days and is often a year or longer. In addition, a SRO would offer rents affordable to a low-income person. These elements should

be reflected in the definition of a residential hotel room. Furthermore, these factors would trigger the application of any regulation.

Tenant Relocation Assistance and Replacement Housing

The issues of tenant relocation assistance and replacement housing have consistently been the most contentious elements of any discussion regarding SROs. As of the writing of this report, the Working Group has not finalized its recommendations on these issues. The Working Group is meeting again on September 9, 2003 to further discuss these issues. An oral report of their progress will be provided at the Housing Commission meeting. The following is a summary of the Working Group's discussions to date.

Any new or existing Residential Hotel that has submitted an application for conversion, demolition, or rehabilitation of the property should be referred to the Housing Commission for further review. The Housing Commission would then work with the property owner to determine the number of Residential Hotel Rooms in the property.

Relocation assistance would be required for any long-term, low-income tenant displaced by the conversion, demolition, or rehabilitation of the Residential Hotel. However, the amount of relocation assistance has not been agreed upon within the Working Group. Existing SRO Regulations require that a property owner pay a displaced tenant an amount equal to two times the average amount of monthly rent paid over the last twelve months. In recent months, it has become apparent that this amount is insufficient to ensure the successful long-term relocation of a tenant. Two alternatives have been discussed in the Working Group. The first alternative is that the amount of relocation assistance be increased to six months rent based on the same methodology as described above. A second alternative would be based on a methodology established by State Relocation law used by Redevelopment Agencies. Relocation law requires a relocation payment that is calculated based on the difference between current rent or household's ability to pay and new rent after relocation for a period of 42 months, up to a maximum of \$5250.

In addition, Relocation law requires a payment to assist with tenant moving expenses. State law sets this payment dependent upon whether the tenant has furniture or not at \$575.00 or \$375.000 respectively. The Working Group has not determined whether to recommend that moving expenses be paid.

Regardless of the level of relocation assistance required, the Working Group has recommended that relocation assistance not be required under a specific scenario. In the case of rehabilitation of a Residential Hotel, property owners could be exempted from providing relocation assistance if they are able to provide comparable size accommodations at cost that does not exceed 110% of the permanent resident's rental charged for the last month of residency preceding his or her relocation.

The requirement that property owners provide replacement housing units enables the City to ensure that the impacts to residents being displaced are minimized by providing that sufficient comparable housing is available when Residential Hotels are removed from the market. However, if the market is able to provide for sufficient new housing without regulation, replacement requirements may be unnecessary.

The City's existing SRO Regulations require a property owner either replace SROs rooms that are removed from the market or pay a fee equal to 50% of the replacement cost. (The Affordable Housing Task Force recommends doubling the fee to 100%.) The Working Group has discussed a number of variations on this requirement. Among those are two proposals from the Coalition for Affordable Housing Solutions (Coalition), a group of SRO owners, developers, and managers.

The first proposal includes a replacement requirement; however, it would only be enforced if the total number of Residential Hotel rooms dropped below the threshold described previously in this report. It is recommended that the construction of new Residential Hotels Units be closely monitored and reported to the City Council annually. Under this scenario, staff would report to the City Council annually on the level of the threshold and the total number of rooms in the inventory. If the number of rooms was reported to be below the threshold, the Council could enact the replacement provision in the ordinance. The Coalition favors this proposal over a second proposal that it introduced.

Under the second proposal, a mitigation bank system would be developed that would allow the market to exchange credits when units are constructed or removed from the market. This program would be developed based on a system found in the Multiple Species Conservation Program (MSCP) that has had proven success. Each new SRO unit built after the new ordinance is passed is credited to the developer of the unit. The developer may either use those credits to remove other SRO units from the market or sell them to another developer wishing to remove units. This mitigation bank would satisfy the replacement requirement only if the total number of SRO units stays above the threshold. Any attempt to remove SRO units when the total units have fallen below the threshold should trigger the replacement requirement.

Zoning and Development Regulations

An integral part of the Residential Hotel work plan is the construction of new housing stock to meet the needs of low-income individuals. Existing zoning and development regulations appear to deter the developments of new Residential Hotels. As a result, the Working Group spent a substantial amount of time discussing how the regulatory environment could be improved.

Although Residential Hotel development can represent a viable and less expensive housing option for the city, projects should be developed only in areas that provide appropriate amenities, such as access to transit and commercial services. Further, the location of

Residential Hotels should be weighed against impacts such as building scale, community impacts, neighborhood compatibility, and quality of life for SRO residents. Ensuring the development is located in the most appropriate location will provide the best opportunity for successful integration with minimal impacts to the surrounding neighborhoods. The Working Group agreed that the most appropriate location to meet these goals is downtown; however, some locations along major transportation corridors outside of downtown are also appropriate.

In acknowledging the differences between the planned environments of downtown and other areas, the Working Group developed separate policies for zoning and development regulations within downtown and outside of downtown. A summary of the existing and proposed land use regulations are found in Attachment 2.

The proposed regulatory changes within downtown would require the amendment of the three downtown Planned District Ordinances. In addition to the SRO, current downtown zoning allows for a similar housing type called the Living Unit. While SROs are a commercial use, a Living Unit is considered to be a residential use. As such, Living Units are allowed in any residential zone; however, they currently require a Conditional Use Permit (CUP) and are limited to three projects. To date, two projects have been constructed. The Working Group has recommended that the limit on the number of projects be removed and that the projects be subject to a Process 2 approval rather than a CUP. Furthermore, the Living Unit Regulations should be amended to incorporate changes discussed below.

Within downtown, SROs are allowed by right in commercial zones and within a limited number of residential areas as an ancillary use. The Working Group has not recommended changes to this zoning. For simplification, the Working Group has recommended that the two land-use classifications merge into one Hybrid land use that retains the features described above, including zoning rights.

Outside of downtown, SROs are currently allowed in any zone in which a hotel is allowed. This includes several commercial zones and a number of high-density residential zones. All zones are transit-oriented locations. No changes are recommended in this area.

Currently SROs are not called out as a separately regulated use within the City's zoning code; however, they have been interpreted to be a Visitor Accommodation in other sections of the Municipal Code. It is recommended that the land-use classification remain the same; however, be called out as a Separately Regulated Use. It is further recommended that it be listed as a Limited Use with a reference to Special Regulations developed in accordance with the Work Plan described in this report.

Outside of downtown, there are 15 Planned District Ordinances (PDO), which may contain conflicting underlying zones. It is recommended that these communities consider whether they would to amend their PDOs to integrate the Residential Hotel Work Plan.

The Working Group has recommended that Special Regulations be developed to specify the size and amenities of Residential Hotels and Residential Hotel Rooms. It is recommended that the size of Residential Hotel Rooms be allowed to be between 70 and 400 square feet with a requirement that the average unit size within the project be no greater than the 235 square feet. The proposed change would allow a wider range of unit sizes, but require the average unit size to be modest to encourage affordability.

The recommended regulations would define a type of housing with intentionally fewer amenities than a studio apartment to keep rents low and to allow for new housing to be constructed without public subsidies. It is recommended that flexibility be expanded to allow Residential Hotels to provide units with full or partial kitchen in all rooms. However, the flexibility would be limited as to the provision of a full bathroom (defined as having a toilet, sink, and shower/bathtub). The Working Group would like to restrict the provision of a full bath dependent on whether the units are market-rate or restricted affordable housing. The Working Group has recommended limiting the number of rooms that would be permitted to have full baths to 50% of the total rooms. However, projects with restricted affordability would be allowed full flexibility in providing full, partial, or shared baths. It is believed that this distinction will discourage the conversion of market-rate units, while giving maximum flexibility to developers of restricted affordable housing.

Incentives for Construction

In addition to the regulatory changes described above, incentives were discussed as part of the new construction program. Two development incentives have been identified as having the greatest benefits to the provision of new Residential Hotel stock; parking reductions and water and sewer fee reductions.

Developers of affordable housing often point to the fact that they are required to construct dedicated parking facilities that ultimately go largely underutilized. The cost of providing parking, especially when developing in an urban setting, can contribute a tremendous amount to the cost of construction. However, there is also a significant concern that if sufficient parking is not provided a negative impact on the surrounding communities could result.

Environmental factors may impact the parking demand of a particular project. Studies have provided data to correlate reduced parking demand and a project's proximity to mass transit, as well as reduced automobile ownership for low-income households. These issues should be considered in the discussion of parking requirements.

Within downtown, parking requirements for Single Room Occupancy Hotels are 0.2 spaces per unit, while parking for Living Units are 0.7-0.9 spaces per unit. The Working Group has recommended that parking for the Hybrid unit retain the 0.2 space per unit requirement of the SRO. In addition, they would recommend that that a deviation for further reduction be allowed with findings. Findings could include demographic characteristics (household size and income), access to public transportation, availability of alternative parking, and unit sizes.

Existing parking requirements outside of downtown are one space per room. However, reductions are allowed for very-low income housing (0.5 per room), within a transit area (0.5 per room), or for very-low income housing within a transit area (0.25 per room). Further parking reductions may be justified outside of downtown; however, there is insufficient data to rationalize reductions at this time. It is recommended that any future parking reductions for Residential Hotels be studied further prior to implementation. The Committee could direct staff to include Residential Hotels in the parking study being prepared in response to Affordable Housing Task Force recommendations if they wish to pursue further reductions.

A second incentive that was examined by the Working Group is water and sewer capacity fee reduction. Two methods for a reduction were discussed by the Group. The first was a proposal by the Coalition that recommended a 40% water and sewer fee capacity reduction based on a theory that SROs use 40% less water and need 40% less sewer capacity than traditional hotels. Based on a superficial analysis of water usage, by comparing 10 SROs and 10 hotels of similar sizes, water usage appears to be substantially less in SROs. The Committee could direct staff to perform a more comprehensive analysis of the data if they would like to pursue water and sewer fee reductions in this manner. However, a second alternative seemed more viable to the Working Group.

Existing City water and sewer capacity charge policies allow for reductions for multiple living units based on the application of a density formula. The basis for the reduction is that an increase in units per acre and smaller unit sizes will result in less water and sewer capacity needs. The Working Group has recommended that water and sewer capacity charges for Residential Hotel development be calculated using this density formula.

Affordability Restrictions and Rehabilitation

Current SRO rents are approximately \$500-\$750 per month. By Department of Housing and Urban Development (HUD) standards, these rent levels are affordable to a single-person household earning between 45% (very low-income) and 75% (low-income) of the area median income. Rents are typically more affordable in older housing stock than new housing stock. There is a concern that as older housing stock is eliminated, all Residential Hotel stock will be too expensive for lower income persons. It is anticipated that rent levels for new market-rate Residential Hotel stock will always be limited through market forces by the next tier of housing, the studio or efficiency unit. The assumption is that given the ability to pay, the majority of tenants will choose the more expensive studio unit that has a higher level of amenities. This market reaction, in turn, limits the amount that a Residential Hotel property owner can charge for rent. However, if market trends continue, rents in all housing types will continue to escalate. This would result in pushing Residential Hotel rates out of reach for low-income tenants.

One way to address these concerns is to apply inclusionary housing requirements to new Residential Hotel development. This would require all projects to provide 10% of the units at

65% of area median income and in turn ensure that at least 10% of the units remain affordable. The current rent level, as established by HUD for a one-person household, is \$684 per month.

Another factor to be considered are current rent restrictions required in Living Units projects. The downtown Living Unit regulations require that 100% of the units be restricted at rent level affordable to households at or below 80% of the area median income. The Working Group has not addressed these policies to date.

While many of the Working Group's efforts have emphasized the ability of the private market to provide Residential Hotels, the ability to provide units at levels meeting the needs of the lowest income individuals may not be possible without public subsidy. While the expanding supply of housing will benefit the overall market demand for this type of housing, it will be difficult to address the needs of individuals on fixed-incomes without significant resources for subsidy. Basic operating expenses on Residential Hotels may not allow for rent levels that address the housing needs of very-low and extremely low-income populations. While older housing stock can in part address these needs, the public sector will necessarily need to assist in ensuring that developers can bring the rent structure lower in new or rehabilitated buildings.

This issue may be exacerbated to the aging of existing housing stock. Many of these properties have existing or potential capital improvement issues that could ultimately result in their removal from the housing market. One significant example of this is city regulations dealing with properties with Unreinforced Masonry (URM) construction. These regulations will require many SRO property owners to invest significant unanticipated capital improvement dollars into their buildings to provide seismic reinforcement. The result could be that property owners are motivated to convert or are forced to delay other needed improvements to the property resulting in unsafe or unsanitary conditions for the residents.

The public sector may be required to provide subsidy to property owners to secure this housing stock and to ensure that it remains safe and sanitary for its inhabitants. Through a targeted rehabilitation program, existing stock in need of rehabilitation could be assisted in addressing minor capital improvement needs. This could be structured as financing in the form of a low or no interest loan or a grant. Dependent on the form and level of assistance, developers could be required to restrict rents in some or all units.

In considering ways to subsidize the efforts described above, the Housing Commission may wish to consider the reallocation of existing housing monies or the pursuit of new revenues. In considering the reallocation of existing resources, the benefits of Residential Hotels should be weighed against the need for other forms of affordable multi-family housing. It is believed that there are some untapped funding sources that could be accessed for the purpose of subsidizing the construction and rehabilitation of SRO units that the city is not fully accessing. It is recommended that City and Housing Commission staffs undertake a thorough investigation of revenue sources available, including public and private sources. Staff time could be dedicated to aggressively pursuing new revenues appropriate for the construction and rehabilitation of SROs and then target, in a systematic way, those resources that best align with the city's goals.

Naming the Use

A final issue of the Residential Hotel Working Group is what to name the subject housing stock. Traditionally, the stock has been called Single Room Occupancy Hotels. However, Working Group discussion has included concerns of public perception and the ability to access financing if the stock is called SROs. Other names have been considered by the Group, including Living Unit and Compact Urban Living Unit (CULU). There are also concerns that local regulations should be complementary to state laws, which define Residential Hotels as an approved building type. A compromise of "Residential Hotel" may be considered.

Respectfully submitted,

Signature on File with Original Document

Elizabeth C. Morris
Chief Executive Officer

ATTACHMENTS:

1. Summary of Working Group Recommendations
2. Matrix of Proposed Zoning and Regulatory Amendments

**Summary of Working Group
Draft Recommendations for the Residential Hotel Work Plan**

The Residential Hotel Work Plan proposes a three-pronged approach to providing safe, sanitary, and stable housing for populations living in Single Room Occupancy Hotels (SRO). The plan would include an aggressive new construction program coupled with targeted rehabilitation of existing SRO housing stock and sufficient relocation assistance for tenants displaced from SROs to ensure their successful, long-term relocation to new affordable housing.

- Establish inventory of existing SRO stock
 - Use TOT as a basis for identifying existing stock
 - Exemption of 1/3 or more TOT
 - Property owners notified and can provide justification for being removed from list
- Establish Threshold
 - Existing stock determines threshold
 - New stock adds to threshold (restricted or market)*
 - Provides a mechanism for measuring and setting goals
- Regulation
 - New or existing properties regulated upon conversion, demolition, or rehabilitation
 - Housing Replacement*
 - Below threshold, property owners required to replace housing
 - Utilize a unit bank system, replacement triggers below threshold
 - Relocation payments required for any long-term, low-income tenant displaced
 - Redevelopment law- Difference between current rent and new rent for a period of 42 months or up to \$5250; or
 - 6 months rent; and/or
 - Include moving expenses
 - Provision to exempt requirements in the case of rehabilitation
- Rehabilitation
 - Ensure safe and sanitary housing stock
 - Address minor capital improvement needs and code violations
 - Target existing stock in need of rehab
 - Loan or grant \$ in return for restricted rents
- New Construction
 - Improve regulatory environment (zoning codes)
 - Downtown Process 2 approvals in existing allowed zones
 - Citywide in existing allowed zones
 - Apply different building code requirements for market-rate vs. restricted housing
 - Aggressively target new funding to subsidize units restricted units
 - Apply inclusionary housing*
 - Incentives for construction
 - Parking
 - Reductions downtown
 - To be studied outside of downtown
 - Water and Sewer Fee
 - Application of density formula

* These issues require further policy discussion.

Residential Hotel Proposed Zoning and Regulatory Amendments

The Residential Hotel Working Group has proposed changes to land use regulations that apply to SRO units and Living Units. Their goal is to provide builders more flexibility as a way to encourage developers to add new units to the inventory. These regulations would define a type of housing with intentionally fewer amenities than a studio apartment to keep rents low and to allow for new housing to be constructed without public subsidies.

The following table summarizes the Residential Hotel Working Group's recommendations:

	Existing SRO	Existing LIVING UNIT (Downtown only)	<i>Proposed Regulatory Adjustments (Downtown)</i>	<i>Proposed Regulatory Adjustments (Outside Downtown)</i>
UNIT SIZE	70 - 220 square feet	150 - 400 sf average = 275 sf	70-400 square feet average = 235 sf	70-400 square feet average = 235 sf
PARKING	0.2 spaces/unit	0.7-0.9 spaces/unit	0.1 – 0.2 spaces/unit	0.25 – 1.0 spaces/unit
LAND USE	Commercial	Residential	Both in limited zones	Both in limited zones
LIMIT ON NUMBER OF PROJECTS	None	3 allowed in downtown. 2 approved to date.	None	None
CUP REQUIRED	No	Yes	No	No
PRIVATE KITCHEN	Permitted	Partial required (sink, refrigerator, microwave)	Permitted	Permitted
PRIVATE BATH	Permitted	Permitted. Toilet required in each unit.	Full bath permitted in up to 50% of units in market-rate unit; 100% in restricted units	Full bath permitted in up to 50% of units in market-rate unit; 100% in restricted units
INCOME RESTRICTIONS	None required	Required for all units to be affordable to 80% AMI or below	To be determined	To be determined