



Good Neighbors

San Diego
Housing Commission

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REPORT

DATE: For the Agenda of October 12, 2001 **Item 109**

REPORT NO.: HCR01-113

SUBJECT: Workshop Regarding Balanced Communities Housing Program
(Citywide)

SUMMARY

Issue: What is the Housing Commission's initial feedback regarding the proposed Balanced Communities Housing Program, described herein, which is designed to foster the creation of a permanent, on-going supply of affordable housing for lower-income households?

Recommendation: Discuss the proposed outline for a "Balanced Communities Housing Program" in anticipation of a joint hearing with the Planning Commission.

Previous Related Action: In July 2000, the City Council directed City and Housing Commission staff to draft a citywide inclusionary housing program.

Future Related Action: If authorized by the Boards of Commissioners of the Planning Commission and Housing Commission, this conceptual program will be brought before the Land Use and Housing Committee October 31, 2001. If authorized, implementing documents will be drafted for Commission and Council consideration.

BACKGROUND

In July of 2000, the San Diego City Council was asked to authorize submittal of the draft Housing Element Update to the State of California Department of Housing and Community Development for review prior to its adoption. At that time, the City Council adopted a resolution, which included direction to City and Housing Commission staff to pursue several new housing policies, including direction to draft a "flexible inclusionary housing program on a citywide basis, with incentives to build affordable units". This request came in response to recognition of the severity of the housing crisis in San Diego. Since the crisis is most severe for lower income households, the intent of an inclusionary



A state agency authorized by the City of San Diego

housing program would be to provide housing opportunities for this segment of the population within market rate developments.

Inclusionary housing programs foster the creation of a continuous and consistent supply of housing at below market prices. As a result, nationally, many local governments are looking to inclusionary housing programs as a successful means of addressing the problems created by a critical shortages of affordable housing. Inclusionary housing programs represent an extension of cities police powers to regulate land use, assuring that the limited supply of developable land provides housing opportunities for all incomes. The programs require developers to reserve a specified percentage of new residential units for affordable housing. Program elements such as the required number of units and affordability level, the allowance of offsite development or payment of in-lieu fees, developer incentives and thresholds vary greatly among the programs.

Housing Needs

Inclusionary housing programs are typically established in areas where the median cost of housing has far exceeded the affordability level for the median household. The programs typically attempt to address the housing needs of households earning less than median income, and especially low and very-low income households, as defined by the Department of Housing and Urban Development (HUD). This definition establishes categories of affordability by level of household income. Moderate-income housing is affordable to those earning 81% to 120% Area Median Income (AMI), low-income 51% to 80% AMI, very low-income 31% to 50% AMI and extremely low-income 30% AMI or lower. HUD also defines housing as “affordable” when it does not exceed 30% of family income.

According to the 1990 Census data¹, approximately 40% of all households in the City of San Diego were paying 30% or more of their income for housing and 18% were paying 50% or more for housing. Given that housing costs have continued to increase faster than incomes in the last decade, it is probable that even more households are overpaying now.

Furthermore, the proportion of households paying a larger share of their income is much higher for lower income households. In 1990, approximately 73% of all low-income renters in the City of San Diego were paying more than 30% of their income for housing and 50% of low-income homeowners were paying more than 30% of their income for housing. Again, based on recent market conditions these figures have likely worsened since 1990.

Assuming that the citywide proportion of owner and renter occupied units has remained similar to 1990 and the 1990 proportion of low-income renters and owners is still applicable, it can be estimated that approximately 93,600 low-income renters are now

¹ American Housing Survey for the San Diego Metropolitan Area in 1994

overpaying for housing and that 24,000 low-income homeowners are overpaying for housing.

An important result of this housing crisis is overcrowding. According to the 1990 Census, approximately 10% of San Diego's housing units met the Census Bureau definition of overcrowding, which is a housing unit that contains more than 1 person per room. Given that the level of new housing development has not kept up with population growth, the incidence of overcrowding has likely increased significantly since that time.

Meeting the Need

While an inclusionary housing program can become an important component in the overall strategy to address our affordable housing deficit, the Balanced Communities Housing Program could fulfill only part of the critical affordable housing needs for our City. For this reason, it is advised that the program be implemented as a component of a multi-faceted, comprehensive set of policies and programs to address the housing crisis. The Housing Element of the General Plan suggests a well-rounded set of policies. They include the following:

- Removal of current regulatory constraints to housing production
- Provisions to ensure that future housing proposals implement the density provisions of adopted community plans.
- Identification of additional funding sources for the Housing Trust Fund
- Preservation of existing affordable housing units threatened by conversion to market rate status or demolition

It is also necessary to continue the current major housing programs that are working to address the issues. These include:

- First-time homebuyer assistance;
- Acquisition and rehabilitation of existing housing units;
- Preservation of existing SRO units;
- Rehabilitation of existing affordable units;
- Construction of new affordable units;
- Rent subsidies;
- Provision of additional transitional housing and emergency shelter facilities; and
- Additional military family housing.

A significant impact on meeting the housing needs described above can be achieved by the Balanced Communities Housing Program and a continued commitment to follow through on the implementation of all of these policies and programs.

Precedent

The State Supreme Court has stated that the assistance of families with their housing needs is recognized in this state as “a legitimate governmental purpose.” This is consistent with repeated pronouncements from the state Legislature which has declared that “the development of a sufficient supply of housing to meet the needs of all Californians is a matter of statewide concern,” and that local governments have “a responsibility to use the powers vested in them to facilitate the improvement and development of housing to make adequate provision for the housing needs of all economic segments of the community”. Furthermore, recent court decisions have upheld the validity of inclusionary housing as a valuable and legitimate way of fulfilling the public goal of providing housing for all income levels.

Cities across the entire State of California are currently facing a common set of housing problems created by population increase and dwindling land supply that we have experienced over the last decades. The critical nature of the State’s housing crisis is validated by the number of California jurisdictions that are adopting policies to address the shortage of affordable housing. In the State of California, there are currently well over 100 inclusionary housing programs. Recently, the cities of Pasadena and San Jose have passed inclusionary ordinances and the City of Los Angeles is currently considering a citywide program.

On the state level, California has mandated an inclusionary housing requirement within Redevelopment Project areas. State redevelopment law set forth under the California Community Redevelopment Law (Health and Safety Code 33000) requires that at least 15% of new and rehabilitated housing units be affordable and of those 40% must be affordable to those earning 50% or less of the area median income. This is in addition to the requirement that 20% of tax increment revenues be allocated for affordable housing. Within the City of San Diego, there are 15 redevelopment project areas. The requirements for those areas are currently based on State Redevelopment law and are administered by the Centre City Development Corporation, Southeastern Economic Development Corporation and the City’s Redevelopment Agency.

At the local level, the housing crisis has impacted the entire San Diego region in a critical way. Jurisdictions within the region are addressing the problems in a number of ways, including inclusionary housing programs. Ten cities in San Diego County have adopted inclusionary housing programs, with Carlsbad and Chula Vista among the most productive.

In addition to the Redevelopment Area inclusionary housing program, the City of San Diego has another inclusionary program. In 1992, a program was established for the North City Future Urbanizing Area. The requirements of the program are detailed in the North City Future Urbanizing Area (NCFUA) Framework Plan. This document established a requirement for developers of residential projects North City Future Urbanizing Area to provide a set-aside of 20% for affordable housing at a level of 65% Area Median Income. Subsequent development agreements and maps have incorporated

provisions of affordable housing in the project approvals. New affordable housing is now being built.

DISCUSSION

City Council direction to draft a “flexible inclusionary housing program with incentives” was delegated to the City’s Housing Commission and Planning Department staffs. We were assisted by staff from Development Services, Community and Economic Development, Redevelopment, as well as, consultants and an advisory group. With their assistance, a conceptual outline of a program, named the Balanced Communities Housing Program, has been developed. If accepted by the policy-making boards, more detailed implementing ordinances and other documents would be drafted for future consideration.

Methodology

In May of 2001, an Inclusionary Housing Working Group (IHWG) was formed to advise staff on a variety of issues surrounding the design and implementation of the Balanced Communities Housing Program. The Group was comprised of 21 individuals representing diverse perspectives and interests in the housing policy area, including private and non-profit developers, financial institutions, and affordable housing advocates. In addition to the designated group members, other interested parties regularly attended and participated in the meetings. A list of the members and regular attendees is attached herein.

The IHWG met on seven separate occasions over a six-month period to discuss issues surrounding a potential inclusionary housing ordinance. Topics discussed by the group included a discussion of ordinances implemented in other jurisdictions, the components of a program that would need to be addressed in forming an ordinance, and the financial implications for developers and landowners if an ordinance were adopted in San Diego.

Keyser Marston Associates Inc. (KMA) was retained to act as a financial consultant for the program. KMA, an expert in economic analysis, was tasked with determining the financial implications of an inclusionary set-aside and further determining the financial significance of potential benefits or incentives available to add economic benefit to developments. A detailed report on KMA’s findings is contained as an attachment.

In attempting to quantify the financial impact on new residential development, the IHWG first determined six development types or prototypes that would most likely be developed in the City over the next twenty years. In making recommendations, a variety of factors were considered, including current and future land supply, constraints on new construction, current and future zoning, including allowable densities, and demand from the market. The prototypes take into account the great geographic and economic distinctions found throughout the City and strive to represent average models of new development within the prototypes. Once the prototypes were established, KMA performed in-depth analysis on the cost associated with developing each prototype. This

included a thorough pro forma for each prototype, including land cost, construction cost, applicable permits and fees, financing costs and developer/builder returns.

The base case pro formas were then tested against a variety of potential program requirements. Staff and KMA evaluated nine different inclusionary requirements, which ranged from the provision of 10%-30% set-aside for affordable housing at levels between 50% and 120% of Area Median Income. The inclusionary requirements were then tested against a variety of both quantifiable and non-quantifiable incentives. The Inclusionary Housing Working Group worked closely to advise staff as to which incentives were most significant in terms providing an offset in the actual market.

Topics of Discussion

Several macro issues came out of the IHWG discussions; most of which could be summed up as a need to balance competing interests. Some of the overall issues are reviewed below.

A core discussion revolved around weighing the enormity of the housing crisis with the need to avoid saddling the private sector with onerous requirements that would further impair its ability to provide affordable housing. As such, some members disagreed fervently as to program requirements that either inflicted too much burden on the developer or did not have sufficient impact on the housing crisis.

The level of obligation placed upon the developer was the focus of several themes of discussion among the IHWG. A wide variety of opinions were presented regarding this subject. One area of contention was the degree to which the proposed incentives package should be expected to negate any financial impacts that the “Balanced Housing Communities Program” would impose. Some members expressed that the City should share or absorb the cost burden entirely; others felt the provided a reasonable accommodation in exchange for development rights.

Assessing actual impact on developers is complex because many factors particular to the development could mitigate cost. Some found the incentives to be of significant value, while others did not think that they went far enough. Some IHWG participants were concerned that not all incentives could be fully implemented on adoption of the program and, in particular, questioned the City’s ability to act as a financial partner in all cases. Some participants questioned the potential impacts of some incentives on communities. Others urged simultaneous implementation of incentives where possible and asked for a commitment to vigorously pursue additional ones or even seek legislative remedies to enable additional incentives.

Program flexibility was another topic of much discussion. Some advocated for a program which would offer alternative means of compliance such as the ability to pay an in lieu fee and provide affordable housing offsite, as well as, providing the flexibility to provide a range of housing types and affordability levels. On the other hand, some contended that

the provision of housing, rather than collecting in lieu fee revenue, was paramount as a policy that benefits the public most.

The IHWG concurred that the City of San Diego is comprised of a mix of extremely diverse communities that have unique economic and social needs and desires. Therefore, many discussions were centered on the desire to balance the needs and interests of all communities. At the same time, the group acknowledged that a program designed to meet all parties needs would conflict with the goal of designing a program that would be easily implemented and understood.

In designing the proposed “Balanced Communities Housing Program” for San Diego, a complex web of program components had to be considered. Through the ongoing discussions between the IHWG and staff, it became apparent that an inclusionary ordinance could be designed in an unlimited number of ways. In order to address many of the above concerns, it was established that the design of the program would need to allow maximum flexibility to address the critical housing need, as well as, the diverse concerns of developers and the communities.

Program Goals

Early in its deliberations, the IHWG established a set of goals for the program that endeavored to address the unique need of the San Diego market. The goals for the program are:

- To balance housing needs with economic realities, acknowledging the difference between master planned communities and infill development;
- To provide a choice of affordable housing types and enhance homeownership opportunities;
- To further geographic and community balance through providing a range of housing opportunities throughout the city by specifically promoting further balance between jobs and housing;
- To be flexible, taking into account different housing types, development conditions and incentives; and
- To be easily understood, implemented and monitored.

The following is the proposed “Balanced Communities Housing Program”. A summary of the program is contained herein as Attachment 1.

Proposed “Balanced Communities Housing Program”

The foundation for the proposed “Balanced Communities Housing Program” requirements is the established inclusionary housing program in the Future Urbanizing Area (FUA), which requires that residential development provide 20% of the units at 65% AMI. The program proposes to make a distinction between three types of development: large-scale development, urban development and development within

redevelopment project areas. The rationale for these distinctions is outlined throughout the text below. We have used the FUA level of inclusionary requirements as a starting point from which to make the distinctions between the areas of development.

Large-Scale Development

The first tier of the proposed “Balanced Communities Housing Program” applies to large-scale development, which would include any development in the Future Urbanizing Area and other large developments located elsewhere in the City that contain 400 or more housing units, including any master-planned development. This type of development typically occurs on a larger than average parcel of land which provides the developer a significant amount of flexibility in the type and amount of housing produced. In the interest of creating balanced communities, it is proposed that the affordable housing component in large-scale development be revised to allow a developer to provide a total of 20% of the project’s units at an *average* of 65% AMI. This modification to the program would allow developers to provide units at affordability levels above and below 65% AMI provided that the average of 65% AMI is met. Therefore, it could encourage the development of a more diverse mix of affordability levels among the housing that is constructed and will result in improved balance in our communities.

The program proposes to retain the stipulation that all affordable units located in large-scale developments remain at the restricted level for a period of 55 years. This is the term of affordability under the established inclusionary program in the FUA, as well as, the minimum restriction term required to qualify for many State-level financing programs.

Currently the FUA allows a developer of 10 or fewer units or developments located in estate or very low-density zones to pay a fee in-lieu of constructing units. It is proposed that this policy goal should be mirrored in the “Balanced Communities Housing Program” for FUA development. By limiting the availability of the in-lieu fee option, the approach addresses an important policy goal of maximizing the number of affordable units constructed.

Urban Development

The proposed “Balanced Communities Housing Program” for the second tier would apply to development occurring outside of large-scale development. Due to a dwindling land supply, it is believed that much of the development over the next 20 years will occur in the denser urban areas. In acknowledging the difference between large-scale development and urban development, the reduced flexibility and increased constraints on development that occur in the urban area must be considered. Furthermore, the development of housing is encouraged within the urban area as a component of an overall strategy for future growth. For these reasons, the draft program proposes to reduce program requirements as an incentive for developers meeting this program goal.

Due to the nature of small developments, the program proposes to *exempt* developments of 1 - 4 units from inclusionary requirements. Alternatively, a nominal fee could be charged for these projects in lieu of providing any affordable housing, which would be used to further contribute to a fund to create additional affordable units.

Within the urban area, any developer may pay *a fee in lieu of providing affordable units*. This fee would be a dollar amount based on the gap analysis of providing the overall program requirements of 20% of units at 65% AMI. It is recognized that smaller developments typically must contend with a greater level of external constraints to development and would therefore face a more significant hardship in providing affordable units. As a result, projects of 5 - 25 units could request a 25% discount on the above in-lieu fee. Furthermore, current City policy goals seek to maximize the use of developable land. As such, developments of 5-25 units, which come within 10% of the maximum allowable density, could request a 50% discount of the in-lieu fee.

The proposed *term of restricted affordability* for rental units within the urban area would remain at a 55-year period. However, it is proposed that for-sale units be restricted for only one ownership cycle. These units would be subject to deed restrictions that would require the first buyer to contribute a share of any increased equity in the property back to an affordable housing fund.

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. Therefore, requirements would be reduced to give additional incentive to developers that build the required affordable units rather than paying a fee.

Developers may choose to provide the affordable *units off-site* within the same community planning area as the market rate units. It is proposed that developers providing inclusionary units offsite may choose any one of the following categories to fulfill the “Balanced Communities Housing Program” requirements:

10% @ 50% AMI rent or for sale	15% @ 65% AMI rent or for sale	20% @ 80% AMI rent or for sale	25% @ 100% AMI rent or for sale
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The provision of affordable *units onsite* fosters the valuable social goal of balanced communities. As additional incentive for achieving the goal, it is proposed that requirements for developers providing affordable units onsite be further reduced. Developers providing inclusionary units onsite may choose any one of the following categories to fulfill the “Balanced Communities Housing Program” requirements:

6% @ 50% AMI rent or for sale	10% @65% AMI rent or for sale	15% @80% AMI rent or for sale	20% @ 100% AMI rent or for sale	30% @ 120% AMI for sale only
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The program proposes to draw a distinction between rental and for-sale units. Based on the analysis of KMA's pro formas, the production of affordable for-sale housing creates a larger gap for the developer than providing rental housing. Nonetheless, a component of creating balanced communities should be balancing affordable rental housing with affordable ownership opportunities. For this reason, the program proposes to make an allowance for onsite ownership housing that would allow development at an affordability level of up to 120% AMI. This level of affordability would not adequately address affordability concerns in rental units.

In order to provide further flexibility in the program, the *blending of affordability levels* would be allowed with prior approval of the San Diego Housing Commission. Any developer within an urban area can request blending of the affordability categories set forth above.

Redevelopment Project Areas

The third tier of the proposed "Balanced Communities Housing Program" would be applied to the City's 15 redevelopment project areas. As described above, redevelopment project areas have state-mandated inclusionary requirements. The program would propose to apply urban inclusionary requirements to all redevelopment project areas. However, the Redevelopment Agency would be able to modify the citywide requirements for projects that are subject to an Agency agreement. The modification of urban program requirements would be determined on a case-by-case basis for developments that intend to fulfill goals as described in the applicable adopted redevelopment project area plan.

Other Program Considerations

In order to assure that affordable units are fully integrated into the community and that the units are meeting the needs of the market, the program proposes to require a level of comparability for affordable units. All affordable units must have comparable exterior design and finishes as the constructed market-rate units. In addition, a proportional number of bedrooms must be provided as provided in the market rate units. These requirements would apply to the program citywide.

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. This policy would also be applied to development on a citywide basis.

It would be impossible to anticipate all impacts and implications of the proposed program. As such, it is proposed that the entire program be reevaluated after one year of implementation. This would allow for staff to consider the program's success and attainment of goals, as well as, provide an opportunity to make modifications and adjustments to the program to address any unanticipated issues.

Due to the critical deficit in today's affordable housing supply, it is proposed that the program be implemented in its entirety as quickly as possible. However, the program would lend itself to be implemented in phases or as tied to benchmarks.

Proposed Developer Incentives

The "Balanced Communities Housing Program" proposes to make available a range of incentives to developers to help offset the costs associated with providing inclusionary units. Under the guidance of the IHWG, a comprehensive list of financial and other incentives has been compiled. The incentives have been categorized as to their availability to developers based on the type of units provided.

The following incentives are proposed to be available to all developers of affordable units:

- State mandated density bonus would be available for developers providing 10% of units at 50% AMI or 20% at 60% AMI,
- Reduction of affordable unit square footage by up to 10%, and
- Modified interior finishes.

While the following incentives are available to all developers of affordable units, the availability may be limited or the allocation may be competitive. They are:

- Tax credits and tax-exempt bonds,
- Redevelopment Low-Mod housing set-aside funds (State law allows Redevelopment Set-Aside funds to be used outside of a Redevelopment Project Area if a benefit to the Project Area can be demonstrated),
- Housing Trust Fund monies, and
- Allocation of Project-Based Section 8.

A package of incentives is proposed for the exclusive use of developers constructing inclusionary *units onsite*, in order to give additional incentive for meeting this program goal. They are as follows:

- FAR Bonus - Terms of the bonus have yet to be defined.
- Water and Sewer Fee reductions - For affordable housing, water and sewer fee reductions are already authorized. The required affordability level for the fee reduction has recently been revised by Council action. In Redevelopment Areas, if units meet affordability requirements for Redevelopment Areas, the entire project is eligible for the water and sewer fee reductions. Similar provisions could be developed to make water and sewer fee reductions elsewhere in the City more significant incentive. At a minimum, the fee reductions should be made available to the range of affordable housing found in this program.

- Expedited permit processing by dedicating staff to assist affordable developments through the project review process
- Establish a timeline and accountability for project processing
- Development Impact Fee (DIF) and Facilities Benefit Assessment (FBA) fee deferrals- Fee deferrals to Certificate of Occupancy are currently authorized for DIF's and FBA's; however, the policy may need to be revised to make it more beneficial. Income level restrictions for deferrals may also need revision.

Some incentives have been suggested by the IHWG that may need additional action in order to implement. These additional Incentives are currently under consideration:

- Parking reductions/On-street parking by right. (On-street is already available discretionarily). Potential parking reductions are subject to study findings and further hearings.
- Master EIRs
- Design standards for ministerial review (through community plan updates).
- Automatic authorization of additional staff as workload and, hence, fee revenue increases.

CONCLUSION

As discussed above, the implementation of the “Balanced Communities Housing Program” is not intended as a total 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. Nonetheless, the program would have the potential to make a significant impact on the crisis that we are currently facing by contributing a continuous and consistent supply of new affordable housing. Assuming that housing production maintains the same pace as the previous three years, we may be able expect to produce on average between 700-1,000 affordable units annually. This total number of affordable units produced is also subject to changes in the distribution of units produced in large-scale verses in urban areas, the number of 1-4 unit projects that are produced, which would be exempt from the program, and the number of developers that would elect to pay a fee in lieu of providing units.

ALTERNATIVES

Alternatives for many of the program components may be apparent and in some cases suggestions for alternatives have been provided for consideration. One option to implementing the proposed “Balanced Communities Housing Program” is to decline to pursue a program. In addition, there are alternatives to the various components presented, including:

- Adopt different affordability levels
- Eliminate or reduce the ability for developers to pay an in lieu fee

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- Reduce the term of affordability restriction on projects
- Set fixed percentage for the amount of affordable set-aside
- Create one set of program requirements for the entire City
- Do not exempt projects of 1-4 units
- Add additional incentives

Submitted by,

**Signature on File
With Original Document**

Approved by,

Elizabeth C. Morris
Chief Executive Officer

S. Gail Goldberg, A.I.C.P.
Planning Director

Attachments:

- 1) Summary of Proposed Balanced Communities Housing Program
- 2) IHWG Members and Attendees
- 3) Summary of Select Jurisdictions with Inclusionary Programs
- 4) Keyer Marston Associates Report