

**Analysis of Proposed Legislation on Housing “Balance”**

May 23, 2014

On April 8, 2014, Supervisor Jane Kim introduced legislation creating a “Central City/South of Market Housing Balance Special Use District” for all of District 6 (South of Market, the Tenderloin and Treasure Island). Under this legislation, more commonly known as “metering,” any market-rate housing project in the district seeking approvals would need a separate conditional use approval by the Planning Commission if the ratio of affordable housing to market-rate housing in District 6 were below 30 percent at the time of application to the planning or building department. This separate conditional use approval would require special findings, and would be in addition to all the other entitlements the project would otherwise have to get.

While the proposal intends to address the problem of housing un-affordability, SPUR’s analysis is that this ordinance is likely to backfire—resulting in less market-rate housing, not more affordable housing. The ordinance will make it extremely difficult to construct new residential market-rate development in the district, which puts more pressure on the existing housing stock (the same number of renters and buyers competing for a smaller number of homes) and further aggravates our housing affordability crisis.

Some of the specific impacts of this legislation include:

- Fewer overall housing units (because supply will have to be suppressed to stay within the “balance”)
- Fewer affordable units (because there will be fewer inclusionary units produced)
- Potential de-funding of citywide affordable housing needs such as HOPE SF (because funds generated in D6 will need to be kept within the district in order to avoid the worst impact on production)

**In short, this ordinance will make housing in San Francisco more expensive.** SPUR believes the better approach is to increase funding for affordable housing.

**Summary of the ordinance**

The proposed ordinance creates a “Housing Balance” Special Use District (SUD) coterminous with District 6. Within this district, any new market-rate housing development (defined as any project 10 units or larger that is not a subsidized project 100% affordable to low or moderate income households) would need to obtain a conditional use permit if the cumulative housing balance ratio is less than 30% at the time of the project’s first application to either the Department of Building Inspection or the Planning Department.

The cumulative housing balance ratio is defined as all new housing units affordable to very low, low and moderate income households constructed or entitled from January 1, 1993 to the end of the most recent calendar quarter, less any affordable housing units

demolished, converted, or removed from rent control, divided by all new housing units constructed or entitled but not yet built within the same time period. Although property in a redevelopment area within the SUD (e.g., Mission Bay) would be included for purposes of calculating the cumulative housing balance ratio, the conditional use requirement would not apply to such property until the applicable Redevelopment Plan expires. (Note: if the Planning Department simply cannot calculate the ratio, a conditional use permit will be required regardless.)

The conditional use permit criteria would include:

1. The project's effect on the cumulative housing balance ratio
2. The location/intensity/size of the project, and whether it will hamper the location or viability of affordable housing projects
3. Whether approval of the project would cause or exacerbate direct or indirect displacement of low- and moderate- income households
4. Any specific adverse impacts on the district if the project were approved or disapproved
5. Whether the project mitigates any potential adverse impact on preserving the mixed-income character of the district

The Planning Commission would also have to make a finding that the project promotes the health, safety and welfare of the city and the district in spite of any citywide failure to provide sufficient affordable housing per the Regional Housing Needs Allocation or the General Plan, in spite of any failure to meet the district's cumulative housing balance ratio, and in spite of any direct or indirect impact the project might have on displacing very low-, low- or moderate-income households. For disapproval of a project, the Planning Commission would have to make findings to explain how the project would have adverse impacts on the public health and safety of the city and the district.

## **Analysis**

This legislation looks at the overall mix of housing in the district. It does not change the inclusionary requirement within any single project. Proposition C, the 2012 Housing Trust Fund, caps the inclusionary requirement at current levels (except when a site is up-zoned) in recognition of the fact that the current requirements are about as high as they can go without rendering private projects un-financeable.

In a sense, the ordinance seeks to re-create redevelopment—one of the main ways the city produced affordable housing before the State eliminated redevelopment agencies in 2012. The Mission Bay Redevelopment Plan contains 28% below market-rate (BMR) units. The Transbay Redevelopment Plan contains 35% BMR units. The Housing Balance Act would like to attain those results again across District 6.

The problem is this: redevelopment attained those high affordability numbers because it was able to use the growth of property tax in a district over a thirty-year period and other financing tools to pay for the affordable housing. In fact, it didn't just get to use the

City’s share of the property tax; redevelopment also got to use the tax increment that would otherwise have gone to the State of California.

What will the source of funding be now? It’s not clear that there is a good answer. But without a funding component, the legislation will not be redevelopment 2.0, nor will it be any increase in affordable housing; it will simply reduce market-rate housing.

To illustrate some of the unintended consequences of this legislation, SPUR analyzed five hypothetical scenarios projecting future development possibilities over the next twenty years. The calculations use a 15% inclusionary requirement as a district average, taking into account the 12% baseline requirement and higher requirements in particular areas.

***A. Development following current trends***

Scenario A looks at building a total of 10,000 units in District 6 under today’s laws.

<b>SCENARIO A - CURRENT TRENDS</b>	
<i>Assumes total of 10,000 units developed over 20 years</i>	
Market rate units	7,650
Inclusionary affordable units (15% of market rate units)	1,350
Non-inclusionary affordable project units (100% affordable projects)	1,000
TOTAL # UNITS	10,000
TOTAL % AFFORDABLE	24%
TOTAL SUBSIDY REQUIRED	\$200,000,000

This hypothetical scenario results in the development of 7,650 market-rate units, 1,350 inclusionary affordable units and 1,000 non-inclusionary affordable units. To build the 1,000 non-inclusionary affordable units, \$200 million (assuming \$200,000 in subsidy per unit) would be required in subsidy.

***B. Development under the legislation***

Scenario B looks at how the proposed legislation would affect housing development in the absence of additional funding for affordable housing.

<b>SCENARIO B - UNDER PROPOSED LEGISLATION</b>	
<i>Assumes affordable funding held constant</i>	
Market rate units	3,967
Inclusionary affordable units (15% of market rate units)	700
Non-inclusionary affordable project units (100% affordable projects)	1,000
TOTAL # UNITS	5,667
TOTAL % AFFORDABLE	30%
TOTAL SUBSIDY REQUIRED	\$200,000,000

In this scenario, we hold available affordable housing funding constant at \$200 million. Under this legislation market-rate development is suppressed by almost 50% in order to produce the same 1,000 non-inclusionary affordable units and keep the housing balance ratio at 30%. Likewise, affordable inclusionary units are cut in half, which is not a favorable outcome. This scenario is what we believe the legislation is most likely to lead to.

***C. Required subsidy needed under legislation if production of market-rate development follows current trends***

Another way to think about this legislation is to ask how much additional funding would be required to keep the 30/70 “balance” if we kept the market rate production from scenario A constant.

<b>SCENARIO C - FULLY FUND AFFORDABLE AT CURRENT MARKET RATE PRODUCTION LEVELS</b>	
<i>Assumes existing market rate and inclusionary units held constant</i>	
Market rate units	7,650
Inclusionary affordable units (15% of market rate units)	1,350
Non-inclusionary affordable project units (100% affordable projects)	1,929
TOTAL # UNITS	10,929
TOTAL % AFFORDABLE	30%
TOTAL SUBSIDY REQUIRED	\$385,714,286

Per Scenario C, \$386 million would be required to build 1,929 non-inclusionary affordable units to keep the housing balance ratio at 30% in District 6. This nearly doubles the amount of affordable housing subsidy assumed under the “current trends” Scenario A. This is probably what many proponents of the measure would like to see – a doubling of funding for affordable housing within the district. But as of now, the legislation does not help us get there.

***D. Increasing the housing supply, while holding funding for affordable housing flat***

We can really see how damaging this legislation is if we explore another scenario: what happens if we actually succeed in ramping up housing production overall? Scenario D looks at a major increase in market-rate (and inclusionary) housing production under current law but assumes that the (highly optimistic) amount of \$200 million in funding for affordable housing stays the same. This is a scenario that would make prices for the bulk of the housing supply less expensive than scenarios A, B, or C, and it would also help more people at below market income levels because of the inclusionary units. But it would lead to a worse “balance.”

<b>SCENARIO D - MAJOR INCREASE TO HOUSING SUPPLY + SUBSIDY STAYS FLAT</b>	
<i>Assumes market rate and inclusionary units quadruple, affordable funding held constant</i>	
Market rate units	30,600
Inclusionary affordable units (15% of market rate units)	5,400
Non-inclusionary affordable project units (100% affordable projects)	1,000
TOTAL # UNITS	37,000
TOTAL % AFFORDABLE	17%
TOTAL SUBSIDY REQUIRED	\$200,000,000

In this scenario, we would produce 30,600 market-rate units, 5,400 inclusionary affordable units, and 1,000 non-inclusionary affordable units, increasing the supply by a massive amount without allocation of new public resources. However, this reduces the housing balance ratio to 17%.

We believe it is clear that scenario D helps the most people, including those who are most in need, and gives the most people the chance to live in San Francisco. But it would not be possible if the proposed legislation is adopted as-is.

***E. Required subsidy needed under legislation if market-rate production increases***

Finally, we look at a scenario that calculates how much new funding for affordable housing would be necessary to maintain the 30/70 “balance” if we ramped up overall housing production to the levels of scenario D.

SCENARIO E - MAJOR INCREASE TO HOUSING SUPPLY UNDER THIS LEGISLATION + FULLY FUND AFFORDABLE	
<i>Assumes market rate and inclusionary units quadruple</i>	
Market rate units	30,600
Inclusionary affordable units (15% of market rate units)	5,400
Non-inclusionary affordable project units (100% affordable projects)	7,714
TOTAL # UNITS	43,714
TOTAL % AFFORDABLE	30%
TOTAL SUBSIDY REQUIRED	\$1,542,857,143

This hypothetical scenario would need \$1.5 billion to produce 7,714 non-inclusionary affordable units to keep the housing balance ratio at 30%. Is this what the legislation's proponents hope for?

**Overall, if this legislation passes the most likely outcome will be to suppress the total supply of housing – by almost 50%, as shown in scenario B.**

The proposed legislation also makes every single land transaction in the district face increased uncertainty because of the future possibility of a Conditional Use requirement. The increased risk and lengthier approval process will drive up the cost of capital and subsequently the minimum feasible price point needed for market-rate housing development to be financed.

Given increased uncertainty around residential entitlements, it is also likely to shift sites in mixed-use zones (which cover much of District 6) to office development and away from housing.

**In summary, this proposal is likely to make the average cost of housing more expensive and is likely to result in fewer people – at all income levels – having the chance to live in San Francisco.**

We believe there are some revisions or new concepts that could make the legislation more workable or less damaging.

### **Recommended Amendments + Additions**

#### **1. Make the off-site inclusionary option work**

Over the life of the City's inclusionary housing program, there have always been three different options: payment of an in-lieu fee, an on-site development option, and building the units off-site. In practice, however, the off-site option is rarely used because of its complexity, the need to complete all off-site units prior to the

marketing of the market-rate project, and the virtual prohibition on combining any subsidies from non-profit affordable housing funds with market-rate funds.

This legislation further emphasizes the importance of making the off-site below-market rate (BMR) alternative functional. Changing these requirements and encouraging partnerships with non-profit developers, as well as making simple adjustments to the rules will make the inclusionary requirements more functional within the district. For example, changing the one-mile radius requirement to instead include the entire district would possibly expand off-site opportunities for District 6 market-rate projects so that an off-site location could be selected anywhere in District 6. Other suggestions for improvements include allowing additional time to deliver off-site affordable units, allowing flexibility on the affordable unit mix and enabling more than one market-rate project to support off-site inclusionary units in a combined affordable project. If these and other issues are remedied and the off-site inclusionary were to become the default choice, the affordability component of market-rate projects would go from the current on-site percentage of 12% to 20%.

## **2. Enact the inclusionary “dial” concept**

SPUR’s Middle Income Taskforce has been working on a draft of the “dial” concept. Using the existing inclusionary requirement as a base (12 percent of units at 55 percent of average median income (AMI) for rental and 90 percent of AMI for ownership), the “dial” concept shows how more BMR units could be provided at somewhat higher AMIs, keeping the cost to the project sponsor roughly constant. Allowing somewhat higher AMIs as part of the “dial” concept would be consistent with this legislation because the cumulative housing balance ratio also accounts for moderate-income units (currently defined under Planning Code Section 401 as units affordable to households earning up to 110% AMI). The “dial” standard would give developers more flexibility in meeting their requirements and would help meet current policy goals of addressing affordability issues for moderate-income households. This would increase the number of affordable on-site BMR units provided in market-rate projects from 12% up to roughly 15% at 120% AMI for ownership projects and 22% at 120% AMI for rental projects.

## **3. Reduce required cumulative housing balance ratio from 30% to 20%.**

The limiting factor on the amount of affordable housing is simply the amount of subsidy that is available. At this point there is not enough to build 30%; there is not even enough to build 20%. Reducing the threshold before the conditional use requirement is triggered would be one of the more direct ways to help make the legislation workable. A 20% threshold would also more closely align with the BMR in-lieu fee, the BMR off-site alternative and the affordability requirement for 80/20 projects.

**4. Change the findings language to be implementable**

Right now, the required conditional use findings are an invitation to endless lawsuits. The findings should be straightforward and focus on issues that the project sponsor can influence.

The findings should be adjusted such that the Planning Commission has real discretion to make the decision as to whether a market-rate housing project can go forward or not. Currently, the findings requirements put the Planning Department staff, Commission and project sponsor in an impossible situation in trying to answer questions that inevitably cannot be answered. For example, how can the Planning Commission determine whether a single project will “substantially hamper the location or viability of affordable housing in the Special Use District”? Or how do you determine if a project that will convert vacant commercial use to housing “will cause or exacerbate the direct or indirect displacement of households of very low, low or moderate income from the Special Use District”? It is problematic to make such open-ended statements be part of the required CU findings for every project.

**5. Set a grandfathering date**

It is unfair to the property owners and developers who are in the middle of their entitlement process today to be subject to the new rules that are proposed under this ordinance. A reasonable grandfather date that would protect this group would exempt all projects that filed their preliminary project assessment (PPA) application prior to the date the ordinance was introduced should be exempt from any requirements under this new law.

**6. Clarify what counts toward the required ratio**

Projects that pay the in-lieu fee should be deemed to contain 20% affordable units, and projects that elect the off-site option should be deemed to contain 20% affordable units, whether the off-site units are located within District 6 or not.

**7. Make a one-time allocation from the General Fund to the Housing Trust Fund**

Given the current demand for more affordable housing as well as ambitious plans for re-envisioning the San Francisco Housing Authority, there is extraordinary need for more affordable housing funding at this moment, while the Prop. C Housing Trust Fund gets built up over the next several years. The City also happens to have extraordinary resources available. San Francisco’s budget grew by \$700 million from last year to this year. The city should make a one-time allocation from the General Fund to affordable housing.

**8. Require Jobs-Housing Linkage funds paid by commercial development and/or In-Lieu affordable housing fees generated in the district to stay within the district**

The Mayor's Office of Housing and Community Development is not currently required to use BMR in-lieu fees or Jobs Housing Linkage Fees within the same

voting district as the market rate project or commercial development. If there is going to be legislation that meters the amount of market rate supply to the amount of affordable supply, then it is essential that fees generated from development within the district remain in the district. (Otherwise, projects in District 6 could pay huge fees for affordable housing that don't even count toward the 30% goal.) This would be at the expense of citywide affordable housing needs (such as HOPE SF). This is not SPUR's desired outcome, but linking the affordable funds to the district is one logical way to mitigate the likely suppression of market-rate and affordable supply. If the belief is that MOH should continue to have flexibility to allocate fees to the areas of greatest need in the city, then the fees paid by development within the district still need to be treated as "counting" toward the overall requirement.

**9. Subject to future State legislation, establish an infrastructure financing district (IFD) in District 6 to capture tax increments to support affordable housing development**

Redevelopment is what made the city's affordable housing development accomplishments in District 6 originally possible, and IFDs are perhaps the largest opportunity San Francisco has to capture the district's tax-increment over a long period of time. Conversely, if the City decides that using tax growth for affordable housing is not the highest priority or does not want to lock in that use of funds, then it is not workable to meter market-rate housing production in this way.

**10. Exempt existing area plans from the proposed legislation.**

This legislation makes it impossible to fulfill the intent of the area plans (for example, Eastern Neighborhoods, Rincon Hill and Transbay) that were just adopted after years of collaboration and negotiation and that already have heightened affordable housing and/or impact fee requirements.

**11. Exempt Student Housing projects**

Student Housing projects (i.e., student housing owned, operated or otherwise controlled by an accredited post-secondary educational institution) should be exempted from this legislation, consistent with the City's policy decisions aimed at encouraging the production of new Student Housing projects. In 2010 the Board of Supervisors adopted legislation exempting Student Housing projects from the City's Inclusionary Housing Program. This legislation would be inconsistent with that policy decision, which came at a high price. Shortly thereafter, Student Housing projects were prohibited from occupying existing residential buildings Citywide, meaning that new construction is now the default and cannot be hindered by this legislation. Regardless of whether Student Housing projects are exempted from this legislation, they should not be included in the calculation of the cumulative housing balance ratio (neither numerator nor denominator).

## **Conclusion**

Though well intended, this legislation is unlikely to address our current housing affordability crisis in District 6, since it does not direct more resources to affordable housing. Its most likely impact will be to reduce the overall housing supply. We believe that a better approach would be to work towards increasing affordable housing production in District 6 and citywide.

## Appendix

## METERING SCENARIOS

*Key Assumptions*

<i>Subsidy needed per affordable unit</i>	\$200,000
<i>Inclusionary requirement (district-wide average)</i>	15%

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