

## City of San Diego Update to Linkage Fee *September 2013*

**SDCTA Position:**                      **OPPOSE**

**Rationale for Position:**        The Housing Impact Fee (linkage fee) is an unstable source of funding for construction of affordable housing because it is based on volatile conditions relating to development activities and economic climate. If affordable housing is truly a priority of the City Council, a stable source of revenue to support affordable housing projects should be identified. The City must implement the remaining audit recommendations that have been provided in an effort to produce efficiencies. Increasing the linkage fee between 500-900 percent, as is currently proposed, could drastically harm the region's economy. SDCTA believes the proposed fee is based on the false nexus that each job created within the city increases the need for affordable housing regardless of the type of job. Alternatively, market-based approaches offer opportunities to increase housing affordability by reducing the cost to develop and limiting time delays, additional fees, and costly regulatory requirements that drive up the cost of home construction.

**Title:** Update to Linkage Fee (Workforce Housing Offset)

**Jurisdiction:** City of San Diego

**Type:** Fee Increase

**Vote:** Majority

**Status:** Awaiting hearing at Land, Use & Housing Committee

**Issue:** Funding for affordable housing within the City of San Diego.

**Description:** The City of San Diego charges a fee to non-residential building development on a per square foot basis. This fee, called the Housing Impact Fee or linkage fee, is the primary source of revenue for the Housing Trust Fund to finance the construction of affordable housing. In response to a recession in 1996, the linkage fee was reduced by 50%, and the fee has not been changed since.

**Fiscal Impact:** The proposal brought forward will increase the fee between 500 and 900 percent based on the type of non-residential development. Revenue projections from the new fee amounts have not been produced. Since Fiscal Year 2000, average annual revenue from the fee totaled approximately \$2.1 million. Since Fiscal Year 2009, average annual revenue from the fee totaled approximately \$784,000.

**Proponents:** San Diego Housing Commission, Affordable Housing Advocates

**Opponents:** JOBs Coalition, various business groups

**Background:**

The City of San Diego charges a fee to non-residential building development on a per square foot basis. This fee, called the Housing Impact Fee or linkage fee, is the primary source of revenue for the Housing Trust Fund to finance the construction of affordable housing. It was initially established in 1989 through a nexus study that examined the relationship between new commercial building or workplaces and new workers in the city. The linkage fee levels were determined by quantifying the demand for housing new workers in low income households in units per square foot and the cost of providing affordable housing. Table 1 shows the initial linkage fee schedule in 1990. In response to a recession in 1996, the linkage fee was reduced by 50%, and the fee has not been

changed since. Table 1 also includes the current linkage fee level and Keyser Marston Associates (KMA) recommended linkage fee level

*Table 1: Linkage Fee Schedule*

Type of Building Use	Linkage Fee in 1990 (Fee/Sq Ft)	Current Linkage Fee since 1996 <sup>1</sup> (Fee/Sq Ft)	Recommended Linkage Fee (Fee/Sq Ft)
<b>Office</b>	\$2.12	\$1.06	\$5.32
<b>Hotel</b>	\$1.28	\$0.64	\$4.73
<b>Research and Development</b>	\$1.60	\$0.80	4.14
<b>Retail</b>	\$1.28	\$0.64	\$4.96
<b>Manufacturing</b>	1.28	\$0.64	\$3.05
<b>Warehouse</b>	0.54	\$0.27	\$2.28

**San Diego Housing Commission Recommendations:**

In March 2013 the City of San Diego’s San Diego Housing Commission (SDHC) requested an update to the 2010 study of the linkage fee completed by Keyser Marston Associates, Inc. (KMA). Following completion of the report, the SDHC has made the following recommendations:

- Rename the fee as “Workforce Housing Offsets” to better describe its purpose.
- Reset the Workforce Housing Offsets to a level that represents 1.5 percent of total current development costs.
- Require the Workforce Housing Offsets to be adjusted annually on a ministerial bases by SDHC based on changes to the Engineering News-Record (ENR) Building Cost Index.

The recommended fee levels are outlined in Table 1.

**Commissioned Study Results:**

The purpose of a nexus analysis is to:

“Document the linkages among construction of new workplace buildings (such as office, retail, hotel, etc.), the employees that work in them, and the demand for affordable housing.”

The analysis further states:

“The analysis quantifies the housing need at each affordability level associated with each type of workplace building.”

<sup>1</sup> City of San Diego Municipal Code Chapter 9 Article 8 Division 6.

The methodology used to complete this study was as follows:

- Estimate the total number of employees working in the building based on average employment density experience.
- Use occupation and income information for typical job types in the building to calculate how many of those jobs pay compensation at the levels addressed in the analysis.
- Use factors derived from the Census to translate number of workers into households of various size represented in each income category.
- Calculate how many of the Very Low-, Low-, and Moderate-Income households are associated with the building and divide the building size to arrive at coefficients of housing units per square foot of building area.
- The last step in the linkage fee analysis marries the findings on the numbers of households at each of the lower income ranges associated with the five types of buildings to the affordability gap, or the costs of delivering or housing for them in San Diego.

These costs express the total linkage or nexus costs (ceiling) per square foot for the five building types. The totals are not recommended levels for fees; they represent only the maximums established by this analysis, below which fees or other requirements may be set. Table 2 outlines these costs.

*Table 2: Total Nexus Costs*

Type of Building Use	Nexus Cost per Square Foot
<b>Office</b>	\$72.41
<b>Hotel</b>	\$66.88
<b>Retail</b>	\$96.28
<b>Research and Development</b>	\$33.78
<b>Manufacturing</b>	\$33.78
<b>Warehouse</b>	\$11.91

Following the completion of this analysis, the SDHC proposed linking the amount of the fee to total development costs. The fee is proposed to be set at 1.5 percent of development costs. The nexus study provided an analysis of average development costs based on each non-residential development type.

*Table 3: Nexus Study Analysis of Development Costs and Associated Fee Levels*

Non-Residential Building Type	Average Development Costs (\$/Sq. Ft)	Fee Level Per Sq. Ft. @ Percent of Total Costs			
		0.50%	1.00%	1.50%	2.00%
<b>Office</b>	\$354	\$1.77	\$3.54	\$5.31	\$7.08
<b>Hotel</b>	\$315	\$1.58	\$3.15	\$4.73	\$6.30
<b>Retail</b>	\$331	\$1.66	\$3.31	\$4.97	\$6.62
<b>Research and Development</b>	\$276	\$1.38	\$2.76	\$4.14	\$5.52
<b>Manufacturing</b>	\$203	\$1.02	\$2.03	\$3.05	\$4.06
<b>Warehouse</b>	\$152	\$0.76	\$1.52	\$2.28	\$3.04

**Policy Discussion:**

*Linkage Fee Adjustment:*

As the primary revenue source for the Housing Trust Fund, the linkage fee revenue finances affordable housing projects such as loan assistance for restoring deteriorated housing units, financial assistance to first time homeowners, and housing for the homeless. Following the initial increase in the fee, the fee level would adjust according to ENR Building Cost Index. Since the linkage fee rate would rely on the index and economic conditions, this would avoid the cost of annual discretionary action by the City Council. However, unpredictable economic conditions may exacerbate the linkage fee as an unstable source of revenue for affordable housing.

*Impact from Increasing Linkage Fee:*

Increasing the linkage fee can have both positive and negative economic impacts. With an increased linkage fee, there would be more resources available to help provide affordable housing for potential employees coming to work in San Diego. However, the cost of development would also increase which may result in a disincentive for developers to conduct business in San Diego.

*Timing of the Linkage Fee Adjustment:*

When the linkage fee was proposed to be increased in 2011, there was a consensus among the proponents and the opposition of linkage fee that an adjustment or an increase to the linkage fee should not occur until there is evidence of an economic recovery. In 1996, the fee was reduced by half as a way to spur economic development during a recession within the city. In 1996, the area's unemployment rate stood at 5.4 percent. As of the end of July 2013, the unemployment stands at 7.8 percent. While there has been a slight decline in the unemployment rate over the past two years since an increase in the fee was last proposed, it is not at a level in which the city decided to cut the fee to spur growth. It is unclear what measurements are being used to determine the impact on businesses, if any that are being used to justify an increase at this time.

*Table 4: San Diego MSA Unemployment Rate*

Year	1990	1991	1992	1993	1994	1995	1996	1997
<b>Unemployment Rate</b>	4.6%	6.3%	7.3%	7.9%	7.1%	6.4%	5.4%	4.3%
Year	1998	1999	2000	2001	2002	2003	2004	2005
<b>Unemployment Rate</b>	3.5%	3.1%	3.9%	4.2%	5.2%	5.2%	4.7%	4.3%
Year	2006	2007	2008	2009	2010	2011	2012	2013 (July)
<b>Unemployment Rate</b>	4.0%	4.6%	6.0%	9.6%	10.5%	10.0%	8.9%	7.8%

*Linkage Fee Revenue*

Since its inception, the linkage fee has generated \$53.32 million. Between the Housing Trust Fund and the Inclusionary Housing Fund, the SDHC has produced over 18,500 units of affordable housing opportunities for San Diego residents.

*Table 5: Total Linkage Fee Revenues*

Fiscal Year	Actual Collected	% Change (Actual Collected)
<b>FY 1992</b>	\$6,211,000	-
<b>FY 1993</b>	\$1,899,000	-69.43%
<b>FY 1994</b>	\$1,432,000	-24.59%
<b>FY 1995</b>	\$2,242,000	56.56%
<b>FY 1996</b>	\$2,885,000	28.68%
<b>FY 1997</b>	\$1,859,000	-35.56%
<b>FY 1998</b>	\$3,283,000	76.60%
<b>FY 1999</b>	\$5,398,000	64.42%
<b>FY 2000</b>	\$4,953,000	-8.24%
<b>FY 2001</b>	\$3,382,000	-31.72%
<b>FY 2002</b>	\$2,425,000	-28.30%
<b>FY 2003</b>	\$1,645,000	-32.16%
<b>FY 2004</b>	\$1,448,000	-11.98%
<b>FY 2005</b>	\$2,262,000	56.22%
<b>FY 2006</b>	\$3,520,000	55.61%
<b>FY 2007</b>	\$2,949,000	-16.22%
<b>FY 2008</b>	\$2,389,000	-18.99%
<b>FY 2009</b>	\$677,000	-71.66%
<b>FY 2010</b>	\$333,000	-103.30%
<b>FY 2011</b>	\$662,000	49.70%
<b>FY 2012</b>	\$1,463,000	54.75%

On July 29, 2009, City Auditor Eduardo Luna released a two-part Performance Audit of the San Diego Housing Commission. Part I of the audit focused primarily on the governance structure and policies and procedures of the SDHC, while Part II focused on the operations, collection of fee revenues, and expenditures related to affordable housing. Part II of the audit made six (6) significant findings:

- Housing Trust Fund-related commercial linkage fees are outdated, substantially lower than comparable cities, and were not adjusted as required by the municipal code resulting in an estimated underfunding of \$2.79 million for fiscal years 2006 through 2008;
- SDHC receipt of direct payments from developers is inconsistent with the municipal code;
- The City and SDHC reported, but did not reconcile, different fee revenue amounts;
- SDHC Inclusionary Housing Fund policies and regulations are inadequate or poorly defined;
- The City's Inclusionary Affordable Housing Regulations need to be updated; and,
- City and SDHC reporting, monitoring, and disbursements of Affordable Housing Fund revenues are fragmented and disjointed.

In addition to these findings, the audit made 12 recommendations for implementation by the SDHC. Three of these recommendations dealt with updating the linkage fee and satisfying the policy of updating the fee. The audit also called upon the SDHC to update its policies relating to the collection of fee revenues. Other recommendations dealt with updating various internal controls for collection of revenues and updating policies and procedures for budgeting and reporting. SDHC has responded to all of the recommendations and all of the recommendations have been implemented.

Within the response to the audit findings, the SDHC estimated implementation of most the audit recommendations could be completed by end of the 2010 calendar year. Due to the delay in adjusting the linkage fee and amending various portions of the municipal code, SDHC has estimated full implementation will be complete prior to beginning of Fiscal Year 2012. Those recommendations not requiring the assistance of the City Attorney or City Council approval have been implemented. It is unclear what the status is of the other recommendations.