



REPORT

TO: The Chair and Members of the Committee on Land Use and Housing

DATE ISSUED: November 23, 2004
For the Agenda of December 1, 2004

REPORT NO.: LUH-04-004

SUBJECT: Inclusionary Housing

SUMMARY

Issue: Should the Land Use and Housing Committee recommend policy changes to amend the 2003 Inclusionary Housing Ordinance to improve its clarity and the specificity of application?

Recommendation: That the Land Use and Housing Committee consider the information contained in this report and recommend adoption of the proposed amendments to the Inclusionary Housing Ordinance (Attachments 1) as summarized on page 9 of this Report.

Other Recommendations: The San Diego Housing Commission considered this Report on October 29, 2004. The Commission's recommendations are included in Attachment 6.

Fiscal Impact: In the event that the recommended action is approved, there will be nominal financial costs associated with the administration of future actions which would be absorbed by the Housing Commission as well as the City's Planning and Development Services Departments.

Affordable Housing Impact: The approval of this item would facilitate implementation of the Inclusionary Housing Ordinance. The Inclusionary Housing Ordinance is designed to increase the existing stock of affordable housing to families at the 65% AMI level for for-rent units and 100% AMI for for-sale units.

BACKGROUND

Inclusionary Housing

In August 2002, the San Diego City Council adopted a framework for an inclusionary housing program for the City of San Diego. Staff formed a team to craft implementation documents in consultation with various interested parties. On May 20, 2003 the City Council adopted the Inclusionary Housing Ordinance which took effect citywide on July 3, 2003. The basic requirements of the ordinance are:

- 10 % of the units in a residential development are to be set-aside at 65% AMI for rental units and at 100% AMI for for-sale units.
- At the developer's discretion, inclusionary units could be constructed on the original development site or off the site within the same community planning area as the original site.
- The obligation applies to any residential development of more than two units.
- Rents are restricted for 55 years. Individual purchasers are allowed to resell, with financial recapture provisions.
- As an alternative to constructing the affordable housing, a developer can choose to pay an in-lieu fee. The fee amount was phased in to provide time for the market to adjust to the new fee structure. Currently, the fee is \$1.75 per sq. ft. and is scheduled to rise to \$2.50 per sq. ft. in July 2005. Fees for projects of 10 or fewer units will pay half of these amounts.
- Modestly priced units affordable to families earning up to 150 percent of area median income are exempt from the inclusionary housing provisions.

In June 2003, the Affordable Housing Task Force (AHTF) issued their housing recommendations to the Land Use & Housing Committee (LU&H) of the City Council. Included in their report were specific recommendations concerning the inclusionary housing ordinance. At the September and October 2003 LU&H meetings, the Committee did take a position on many of the AHTF recommendations. Little discussion was specifically devoted to the inclusionary ordinance recommendations.

When the ordinance was adopted by the City Council it was indicated that rather than to immediately act upon the inclusionary-specific recommendations put forth by that AHTF, the ordinance should be reviewed after one year of implementation. In August 2004, a statistical summary was provided to Council during the Affordable Housing Update. In summary, it related that as of July 2004:

- All residential development projects of two or more units, including condominium conversions, are subject to the Inclusionary Housing Ordinance;
- Two hundred proposed projects are currently subject to the Inclusionary Housing Ordinance;
- Twenty-four (24) projects plan to build the affordable housing;
- One hundred seventy-six (176) projects are electing to pay In-Lieu Fees generating approximately \$3.6 million;
- Fees are assessed when a completed building permit application is submitted and collected at the time of building permit issuance; the fee amount is designed to phase in over four years;
- The amount of In-Lieu Fees collected as of June 30, 2004 was \$763,041;
- Of the \$3.6 million anticipated, approximately \$1.4 million is from the Downtown area, \$600,000 is from the Mission Valley area, \$350,000 is from Carmel Valley, and \$200,000 (each) is from the Uptown, La Jolla, and University City areas;
- As approved in the Affordable Housing Fund Annual Plan, \$890,000 of Inclusionary Housing Funds will be made available in FY2005 for a Condominium Conversion Purchase Assistance Program.

Experience with the ordinance, in conjunction with the AHTF proposals, has led to recommended changes to the original ordinance as detailed in the Discussion section below.

DISCUSSION

Inclusionary Housing

A number of the proposed amendments to the current Inclusionary Housing Ordinance are the result of suggested amendments put forth by the AHTF and center around significant policy changes where Staff is requesting direction. Other recommendations have arisen from the year-long experience with the implementation of the Ordinance itself.

AHTF Recommended Changes:

1. *Large-Scale Development* – The AHTF agreed that “large-scale developments” continue to be treated the same as any other development types under the inclusionary housing program, and should in fact be offered all three methods of compliance contained in the Inclusionary Housing Ordinance. These include: construction of the affordable units on-site, construction of the units off-site or paying the in-lieu fee.

Larger scale development projects are viewed as having more flexibility both in physical attributes and financial ability to build the required affordable units. It has been suggested that larger scale developments should be precluded from the in-lieu fee option. However, no definition currently exists which defines a “large scale” project. If larger projects are to be treated differently, then a definition should include both a number of dwelling units as well as a minimum acreage in order for a development project to qualify as “large scale”. Any further discussion should also take into account downtown high-rise condominium projects where a requirement to build affordable housing within such developments is not considered to be practical.

Staff’s recommendation reflects the Task Force’s vote: continue applying the inclusionary housing ordinance to development projects regardless of size, allowing for all developments to take advantage of the three methods of compliance.

2. Off-site Affordable Housing – The AHTF voted to modify the geographic areas for off-site construction of inclusionary housing units to allow off-site units to be constructed within a 4-mile radius of the primary project rather than only in locations within the same community planning area as the primary project as is now required. Previously, LU&H concluded that this policy may create unintended consequences if a primary project were located on the border between two community plan areas. Under this proposed methodology differing community planning areas could impact a neighboring planning area over which they have no land use recommendation jurisdiction. Additionally, the primary community planning area could unduly shift their affordable housing requirement and balanced community allotment to other planning areas. Therefore, Staff does not recommend the adoption of this proposal by the AHTF.

3. Shared Equity Provisions – The AHTF voted and LU&H previously agreed that the structure of the shared-equity for the for-sale inclusionary housing units be changed from a 15-year buy-in period to a 30-year, straight-line amortization of the share in equity. Attachment 4 illustrates the original 15-year shared equity timetable and the recommended 30-year timetable.

In addition to extending the shared equity timeframe, the Task Force voted to recommend a 3% simple interest be applied to the “price differential” between the initial purchase price and the appraised value at the time of purchase. Housing Commission General Counsel recommends against adding an interest payment to the shared equity provision in keeping with State of California prohibitions. To require an additional interest payment in addition to taking a shared interest in the equity of the property is viewed as potentially usurious. Therefore, either interest or shared equity would be appropriate and Staff recommends keeping the shared equity provision but extending it to a 30-year buy-in timeframe and not instituting an interest payment as well.

4. Threshold Project Size for Application of Ordinance – The AHTF recommended that the threshold of exempted projects be set at 4 units or less. Currently, the ordinance exemption applies to projects of 2 units or less. LU&H agreed that the threshold should be raised to 4 units, but little discussion was devoted to this proposed amendment.

Upon further analysis, it was discovered that since the inception of the Inclusionary Housing Ordinance, approximately 90 projects have been submitted that are of 4 units or less. Approximately 50 of those 90 are projects of 2 units or less. Approximately \$42,600 has been collected in in-lieu fees for those non-exempt projects with another \$98,000 still anticipated. Additionally, roughly a third of the projects consisting of two to four units are located in high cost areas in town (e.g. La Jolla, Uptown, the beachside communities area).

It should be noted that the in-lieu fee for smaller projects (fewer than 10 units) are half of the amount of the established fee for projects of 10 units or more. Staff does not find that the discounted fee is detrimental to development. Therefore, Staff recommends that the number of units exempted from the ordinance should remain at 2 units or less.

5. *Self-Certification* – The AHTF recommended that units qualifying for the exemption under the modestly priced home provision of the ordinance (units in a project that are offered to families earning 150% AMI or less) be allowed to self-certify prospective buyers. Self-certification was included in the inclusionary provisions applicable to condominium conversion projects. Staff recommends that self-certification be extended to all inclusionary housing meeting this criteria.

Staff Recommended Changes:

1. *Exemptions from the Ordinance* – Currently, the Inclusionary Housing Ordinance applies to all residential uses. One of the goals of the inclusionary housing policy is to create a balance in the neighborhoods of San Diego between multi-family and single family homes as well as a balance of affordability. Many existing residential land uses appear inappropriate for application of the ordinance, for example: requiring affordable units to be built as part of property building a guest quarters does not comport with the original intent of the ordinance.

Therefore, Staff suggests that the following residential uses be exempted:

- Border and Lodging Accommodations
- Companion Units
- Fraternity/Sorority Housing
- Student Dormitories
- Group Living Accommodations
- Guest Quarters
- Residential Care Facilities
- Transitional Housing Facilities
- Time Shares
- Developments subject to a Vesting Tentative Map deemed complete prior to June 3, 2003
- Development Agreements approved prior to June 3, 2003

2. *Moderately Priced Housing Exemption* – The adopted Inclusionary Housing Ordinance includes a provision to exempt housing units offered for-sale at prices affordable to families earning 150% AMI or less. This exemption was intended as an incentive for developers. Under

this provision, developers would agree to sell all units in the development at the 150% AMI affordability, thus assisting a segment of the population that has few programs designed to assist in the procurement of affordable housing. Additionally, the developer would agree to certify that each buyer meets all requirements under the inclusionary housing program under penalty of perjury.

When this item was discussed at Council in August of 2004, testimony was presented that, because few if any homes are being built for the 150% AMI affordability range, this exemption is an empty one. Therefore it was requested of Staff to look at other levels and what the ramifications of raising the self-certification level would mean. Looking at the 150% AMI level and the 200% AMI level generates differing results for a family of four (Attachment 5). These two income levels illustrate the range of choices available to decision makers. Other income levels in this range could be analyzed as well. The information from Attachment 5 is summarized below:

150% AMI: \$95,100/year
 Monthly Income: \$7,925

Housing Debt (as % of Income)	30%	35%	40%	45%	50%
Amt. Avail. For Housing	\$2,378	\$2,774	\$3,170	\$3,566	\$3,963
Max. Sales Price	\$320,392	\$379,400	\$438,403	\$497,233	\$566,415

200% AMI: \$126,800/year
 Monthly Income: \$10,567

Housing Debt (as % of Income)	30%	35%	40%	45%	50%
Amt. Avail. For Housing	\$3,170	\$3,698	\$4,227	\$4,755	\$5,283
Max. Sales Price	\$438,228	\$516,960	\$595,517	\$674,074	\$752,807

With the median priced home costing approximately \$500,000, there are few homes for sale within reach of a family falling in the 150% AMI level. A family of four would need to spend between 45 and 50% of their monthly income to afford the median priced home. A family of four can be served by the housing market and comfortably afford the median priced home, spending between 30 and 35% of their monthly income. Therefore, Staff recommends keeping the exemption at the 150% AMI level to create an incentive for modestly priced housing that the market might not otherwise provide.

Other Inclusionary Housing Topics:

1. *In-Lieu Fee Assessment* – In May 2004, the City Council voted 7-1 to approve a settlement agreement from the Building Industry Association (BIA) over the issue of when the in-lieu fee is assessed on a development. This acceptance obligates the Council to consider an amendment to the inclusionary ordinance to assess the in-lieu fee at the time a development application is deemed complete rather than at the time a developer applies for a building permit. The City Council retains full discretion to approve or deny this proposal. The BIA retains the option to resume its lawsuit if the amendment is defeated or a mutually agreeable compromise is not reached.

During Staff discussions on this matter it was noted that assessing the fee when the development application is deemed complete would result in many projects whereby the fee would not be collected for 3-9 years, thus resulting in a fee that would be artificially low and would not be sufficient at the time of payment to provide the affordable housing.

Housing Commission Staff has also met with representatives from the BIA and discussions have revolved around a variety of possible resolutions. Chief among the developers' concerns is the certainty of the fee they will be charged and what point in the development timeline it will be assessed. Potential alternatives include:

- a. Retain the current provisions.
- b. Re-assess the fee each time the developer extends the project's development approvals. This option would allow for the fee to be re-assessed every three years and the developer would have some certainty as to what that fee would be and when it would be assessed. However, the fee amount would still be out of date by two or three years.
- c. The fee could be assessed at the time the application is deemed complete, but require a non-refundable fee to be paid at the same time of assessment.

Staff continues to recommend the current procedure of assessing the fee at the time a developer submits their application for their building permit.

2. Members of the City Council have noted that most developers opt to pay the in-lieu fee rather than build the affordable housing, and have asked whether policy changes could alter that trend. The fee amount was phased in to allow for the market to adjust to the new fee structure and to avoid undue burden on pipeline projects. Therefore, it is to be expected that payment of the fee is chosen over building the affordable units because, at this time in the phase-in process, it is better business sense to do so.

Were the City Council to want the Inclusionary Housing Ordinance to result in more affordable housing construction it could accelerate the phase-in of the in-lieu fee, preclude payment of the fee for some types of developments (e.g. large scale developments) or provide additional

incentives for on-site development. In keeping with the reasons for phasing in the fee initially, Staff does not recommend changing the ordinance in this regard.

3. Relationship of Inclusionary Housing Ordinance to Density Bonus Programs – At the August 2, 2004 Affordable Housing Day, it was suggested that Council consider a 10% on-site building bonus to the Inclusionary Housing Ordinance. In the Fall of 2004 SB 1818 was signed into law. Preliminary discussion with City Staff and the City Attorney's office indicates that significant changes to the City's Density Bonus program are needed to comply with State Law, and it is recommended that the proposed 10% on site bldg. bonus and the manner in which the Inclusionary Housing program and Density Bonus interrelate be incorporated as discussion topics during Committee consideration in the overall Density Bonus revisions.

RECOMMENDATIONS

Amend Municipal Code Chapter 14, Article 2, Division 13 and Chapter 14, Article 3, Division 7 as follows:

1. Maintain the in-lieu fee payment option for Large-Scale Developments.
 2. Maintain off-site building to within same Community Planning Zone.
 3. Extend the shared equity provisions for for-sale affordable units from 15-years to 30-years.
 4. Maintain Inclusionary Housing Ordinance exemption for projects of 2 dwelling units or less.
 5. Extend the application of the self-certification provision for Moderately Priced Housing projects.
 6. Exempt from the Inclusionary Housing Ordinance certain above-referenced residential uses detailed in Number 1 on page 5 of this Report.
 7. Maintain the Moderately Affordable Housing exemption at 150% AMI.
 8. Maintain the time of assessment of the in-lieu fee to be at the time of building permit application.
 9. Maintain the in-lieu fee payment phase-in schedule.
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10. Direct Staff to clarify the interrelationship of the Density Bonus with Inclusionary Housing and incorporate consideration of an on-site building bonus where the developer agrees to

create the required affordable housing units on the same site as the market rate units into the Density Bonus Ordinance revisions.

Respectfully Submitted,

Signature on File

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

Signature on File

Approved: P. Lamont Ewell
City Manager

Signature on File

Elizabeth C. Morris
President and Chief Executive Officer
San Diego Housing Commission

Attachments:

1. Ordinance 1: Amendments to Inclusionary Housing Ordinance
2. Shared Equity Tables
3. AMI Level Affordability Index
4. San Diego Housing Commission Recommendations