

DATE ISSUED: May 26, 2011

REPORT NO. PC-11-050

ATTENTION: Planning Commission, Agenda of June 2, 2011

SUBJECT: PROPOSED AMENDMENTS TO INCLUSIONARY ORDINANCE
[INCLUSIONARY AFFORDABLE HOUSING REGULATIONS]

REFERENCE: San Diego Municipal Code: Chapter 14, Article 2, Division 13: The
Inclusionary Affordable Housing Regulations.
<http://docs.sandiego.gov/municode/MuniCodeChapter14/Ch14Art02Division13.pdf>

SUMMARY

Issue(s): Should the Planning Commission recommend adoption of proposed amendments to the Inclusionary Affordable Housing Regulations (Chapter 14, Article 2, Division 13 of the San Diego Municipal Code) and Inclusionary Affordable Housing Implementation and Monitoring Procedures (“Procedures Manual”) to the San Diego City Council?

Staff Recommendation: RECOMMEND the proposed amendments to the Inclusionary Affordable Housing Regulations and Procedures Manual be adopted by City Council.

Community Planning Group Recommendation: On April 26, 2011 the Community Planners Committee heard a presentation concerning the proposed amendments to the Inclusionary Affordable Housing Regulations and declined to take any action on the issue.

Other Recommendations: On April 13, 2011, the proposed amendments to the Inclusionary Affordable Housing Regulations were presented to the Code Monitoring Team, which recommended the amendments by a vote of 5-3-3. On April 27, 2011, the Land Use and Housing Committee recommended that the Housing Commission move forward with the proposed amendments by presentation to Planning Commission and City Council. The Land Use and Housing Committee further instructed the Housing Commission to hold a stakeholders meeting, which was held on May 12, 2011. The

stakeholders meeting was attended by representatives of the Building Industry Association of San Diego, the San Diego Association of Realtors and the San Diego Chamber of Commerce.

Environmental Review: This proposed transaction is not a “project” pursuant to Section 15378(b)(5) the California Environmental Quality Act (CEQA) Guidelines.

Fiscal Impact Statement: Approval of the action could provide additional income to the Affordable Housing Fund; however, Staff and General Counsel of the San Diego Housing Commission believe that the requirements and options available to applicants are not so significantly changed as to dissuade the development of affordable housing by applicants.

Code Enforcement Impact: None.

Housing Impact Statement: Overall, the proposed amendments to Inclusionary Regulations further the City’s goals for development of affordable housing throughout the City of San Diego. The amendments maintain requirements on the majority of residential developments that would assist in the development of affordable housing. Under the proposed amendments, residential development projects would be subject to an Inclusionary Affordable Housing Fee, which is based on the square footage of the proposed development. The fee is deposited into the Affordable Housing Fund and used by the San Diego Housing Commission to develop affordable units.

Applicants for residential development permits may still elect to provide at least ten percent (10%) of the units at the project as affordable housing instead of paying the fee, if they meet certain criteria set forth in the Regulations.

The amendments reduce the requirement for applicants for condominium conversions. Applicants for condominium conversions subject to the Regulations will pay a Condominium Conversion Inclusionary Affordable Housing Fee which is half of the Inclusionary Affordable Housing Fee or may elect to provide at least five percent (5%) of the units as affordable for-sale units instead of paying the fee. Certain condominium conversions will be exempt from the Inclusionary Regulations if they are to be sold to households earning at or below 80% AMI. Additionally, any units affordable to households earning at or below 150% AMI and meet certain other requirements are also exempt, as they are under the existing Regulations. Since the options available to applicants for residential development remain relatively unchanged from the existing Regulations, Staff and General Counsel to the Housing Commission believe the net impact on housing will be minimal.

BACKGROUND

The City of San Diego’s Inclusionary Affordable Housing Regulations (SDMC §142.1301 et seq.) (the “Regulations” or “Inclusionary Regulations”, herein) require the San Diego Housing

Commission to annually report to the City Council and the Housing Authority of the City of San Diego on the results of implementing the Inclusionary Regulations. (SDMC §142.1312.) Per the code, the San Diego Housing Commission's report should include information concerning the number of developments before the City for approval, the number of units and developments subject to the Inclusionary Regulations, the number of waivers, variances and exemptions applied for and received, and the number of market rate units and affordable units developed under the Inclusionary Regulations.

This section of the Report is intended to fulfill the Housing Commission's reporting requirements under the Regulations.

1. Number of Projects and Units Subject to Inclusionary Regulations: Since adoption of the Inclusionary Regulations in 2003, a total of 563 new residential developments have come before the City requesting a ministerial building permit, representing a total of 16,116 units. Of these new developments, 46 have building permits pending and 517 have received a building permit. All discretionary projects that have come to fruition have also sought ministerial building permits from the City, and are therefore tracked for purposes of the Regulations, as ministerial projects. These developments are located all over the City but most of the permits were concentrated in the Mission Beach Community Plan Area (69 permits), Pacific Beach (59 permits) and Uptown (44 permits). If the total permits were examined by number of units, Centre City (6,052 units) experienced the largest number of permits by unit followed by University (1,321 units) and Mission Valley (808 units). The largest number of permits issued for affordable units were found in Centre City (535 affordable units), City Heights (321 affordable units) and Barrio Logan (216 affordable units).

2. Waivers and Variances. Since the Inclusionary Regulations were enacted, there have been 3 variances and 1 waiver. The Morena Vista project was granted a variance to allow fewer units at a higher restricted rent, where the project was also subject to an agreement with the Redevelopment Agency. The other two variances were granted to the Costa Verde North and South condominium conversions allowing the developer to fix the rate of the in lieu fee at the current rate but defer payment until the time that the first condominium sells. One waiver has been granted during the history of the Inclusionary Regulations to the Chabad School's development of student and faculty housing.

3. Exemptions. Exemptions from the Inclusionary Regulations were granted to 159 developments including developments with an existing vesting tentative map, an existing development agreement with the City, and/or projects involving development of affordable, Navy or student housing. This number does not include exemptions for developments located in the North City Future Urbanizing Area, which are subject to different inclusionary zoning requirements in the North City Future Urbanizing Area Framework Plan.

4. In Lieu Fees. Since the adoption of the Inclusionary Regulations, the City has collected a total of \$46.1 million in inclusionary housing in lieu fees. Of this amount, \$44.9 million has been committed toward the development of 1,565 affordable units. Inclusionary housing fees collected are typically leveraged with other funding sources including funds from Housing Trust

Fund, Low/Mod Housing Funds from the Redevelopment Agency and other State and Federal resources. A total of \$1.26 million remains uncommitted for use towards future affordable housing developments.

5. Study. Additionally, Section 142.1312 of the Inclusionary Regulations requires the San Diego Housing Commission to direct a study “to determine the relationship in nature and amount between the production of market-rate residential housing and the availability and demand for affordable housing in San Diego.” To that end, the Housing Commission issued a request for proposals and contracted with Keyser Marston Associates for the completion of such a study. Keyser Marston Associates has prepared a 2011 Residential Nexus Analysis, attached, which addresses the linkages between the construction of market rate residential units and the demand for affordable housing in the City. The Residential Nexus Analysis illustrates a supported nexus between market rate residential housing and the need for affordable housing in the City of San Diego, which is addressed by the Inclusionary Regulations. The Residential Nexus Analysis determined that the in lieu fee currently at \$4.98 per square foot for projects of 10 or more units is reasonable and is significantly lower than the maximum supportable fees from the nexus perspective.

DISCUSSION:

The Costa-Hawkins Rental Housing Act was enacted in response to rent control issues and generally requires that an owner of residential property be allowed to establish the initial rents for a dwelling unit, except when certain exceptions apply. (Cal. Civil Code §1954.52.) In 2009, the California Court of Appeals applied the Costa-Hawkins Rental Housing Act to an inclusionary housing ordinance in the City of Los Angeles. (*Palmer/Sixth Street Properties L.P. v. City of Los Angeles* (“Palmer”) (2009) 175 Cal. App. 4th 1396.)

General Counsel of the San Diego Housing Commission and the City Attorney’s Office continue to agree that neither *Palmer*, nor any other case law or regulation, has invalidated the City’s Inclusionary Affordable Housing Regulations. Further, the Costa-Hawkins Rental Housing Act only applies to rental units, and, therefore, does not affect the Regulations’ requirements applicable to for-sale residential development or to condominium conversions. Importantly, the Inclusionary Affordable Housing Regulations, as applied to rental residential developments, are significantly different from the inclusionary housing ordinance at issue in the *Palmer* decision.

The in lieu fee in the Regulations is also substantially different in application and calculation from the fee at issue in *Palmer*. The fee at issue in *Palmer* was based “solely” upon the number of units to be made affordable. In San Diego, the fee is based upon the total square footage of the project, including all units. In *Palmer*, the fee was set based upon whether a unit was a low or very low income unit, each type of unit paying a set fee. In San Diego, two projects with the same number of units could pay a slightly different fee, because the square footage of the two projects is different. So the City of San Diego’s fee is not based solely upon the number of affordable units within any project.

For the foregoing reasons and others, General Counsel and the City Attorney have taken the

position that rental residential development in the City of San Diego remains subject to the Regulations and that applicants may elect to comply by either providing affordable rental units on site in compliance with applicable state law or by the payment of the fee. Each application is being reviewed, on a case by case basis, to assure compliance with the applicable law.

However, since the *Palmer* decision, the City and Housing Commission have received numerous inquiries about the application of the Inclusionary Affordable Housing Regulations to specific developments. In order to provide clarity with respect to the Regulations in light of *Palmer*, the San Diego Housing Commission, the City, General Counsel of the San Diego Housing Commission and the City Attorney are all recommending an amendment to the Regulations, at this time, to provide desired simplification and clarity. Several other California cities have amended or are in the process of amending their inclusionary programs in light of *Palmer* and the Costa-Hawkins Rental Housing Act.

SUMMARY OF REVISIONS:

Under the current Inclusionary Affordable Housing Regulations, applicants for the development of residential projects that are subject to the Regulations may elect one of three separate and distinct ways of satisfying the Regulations: (1) providing ten percent (10%) of the total dwelling units as affordable for-sale units; (2) providing ten percent (10%) of the total dwelling units as affordable rental units; or (3) paying an in lieu fee.

A. Inclusionary Affordable Housing Fee:

The proposed amendment would require all applicants subject to the Regulations to pay an “Inclusionary Affordable Housing Fee”. Under the proposed amendment, an applicant could, at its sole option, elect to provide affordable for-sale units instead of paying the fee. The rate of the Inclusionary Affordable Housing Fee would be calculated in the same manner as the in lieu fee under the existing Regulations:

- Fifty percent (50%) of the difference between the median sales price of all new construction home sales in the City for the last year to the time of adjustment and the amount of money a median-income family of the appropriate size is able to afford to purchase a unit.
- The product of the above calculation is then multiplied by ten percent (10%), the inclusionary requirement.
- The result of the above calculation shall then be divided by the average square footage of the new units constructed in the City in order to determine the level of the Inclusionary Affordable Housing Fee.

It is being proposed that the reduced fee applicable to projects of fewer than ten units be removed, as there is really no justification for this reduction. A separate Condominium Conversion Inclusionary Affordable Housing Fee would also be created, which is discussed in

more detail below.

Consistent with current practice, applicants would be required to pay the Inclusionary Affordable Housing Fee prior to receiving their initial building permit(s). Under the proposed amendment, the amount of the Inclusionary Affordable Housing Fee would be determined based on the date that the application for building permit was filed. An applicant could pre-pay the fee, however, which would freeze the fee at the rate in effect at the time of pre-payment.

The Residential Nexus Analysis prepared by Keyser Marston Associates, discussed above, determined that the current fee of \$4.98 per square foot, is substantially below the fee that could be legally charged. Depending upon the building type, the fee being charged is between 7.9% and 21.1% of the fee that could be charged in accordance with the nexus study. The fees could range from \$23.56 per foot for single family homes to \$62.84 for high density condominium projects. **There is no intention to increase the amount of the fee to the levels supported by the analysis.**

The City requires that ten percent (10%) of the units constructed be affordable, if an applicant chooses to restrict units rather than paying a fee. However, under the findings of the Residential Nexus Analysis, that percentage for newly constructed units could range from 15% to 27.4% depending upon the building type. Again, there is no recommendation to change the nexus percentages with this proposed amendment. The requirement is proposed to stay at the ten percent (10%) level for all new development. The proposed fee meets all legal nexus requirements of the recent case of *Building Industry Association of Central California v. City of Patterson* (“*Patterson*”) (2009) 171 Cal. App. 4th 886.

B. For-Sale Affordable Units.

Instead of paying the Inclusionary Affordable Housing Fee, under the amended Regulations an applicant can elect to comply with the Regulations by providing at least ten percent (10%) of the total units as affordable to and occupied by targeted ownership households, which are households earning at or below 100% of area median income. Any applicants developing condominium conversions could elect to provide at least five percent (5%) of the total units as affordable for sale units, discussed below.

The requirements applicable to for-sale affordable units in the amended Regulations would not change substantially from the requirements applicable to for-sale affordable units provided under the current Regulations. The sales price would be restricted to an amount that is affordable to households earning at or below 100% of area median income. The equity in the unit would still be shared between the owner and the Housing Commission at the time of the first sale. The amended Regulations adopt clarified definitions of “equity” and “resale” based on the documentation currently used for for-sale affordable units provided under the current Regulations. Equity would not be shared if the resale was to another qualified targeted ownership household. The Housing Commission is entitled to the first right of refusal of any for-sale affordable unit.

The Procedures Manual, as amended, would require that for any partial unit calculated, the applicant would either pay a prorated Inclusionary Affordable Housing Fee or provide an additional affordable unit, at the applicant's option. Applicants providing affordable for-sale units would be subject to all of the regulations already in effect concerning such units, including the requirement to record a declaration of covenants, conditions and restrictions against the property secured by a deed of trust in favor of the Housing Commission.

C. Affordable Rental Units.

Under the amended Regulations, any applicant desiring to construct and operate affordable rental housing would apply to the San Diego Housing Commission for an exemption from the payment of the Inclusionary Affordable Housing Fee. To qualify for the exemption, an applicant would be required to demonstrate, to the satisfaction of the San Diego Housing Commission, all of the following:

(1) That at least ten percent (10%) of the total units at the project will be affordable to and occupied by targeted rental households, which are households earning at or below 65% of area median income, for a period of not less than 55 years;

(2) That the dwelling units are not subject to any prohibitions against the restriction of rents contained within the Costa-Hawkins Rental Housing Act, as explained in the *Palmer* case, for any reason. The applicant may demonstrate an exemption from the Act, for example, by entering into an agreement with a public entity in consideration for a direct financial contribution or any other form of assistance specified in Government Code section 65915 et seq. and/or as otherwise permitted under the provisions of the Costa Hawkins Rental Housing Act; and

(3) That the applicant agrees to execute a declaration under penalty of perjury stating that the dwelling units at the project satisfy (1) and (2) above.

An applicant who seeks and is granted an exemption for rental affordable housing units would also record a declaration of covenants, conditions and restrictions against the property, which would set forth the restricted rents and occupancy requirements. The declaration would be secured by a deed of trust in favor of the San Diego Housing Commission. This requirement is not a significant change from the current Regulations, but would serve to provide clarity to applicants.

The Procedures Manual, as amended, would require that for any partial unit calculated, the applicant would either pay a prorated Inclusionary Affordable Housing Fee or provide an additional affordable unit, at the applicant's option. Affordable units provided pursuant to this exemption could be provided off site, subject to the restrictions currently applicable to off-site affordable units. The Procedures Manual would also contain other requirements that are currently applicable to affordable rental units including the method of the determination of rent, construction standards for affordable units, monitoring procedures, etc.

D. Condominium Conversions.

The proposed amendment would create a new section addressing application of Inclusionary Regulations specifically for condominium conversions. All condominium conversions would be required to pay a Condominium Conversion Inclusionary Affordable Housing Fee, which is equal to half of the Inclusionary Affordable Housing Fee. The Condominium Conversion Inclusionary Affordable Housing Fee shall be paid at the close of escrow of the first condominium sold and will be calculated using the rate in effect at that time, just as is currently the practice under the provisions of the Procedures Manual. An applicant would be able to pre-pay the Fee at the rate in effect at the time of payment. Since all condominium conversions would be required to pay the Fee, the requirement that condominium conversions of twenty or more units provide on-site affordable for-sale housing units would be removed.

Instead of paying the Condominium Conversion Inclusionary Affordable Housing Fee, a condominium conversion applicant could elect to provide at least five percent (5%) of the total units at the project as affordable to and occupied by targeted ownership households, earning at or below 100% AMI. These affordable for-sale units would be provided in the same manner as the affordable for-sale units discussed above. They would be restricted by declaration of covenants, conditions and restriction and deed of trust in favor of the San Diego Housing Commission. They would also be subject to the equity sharing provisions in the Regulations. The 5 percent inclusionary requirement for condominium conversions represents a decrease in the percentage from ten percent (10%). This is being proposed because the current Residential Nexus Analysis shows that the nexus for condominium conversions, in this greatly depressed market, is generally between five percent (5%) and eight percent (8%), resulting in a recommendation to reduce the inclusionary requirement for condominium conversions to five percent (5%).

Even at this reduced percentage, the current per square foot rate of \$4.98 is lower than the rate supported by the Residential Nexus Analysis. Even in this market, the rate could be set in the range of between \$6.57 to \$15.26 per square foot according to the Residential Nexus Analysis. With the proposed change in the Regulations, the rate for all condominium conversions will be \$2.49 per square foot, or one half of the current rate for projects having 10 units or more. This is being suggested because of the current depressed market and because inclusionary requirement is being reduced from ten percent (10%) to five percent (5%). Accordingly, under the proposed change the rate for new applications will be \$2.49 per foot for all sized condominium conversion projects, whether below or above 10 units.

A third option available to some applicants developing a condominium conversion is an exemption for condominiums that will initially be affordable to and sold to households earning at or below 80% of area median income. The market surveys conducted for the Residential Nexus Analysis indicates that because of the depressed market currently, some condominium conversions will be affordable both before and after conversion at or below 80% of AMI. For these projects, there is a recommendation that they be exempt from the regulations, if the applicants seek the exemption. Under this exemption there would be no limit on the size of the units, nor restriction that the sale be to a first time homebuyers, nor that the units be occupied by the low income purchasers. In addition, the buyers could own other property. Applicants

desiring to be exempt from the Regulations would execute a declaration under penalty of perjury stating that all the condominium units in their projects will be initially sold at or below 80% of area median income. This exemption is intended to address those condominium conversions. New applications meeting the exemption requirements would be exempt from the Regulations, including payment of the inclusionary fee. However, if the Commission were to later determine that the units were actually being sold at or above the 80% level, then the Commission would impose the Condominium Conversion Inclusionary Affordable Housing Fee. This would be determined through a requirement that the applicant report to the Commission as each of the units are sold. At such time the Commission could spot verify that the exemption is appropriate.

The 80% AMI, or low income exemption, is in addition to the 150% AMI exemption that is also included within the Regulations. The 150% exemption requires that the prospective purchaser be a first time homebuyer, occupy the unit, not own other real estate and that unit contain at least two bedrooms.

E. Pending Projects.

A new section was added to the Procedures Manual to address projects that have already been processed under the existing Inclusionary Affordable Housing Regulations and that have entered into written agreements with the San Diego Housing Commission to pay the “In Lieu Fee”, that is applicable at the time of the close of escrow for the first condominium unit within the project. Under these agreements, payment of the In Lieu Fee is required at a future date at the rate in effect on that date. This new section states that for purposes of these agreements the In Lieu Fee shall mean the Inclusionary Affordable Housing Fee in effect at the due date, not the reduced Condominium Conversion Inclusionary Affordable Housing Fee. If the project was a condominium conversion of fewer than 10 units, then the In Lieu Fee shall be half of the Inclusionary Affordable Housing Fee, as is the current law.

F. Other Changes.

Additional revisions to the Regulations and Procedures Manual are being proposed to clarify and simplify the Regulations. Further revisions were needed to effectuate the change from an in lieu fee to an Inclusionary Affordable Housing Fee. Going forward all projects would be required to pay the Inclusionary Affordable Housing Fee, unless it sought and was granted a Costa Hawkins exemption from the Commission or unless the applicant determined to provide affordable for sale housing. The waiver language in the Procedures Manual was removed since that language was previously incorporated into the Regulations.

Conclusion:

The amendments to the Inclusionary Regulations and Procedures Manual are proposed in order to simplify and clarify the Inclusionary Regulations and to address changes arising out of recent case law. There is no proposal to change the method of calculating the fee or changing the current rate, as set by the Housing Commission.

ALTERNATIVE

Not recommend adoption of the proposed amendments to the Inclusionary Affordable Housing Regulations and Procedures Manual to City Council.

Respectfully submitted,



Mike Westlake
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Charles B. Christensen
General Counsel
San Diego Housing Commission

Attachments:

1. Inclusionary Affordable Housing Regulations, Redline Version
2. Inclusionary Affordable Housing Regulations, Final Version
3. Inclusionary Affordable Housing Implementation and Monitoring Procedures, Redline Version
4. Inclusionary Affordable Housing Implementation and Monitoring Procedures, Final Version
5. Keyser Marston Associates (KMA) Nexus Study
6. KMA Addendum Condominium Conversion Nexus Analysis