



THE CITY OF SAN DIEGO

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## OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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**Date Issued:** July 9, 2018

**IBA Report Number:** 18-20

**City Council Date:** July 16, 2018

**Item Number:** TBD

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# Short-Term Rental Nexus Study

## BACKGROUND

On July 16, 2018, the City Council will consider taking various actions to allow for the regulation of short-term vacation rentals, also known as short-term residential occupancy (STRO). Among these actions is the approval of a Resolution establishing an Affordable Housing Impact Fee for STROs (or STRO Impact Fee) which would be levied on a per night basis on both whole home and home share STROs. While the inclusion of an STRO Impact Fee was discussed at the December 12, 2017 City Council meeting where STRO regulations were last considered, a nexus study had not yet been conducted to determine the impact fee that may legally be charged.

Since that time, staff has engaged a consultant, Keyser Marston Associates (KMA), to conduct the nexus study (STRO Nexus Study) who has quantified the affordable housing impact caused by the use of housing units for STROs. However, the methodology used by the consultant in the STRO Nexus Study has raised some questions regarding whether it appropriately addresses concerns specifically with respect to housing supply impacts.

Our Office has reviewed the STRO Nexus Study and researched to find other similar studies directly relevant to STRO Impact Fees but was unable to find any other examples. We also reviewed the methodology used for other nexus studies prepared for both the City and other municipalities and discussed the appropriateness of the STRO Nexus Study methodology with the consultant. In this report we provide additional information regarding the methodology used and highlight other considerations for the Council to contemplate in its review of the proposed STRO regulations.

# FISCAL/POLICY DISCUSSION

## **Nexus Study Methodology**

Typically, a nexus study assesses the impact of *new development* on the need for new affordable housing. Examples of this include the nexus studies which formed the basis for the City's Housing Impact Fee (also known as a Commercial Linkage Fee) and the Inclusionary Affordable Housing Fee, both of which were prepared in the past by KMA. In the case of the Inclusionary Affordable Housing Fee nexus study for example, the underlying logic is that the newly constructed residential units represent new households that will spend money on a wide variety of goods and services like landscaping, child care, restaurants, etc. It is assumed that a portion of the workers at these businesses earn lower wages, and cannot afford to buy or rent a home at market-rate and therefore need affordable housing. The study estimates the number of households that need affordable housing and determines their affordability gap (the difference between what the household can afford to buy or rent, and the cost of building a new unit). This information is then used to determine the maximum fee that may be charged to developers to help address the projected affordability gap. In addition to the City's nexus studies, our Office reviewed several other nexus studies prepared for other municipalities and found that the approach used by KMA is the commonly accepted methodology.

KMA used a similar approach when preparing the STRO Nexus Study. However, rather than assessing the impact of new development, they looked at the net additional impact from the change in use of a residential dwelling unit to STRO. To do so, KMA estimated the spending of both a typical residential unit and a STRO unit, and separately equated each to a need for additional affordable housing and affordability gap using the concept discussed above (i.e., spending generates jobs; a portion of the jobs are low paying and require the need for affordable housing.) The results were then subtracted against each other to determine the net impact caused by the unit being operated as an STRO, and then converted to a nightly STRO Impact Fee. This analysis was conducted for seven whole home prototypes in various communities (or submarkets) in the City, as well as two home share prototypes (high-market and mid-market home shares) that are intended to be representative of the STROs located throughout the City (see "Alternative Fee Option" below.)

Questions have been raised regarding whether the STRO Nexus Study should have assessed STRO impacts on the City's housing supply rather than the impact on new affordable housing demand generated from additional spending. This is a valid concern considering that all units being utilized as full time STROs are effectively reducing the City's housing supply and likely putting upward pressure on rents and housing prices. We were unable to find any other nexus studies specific to STROs that used alternate approaches. KMA and the City Attorney's Office is also unaware of any other STRO specific nexus studies. After discussing their methodology to the STRO Nexus Study with KMA, we understand that they did explore this alternative approach but were not able to generate a compelling nexus connection that would result in a legally defensible impact fee.

## **STRO Affordable Housing Impact Fee**

As discussed above, STRO Nexus Study analyzed multiple submarkets that are intended to be representative of the STROs located throughout the City, and determined the maximum supportable STRO nightly fee for

each. As shown in Table 1 below, this includes seven whole home submarkets and two home share prototypes.

Table 1 – Maximum Supportable Nightly Fees

Submarket	Max. Nightly Fee
<b>Whole Home Rentals</b>	
Downtown	\$3.96
La Jolla	\$19.37
Mission Beach	\$8.22
Mission Valley	\$5.83
North Park	\$4.09
Pacific Beach	\$9.66
Southeastern / Encanto	\$4.63
<b>Home Shares</b>	
High-Market (La Jolla)	\$4.02
Mid-Market (North Park)	\$2.73

Source: STRO Nexus Study

The impact fee charged to a STRO cannot legally exceed the maximum supportable nightly fee determined by the STRO Nexus Study for that STRO’s submarket. Given that the proposed STRO regulations contemplate a single nightly fee to be established citywide, the lowest impact fee amongst all prototypes that were evaluated for both the whole home and home shares was utilized to meet this legal requirement. This results in a citywide fee of \$2.73 per night (based on a mid-market home share) which is estimated to generate approximately \$2.1 million annually towards the existing Affordable Housing Fund. The San Diego Housing Commission estimates that this could be leveraged to produce approximately 35 additional affordable units (or 17 units per each \$1 million generated from the STRO Impact Fee) based on recent experience.

**Alternative Fee Option**

According to the Mayor’s Office, their intention in instituting a single nightly fee was to reduce the overall complexity of the proposed STRO regulations, both for City staff operationally and for STRO hosts/guests. However, per the City Attorney’s Office, different fees may legally be charged provided they do not exceed the maximum supportable fee for the applicable submarket area, as determined by the STRO Nexus Study. Should Councilmembers be interested in generating more revenue for the Affordable Housing Fund, they could consider instituting different fees for different submarkets.

In order to balance the concerns of the Mayor’s Office regarding increased operational and other complexity involved with multiple fees, we would recommend separate fees differentiated by whole home and home sharing uses. Utilizing the lowest submarket for each, as determined by the STRO Nexus Study, the STRO Impact Fees would be as follows: \$3.96 for whole home rentals (based on the Downtown submarket) and \$2.73 for home share rentals. As shown in Table 2 below, we estimate that this alternative fee structure could generate an additional \$751,000, or approximately \$2.9 million annually. This translates to approximately 48 units once leveraged by the San Diego Housing Commission, or 13 units more than the single fee option.

Table 2 – Estimated Affordable Housing Impact Fee Revenue

	Annual Nights <sup>(1)</sup>	Proposed (Single Fee)		Alternative (Separate Fees)	
		Nightly Fee	Annual Revenue	Nightly Fee	Annual Revenue
Whole Home	610,715	\$2.73	\$1,667,252	\$3.96	\$2,418,431
Home Share	162,342	\$2.73	\$443,194	\$2.73	\$443,194
<b>Total</b>	<b>773,057</b>		<b>\$2,110,446</b>		<b>\$2,861,625</b>

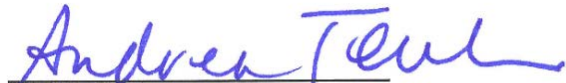
(1) Median estimate based on STRO room nights in 2017 estimated by Host Compliance to range between 687,171 and 858,944. Whole home and home share split based on December 2017 Host Compliance reports estimating that 79% of STROs are whole home and 21% are home shares.

## CONCLUSION

This report provides additional information regarding the methodology used in the STRO Nexus Study that was prepared in order to establish an STRO Impact Fee. Though there are no other STRO nexus studies that we are aware of, the methodology used is generally consistent with other nexus studies that we have reviewed, including two of the City’s own. Proceeds from the STRO Impact Fee will be directed to the Affordable Housing Fund which is administered by the San Diego Housing Commission to produce affordable housing. Under the Mayor’s proposal, the lowest STRO Impact Fee amongst all the submarkets that were evaluated in the STRO Nexus Study is proposed as a single Citywide fee. In our report, we highlight an alternative fee option involving a separate fee for whole home and home share rentals should the Council wish to generate additional STRO Impact Fee revenue to support additional affordable housing units.



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