



City of San Diego
Councilmember Scott Sherman
Seventh District

MEMORANDUM

DATE: November 16, 2017
TO: Planning Commissioners
FROM: Councilmember Scott Sherman
RE: Commercial Flexibility

I. Introduction

As the trend in development moves away from traditional commercial with the growth of innovative commercial alternatives¹, the City of San Diego and cities across the country are facing challenges filling this traditional commercial space.² Many parts of the City's urbanized regions, where a significant portion of the in-fill development will occur over the next decade, has a ground floor commercial requirement.

There are two issues that consistently arise with the ground floor commercial requirement: 1) inability to rent the ground floor commercial space once the project is complete and 2) commercial space requirements often pose difficulties for financing the project because the commercial space adds risk to the project that would not otherwise exist as part of a housing development. Due to the housing crisis the City of San Diego currently faces, it is important to explore alternatives to this oftentimes burdensome commercial requirement.

II. Background

In 2015 the San Diego Housing Commission published a report titled, *Addressing the Housing Affordability Crisis in San Diego and Beyond* providing one of the first blueprints to identify the costs of developing affordable housing and giving actionable recommendations to lower those

¹ Peterson, Hayley. "Warren Buffett just confirmed the death of retail as we know it." *Business Insider*. May 8, 2017

² Figueroa, Teri. "Is mixed use too urban for suburbia?" *San Diego Union Tribune*. December 31, 2016

costs.³ One of their 11 recommended action opportunities was to reduce the commercial space requirement. They note that in both market rate and affordable units, reducing commercial space requirements comes with significant financial benefits. In their analysis they addressed the savings per unit. The savings per unit ranged from a low of \$11,000 to a high of \$19,000, both for affordable and market rate developments.⁴

The report goes on to also explain the rationale of such a proposal by addressing the opportunity for action:

“Commercial space requirements often pose difficulties for developers in leasing up the space and financing the overall project because the commercial space inserts an element of risk in the project that would not otherwise exist as part of a housing development. As a result, developers often underwrite their commercial space income with high vacancies and low rental values due to a historic lack of success in leasing these spaces and monetizing them for the benefit of the project. By reducing or eliminating commercial space requirements, developers will be able to demonstrate stronger cash flows to their capital partners. In addition, an occupied, well-maintained residential space will be better for community stability and neighborhood property values than an empty commercial space.”⁵

Additionally, by utilizing the ground floor commercial space in alternative ways, whether it occupies exclusively residential or a combination of commercial and residential, the ground floor space may end up being more activated than it would have been previously. The Housing Commission report suggests that this could both boost property values in a community and provide for greater stability in certain regions.

III. Policy Provisions

After working with various stakeholders, a solution to the ground floor commercial requirement was created. This policy does not encourage widespread dissolution of mixed used development, but rather allows for it only in circumstances that make financial sense. This ordinance addresses the worst-case mixed use project scenarios in order to make the project successful both in the financing and post-development stages. A project applicant may request to substitute a portion or all of the required commercial space in lieu of a payment to the City’s Affordable Housing Trust Fund. The concept is that by giving the project a financial incentive, in the form of reducing the commercial requirement, the City would receive a benefit in return in the form of an additional revenue stream for affordable housing.

The Commercial Space Substitution would require staff level approval for oversight of exceptional cases. Furthermore, the price to buy out of a commercial requirement is 1 square foot for \$15 per square foot. This price would not incentivize every development to eliminate their commercial

³ [*Addressing the Housing Affordability Crisis in San Diego and Beyond*](#), San Diego Housing Commission and LeSar Development Consultants, 2015.

⁴ These numbers were derived from a study Keyser Marston Associates, Inc. provided to LeSar Consultants and the San Diego Housing Commission. For more details please see page 11 of the report [*Addressing the Housing Affordability Crisis in San Diego and Beyond*](#).

⁵ [*Addressing the Housing Affordability Crisis in San Diego and Beyond*](#), pg. 24

requirement, but rather would assist only those projects that need commercial flexibility to make the project viable or secure the proper funding.

This Commercial Space substitution would not change the underlying density. The project must still conform to the density requirements, where dwelling units are applicable. An outcome that may occur is an increase in dwelling units on the site that would have been previously occupied by commercial space.

IV. Conclusions

Ground floor commercial requirements serve an important role in mixed use development across many communities in the City. However, some communities are facing challenges filling and financing ground floor commercial and therefore need flexible alternatives. The proposed code changes provide for that flexibility. In an era where the City of San Diego is facing a severely high cost of living it is important to find solutions that not only reduce the cost of housing, but also increase the opportunity for projects to receive funding. In addition, projects may potentially increase the number of units on a traditionally mixed-use project site. Projects that need to utilize this commercial flexibility will provide a new stream of funding into the Affordable Housing Trust Fund will ultimately provide a new benefit to the City.