

City of San Diego Housing Impact Fee Increase *December 2010*

Board Action:

OPPOSE Increase in Linkage Fee

Rationale:

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. Even with the consideration of delaying implementation of the increase until the economy improves, the fee is not a steady revenue source for affordable housing. If affordable housing is truly a priority of the City Council, a stable source of revenue to support affordable housing projects should be identified. Once a final decision has been made, the City must update the Municipal Code to reflect the current status of the fee and include any provisions that are adopted, as well implement the remaining audit recommendations that have been provided in an effort to produce efficiencies.

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 range.

Table1: Linkage Fee Schedule

Type of Building Use	Linkage Fee in 1990 (Fee/Sq Ft)	Current Linkage Fee since 1996 ¹ (Fee/Sq Ft)	Recommended Linkage Fee Range (Fee/Sq Ft)
Office	\$2.12	\$1.06	\$1.90~\$3.80
Hotel	\$1.28	\$0.64	\$1.60~\$3.20
Research and Development	\$1.60	\$0.80	R&D uses would be defined as Manufacturing uses.
Retail	\$1.28	\$0.64	\$1.70~\$3.40
Manufacturing	1.28	\$0.64	\$1.20~\$2.40
Warehouse	0.54	\$0.27	\$0.80~\$1.50

Commissioned Study Results:

The City of San Diego’s Land Use and Housing (LU&H) Committee has directed the San Diego Housing Commission (SDHC) to review the linkage fee and provide recommendations for changes to its affordable housing policies and funding sources. SDHC has taken the Keyser

¹ City of San Diego Municipal Code Chapter 9 Article 8 Division 6.

Marston Associates' (KMA) "Jobs Housing Nexus Study" into consideration in providing the following recommendations for updating the linkage fee²:

- Apply an Annual Index
- Maintain Current Fees Until the Economy Improves
- Range of Options for Increased Fees Once Economy Improves

The purpose of the nexus analysis was 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 yields a connection between new construction of the types of buildings in which there are workers and the need for additional affordable housing, a connection that is quantified both in terms of number of units and the amount of subsidy assistance needed to make the units affordable."

In *Commercial Builders of Northern California v. City of Sacramento*, the commercial builders of Sacramento sued the City following the City's adoption of a housing linkage fee. Commercial Builders challenged the ordinance, arguing that it constituted a taking requiring just compensation under the Fifth and Fourteenth Amendments to the United States Constitution³. Both the U.S. District Court and the Ninth Circuit Court of Appeals upheld the City of Sacramento and rejected the builders' petition on the basis the City had shown the nexus required between nonresidential development and the demand for low-income housing and that there was a rational relationship between the exaction and the cost of the low-rent housing projects. The U.S. Supreme Court denied a petition to hear the case.

SDHC has also taken study results from Bay Area Economics' "Affordable Housing Best Practices and Funding Study" to develop a set of recommendations for alternative sources of funding and changes to its affordable housing policies. The Bay Area Economics' analysis provided the following recommendations⁴:

- Engage Civic Leaders from the Business and Philanthropic Community in a renewed effort to support affordable housing
- Form a Regional Land Bank
- Increase the amount of Community Development Block Grants (CDBG) Funding Dedicated to Affordable Housing
- Increase the Percentage of Redevelopment Tax Increment Funding Dedicated to Housing

²Prepared by Keyser Marston Associates, Inc. "Jobs Housing Nexus Study." October 2010.

³Timothy M. Tesluck, *Commercial Builders of Northern California v. City of Sacramento: Commerce Creates Poverty*, 42 Case W. Res. 1339.

⁴Prepared by Bay Area Economics. "Affordable Housing Best Practices and Funding Study." November 1, 2010.

- Maintain and Update Inclusionary Housing Program
- Maintain and Update Commercial Linkage Fee
- Consider Forming Affordable Housing Overlay Zoning in Key Parts of the City
- Dedicate a Percentage of Transient Occupancy Tax (TOT) Revenues to the Housing Trust Fund
- Consider Forming a “Leading Way Fund” – similar to the Boston model in which one-time city revenues are collected to support affordable housing production

Currently, the SDHC is still discussing the linkage fee issue with public stakeholders, and has stated is open to dialogue for finding alternative solutions to fund affordable housing. SDHC is planning to give its recommendation regarding the linkage fee to the LU&H Committee during the first quarter of 2011, following additional stakeholder meetings and another potential presentation to the LU&H Committee.

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 (see Table 2 and 3). The San Diego Housing Commission is researching ways to update and re-adjust the linkage fee rate. The recommendations SDHC suggested may lead to an increase in the linkage fee rate and establish an automatic adjustment to the rate based on economic conditions. The fee level would adjust according to suggested indexes that are related to the subject, such as: Building Cost Index, Construction Cost Index, Consumer Index, Housing Affordability Index, or Bureau of Labor Statistics Construction Index. Since the linkage fee rate would rely on the 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.

Impact of Proposition 26

In November 2010, voters in California passed Proposition 26, otherwise known as the “Stop Hidden Taxes” ballot measure. Proposition 26 amended the California Constitution by expanding the definition of a state or local tax to include many payments currently considered to be fees or charges.⁵ Proposition 26 requires taxes, under the new definition, to receive a two-thirds vote of the voting public in order to take effect. A tax is defined as any levy, charge or exaction imposed on the payor, and whose revenue is used to benefit the public as a whole, not

⁵ Legislative Analyst Office analysis of Proposition 26. July 15, 2010.

the individual payor. The measure did allow for various exceptions to this requirement, including “a charge imposed as a condition of property development”.

Local governments commonly charge various types of development impact fees, which are charges imposed as a condition of property development. A development impact fee is a monetary exaction other than a tax or special assessment that is charged by a local governmental agency to an applicant in connection with approval of a development project for the purpose of defraying all or a portion of the cost of public facilities related to the development project.⁶ These fees are intended to mitigate the adverse effects that can be attributed to increased development such as increased traffic congestion, increased burden on local services, or decreased air and water quality. If a development impact fee does not relate to the impact created by development or exceeds the reasonable cost of providing the public service, then the fee may be declared a special tax and must then be subject to a two-thirds voter approval.⁷

It is still unclear as to whether the language under Proposition 26 would define the City’s linkage fee as a tax and require any increase to be put before voters. This ambiguity could potentially lead to legal action should the City move forward with an increase to the fee.

Timing of the Linkage Fee Adjustment:

Due to the current economic downturn, there is 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 economic recovery. To define the threshold in which the linkage fee adjustment would occur, KMA recommended several indicators: Number of Non-Residential Building Permits or Valuation, Employment, and Vacancy Rates. KMA also suggested a fixed schedule adjustment, where the fee is increased or adjusted over a period of years.

Table 2: Linkage Fee Use (FY10)⁸

Activity/Project Group	Activity/Project	Amount
Rental Housing Finance	Acquisition & Rehab ⁹ – HDP	\$157,142
	Acquisition & Rehab - 34th Street / Townspeople	\$2,040,000*
	Development - Pacific Hwy / Veteran's Village	\$301,000.00*
	Development - Commercial & 22nd Street	\$4,200,000*
Homeownership	Down Payment/Closing Costs Assistance	\$198,269*
	First-Time Homebuyer Assistance	\$1,361,252*
Special Purpose Housing	Acquisition & Rehab - University Ave / Pathfinders	\$650,000
	Transitional Housing ¹⁰	\$9,685
Total		\$3,157,827

⁶ Gov. Code § 66000(b).

⁷ Cal. Const., Art. XIII A, § 4.

⁸ San Diego Housing Commission Fiscal Year 2010 Budget. This is a combined dollar amount of linkage fee and other funds, such as HOME, inclusionary fee, and CCDC Homeownership.

⁹ Providing below market interest rate deferred loans to improve deteriorated or functionally obsolete house units. Units need to be owner-occupied, single family to four-plex, or mobile home to be considered for the program.

¹⁰ Housing homeless people for a short period of time until they move into a permanent housing (2 weeks to 24 months). This group of people includes: mentally ill, serial inebriates, veterans, victims of domestic violence, and youth.

Table 3: Linkage Fee Revenue¹¹

Fiscal Year	Actual Collected	% Change (Actual Collected)	Fee Revenue Collected under Suggested Adjustment	% Change (Fee Rev. Collected under Suggested Adj.)
FY 1992	\$6,211,000	-	\$6,211,000	-
FY 1993	\$1,899,000	-69.43%	\$1,933,000	-68.88%
FY 1994	\$1,432,000	-24.59%	\$1,502,000	-22.30%
FY 1995	\$2,242,000	56.56%	\$2,485,000	65.45%
FY 1996	\$2,885,000	28.68%	\$3,319,000	33.56%
FY 1997	\$1,859,000	-35.56%	\$4,277,000	28.86%
FY 1998	\$3,283,000	76.60%	\$7,773,000	81.74%
FY 1999	\$5,398,000	64.42%	\$13,419,000	72.64%
FY 2000	\$4,953,000	-8.24%	\$12,411,000	-7.51%
FY 2001	\$3,382,000	-31.72%	\$8,636,000	-30.42%
FY 2002	\$2,425,000	-28.30%	\$6,341,000	-26.57%
FY 2003	\$1,645,000	-32.16%	\$4,344,000	-31.49%
FY 2004	\$1,448,000	-11.98%	\$3,878,000	-10.73%
FY 2005	\$2,262,000	56.22%	\$6,172,000	59.15%
FY 2006	\$3,520,000	55.61%	\$10,364,000	67.92%
FY 2007	\$2,949,000	-16.22%	\$9,160,000	-11.62%
FY 2008	\$2,389,000	-18.99%	\$7,710,000	-15.83%
FY 2009	\$677,000	-71.66%	\$2,244,000	-70.89%
FY 2010	\$256,000	-62.19%	\$888,000	-60.43%

*Note: Under the Actual Collected, the linkage fee revenue collected starting after FY2008 has significantly decreased relative to previous fiscal years at an alarming rate.

*Note: There is a discrepancy between the fee's revenue and expenditure. This might due to different accounting of the two different data sources and lack of precise expenditure dataset.

Since its inception, the linkage fee has generated \$51.15 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. These opportunities include¹²:

- 6,389 rental units
- 914 homebuyers
- 1,958 homes rehabilitated
- 9,032 transitional housing beds
- 139 pre development loans
- 9 Target of Opportunity grants
- 95 mobile home space purchases

Audit Recommendations

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

¹¹ Data obtained from Keyser Marston Associates, Inc. "Jobs Housing Nexus Study." October 2010.

¹² Performance Audit of the San Diego Housing Commission – Part II. July 29, 2009. Office of the City Auditor. SHDC Response to City Auditor's Report.

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.