POLICY PROPOSAL FOR INCLUSIONARY HOUSING IN THE CITY OF SAN DIEGO

May 2019

Overview and Intent

The San Diego County Taxpayers Association (SDCTA) recognizes that affordable housing, but more importantly, housing for the middle-class, is a priority for the community. Considering the complexity and the stakes, SDCTA staff have closely followed the efforts of Council President Georgette Gomez's office to amend inclusionary housing regulations in the City of San Diego. As part of those efforts, the City retained the services of Kaiser Marston Associates (KMA) to determine the impact of changing the City's inclusionary housing requirements. The KMA analysis and other stakeholders conclude that many of the potential changes explored would render future development infeasible and increase overall housing prices, exacerbating the current housing crisis.

While this paper specifically addresses inclusionary housing policies in the City of San Diego, SDCTA encourages the leadership of the City of San Diego to consider a comprehensive set of housing policies that provide a net benefit to all taxpayers and that properly address the needs of the community. Inclusionary housing policy is only one among several tools that cities consider in addressing the need for affordable housing. SDCTA notes that evidence from other cities do not show the inclusionary housing minima actually result in the intended outcome and have an inadvertent effect of making all housing more expensive.

That said, when updating inclusionary housing regulations, SDCTA recommends an approach that will: (1) help de-concentrate poverty; (2) apply inclusionary housing requirements based on geographic sub-markets in a fashion that will encourage the development of low and middle-income market rate housing; and (3) prevent the addition of requirements that may inhibit new development.

Summary Recommendations and Reasoning

Based on its research and analysis, SDCTA recommends that any inclusionary zoning ordinance should reflect the following principles:

1. Inclusionary housing requirements should vary by sub-market and be determined based on the ability of market-rate development to sustain the costs of building new affordable units.

Any increase in inclusionary housing requirements would make future development infeasible, where for every low-income household finding a new apartment or home, five other households would be shut out of the market. A "one size fits all" policy would similarly be counterproductive in the development of new housing in middle- and lower-income markets. The new regulations should divide the city into sub-markets to reflect the different market conditions throughout the City. Lowering inclusionary housing requirements in targeted submarkets may incentivize housing production. Finally, the regulations should include accountability measures that allow the regulations to change if they are not working as intended, such as a sunset provision.

For example, there are three types of geographic boundaries that the City of San Diego could use to differentiate housing by submarkets:

- The City of San Diego could explore regulations based on the respective geographic boundaries that govern San Diego Housing Commission's Housing Choice Vouchers rental program.
- The City could consider ZIP Code Tabulation Areas (ZCTAs), which may be helpful at accurately depicting potential inclusionary housing zoning areas by summarizing statistics for subjects like sex, age, race, relationships, households by type, housing occupancy, and housing tenure.
- Lastly, the City could consider public high school attendance boundaries as a good proxy of poverty through the reporting of at-risk student enrollment.

2. Prevailing wage requirements should not be imposed on new development.

The City of San Diego's commissioned study by Keyser Marston Associates (KMA) estimates that in most, if not all scenarios, the addition of a prevailing wage requirement in development would increase rents by approximately one-third. This would cripple the ability of the San Diego middle class to acquire housing, and thus this requirement should not be added.

SDCTA believes that holistic and properly implemented housing policy can help meet the community's housing needs and provide a net benefit to all taxpayers. As the issue advances through the legislative process, SDCTA may provide further recommendations and options for policy makers based upon its research. SDCTA looks forward to collaborating with the City of San Diego as it plans to update its inclusionary housing ordinance later this year.

SAN DIEGO COUNTY TAXPAYERS ASSOCIATION

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I. Introduction

The City of San Diego (City) has been identified as one of the least affordable cities in the United States. From 2009 through 2017, San Diego rents and housing prices have consistently gone up more than inflation. Between January 2017 and January 2018, the median home price grew 8%, from $560,000 to $605,000. Over the same time period, median sales price for condos and townhomes rose from $370,000 to $400,000. The average cost of living in San Diego is approximately 33% higher than the national average.[1] Rent is a big driver of that number, where 44.1% of the population pays 35% or more of their household income in gross rent.[2]

SDCTA is concerned with the most cost-efficient delivery of public goods and services. As set forth below, this can be achieved by deconcentrating poverty and setting the correct incentives for developers to increase the income diversity of all neighborhoods in the City of San Diego.

II. The City's Feasibility Study

The City of San Diego's inclusionary housing ordinance was first adopted in 2003. Since that time, City councilmembers have identified the need to correct adverse incentives in the existing inclusionary housing regulations. As part of its efforts, the City retained Keyser Marston Associates (KMA) to conduct a feasibility study. The purpose of the study was to analyze the effects of different inclusionary policy options on production of both rental and for-sale housing.

The study has been criticized by the Fermanian Business and Economic Institute, at Point Loma Nazarene University. For instance, the Institute notes the KMA study assumes rates of return below what most lenders would require. The KMA study also forecasts a negative impact on overall housing affordability, with a predicted 6.7% to 8% increase in rental and for-sale housing prices.[3] The Institute concludes that the measures analyzed by KMA would do more harm than good by rendering future development infeasible. According to the report, for every low-income household finding a new apartment or home, five other households would be shut out of the housing market.

Considering the complexity and the stakes, SDCTA staff have closely followed the efforts of Council President Georgette Gomez's office to amend the inclusionary housing regulations. As part of this effort, SDCTA formed a working group of stakeholders to advise the policy creation process. The working group's goal was to analyze the KMA study. Based on the work by this group and further Staff research and analysis, SDCTA has formulated several recommendations. SDCTA's goal is to provide a community perspective on key considerations and to safeguard the taxpayers' interests by providing oversight over the development of new regulations.

[1] (2019). The Cost of Living in San Diego. Smart Asset.
[2] (2019). American FactFinder. US Census Bureau Data.
[3] (2018). Summary of Analysis of Inclusionary – Affordable Housing Policy Options. Point Loma Nazarene University.

III. Background

Inclusionary housing regulations are a way for a jurisdiction to achieve economic integration, partially address a shortage of moderately priced housing, and respond to declining federal funds. Inclusionary policies seek to "capture" a portion of the higher value of housing prices by requiring that developers include affordable housing in developments that otherwise would not include it.

Local inclusionary housing programs in California have been explored as a tool for producing new homes that are affordable for working families. Around 170 cities and counties have some form of inclusionary housing requirement in place to address California's affordable housing shortage. However, there is no national research on the effectiveness of these programs and there is substantial variance across California jurisdictions on the number of units produced by inclusionary housing programs.

Current Regulations in the City of San Diego

The City of San Diego adopted its ordinance for inclusionary and affordable housing in 2003. The ordinance requires housing developers of two units or more who received government assistant to set aside at least 10% of their projects for low- and moderate-income households. These units are required to remain affordable for a standard of 55 years. However, since 2009, that portion of the ordinance has been largely ignored, due in part to concerns that the measure acted as an illegal expansion of rent control.[4]

In 2011, the City of San Diego began collecting a one-time, "in-lieu" fee, called the Inclusionary Affordable Housing Fee that applies to all new residential development of two or more units. Per the municipal code, this has since given developers the option to either fulfill the affordable requirement, or to pay a fee to offset the lack of affordable development. The fee is calculated by multiplying the applicable charge per square foot by the aggregate gross floor area of all of the units in the development. The current fee varies depending on the project's size, ranging from $1.41 per square foot to $7.03 per square foot. According to a report from the Office of the Independent Budget Analyst, $133.3 million have been collected in fees from the program.[5]

The San Diego Housing Commission (SDHC), the City of San Diego's housing authority, determines the charge per square foot each year, based on the formula in the Inclusionary Affordable Housing Implementation and Monitoring Procedures Manual, as approved by the City Council. The fee is determined based on the rate in effect at the time the building application is filed, and it is to be paid on or before the first residential building permit is issued for the development. Funds from Inclusionary Affordable Housing Fee are deposited into the City of San Diego's Affordable Housing Fund to help meet the housing needs of the City's very low-, low-, and median-income households. SDHC administers the Affordable Housing Fund in the form of loans to support these kinds of projects. The current base rate is $4.98 per square foot for developments containing fewer than 10 units.

[4] (2018). San Diego Considering Changes to its Affordable Housing Requirements. Mynd Property Management.
[5] (2018). Comparison of Inclusionary Housing Programs. Office of the Independent Budget Analyst.

Figure 1: Existing Prorated Affordable Housing Fee, Developments Containing 2-9 Units

Units in Development	Percentage of Fee Imposed	Applicable Square Foot Charge (Rate) to Calculate Fee
2 units	20%	$1.00/sq. ft.
3 units	30%	$1.49/sq. ft.
4 units	40%	$1.99/sq. ft.
5 units	50%	$2.49/sq. ft.
6 units	60%	$2.99/sq. ft.
7 units	70%	$3.49/sq. ft.
8 units	80%	$3.98/sq. ft.
9 units	90%	$4.48/sq. ft.

Source: San Diego Housing Commission Inclusionary Affordable Housing – Implementation and Monitoring Procedures 2011

Assembly Bill 1505 Land Use: Zoning Regulations

In practice, the current ordinance has had a limited impact on the City's affordable housing stock. In an effort to bolster production, California Assembly Bill (AB) 1505, approved by the Governor of California on September 29, 2017, allows cities to require that all rental residential development include a certain percentage of affordable rental units and provide alternative means of compliance. This bill supersedes a court decision that deemed inclusionary zoning policies for rental residential development in conflict with the state's Costa-Hawkins Rental Housing Act.[6]

AB 1505, which took effect on January 1, 2018, restored the long-standing authority of local governments to choose to require the inclusion of affordable rental units as one component of their local inclusionary housing policies. As a local decision, the City of San Diego now has the power to involve input from local stakeholders when determining what mix of policies, if any, make sense for the community.

The Need for More Affordable Housing

A shortage of housing paired with an increase in population has exacerbated the problem. Over the past year, the gap between a mortgage payment and average monthly rent widened by $500, limiting housing options for many households even further.[7] Housing costs in the area have risen in part because the City of San Diego cannot keep up with the demand for housing—especially of very low, low, and moderate-income housing.

According to the U.S. Census 2012-2016 data, the City of San Diego has a total housing supply of 527,049 housing units, of which 286,205 (54%) are single family homes and 240,844 (46%) are multi-family units. Development has mostly been concentrated on above moderate-income units, and the bulk of new units available are affordable to just 15% of local renters. This issue is also

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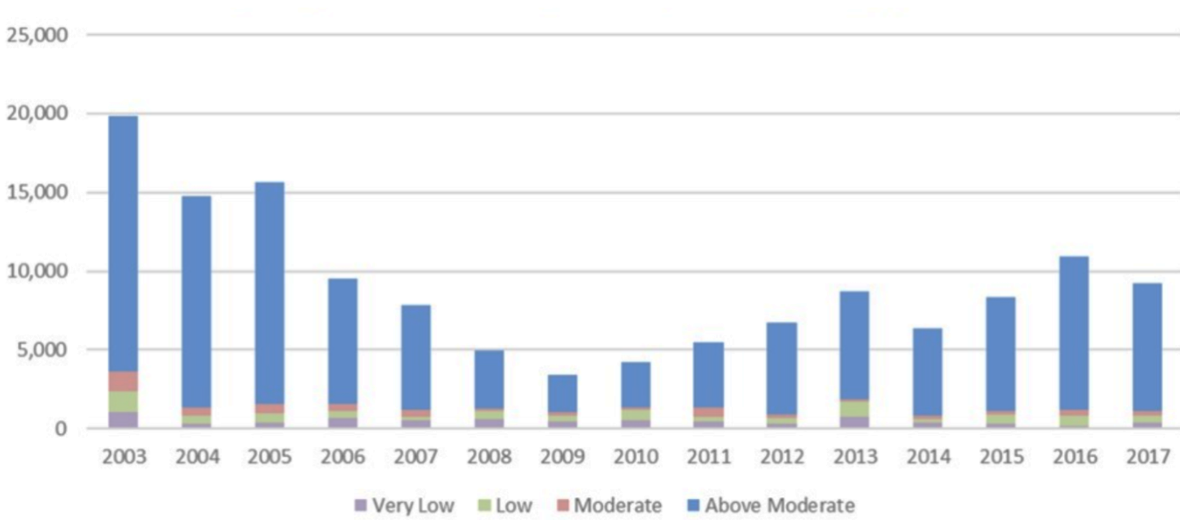
[6] The 1995 Costa-Hawkins Rental Housing Act places limits on municipal rent control ordinances by prohibiting cities from establishing rent control over certain types of units and by prohibiting vacancy control.
[7] (2019). San Diego Multifamily Investment Forecast: 2019 Outlook. Marcus & Millichap.

difficult to quantify, as often the data provides unclear distinctions between “moderate” and “above moderate” developments.

In its agency-wide Strategic Plan: 2016-2020, the San Diego Housing Commission set an objective to create 2,000 units of mixed-income and affordable housing.[8] In the first year, the City claims that 627 affordable units closed financing and are currently under construction or rehabilitation. The 2018 Housing Inventory Annual Report from the City of San Diego, which takes a closer look at affordability, supply, and production, states that the City of San Diego, with a population of over 1.3 million people in 2016, had 0.38 housing units per person. This is less than cities with much more density like New York and San Francisco.[9] Moreover, the document places the City’s vacancy rate at 1.3% in 2016, well below the recommended 5% by the California Department of Housing and Community Development (HCD). The vacancy rate reflects the percentage of all available units in a rental property that are vacant or unoccupied at a particular time.

The current shortage of housing has been driven in part by a growing population. Current projections from the San Diego Association of Governments (SANDAG) reflect a growing population that will continue to grow. A part of the problem is that new developments do not match the economic make-up of the population. The following chart maps the types of housing units permitted by income category from 2003 to 2017.

Figure 2: San Diego Region New Housing Units by Income Category 2003-2017



The SDHC’s housing production objectives report, titled “Addressing the Housing Affordability Crisis: San Diego Housing Production Objectives 2018-2028,” identified San Diego’s 10-year housing need (150,000 to 220,000 additional housing units), as well as proposals to meet that need. SANDAG provides the share of new housing units by income category for the last seven years below.

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8 (2016). San Diego Housing Commission Strategic Plan 2016-2020. San Diego Housing Commission.

9 (2018). City of San Diego Housing Inventory Annual Report: A Closer Look at Housing Affordability, Supply and Production. City of San Diego.

Figure 3: Share of New housing Units by Income Category (January 1, 2010 – December 31, 2017)

Income Level	Very-Low	Low	Moderate	Above Moderate	Total for all categories
Total Housing Units Permitted	3,274	4,172	2,331	50,135	59,912
RHNA Goal (5th Cycle)	36,450	27,700	30,610	67,220	161,980
Percent of Goal Produced	8.9%	15.1%	7.6%	74.6%	37%
Units Left to Permit	33,167	23,528	28,279	17,805	102,068

Source: SANDAG; Data compiled from building permits issued by the local jurisdictions in the San Diego region. Permitted units include deed-restricted and non-deed restricted units as reported by each jurisdiction.

Other important factors for the development of inclusionary housing regulations are standardized information on income and rents. The San Diego Housing Commission derives general income and rental rate information from the U.S. Department of Housing and Urban Development (HUD) to inform its inclusionary and affordable housing regulations formulas. Per the HUD data, the San Diego the Area Median Income (AMI) is $79,300 for 2017.[10] The AMI is the median income for the designated area as adjusted for family size. **Figure 4** outlines the San Diego Housing Commission's income and rent calculations for 2017.

[10] (2017). San Diego Housing Commission Income and Rent Calculations. San Diego Housing Commission.

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Figure 4: 2017 San Diego Housing Commission Income and Rent Calculation

Family Size	Unit Size	Extremely Low Income 30% AMI (Adjusted by HUD)			35% AMI (Adjusted by HUD)			40% AMI (Adjusted by HUD)			Very Low Income 50% AMI (Adjusted by HUD)			
		Annual Income	*Gross Rent*	*TCAC*	*Annual Income*	*Gross Rent*	*TCAC*	*Annual Income*	*Gross Rent*	*TCAC*	*Annual Income*	*Gross Rent*	*TCAC*	*Low Income*
One	Studio	$19, 100	$478	$477	$22,300	$558	$557	$25,450	$636	$637	$31,850	$796	$796	$796
Two	1-BR	$21, 800	$545	$511	$25,450	$636	$597	$29,100	$728	$682	$21,800	$545	$511	$853
Three	2-BR	$24,550	$614	$614	$28,650	$716	$716	$32,750	$819	$819	$24,550	$614	$614	$1,023
Four	3-BR	$27,250	$681	$709	$31,800	$795	$827	$36,350	$909	$945	$27,250	$681	$709	$1,181
Five	4-BR	$29,450	$736	$791	$34,350	$859	$923	$39,300	$983	$1,055	$29,450	$736	$791	$1,318
Six	5-BR	$32,960	$824	$873	$36,900	$923	$1,018	$42,200	$1,055	$1,164	$32,960	$824	$873	$1,455
Seven	6-BR	$37, 140	$929		$39,450	$986		$45,100	$1,128		$37,140	$929		$1,590
Eight		$41,320			$42,000			$48,000			$41,320			

Family Size	Unit Size	60% AMI (Adjusted by HUD)			65% AMI (Adjusted by HUD)			70% AMI (Adjusted by HUD)		Low Income 80% AMI (Adjusted by HUD)	
		Annual Income	*Gross Rent*	*TCAC*	*Annual Income*	*Gross Rent*	*"High Home"*	*Annual Income*	*Gross Rent*	*Annual Income*	*Gross Rent*
One	Studio	$38,220	$956	$955	$41,350	$1,034	$1,048	$44,550	$1,114	$50,950	$1,274
Two	1-BR	$43,680	$1,092	$1,023	$47,300	$1,183	$1,124	$50,900	$1,273	$58,200	$1,455
Three	2-BR	$49,140	$1,229	$1,228	$53,200	$1,330	$1,351	$57,300	$1,433	$65,500	$1,638
Four	3-BR	$54,540	$1,364	$1,418	$59,100	$1,478	$1,552	$63,650	$1,591	$72,750	$1,819
Five	4-BR	$58,920	$1,473	$1,582	$63,850	$1,596	$1,713	$68,750	$1,719	$78,600	$1,965
Six	5-BR	$63,300	$1,583	$1,746	$68,550	$1,714	$1,871	$73,850	$1,846	$84,600	$2,110
Seven	6-BR	$67,680	$1,682		$73,300	$1,833	$2,029	$78,950	$1,974	$90,250	$2,256
Eight		$72,000			$78,000			$84,000		$96,050	

Family Size	Unit Size	100% AMI (No HUD Adjustment)		120% AMI (No HUD adjustment)	
		Annual Income	*Gross Rent*	*Annual Income*	*Gross Rent*
One	Studio	$55,500	$1,388	$66,600	$1,665
Two	1-BR	$63,450	$1,586	$76,100	$1,903
Three	2-BR	$71,350	$1,784	$85,650	$2,141
Four	3-BR	$79,300	$1,963	$95,150	$2,379
Five	4-BR	$85,650	$2,141	$102,750	$2,569
Six	5-BR	$92,000	$2,300	$110,350	$2,759
Seven	6-BR	$98,350	$2,459	$118,000	$2,950
Eight		$104,700		$125,600	

Regional Housing Needs Assessment

Various agencies produce estimates of housing needs. The Regional Housing Needs Assessment (RHNA) is a determination made by the Department of Housing and Community Development (HCD). The RHNA quantifies the need for housing within each jurisdiction during specified planning periods. The RHNA Allocation Methodology considers the projected household growth, the healthy market vacancy need, and the housing replacement need of each jurisdiction to determine their projected housing needs.

The HCD's Final RHNA Determination for 2021 to 2029 estimates that 21,460 new housing units are needed per year in the City of San Diego to keep up with demand, as shown in **Figure 5**. The SANDAG Board of Directors will adopt a RHNA for planning purposes in October 2019.

Figure 5: HCD Final RHNA Determination for City of San Diego (2020-2029)

Income Category	Housing Unit Need	Percent
Very Low	42,332	24.7%
Low	26,627	15.5%
Moderate	29,734	17.3%
Above Moderate	72,992	42.5%
Total Housing Units	171,685	100%

Source: California Department of Housing and Community Development

The City of San Diego's 2018 Housing Inventory Annual Report provides a breakdown of the RHNA units actually built and the number of units required to meet the cycle goals. Housing production has only met 38% of the housing needs for the 2013 to 2021 RHNA cycle, with less than two years remaining, as shown in **Figure 6** below.

Figure 6: Actual Housing Production (Units) of New Construction by Income vs RHNA

Year	Very Low	Low	Moderate	Above Moderate	Total
2010	258	175	29	1,239	1,701
2011	221	127	0	2,173	2,521
2012	197	287	0	3,400	3,884
2013	412	628	0	4,269	5,309
2014	229	184	4	1,991	2,408
2015	265	446	0	4,221	4,932
2016	103	253	0	7,028	7,384
2017	324	301	0	4,395	5,020
Total Units	2,009	2,401	33	28,716	33,159
RHNA Allocation	21,977	16,703	15,462	33,954	88,096
Percent of RHNA Achieved	9%	14%	0.2%	85%	38%
Total Remaining RHNA	19,968	14,302	15,429	5,238	54,937

Source: City of San Diego Building Permit Data and SDHC Data (2010-2017)

General Plan Housing Element 2013-2020

Inclusionary housing regulations should acknowledge the City's broader development strategy as outlined in the City's General Plan Housing Element. To comply with California state housing law, California jurisdictions must update their housing element every eight years, which provides an analysis of the housing needs of the community for all income levels and the overall strategy to address those goals. The City of San Diego adopted its most recent housing element, in March 2013. It covers 2013 to 2020.[11] **Figure 7** shows the City's housing element's objectives for housing production, per its most recent housing element.

Figure 7: City of San Diego's Housing Element Quantified Objectives for Housing Production (2013-2010)

Income Group	New Construction	Rehabilitation	Preservation
Extremely Low-Income*	3,000	600	250
Very Low	3,000	600	250
Low	3,600	800	400
Moderate	700	400	0
Above-Moderate	34,800	0	0
Total	45,100	2,400	900

*In accordance with State Law (AB 2634), the City projected the number of extremely low- income housing by assuming 50 % of the very low-income units as extremely low.

The most recent housing element forecasted that the passage of Assembly Bill 26 (AB 26), which dissolved redevelopment in 2012, would worsen the affordability crisis. Until then, the City of San Diego's Redevelopment Agency provided the City and private development financing and development tools by being the source of much of the funding for affordable housing. Primary objectives of redevelopment included expanding the supply of low- and moderate-income housing and eliminating various forms of economic, social and physical blight. Within the City of San Diego, City Heights (2,062 acres), Centre City (1,450 acres), and North Bay (1,350 acres) were the 3 largest established redevelopment project areas.

Since AB 26's passing, the City of San Diego has assumed the former agency's assets, rights, powers, duties, and obligations under the California Community Redevelopment Law. That same year, the City of San Diego established Civic San Diego, a new City corporation, to wind down the former Redevelopment Agency's affairs and to oversee the continuation of neighborhood revitalization.

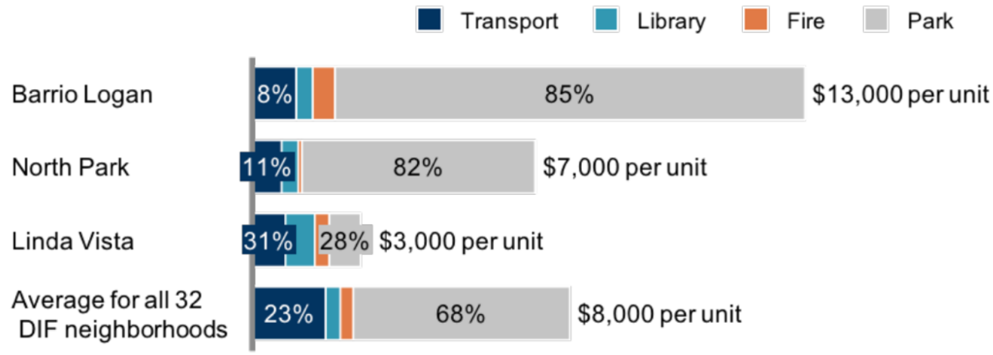
Development Impact Fees

Changes to Development Impact Fees (DIFs) could be part of the inclusionary housing regulations. DIFs are collected to mitigate the anticipated impact of additional development on neighborhoods close to full build-out capacity. According to the San Diego Housing Commission, DIFs pay for the 7 to 10% share of neighborhood improvements that are assumed will be used by new

[11] (2013). General Plan: Housing Element 2013-2020. City of San Diego.

residents.[12] These are one-time payments that must be paid prior to building or the issuing of a construction permit. The fees vary widely by neighborhood, as evidenced by **Figure 8**.

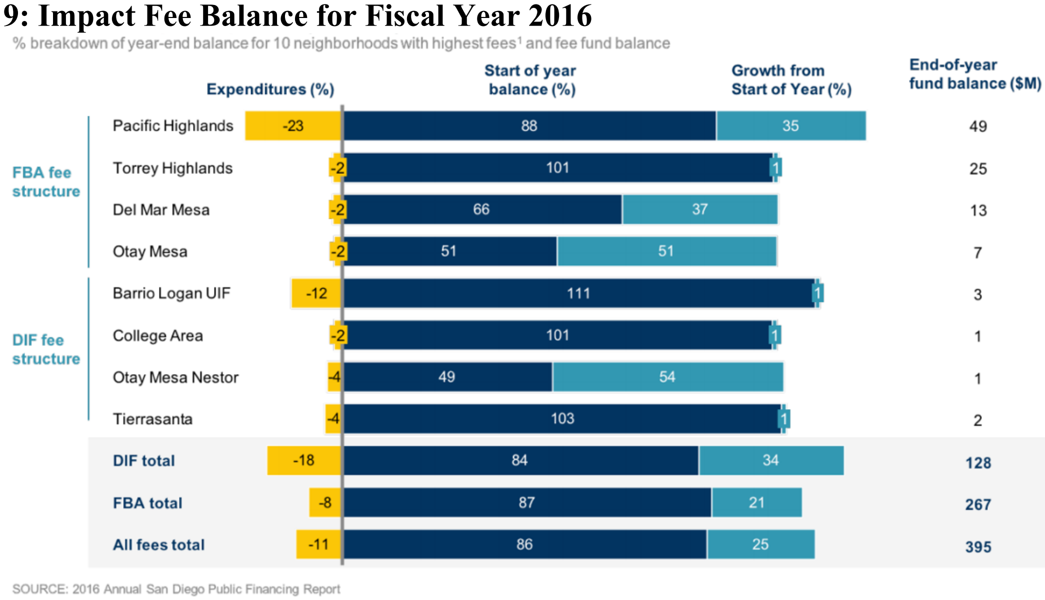
Figure 8: Comparison of DIF Cost Breakdown for Select Neighborhoods
% allocated to facility category and total $000



Source: San Diego Housing Commission, Housing Production Objectives Report 2018-2028

There is potential to optimize fee structures to increase incentives to build. While DIFs may provide certain benefits, they currently exclude parklands, may exclude significant recreational areas in communities, and create disincentives for small units. Most importantly, collections may outpace improvement expenditures. **Figure 9** provides a visual representation of the utilization of development impact fees by neighborhood.

Figure 9: Impact Fee Balance for Fiscal Year 2016



Source: San Diego Housing Commission, Housing Production Objectives Report 2018-2028

SDCTA notes that inclusionary housing policy is only one among several tools that cities can deploy to address the need for housing. Given the general research around the limited effectiveness

[12] (2018). Addressing the Housing Affordability Crisis: San Diego Housing Production Objectives 2018-2028. San Diego Housing Commission.

of DIF, jurisdictions may consider other financing mechanisms that could be more effective than what currently exists.

IV. Proposal

There are different ways to design inclusionary housing policies. Key program design considerations should include the program structure, on-site and off-site development, developer incentives, and affordability preservation to reflect the needs and policy approach of a jurisdiction. SDCTA has observed the trends in development and neighborhood characteristics across the City of San Diego to recommend the following policy options:

1. Inclusionary housing requirements should vary by sub-market and be determined based on the ability of market-rate development to sustain the costs of building new affordable units.

An increase in inclusionary housing requirements would make development infeasible in an area that is large and geographically diverse. A number blanketly applied to all neighborhoods in the City of San Diego may worsen the housing inventory challenge that the region faces. Therefore, the City should prioritize certain geographic areas to meet its local housing needs.

While most cities do not adjust their inclusionary housing requirement at a neighborhood level, some have found success in distinguishing between areas of development. Burlington, Vermont, requires 15% affordable units citywide and 25% in higher-cost waterfront areas.[13] Austin, Texas, has a voluntary program that offers incentives in exchange for affordable units only in certain zoning districts. Other programs in North Carolina have used this approach as well.

Ultimately, geographic targeting recognizes that there is more real estate value in areas that allow for greater residential development intensity. This may result in more opportunities for the public sector to capture some portion of that value and use funds to support mixed-income or affordable housing development.[14] **Figure 10** provides a brief overview of the features of inclusionary housing programs across the nation that in some capacity use geographic targeting, which may include geographically-targeted policies by census tract, policies limited to specific zoning districts, and policies which vary by project type.[15]

There are three geographic boundaries that the City of San Diego could use to differentiate housing by submarkets:

- For example, the City of San Diego could explore regulations based on the respective geographic boundaries that govern San Diego Housing Commission's Housing Choice Vouchers rental program. These payment standards areas are informed by the Federal government's Small Area Fair Market Rents. Their goal is to provide families that receive rental assistance with more opportunities for transportation, schools, and employment.

[13] (2019). Geographically Targeted Programs. Inclusionary Housing.org
[14] (2016). Best Practices in Geographic Scoping and Tiering of Inclusionary Housing Policies. Grounded Solutions Network.
[15] (2016). Best Practices in Geographic Scoping and Tiering of Inclusionary Housing Policies. Grounded Solutions Network.

- Another method would be to consider ZIP Code Tabulation Areas (ZCTAs), which may be helpful at accurately depicting potential inclusionary housing zoning areas by summarizing statistics for subjects like sex, age, race, relationships, households by type, housing occupancy, and housing tenure.
- Lastly, high school attendance boundaries could prove to be a good proxy of poverty through the reporting of at-risk student enrollment.

SDCTA elaborates on some of the potential implementation strategies for these options in the *Appendix* section of this report.

It is also important to consider that development feasibility varies by submarket. Market rents, constructions costs, and the availability and price of land are the main drivers behind the demand for specific submarkets. These variables are influenced by zoning policy because local zoning limits the size and shape of buildings that are allowed for development, as well as the tenants who can occupy them. For example, a city may allow only a three-story building, but those revenues may be too low to justify the purchase and demolition of a one-story building.[16]

Lastly, the City of San Diego should include accountability measures that allow inclusionary housing regulations to change and evolve if they do not work as intended. A 5-year sunset provision based on the number of building permits issued after the new regulations go into effect may be responsive to potential decreases in issuances. This trend has been observed in Portland, Oregon, where only twelve privately financed developments (totaling 89 affordable units out of 654) had sought building permits a year after its inclusionary housing policy took effect.[17]

2. Prevailing wage requirements should not be imposed on new development.

Prevailing wage has been linked to increased rent and development prices. The City of San Diego's commissioned study by Keyser Marston Associates (KMA) estimates that in most, if not all scenarios, the addition of a prevailing wage requirement in development would increase rents by approximately one-third. SDCTA hypothesizes that creating prevailing wage requirements may reduce housing production, and thereby potentially transfer wealth from one low, middle-income segment of the population to another low, middle-income segment. This would cripple the ability of the San Diego middle class to acquire housing, and thus this requirement should not be added.

V. Conclusion

SDCTA believes that holistic and properly implemented housing policy can help meet the community's housing needs and provide a net benefit to all taxpayers. To facilitate that, SDCTA has developed a policy option for inclusionary housing regulations that helps de-concentrate poverty by accounting for geographic sub-markets and preventing increases in minimum requirements that may make future development infeasible. As the issue advances through the legislative process, SDCTA may provide further recommendations and options for policy makers based upon its research. SDCTA looks forward to collaborating with the City of San Diego as it plans to update its inclusionary housing ordinance later this year.

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[16] (2016). The Economics of Inclusionary Development. Urban Land Institute.
[17] (2018). "Apartment Construction is Drying Up. Is Affordable Housing Measure to Blame?" Oregon Live.

Figure 10: Comparison of Geographically-Targeted Inclusionary Housing Programs

	Localities			
	Burlington, VT[18]	**Chapel Hill, NC[19]**	**Charlotte, NC[20]**	**San Francisco, CA[21]**
Inclusionary Housing Unit Requirement	15% for 0 to 139% AMI	10% for Town Center Districts 1 through 3	50% of Single Family and Multi-family Projects *(Not required)*	12% for 80% AMI and 10-25 units
	20% for 140 to 179% AMI	15% for Balance of Planning Area, including town limits		18-20% for 80% AMI and 25 or more units
	25% for 180%+ AMI or water front areas			
Income Target	65% AMI	65% AMI	80% AMI	65% AMI
	75% AMI	80% AMI		100% AMI
Development Threshold	5 or more dwelling units	5 or more units	12 units	10 or more units
Period of Affordability	99 years	99 years	15 years	50 years
Geographic Boundaries	AMI Percentages and Waterfront District Lines	AMI Percentages, Town Center Districts and Areas of Interest	Census block groups with median home values at or above the area median according to five-year estimates from the American Community Survey (ACS)	Higher requirements apply to target areas for new housing as identified in San Francisco's Housing Element
Compliance Options	1.5 times the Requirement Off-Site	Payment in Lieu of ½ a Unit in amount needed to make unit affordable	Voluntary Program	Payment of fee for the Small Sites Program; in some neighborhoods, dedicating land to the City
	Payment in Lieu Per Unit, Indexed to Inflation			Payment in Lieu of 20% of the offsite units in the principal housing project
Cost Offsets	15-25% added density & lot coverage	15% added density & reduced lot sizes	15-20% added density, more if near transit	Added density for 20-30% on-site affordable
	Up to 50% waiver of parking requirements		Reduced lot sizes and mis of housing types up to a quadruplex	

[18] (2017). "Evaluation of the City of Burlington's Inclusionary Zoning Ordinance: How Well is it Working and What Role Can it Play in Shaping the Future of Affordable Housing in Burlington?" Czb.LLC
[19] (2011). "Questions and Answers About Chapel Hill's Inclusionary Zoning Ordinance." Town of Chapel Hill.
[20] (2011). Incentive Based Inclusionary Housing. City of Charlotte.
[21](2019) Article 4: Development Impact Fees and Project Requirements that Authorize the Payment of In-Lieu Fees. American Legal Publishing Corporation.

VI. **Appendix:** Supplemental Policy Options

To achieve the policy approach formulated, the City of San Diego may choose to explore the following options:

- **Inclusionary housing requirements could use public high school attendance boundaries to divide the city into sub-markets.**

A sub-market specific inclusionary housing ordinance requires data to define the submarket boundaries and needs. Public school attendance boundaries provide a good source of information by using at-risk enrollment as a proxy for the distribution of low-income households. This option could maximally leverage taxpayer dollars spent at all levels of government. The suggested geographic segments could further specify scale by the type of public school, where SDCTA suggests high school as the most feasible alternative given their size.

This option, while imperfect, may create checks and balances across government types as an annually revised geographic boundary based on the needs of the population. Exploring how to increase education performance (or levels) in the areas where upward mobility is desired may also achieve some of the core objectives of inclusionary housing regulations.

To establish its boundaries, the San Diego Unified School District considers the following factors when revising its attendance boundaries[22]:

i. School enrollment data, including enrollment trend information
ii. Facility capacity and design, including potential commercial and residential developments
iii. School feeder patterns, including maintaining, to the extent practicable, continuity of student attendance
iv. Federal, state, or court mandates
v. Community input
vi. Student safety
vii. Transportation capacity
viii. Community and neighborhood identity
ix. Geographic features of the district, including traffic patterns
x. Educational programs, such as magnet schools and charter schools (cf. 7160 - Charter School Facilities)
xi. Other factors

In order to alleviate overcrowding, the District may also place some students in a school outside of their attendance area, and if available, transportation is provided for such students. The District's Instructional Facilities Planning Department staff develops the attendance boundaries after consulting the affected communities and other district departments. Recommendations are then presented for approval by the Board of Trustees.

Information on at-risk enrollment can be accessed through the Local Control Funding Formula (LCFF). The LCFF was enacted in 2013 as a finance system that requires school districts to focus on eight key areas when planning (including course access and school climate), provides extra funding for students with greater challenges, and gives the district more flexibility for how to spend

[22] (2016). "School Attendance Boundaries." San Diego Unified School District.

its money to improve local schools. Targeted pupils are those classified as English learners, those who meet income requirements to receive a free or reduced-price meal, foster youth, or any combination of these factors. LCFF funds include a base level of funding for all Local Educational Agencies (LEAs) and extra funding – called "supplemental and concentration" grants – to Local Educational Agencies based on the enrollment of high need students. In the City of San Diego area, funds are distributed to school districts and to charter schools individually.

Information on at-risk enrollment can also be accessed by school through School Accountability Report Cards (SARCs). State law also requires public schools throughout California to provide public information in the form of an annual School Accountability Report Card (SARC), which provides the data used during the planning and allocation of LCFF funds. The report cards allow the public to evaluate and compare schools regarding school demographic, academic, fiscal, and expenditure data. Specifically, each SARC outlines at-risk student enrollment—including foster youth, socioeconomically disadvantaged, English learners, and students with disabilities. Further data on the percent of students who are eligible for Free or Reduced-Price Meals, as identified through the California Longitudinal Pupil Achievement Data System (CALPADS), could also be used as proxy for socioeconomic disadvantage within public schools.

During its research, SDCTA considered other geographic measures by which to guide the inclusionary housing requirements and formulas. However, the sizes and complexities of alternatives explored may prevent these boundaries from capturing the market effectively. For instance, SDCTA considered Opportunity Zones as a potential determination because they are designed to incentivize economic development by providing tax benefits to investors (or in this case, developers), but it is not a determination with a comprehensive geographic grid. SDCTA also considered City Council Districts, but income diversity is not a factor considered when its boundaries are drawn.[23]

SDCTA then learned about ZIP Code Tabulation Areas (ZCTAs), which may be helpful at accurately depicting potential inclusionary housing zoning areas by summarizing statistics for subjects like sex, age, race, relationships, households by type, housing occupancy, and housing tenure. Finally, SDCTA considered the San Diego Housing Commission's Choice Communities initiative, in which the agency divided the City ZIP codes into three groups, each with its own payment standard. According to SDHC, "the payment standard is the maximum subsidy payment that the Section 8 Housing Voucher would pay for an apartment or rental house, minus the applicable tenant rent portion."[24] These communities were informed by the Federal government's Small Area Fair Market Rents determinations. Their goal is to provide families that receive rental assistance with more opportunities for transportation, schools, and employment.

- **Inclusionary housing requirements could adjust to market conditions based on current "at-risk" measurements in the attendance boundary.**

The regulations should be flexible enough to reflect current and evolving market conditions. The minimum requirement could be zero in the attendance boundaries with the most at-risk students. The minimum could be the highest in the attendance boundaries with the least at-risk students. This could incentivize the building of the most economical market-rate housing in the most

[23] (2011). "Filing Statement and Final Redistricting Plan for the City of San Diego." KPBS.
[24] (2018). Choice Communities Initiative Factsheet. The San Diego Housing Commission.

impoverished areas of San Diego, and potentially incentivize the building of inclusionary housing in the sub-markets that can actually bear the costs. Therefore, the minimum inclusionary housing requirement for each public-school attendance boundary could be an inverse proportion of the selected at-risk enrollment variable for the pertinent school, as shown in the formula specified in **Figure 12.**

The ordinance could provide for a reduction in the minimum inclusionary housing requirement over time as new inclusionary housing is built. There could also be a maximum on new luxury development in extremely wealthy neighborhoods. Violations to that maximum could be subject to penalties tied to the actual cost of an affordable housing unit as of that year on a square footage basis.

Figure 12: Potential Formula for Inclusionary Housing Requirements

<table>
<tr><td rowspan="5"><u>Variables</u></td><td>Current Poverty Concentration</td><td>Latest “at risk” student population in a school attendance boundary where a development is being considered.</td></tr>
<tr><td>Highest Poverty Concentration</td><td>Latest highest “at risk” student population in the City of San Diego by school attendance boundary</td></tr>
<tr><td>Lowest Poverty Concentration</td><td>Latest lowest “at risk” student population in the City of San Diego by school attendance boundary</td></tr>
<tr><td>Target Annual Median Income</td><td>Latest AMI level where a family spends more than 30% on housing based on latest average rent prices</td></tr>
<tr><td>Deficit from Housing Element Goal</td><td>If there is a housing deficit against RHNA, this is 1; if there is no deficit, 0.</td></tr>
<tr><th>Requirement</th><th colspan="2">Threshold</th></tr>
<tr><td>0</td><td colspan="2">If in the most impoverished school attendance boundary throughout the city</td></tr>
<tr><td>0</td><td colspan="2">If in the least impoverished school attendance boundary throughout the city AND if the Deficit from Housing Element Goal is zero.</td></tr>
<tr><td>15% for Target Annual Median Income and below</td><td colspan="2">If in the least impoverished school attendance boundary throughout the City</td></tr>
<tr><td>0</td><td colspan="2">If in a school attendance zone in between the most and least impoverished AND if the Deficit from Housing Element Goal is zero.</td></tr>
<tr><td colspan="3">Otherwise, the minimum equals the inverse of (Current Poverty Concentration multiplied by the ratio of Lowest Poverty Concentration and Highest Poverty Concentration) multiplied by 15% of units for Target Annual Median Income and below.</td></tr>
</table>

On Gentrification

Gentrification is defined as the process of renovating and improving housing within a district so that it conforms to middle-class taste. Many residents worry that rent increases associated with gentrification may result in displacement, where when vulnerable households do move from a gentrifying area, they are more likely to move to lower-income neighborhoods than similar households moving from non-gentrifying neighborhoods.[25] Operationalizing the role of local neighborhood community planning groups within the City of San Diego could address concerns on gentrification.

Overall, academic research has not been able to attribute any one factor conclusively to gentrification. While scholars have identified potential tools to address the issue, they stress the need for both quantitative and qualitative research that sheds light on how gentrification affects existing residents of the gentrifying neighborhood, other neighborhoods, and other jurisdictions. Researchers recommend that policy makers: prioritize the preservation of existing affordable rental units; protect long-time residents who wish to stay in the neighborhood; ensure that a share of new development is affordable; utilize the revenue generation that harnesses growth to expand financial resources for affordable housing; and incentivize development of affordable housing and the property acquisition of sites for affordable housing."[26]

- **An auction mechanism to facilitate preservation of existing affordable housing units could serve as an additional alternative compliance mechanism.**

A jurisdiction's "in-lieu" fee reflects the policy priorities of its leadership. A city may want to encourage on-site performance or to collect revenue that it can leverage to build affordable units off-site. A higher fee may incentivize developers to build units on-site; if the fee is below the cost of on-site performance, this may result in poor overall performance of the affordable and inclusionary housing program.

SDCTA recognizes that preserving affordable housing is much more economical than building new affordable housing. Owners of existing affordable housing units could be incentivized to keep their units designated as affordable. This could be accomplished by allowing developers of new construction to pay current owners of affordable housing via an auction market mechanism, in lieu of meeting the applicable new-construction minimum requirement.

A developer could then be able to reduce its requirement by the number of units it successfully preserves through this auction as an alternative compliance mechanism. This auction setup would reflect true free market principles in the preservation of restricted units and may reduce the public role in administering "in lieu of" fees.

Moreover, updates to the existing regulations should incentivize owners of subsidized rental properties to keep those units in the affordable market, where tax credits and other financing mechanisms do not exist at the 55-year point. Any fees collected should be transferred to a private community land or housing trust servicing the city.

Finally, some developers have proposed having project companies pay a developer fee at the end of the project or over time (with interest) to the extent there is operating cash flow to cover it. When thinking about taxpayer protections, the deferral period should not be longer than a few years and it

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[25] Ding, Hwang, and Divringi (2016). Qtd. In Herber et al. (2018). A Shared Future: Fostering Communities of Inclusion in an Era of Inequality. Joint Center for Housing Studies of Harvard University.
[26] Been. (2018). *What More Do We Need to Know about How to Prevent and Mitigate Displacement of Low- and Moderate-Income Households from Gentrifying Neighborhoods?* New York University.

should be clear from the base case model for the project that the project will have the cash to pay the fee on schedule.

- **The efficiency of Developer Impact Fees should be reassessed, and other incentives should be considered.**

SDCTA acknowledges the need to mitigate developer impacts. However, research shows the fees are not effectively deployed while making housing and development more expensive in general, thereby impeding development.

Creating incentives for housing developers that minimize the cost of building inclusionary housing in areas with concentrated poverty and increase the cost in more profitable areas is likely to shift development trends that increase the stock and income diversity in targeted areas. SDCTA predicts that, if the regulations are setup geographically and if the fees are tied to actual market conditions, creating additional incentives with taxpayer cost would become economically inefficient.

However, exploring the impact of other incentives (or their combination) may be beneficial. There could be access to property tax credits for those developers who are employee-owned and sufficiently large. Alternatively, there could be a penalty for large, non-employee-owned developers, with those funds going into a local investment fund for smaller developers. Density bonuses within metropolitan areas that allow building more units on a property than are otherwise permitted as long as a certain percentage of the additional units are reserved for low- or moderate-income households may also prove partially effective in moderation.

At the same time, as trends in job creation remain steady, demand for rentals in more affordable areas of the county will likely outpace construction, causing vacancies in areas to tighten.[27] Employers continue to attract and retain talent; incentivizing business to invest in funding for inclusionary housing in exchange for business personal property tax or real property tax exemptions may be in the best interest of all parties.

Performance-based grants, low interest loans, and other assistance may support business attraction and expansion projects that involve capital investment in the housing. Businesses that locate in a targeted district could receive full or partial tax abatements on business personal property taxes. New warehousing, distribution, and logistics facilities could qualify for a percent reduction in real property taxes for up to certain amount of years.

[27] (2019). "San Diego Multifamily Investment Forecast: 2019 Outlook." Marcus & Millichap.