San Francisco CA: *Inclusionary Affordable Housing Program*

San Francisco, a city of 750,000, is one of two major cities first to adopt inclusionary zoning. This program has been adapted in substantial ways over the years to make it more productive and demanding. It imposes a different affordable housing obligation on developments needing re-zoning and those proceeding as-of-right. It possibly is the only program that does not provide density bonuses or other cost off-sets for as-of-right developments.

INTRODUCTION

The city adopted its first inclusionary zoning program – called its *Inclusionary Affordable Housing Policy* – in 1992. That program was substantially strengthened in early 2002, and formally renamed the *Residential Inclusionary Affordable Housing Program* (but most commonly called by the shorter name used above). It was then amended in 2006 and 2007, generally to tighten and expand provisions. The provisions are contained in Section 315 of the Zoning Procedures of the city's Planning Code.

The first program, like its successors, was mandatory but otherwise was different in two key ways. First, since it was adopted as a policy rather than an ordinance, the regulations were treated as guidelines that were open to interpretation and negotiation. Second, the provisions were applied to only certain developments – namely, those that went through either the zoning amendment process or comprehensive development approval process. This program was changed because it failed to produce much affordable housing.

The city has a population of slightly over 750,000, but is the downtown core for the San Francisco Bay Area, a metropolitan area of nearly 7.5 million. The city is virtually built-out with very few undeveloped tracts available for additional housing. It has been for many years one of the most expensive places to live in the US.

State legislation in California does not mention inclusionary zoning, nor explicitly require or enable local governments to use it. Nevertheless, it is accepted that the legislation provides ample implicit authority for the local jurisdictions to use inclusionary zoning, both voluntary and mandatory.

Support for inclusionary zoning can be found in various housing measures adopted piecemeal fashion over the years. Taken in their entirety, these measures strongly compel local jurisdictions to use their resources and powers (but not necessarily inclusionary zoning) to affirmatively provide for – not just to plan for – their affordable housing needs.

Inclusionary zoning is widely used in the state. According to a 2006 survey, at least 170 local governments in the state have adopted inclusionary zoning, and over 60 in the San Francisco Bay Area alone. Out of this total, approximately 75% are mandatory.

The program is administered by the Mayor's Office of Housing (MOH).

PROVISIONS

Subject Developments

The inclusionary requirements apply to all residential developments of 5 or more units.

This threshold was introduced in 2007; before it was 10 or more units. Although this change was determined to affect only about 6% more housing units, it was considered appropriate in order to treat developments more equitably.

Subject Developments & Set-aside Requirements

Developments using the as-of-right approval process must set aside 15% of the units as affordable.

Developments receiving "special development rights" must set aside 17% as affordable. These include the following:

- developments obtaining a zoning amendment (called 'conditional use permits' in the regulations);
- developments using a comprehensive development approval process (called 'planned unit developments', or PUDs); and
- developments providing live-work units.

The higher rate is applied to these developments because they are considered to receive additional "material economic benefits" from these special rights.

These rates are increased to 20% when the developments build the inclusionary units off-site or pay fees-in-lieu.

These set-aside rates, which were introduced in 2006, substantially increase the amount of housing required by 42% and 50%.

Live-work developments were also added in 2006. For years, they have represented a significant part of the housing growth in the city. They have been included because they are being allowed as-of-right in certain older industrial areas where residential is not otherwise permitted, and under relaxed development standards not allowed elsewhere.

Changes subsequently made in 2007 introduced a temporary exception that is due to expire in 2012. Under this exception, residential buildings of more than 120 ft in height already in the approvals system at the beginning of 2006 have been allowed to proceed under the lower 2002 set-aside provisions that were in effect when they started.

These requirements generally cannot be met by affordable housing units receiving government subsidies. There is one exception: units using tax-exempt state bonds are eligible, but a higher number must be provided and at a deeper level of affordability.

Dates of Key Changes

	1992	2002	2006	2007
development size (units)	10	10	10	5
setaside requirement (%)				
- as-of-right	0	10*	15*	15*
- “special developments rights”	10	12*	17**	17**
control period (years)				
- ownership		50	50	life of project
- rental		50	50	life of project

* + 5% when not built on-site
** + 3% when not built on-site

Targeted Incomes

The affordable units when provided on-site must be affordable to households earning no more than 120% of the local median income when ownership, and 60% when rental.

The prices for the on-site ownership units must be affordable on average to households earning 100% of the local median income, while also serving a range of households from 80% to 120%. This requirement was introduced in 2007 as a way of providing a mix of housing types and income levels in every development.

Units built off-site, whether rental or ownership, must be affordable to households earning no more than 80% of median income.

Cost Offsets

The program does not offer any cost-offsets to the developments in return for the provision of the affordable units.
The only potential but nominal concessions are refunds to the various processing fees for the affordable units, and reductions to the parking requirements, but these concessions are available to all affordable units and are not specific to inclusionary units.

Developments proceeding through a special approvals process, like a re-zoning, can and do indirectly receive various benefits on a negotiated basis – including typically density increases and other regulatory concessions – but these are determined independently of the inclusionary program.

Developments proceeding as-of-right, on the other hand, do not have this indirect way of securing concessions, and so do not receive any cost offsets.

The city's justification for taking this approach, while not coherently presented, can be gleaned from the "findings" that introduce the ordinance:

- The city acknowledges that developments going through the special approvals process receive increases in density and other benefits, and that these benefits should enable the developers to provide the affordable housing without public subsidies or financing.

- The city also states that meeting the affordable housing requirements without cost offsets should be generally feasible, provided that the developer is able to consider those requirements when negotiating the land purchase.

Studies of the economic impact of the affordable housing requirements also have found that the developments can meet these requirements without cost offsets, while making a reasonable profit and rate of return.

Compliance Alternatives

The developers are able to build the affordable units on-site or off-site, or pay fees-in-lieu, or use some combination of the three. The developers have the right to choose the option; the city cannot dictate it.

The off-site and fees-in-lieu alternatives are subject to various additional conditions. In both cases, the housing obligation is increased to 20%.

While the city's primary goal is to develop income-mixed housing, its position is that the city's interest are better served by accepting the alternatives whenever the developer is willing to provide or support a significantly larger number of affordable units.

Off-Site Units

The off-site construction generally must be located within 1 mile of the market units. There is also a special provision that allows for a quarter of the off-site units in any year to be located farther away.

These units are also subject to lower income thresholds and to additional development controls

The earlier programs allowed for the off-site units to be located in a high needs area or high priority project anywhere in the city. That provision was dropped because the city wants to ensure that the affordable units are somewhat near the originating site. (Furthermore, the city had never formally identified any such areas or projects.)

In making this new requirement, the city recognized that it would serve to concentrate the off-site developments in and around the downtown where most new development was occurring, and that this in turn could increase the cost of providing the housing because of the limited site choices and higher land prices.

Fees-in-Lieu

The fees-in-lieu are based on what the city calls the “affordability gap”, which is defined as the difference between the cost of producing a unit and the ability to pay for it.

Since 2007, the city sets the fees annually according to the difference between the total development cost and permitted affordable sales price for each unit type (see the following table). The fees are charged according to the mix of units provided in the on-site market units. The total development costs is adjusted annually according to the changes in the local construction cost index.

Fees-in-Lieu Breakdown (from mid-2008)

	Total Development Cost	Affordable Sales Price	Fees-in-Lieu
studio	$361,145	$181,193	$179,952
one bedroom	$457,240	$209,030	$248,210
two bedroom	$571,550	$237,072	$334,478
three bedroom	$639,826	$265,114	$374,712

Prior to this time, the fees were based upon the difference between average purchase price for single-family residences in the area and the permitted affordable sale price.

The collected fees go to the Citywide Affordable Housing Fund and are used to support affordable housing. A limited part can be tapped by MOH to conduct various specified program reviews. Also, an amount is dedicated specifically to supporting the acquisition and rehabilitation of existing small residential buildings of 25 units or less.

Development Controls

According to the ordinance, the affordable units – whether built on-site or off-site – must be comparable in the number of bedrooms, exterior appearance and overall quality of construction to the market-rate units. The interior features need not be the same, provided they are good quality and consistent with the current standards for new housing. Variations in the square footage by unit type are also permitted.

In both cases, they also must be constructed and made available no later than the market-rate units.

<u>Off-Site Units</u>

The ordinance adds a supplementary requirement for these units. The square footage of the off-site units on average must be no less than the average of the on-site market-rate units.

The procedures manual sets an array of additional requirements. It requires that off-site units be comparable in the number of bathrooms. It also sets minimum floorspace requirements, as well as a detailed and long list of requirements regarding the bathrooms, kitchens, laundries, closets, finishes, and other amenities and features.

<u>On-Site Units</u>

The tenure of the affordable housing units on-site must be same as, or in the same proportion as, the market-rate units. It is not possible to provide affordable rental units in otherwise ownership developments, or vice versa.

Affordability Controls

The MOH along with the city's Planning Department are required to prepare a manual that sets out the program's procedural regulations for the buyers and renters, and also the developers and managers of the inclusionary units. This manual details many of the affordability and related regulations that are only broadly framed in the code. The current manual from mid-2007 is 65 pages in length.

Legal Agreements

The city uses a 'Notice of Special Restrictions' recorded on the title of the inclusionary units with the local Recorder's Office to secure the affordability of these units. That notice, in turn, references the regulations set out in the then current procedures manual.

For each ownership unit, the notice also incorporates the following:

- a 'Deed of Trust' that secures a promissory note in the form of a lien in favour of the city that is based upon the difference between the appraised fair market value and maximum permitted sales price. That lien is re-conveyed to each new owner upon resale to secure the city's stake in the affordable unit.

- A 'grant of right of first refusal' that gives the city the option to purchase the unit whenever it is resold. This provision is seldom – if ever – used, but provides another safeguard.

Control Period

The affordability of the inclusionary units are maintained for the "life of the project". Prior to 2007, it was set for 50 years. The change was made because "life of the project" was considered longer than 50 years in most cases, but also because the restrictions could last only as long as the building. The restrictions are not renewed upon resale.

Eligibility Criteria

In addition to meeting the household income limits, these additional conditions must be met:
- The homebuyer must be a first-time homebuyer.
- One member of the household must live or work in the city.
- The size of the household must be compatible with the unit size.
- The homebuyer must have completed an approved first-time homebuyer education workshop.
- The homebuyer must be pre-qualified for a mortgage.

First-time homebuyer restriction rules out households with a member who has owned an interest in any property in the three years prior to application.

In matching the households to suitable units, typically the household must be one person larger in size than the number of bedrooms in the units. There must be at least one person per bedroom.

Liquid assets above a certain amount are included when determining household income. Specifically, 10% of the value of those assets between $30,000 and $130,000 is added to the income, and 35% of those above $130,000.

Initial Sale Prices

The maximum permitted first sales prices for the initial are annually established by the MOH for each unit size.

The calculations are based on these considerations:
1) the targeted income limits according to household size;
2) the payment of 33% of gross household income for the total housing costs, including taxes, insurance, and homeowners or associations fees;
3) a mortgage interest rate based on the ten-year rolling average for a 30-year interest rate as provided by nationally recognized mortgage lending institution; and
4) a downpayment set by MOH. (Formerly, this was set at 10% by the ordinance.)

Resale Prices

The resale prices must be remain affordable to a household of a corresponding size and with an income at the same percentage of the median income as the first owner.

The maximum permitted resale price is determined by increasing the initial purchase price by the percentage change in the median income from the date of purchase, and then by adding the following:
- the cost of approved capital improvements, and
- the realtor fees equal to 5% of their total.

The costs can be recovered for the capital improvements made up to 10 years before the resale. All of the costs are eligible for specified major improvements and upgrades (like new additions and upgrades for energy efficiency) and half for various replacements and repairs. To maintain affordability, MOH caps the recovered costs at 7% of the resale price.

Initial Sales Process

The developers are responsible for the marketing and selling of the inclusionary units.

The developers are expected to sell to buyers drawn from the general public as well as the city's waiting list. The selection of the potential buyers must be determined by a lottery process supervised by MOH.

Just recently MOH has started applying priorities to the potential buyers. It now gives preferences to 1) households displaced by renewal activities and 2) those that already live and/or work in the city.

The developers through their agents are responsible for collecting all of the relevant eligibility documentation and pre-screening the buyers. MOH checks the documentation and eligibility before approving the sale.

The developers must adhere to the marketing procedures contained in the procedures manual. They are required to prepare a marketing plan and have it approved by MOH. As part of that, they must hire a marketing consultant certified by MOH, and include the details of their lottery process. In their marketing and advertising , the developers are required to use "good faith and affirmative actions" to attract potential minority and lower-income buyers from across the city.

Resale Process

Within the control period, the owner can sell the unit only to an income-eligible buyer within the maximum permitted resale price. Any appreciation gained from the sale belongs to the owner.

The owner must first notify the MOH of their intent to sell, and the MOH will then establish the maximum permitted price.

The seller must market the unit by listing the unit on the MLS through a certified realtor, and also on the MOH's website of affordable units available in the city. MOH has the responsibility for notifying the potential buyers on its list of interested buyers. MOH no longer maintains a waiting list of pre-certified buyers.

A lottery system must be used to select the buyer. The lottery can include potential buyers from the general public and the city's waiting list.

Before they can be included in the lottery, they must provide the relevant documentation to the seller's real estate agent, who is responsible for the pre-screening. MOH reviews the documentation before approving the sale.

Occupancy Restrictions

The owners must use the inclusionary units as their primary residence. They are not permitted to rent or sublease any part of the unit without the prior consent of MOH. MOH is able to grant consent in special circumstances, provided the period is no longer than 6 months, the tenant meets the program qualifications, and the rent is within maximum set by the program.

ADMINISTRATION

The program is administered by a staff of 2½ in the Mayor's Office of Housing (MOH).

This office has the following main on-going responsibilities for the ownership units:
- establishing the affordable housing requirements for each new development;
- monitoring the marketing of the affordable housing units, including the lottery process;
- setting annually the maximum sales price by unit size;
- determining the maximum resale price when the units are resold;
- maintaining a listing of affordable units available for sale;
- maintaining a list of interested buyers;
- resetting the fees-in-lieu rates annually;
- checking buyer eligibility and sales documents before approving the sales;
- reviewing and approving all financing and refinancing arrangements;
- monitoring annually the occupancy of the ownership units; and
- enforcing the regulations.

MOH no longer maintains a waiting list of pre-certified buyers. They found that this was difficult to keep current because the information became out-of-date. What they do instead is keep a list of interested households, which they e-mail when suitable units become available.

MOH must conduct a study every five years to update the program and ordinance, and to review the fees-in-lieu structure and rates. It also reports annually about the results of the program through the city's annual comprehensive housing inventory report.

MOH must approve all financing and refinancing agreements. MOH reviews the loans to ensure that they are based on reasonable interest rates and sound lending practices. The loan must be secured through a standard mortgage from a recognized lending institution, and based on a fully amortizing fixed rate of no more than 40 years.

MOH monitors the occupancy of the units by requiring the owners annually to fill out, sign and return a document confirming their residency.

PRODUCTION

This program from 1992 through the end of 2008 has produced in total 1096 constructed units from 133 developments, plus the equivalent of another 209 from 20 developments paying fees-in-lieu. The fees-in-lieu amounted to roughly $17 million.

Out of the constructed units, 72% were ownership units and 28% rental, and 70½% were built on-site and 29½% off-site. When the fees-in-lieu developments are included, the rental units increase to 40% and on-site decrease to 59%.

The initial program from 1992 through 2002 generated 218 units from 31 developments, plus one providing $150,000 in fees-in-lieu. All of these units were built on-site.

The major changes to the program introduced in 2002 had a significant impact. Most notably, the annual average output from 1992-2002 to 2003-2008 increased by nearly 10-fold. More specifically, the number of units produced on average annually jumped from about 20 to 180, and the number of projects from 2½ to 20.

Based upon building permits issued in 2003-2008, the affordable units generated by this program represent nearly 6% of the total housing built during that period.

Inclusionary units have been provided in a variety of low-rise, mid-rise and high-rise developments. When built off-site, the units have been typically built by non-profit partners, and almost always as rental. In contrast, nearly all of the on-site units are ownership.

COMMENTS

The adoption of San Francisco's partial mandatory program in 1992 and full program in 2002, along with Boston's similar program in 2000, represent important events in the spread of inclusionary zoning. For over 25 years, inclusionary zoning had been a green-field phenomenon; it was associated mainly with fast-growing suburbs and smaller communities, but not with developed cities and downtowns. Since then, at least six other big cities have adopted programs, and still others are actively exploring the practices.

The city's 1992 program was the first to introduce two related practices, which had not been seen in any of the earlier green-field programs, but are now followed in some way by all of the following big-city programs.

- The first of these was applying the affordable housing obligation only to developments needing some sort of special approval, particularly like a re-zoning. In contrast, the greenfield programs typically have applied the requirement to all developments proceeding as-of-right.

- The second of these was requiring the affordable housing without prescribing in advance the specific cost offsets offered in return, but allowing for them to be determined through the case-by-case negotiations associated with those special approvals. Again, in contrast, the earlier green-field programs typically fix the cost offsets and do not allow for negotiations.

In its subsequent 2002 program, the city applied the affordable housing obligation to all developments – including as-of-right developments – while still not offering any cost offsets in return. As a consequence, these as-of-right developments receive no offsetting benefits for providing the affordable housing because, unlike those using special approvals, they do not have the opportunity indirectly to negotiate the cost

offsets.   This makes the program unique because no other program is known not to provide some concessions in return.

This program does distinguish between as-of-right and special approval developments when it sets the affordable housing obligation. Those receiving special approvals are required to provide 42% more affordable housing because those approvals are considered to confer “material economic benefits”.

Another aspect of this program merits comment, and that is the scope of its rules and regulations. The ordinance itself is somewhat more detailed than most, but what sets the program is its procedures manual that fleshes out many matters only broadly framed in the ordinance. In its current 65 pages, it sets out all of the procedural rules and regulation for the buyers and renters, and also for the developers and managers of the affordable housing.   That means – unlike in many other programs – all of the rules and regulations are clearly set out in one place, but the consequential size of the document must be daunting to many users.

RD 18Nov09