THE CITY OF SAN DIEGO

**OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT**

**Date Issued:** September 19, 2014 **IBA Report Number:** 14-36

**Smart Growth and Land Use Docket Date:** September 24, 2014

**Item Number:** 3

# Fiscal Impact of Proposed Housing Impact Fee Exemptions & Status of Revenue Resources Report

## OVERVIEW

On September 24, 2014, the Smart Growth and Land Use Committee (SG&LU) will consider the Workforce Housing Plan that was proposed as a joint recommendation by the San Diego Housing Commission (SDHC) and the Jobs Coalition. It was first presented at the July 17, 2014 SG&LU meeting, and Committee members discussed a variety of elements that were included in the Workforce Housing Plan and corresponding proposed Memorandum of Understanding (MOU), most notably the Housing Impact Fee and other regulatory reforms. Among the proposed changes to the Housing Impact Fee were exemptions for specific commercial development categories including manufacturing, warehouse, and nonprofit hospitals. It also excludes the research and development (R&D) category from the fee *increase* that is proposed for the office, hotel and retail categories.

IBA Report 14-29 was presented at the July 17, 2014 meeting. It provided a preliminary review and summary of key components of the Workforce Housing Plan and Housing Impact Fee amendments. The report identified a number of concerns about the most recent proposal, among them:

- The proposal to return to original 1990 fees ($2.12[1]), effective January 1, 2015, is certain for only a three-year period;
- During this time revenue would increase by an estimated $1.4 million annually[2], providing 42 new housing units after three years;

[1] References the fee for the office category.
[2] This estimate was provided by the San Diego Housing Commission in July 2014

- Whether 1990 fees continue beyond this time is contingent upon the City achieving loosely defined conditions laid out by development community;
- If conditions are not met within three years, the fee would return to 1996 levels ($1.06[3]); and
- The proposal does not include annual adjustments even in the event of returning to lower 1996 levels.

Our office presented three options for revisions for Committee consideration which focused on the following components: removing the sunset provision; adding an automatic annual adjustment; clearly defining the conditions the City must meet; phasing in a 25% increase over the next four years with an automatic annual adjustment.

At the July 17th meeting, our office was directed to conduct a fiscal impact analysis of the proposed Housing Impact Fee exemptions and report back to SG&LU at the September 24, 2014 meeting. Additionally, the Committee requested our office to report back with the scope and timeline of a report intended to examine potential revenue resources that could support affordable housing in the City.

# FISCAL/POLICY DISCUSSION

### *Timing and Scope of Revenue Resources Report*

The proposed MOU includes a section that requests our office to examine potential sources of revenue that could support affordable housing in the City. At SG&LU's last meeting, the Committee requested our office to report back with the scope of that report and a timeline for when it would be issued. We have begun work on the report, and recognize that while affordable housing is an important priority, it is one of several held by the City, including making repairs and improvements to infrastructure and completing projects to comply with new storm water regulations.

To that end, our report will examine a number of major revenue sources the City could pursue for various purposes that are not limited solely to those contemplated in the MOU. We expect to release this report in October.

### *Proposed Exemptions from the Housing Impact Fee*

As part of the Workforce Housing Plan, the MOU proposes exemptions from the Housing Impact Fee for manufacturing, warehouse, and nonprofit hospitals. It also excludes research and development (R&D) projects, as defined in the Municipal Code, from the fee *increase* that is proposed for the office, hotel and retail categories. See the chart below for proposed amendments to the Housing Impact Fee per the proposed MOU.

[3] References the fee for the office category.

| Propsed Amendments to Housing Impact Fee (July 2014 Proposal) | | | |
|---|---|---|---|
| | Current Fee | Proposed Fee (Jan 2015) | Fee if Sunset Provision Enacted (Jan 2018) |
| **Office** | $1.06 | $2.12 | $1.06 |
| **Hotel** | $0.64 | $1.28 | $0.64 |
| **Retail** | $0.64 | $1.28 | $0.64 |
| **R&D** | $0.80 | $0.80 | $0.80 |
| **Manufacturing** | $0.64 | $0.00 | $0.00 |
| **Warehouse** | $0.27 | $0.00 | $0.00 |

As illustrated by the table above, the fees for office, hotel, and retail would increase by 100% to the original amount at the time of the fee's adoption (1990), effective January 1, 2015. R&D would remain constant at $0.80/square foot, and manufacturing, warehouse and nonprofit hospitals would be exempt from the fee entirely. Although there is a provision in the MOU to potentially sunset the fee increase after three years, there is no similar provision for the fee exemptions. It is the IBA's understanding that these exemptions will remain in place in the event the proposed fee increases sunset in January 2018.

It should be noted that a fee for nonprofit hospitals is not specifically shown in the table. Currently, hospital projects are considered and categorized under the office category by staff in the Development Services Department and Facilities Financing Division. Per the proposed exemptions, nonprofit hospitals would no longer be subject to the currently charged office fee.

***Rationale for Proposed Exemptions***

In IBA Report 13-49, our office discussed alternative proposals to the proposed 2013 Housing Impact Fee amendments. At that time, our office recommended consideration of exemptions from the fee for **manufacturing** and **warehouse distribution** projects, citing that exempting this type of use would support the City's economic development goal of attracting and retaining middle-income manufacturing jobs.

The City's recently adopted Economic Development Strategy (actions 2-3-3 and 2-4-2) specifically recommends and provides for amending the Municipal Code to exempt manufacturing and distribution (warehouse) from imposition of the Housing Impact Fee. The proposed exemption for manufacturing and warehouse in the July 2014 MOU is consistent with this recommendation. Over the last five fiscal years, manufacturing and warehouse projects have declined and these exemptions are unlikely to significantly diminish Housing Trust Fund collections going forward.

The proposed MOU also includes an exemption for **nonprofit hospitals** for the purpose of economic development. This is not the first time an exemption of this type has been discussed. Hospital exemptions were also considered as part of the 2011 Housing Impact Fee proposal. They were again mentioned during the November 4, 2014 City Council meeting when the

Council considered the proposed 2013 Housing Impact Fee amendments. Additionally, existing language in Municipal Code Section 98.0618 provides exemptions within Enterprise Zones[4] for "urgent care facilities" and "hospitals, intermediate care facilities, and nursing facilities". City staff indicates the enterprise zone exemption for health care facilities was originally intended to incentivize the construction of health care facilities in what were determined to be medically underserved areas at the time.

Economic Development staff has suggested to our office that hospitals are retailers of medical services, not part of the City's economic base. The Economic Development Strategy does not identify hospitals as an industry that should be accorded economic incentives. Staff also indicates that given their nonprofit status, hospitals are already exempt from property tax.

***Recent Housing Impact Fee Collections & Fiscal Impact of Proposed Exemptions***

Based on information received from the City's Facilities Financing Division, our office has analyzed Housing Impact Fee collections over a nine year period, from FY 2006 to FY 2014. The dataset provided includes all Housing Impact Fee collections coded by type of use. The following analysis refers to the table in Attachment 1, which summarizes these Housing Trust Fund collections.

According to the information provided, fees collected for manufacturing and warehouse projects averaged 8.0% of total Housing Impact Fee revenue over the nine year period. The total Housing Impact Fee average annual collection over the nine year period is about $1.64[5] million. Applying the average 8.0% collection for warehouse and manufacturing projects to the $1.64 million annual average suggests that the cost of these two exemptions is approximately $131,000 annually.

As discussed earlier, hospitals have been historically charged the office Housing Impact Fee. The dataset provided includes information that indicates if the office collection was for a hospital development. This is important for our analysis because, as discussed earlier, nonprofit hospitals were included as a proposed exemption in the MOU, but are not currently specified as a separate category. By breaking out the hospital collections from FY 2006 through FY 2014, our office estimates that approximately 9.6% of average annual collections over this nine year period are due to hospital collections. Although the information does not indicate whether or not these hospital developments are specifically nonprofits, it is the IBA's understanding that most of the larger hospitals in the San Diego region are considered to be nonprofit organizations. Considering this, the fiscal impact of exempting nonprofit hospitals is close to a 9.6% average annual decrease in Housing Impact Fee revenue, which equates to approximately $158,000 annually, on average.

Based on this analysis of collections from FY 2006 through FY 2014, our office roughly estimates that exempting these three use types (manufacturing, warehouse, and nonprofit

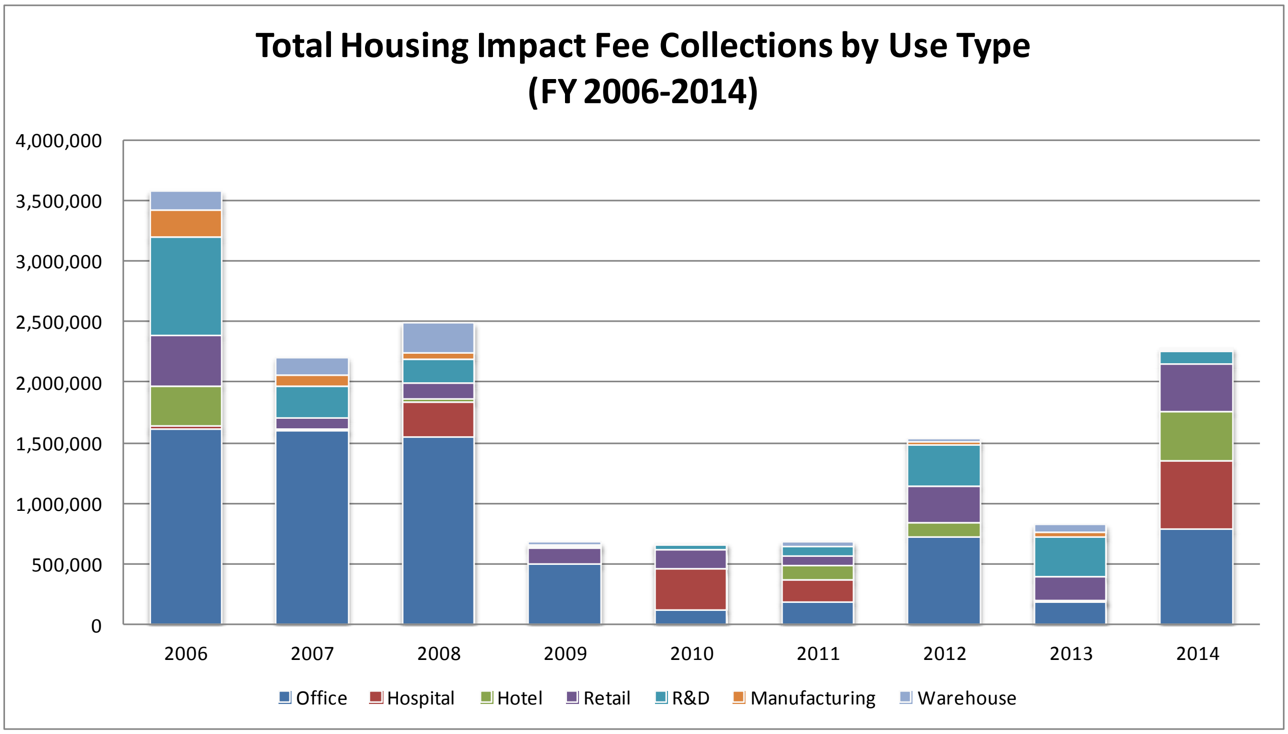
[4] Enterprise Zones were eliminated as of January 1, 2014.

[5] It should be noted that other figures have been used to describe the average annual collection of Housing Impact Fees. Our office believes $1.64 million is an appropriate figure in this case, as it refers to the same time period that was used to evaluate collections by use type which was supplied by the City's Facilities Financing Division.

hospitals) may result in a combined revenue decrease of about 17.6% of Housing Impact Fee revenue, or about $289,000 annually.

Although these figures provide some insight into how these proposed exemptions may fiscally impact Housing Impact Fee revenue, several issues should be noted when considering this analysis, as discussed below:

- Housing Impact Fee revenue fluctuated significantly over the nine year period. As can be seen in the following chart, the lack of an identifiable trend in both total collections and by use type, speaks to the unpredictability of collections. This may be explained by a variety of economic factors, including the significant economic downturn in 2008. Most notably for this specific time period, there was a significant reduction in overall collections during the fiscal years of 2009, 2010, 2011 and 2013.




- Collections from hospital developments occurred in six of the nine years, with particularly large collections in fiscal years 2008, 2010 and 2014. These outliers may skew the estimated collection rate for nonprofit hospitals.

- Recent collections from manufacturing and warehouse development may not accurately represent future trends in revenue collections. According to Economic Development staff, the fiscal impact of the proposed exemptions for manufacturing and warehouse projects to the Housing Trust Fund are expected to be minimal. Despite some demand for new manufacturing and distribution space, rising industrial land values make such new development almost infeasible except in Otay Mesa (mainly warehouses) and for special-purpose high-tech manufacturing (factories) in North City. Even in Otay Mesa, new warehouse construction will not likely occur until most of the current inventory of vacant warehouse space is absorbed. Additionally, staff estimate that developable industrial land in the remainder of the City is likely to be developed for office, retail, R&D, and hospital uses, which is consistent with relatively higher property values coupled with increased demand and relatively low vacancy for these types of uses.

Fee Increases Proposed in the MOU

The remaining non-exempt categories (office, hotel, retail and R&D) represent roughly 83% of collections from FY 2006 – FY 2014. These non-exempt categories represent a significant portion of overall revenue, and the proposed fee increases for office, hotel and retail may offset any potential decreases resulting from the exemptions. However, if specific stipulations are not met as outlined in the MOU, these fee increases may sunset. In this case, although the City may realize increased collections in the short term due to the fee increase for office, hotel and retail, it should be noted that there is no specific provision in the MOU to sunset the exemptions. If the fee increase were to sunset after three years according to conditions in the MOU, reducing the fee to 1996 levels, Housing Impact Fee reductions resulting from these exemptions would continue.

***Other Issues to Consider***

Request to Strengthen the Exemption Process

The MOU also includes language that requests Municipal Code amendments to “strengthen the exemption process for high wage employers”. This refers to an application process currently in place that commercial developers may utilize to determine whether they may be exempted from the applicable Housing Impact Fee. This is undertaken through submitting an appeal to the San Diego Housing Commission, followed by a determination also made by them. Committee members may want to discuss the intent behind this inclusion into the MOU, and for the appeal process to be better defined in order to achieve intended goals.

Nonprofit Hospital Exemption

Hospitals are currently charged housing impact fees under the office category. Although hospitals provide important services to citizens, they may not require fee incentives to promote development or rehabilitation. Over the last nine fiscal years, hospital projects (most, if not all of which, have been nonprofit) have contributed $1.42 million to the Housing Trust Fund. Given that a nonprofit hospital exemption represents approximately 9.6% of all Housing Trust Fund collections over the last nine years, the Committee may wish to consider whether this exemption should be included in this MOU or any subsequent proposal.

If the decision is made to go forward with an exemption for nonprofit hospitals, then the Committee should ask staff to work with the Office of the City Attorney to clarify the language in the MOU and Municipal Code to ensure that staff can accurately determine a hospital project’s exemption status.

# CONCLUSION

The Workforce Housing Plan was proposed as a joint recommendation by the SDHC and the Jobs Coalition to the July 17, 2014 SG&LU meeting. At this meeting, our office was requested to provide a fiscal impact analysis of the proposed Housing Impact Fee exemptions. Our office estimates the fiscal impact of exemptions for manufacturing, warehouse and nonprofit hospitals to be roughly 17.6%, or about $289,000, based on the average collections from FY 2006 – FY 2014. Though this estimate may provide some insight into how these exemptions may affect collections, we note that Housing Impact Fee revenue is difficult to predict and may be influenced by a variety of economic factors.

The Committee also requested our office provide the timing and scope of a report intended to examine potential revenue resources that could support affordable housing in the City. This revenue report is expected to be released in October and while our office recognizes that affordable housing is an important priority, it is one of several held by the City, including making repairs and improvements to infrastructure and completing projects to comply with new storm water regulations. To that end, this report will examine a number of major revenue sources the City could pursue that are not limited solely to those contemplated in the MOU.

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Attachment: 1. Total Housing Impact Fee Collections by Use Type (FY 2006- FY 2014)