Inclusionary Housing Working Group: Final Report

Office of the Controller

With Consulting Team:

- Blue Sky Consulting Group
- Century Urban LLC
- Street Level Advisors

2/13/2016

Background

Proposition C and the Rationale for this Study

In June of 2016, San Francisco voters passed Proposition C, a Charter Amendment which made significant changes to the City's established Inclusionary Housing program.

Inclusionary housing is the policy of requiring developers of market-rate housing to make some new housing units affordable to low- and moderate-income households. Market-rate units can be sold or rented at the market price, while the sales price or rent of affordable units is limited by the income of their residents.

Under San Francisco's policy, developers have the option to build affordable units within their project (the on-site option), build them at another location (the off-site option), or pay a fee in lieu of building affordable units (the fee option), with fee revenues being used by the City to build affordable housing. These requirements are expressed as a percentage: a "25% on-site" requirement means 25% of the units on a site are required to be affordable.

Proposition C made a number of changes to the program, including raising the affordable housing required under all three options, and broadening the income range of households eligible for affordable units.

Following the passage of the Charter Amendment, the Board of Supervisors charged the Controller's Office with preparing a study of the economic feasibility of increased inclusionary housing requirements. To advise on these recommendations, the Controller's Office also convened a Technical Advisory Committee (TAC), with representatives appointed by the Mayor and Board of Supervisors.

The TAC met with Controller's office Staff and its consulting team at a series of meetings in 2016 and early 2017. TAC members include:

- Dan Adams, Bridge Housing
- Jesse Blout, Strada
- Terence Cordero, Wells Fargo
- John Elberling, TODCO
- Emily Johnstone, Housing Investment Trust
- Whitney Jones, Chinatown CDC
- Lydia Tan, Bentall Kennedy
- Eric Tao, AGI Avant

Each of this report's recommendations was approved by the TAC. At the conclusion of the process, two members of the TAC submitted a letter of dissent to the Controller. This letter is reproduced at the end of the report.

Summary of Recommendations		Based on the analysis and research of the consulting team, the Controller's Office developed several policy recommendations and vetted them with the TAC. The recommendations are detailed below. 1. The City should impose different inclusionary housing requirements on rental and for-sale (condominium) properties. 2. The City should set the initial onsite requirements from 14%-18% for rental projects and 17%-20% for ownership projects. 3. The City should set the Fee Option at 18-23% for Rental, 25-28% for Ownership to maintain equivalence with previous on-site recommendations. These percentages are based on MOHCD's 2016 Fee schedule, and should be modified accordingly if MOHCD adjusts its fee schedule in the future. 4. The City should commit to a 15-year schedule of increases to the inclusionary housing rate of 0.5% per year 5. The City should impose additional affordability requirements for any 80/20 project financed through the City's financing approval process. 6. Consistent with current practice for any project to which inclusionary requirements apply, the City should allow projects that are utilizing the State Density Bonus to combine provision of onsite units for the base portion of the project with payment of the fee for bonus portion of the project. 7. The Controller and TAC should reconvene in 3 years to reconsider feasibility, density bonus, and other issues, and produce an updated report.

Summary of Prior Research

Research Overview		The Controller's Office commissioned three consulting firms to engage in different research tasks in support of these objectives: • Century Urban LLC conducted field research and scenario analysis reviewing how various inclusionary housing provisions would affect residual land value of four project prototypes, as well as research into prevailing land prices in San Francisco. The firm played a role with the Housing Working Group, and their work in this effort is a continuation of that field research and scenario analysis. • Blue Sky Consulting Group developed a housing simulation model that estimated how overall market-rate and affordable housing production would change in the city, given different inclusionary requirements. • Street Level Advisors studied how other cities have approached the design of their inclusionary housing programs. The details of the methodology and findings for each of these lines of research were described in a preliminary report issued September 13, 2016[1]. This report provides a high-level overview of the research, findings and recommendations.
Economics of Inclusionary Housing		By requiring market rate housing developments to include a certain number of units for low and moderate income residents, inclusionary housing has the potential to increase the supply of below market-rate (BMR) housing in San Francisco, and make housing more affordable for the city's low- and moderate-income residents. However, providing these BMR reduces the revenues that developers receive from completed projects, because BMR units must be sold or rented for less than market-rate units. This loss of revenues does not necessarily make the project infeasible, or prevent housing from being produced. Feasibility depends on a range of financial variables, including sales prices, construction and project financing costs, and land costs, as well as City-imposed fees. In general, the impact of a higher inclusionary requirement on housing production depends on the extent to which developers can pass on the added costs of the policy to land owners, in the form of lower offers for the land on which housing developments can be constructed. If no new development other than housing can be built on a given parcel, and if the existing use on the parcel generates a low income, land owners may be inclined to accept a lower offer from a developer for their land. In these cases, the cost of the inclusionary policy is passed on to land owners, and the

[1] The preliminary report may be downloaded here: http://openbook.sfgov.org/webreports/details3.aspx?id=2359

		housing is still produced. However, if land owners do not sell their land to housing developers at the lower offering prices that result from increased inclusionary requirements, the overall supply of available land for residential development will diminish, and along with the supply of housing units. Since the inclusionary policy does not change the demand for market rate units, the reduced supply of housing will tend to push up prices relative to what would otherwise be the case. To the extent this occurs, consumers seeking housing would ultimately pay for the policy, in the form of higher market-rate housing prices. To better answer of how changing the inclusionary requirement affects the financial feasibility of housing development, and the overall level of housing production in the city, the consulting team pursued two distinct but complementary methods, which are described below.
Scenario Analysis Methodology		The most common method used by cities to assess the potential impact of exactions and fees on new housing development is by studying how higher costs affect the overall cost of development for certain sample projects (called "prototypes"). This approach builds on the idea that developers cannot pass their higher costs directly on to consumers, so an increased fee or exaction leads to a reduction in the *residual land value*—the amount a development project can afford to bid for land (often expressed per unit of new housing). The approach does not quantify how much a fee can rise, and residual land value can decline, before a project is no longer feasible. However, by comparing the residual land values that would result from a proposed inclusionary policy with land prices from historical sales data, it is possible to make more informed judgments about the proposed policy's risk to project feasibility. The consulting team prepared four prototypes for multifamily for-rent apartments and four prototypes for multifamily for-sale condominiums. These prototypes reflect three different types of construction—low-rise, mid-rise, and high-rise, as relative data points for review and consideration. Similar underwriting assumptions were made for each prototype. These assumptions may be found in the Appendix of the preliminary report. Land sales comparable data was gathered for land sale transactions within San Francisco from 2010 to 2015. This data was analyzed to study land sales prices per unit by year, for both entitled and unentitled land[2]. The land sales price per unit for entitled land increased from approximately $80,000 in 2010 to $163,000 in 2015. This resulted in an estimated compounded annual growth rate of 11.5% for land sales prices per unit for entitled land.

[2] Land is “entitled” once it has received Planning permission for new development. Because of the uncertainty in that process, entitled land is generally more valuable than unentitled land.

Scenario Analysis Results

Table 1 summarizes the results of the Scenario Analysis. For each level of potential on-site requirement, the team analyzed the maximum residual land value for each prototype. The average of the residual land values of each prototype are shown in the table. The table is shaded to represent the relative financial feasibility of the resulting land values. On-site requirements that are shaded red would result in land bids that are below $100,000 per unit – roughly what land prices were in 2010-12. These red cells are thus considered infeasible, under the assumption that if land would not be available in the 2010-12 period at those prices, at the depths of the recession, it would not be available at those prices in 2017.

The cells in Table 1 that are shaded green represent requirement levels that would result in residual land values above $120,000 per unit – a level that the consulting team felt was clearly feasible. The yellow cells represent requirement levels that would result in land values between $100,000 and $120,000 per unit.

There is no way to know with certainty the exact point where reductions in residual land prices result in significant declines in housing production but the consulting team felt that that point likely falls somewhere within this yellow range.

Table 1:

Residual Land Value Per Unit
(Weighted average of prototypes for each tenure)

Rental	Apartments	Condominimums
Pre Prop C	$118,600	$140,400
12%	$126,300	$141,600
14%	$118,900	$129,900
16%	$109,300	$120,800
18%	$102,000	$110,700
20%	$96,100	$104,300
25%	$71,800	$77,800

Assuming no density bonus

More Likely — Residual Land Value > $120k/unit
Uncertain — Residual Land Value $100 to 120k/unit
Less Likely — Residual Land Value below $100K/unit

5

Housing Simulation Methodology		The prototype analysis brings real-world project costing information to the analysis of residual land value. It does not, however, draw bright lines regarding how much residual land value can decline before projects are no longer feasible. In order to determine the potential impact on city-wide housing development associated with a change in the inclusionary requirement, the consulting team conducted an analysis of the San Francisco housing market during the past 15 years. Specifically, the consulting team examined the relationship between housing prices and the extent of development of multifamily housing in the City while controlling for other factors that may influence development. Because an increase in the inclusionary requirement acts like a price reduction for developers (in effect lowering the revenue that developers receive for each BMR unit), reductions in prices (or rents) and increases in the inclusionary requirement will have a similar financial impact on a development project. Therefore, the analysis leads to an estimate, based on the City's actual experience with changes in prices and the other factors that affect development, the likely impact of a change in the inclusionary policy on the extent of development that is likely to occur. If increasing the inclusionary requirement has only a small impact on the likely extent of residential development, this suggests that land owners or developers are bearing most of the cost of a higher inclusionary requirement. If, however, changes in the inclusionary requirement have a large impact on the extent of development, this suggests that the policy has a greater impact on housing prices, and consumers are bearing more of the costs.
Housing Simulation Results		The results of the analysis confirm that residential housing development in San Francisco is sensitive to changes in the City's inclusionary requirements. Specifically, the results suggest that for each one percentage point change in the City's inclusionary requirement (e.g. from 17% to 18%), an additional 175 BMR units would be constructed over the next 15 years. In addition, the number of overall housing units in the city is projected to decline by approximately 1.8%. The decrease in total housing units will result in an increase in average housing prices. Previous research conducted by the Controller's Office on the potential impact of Proposition C found that, for example, reducing the construction of new housing in San Francisco by about 18% would increase housing prices and rents (for all vacant market-rate units – not just new units) by about 2%[3]. Table 2 summarizes the impacts of different onsite inclusionary policies, ranging from 12% inclusionary to 25%. The table indicates the overall housing production, split between market-rate and below-market-rate (BMR) units,

[3] *Increasing Inclusionary Housing Requirements: Economic Impact Report*, February 23, 2016. Available at http://openbook.sfgov.org/webreports/details3.aspx?id=2278

and the average price impact associated with the reduction in overall housing.

Table 2:

IMPACT OF INCREASED INCLUSIONARY REQUIREMENTS

Policy	Estimated housing production 2017-2031	Market-Rate Units	BMR Units	Overall housing prices relative to pre-Prop C
Pre Proposition C	31,460	27,685	3,775	0.00%
Post Prop C, 17% Inclusionary	27,215	22,589	4,627	1.48%
Post Prop C, 18% Inclusionary	26,732	21,920	4,812	1.64%
Post Prop C, 19% Inclusionary	26,258	21,269	4,989	1.81%
Post Prop C, 20% Inclusionary	25,794	20,635	5,159	1.97%
Post Prop C, 25% Inclusionary	23,611	17,708	5,903	2.73%

The fact that the likelihood of development is positively correlated with housing prices, with a 2-year lag, suggests that land prices do not automatically adjust to changes in housing prices. When a policy change, like a fee increase, feels like a price decrease to developers, the likelihood of development declines, indicating at least some projects will be infeasible.

The results of our analysis suggest that increasing the inclusionary requirement would reduce the supply of market rate housing in San Francisco, increase the number of below market rate units available for the City's low income residents and the direct subsidy they receive, while raising housing prices for consumers on average.

Recommendations

Recommendation 1: The City should impose different inclusionary housing requirements on rental and for-sale (condominium) properties.		San Francisco's inclusionary housing program already imposes different requirements on projects of different sizes and in different locations. Many of the areas where the greatest growth is expected have been recently up-zoned through area plans which impose inclusionary housing requirements that exceed the citywide requirements. In addition, projects below 10 units are exempt entirely from inclusionary housing and Proposition C set lower requirements for projects under 25 units. The result is an already complex system which can be difficult to administer and explain. Several TAC members inquired about the feasibility of setting higher inclusionary requirements for high-rise projects. The consulting team explored this idea and did not find evidence to support higher requirements for high-rise projects. • The best practice research examined other cities that have different requirements for high-rise and found only examples where those requirements are lower (due to higher costs for this building type). • The prototype analysis found comparable residual land values for high-rise and lower rise prototypes for all levels of inclusionary requirements analyzed which suggests that it would be no easier (or harder) for high-rise projects to absorb increased requirements. • The regression analysis found that larger projects were somewhat more sensitive to changes in the fee level which suggests that development of these projects is somewhat less likely in the face of increased requirements. The consultants' research has shown, and the TAC has generally supported, that for-sale projects can feasibly support higher fees than rental projects. The scenario analysis suggests that at any given level of the inclusionary policy, the typical ownership project could support a higher residual land value. Put another way, the typical ownership project can support roughly 2 percentage points more affordable housing units onsite while maintaining the same residual land value. For example, for rental projects an 18% onsite requirement results in a weighted average residual land value of approximately $100,000. For ownership projects, an onsite requirement of 20% achieves approximately the same residual land value. ***At the TAC meeting on September 7, 2016, the TAC endorsed this recommendation unanimously.***

Recommendation 2: The City should set the initial onsite requirements from 14%-18% for rental projects and 17%-20% for ownership projects.

As discussed above, the scenario analysis indicated that initial onsite requirements in the zone shaded red in Table 1 should be avoided. Fees in the yellow zone, which range from 14-18% onsite for apartment projects and 17-20% for condominium projects, are the maximum feasible requirements today.

It is important to note that this analysis is based on today's economic conditions, and that interest rates and other market factors could change significantly over coming years. For example, as of February 2017, interest rates have already risen since the scenario analysis was conducted in the summer of 2016, and those rising rates increase the cost of new development. While the TAC discussed ways to adjust the requirements as conditions changed but no practical strategy for doing that effectively was identified. Setting the requirements somewhat below the absolute maximum feasible today allows for some uncertainty about future market conditions.

Residual Land Value Per Unit
(Weighted average of prototypes for each tenure)

Rental	Apartments	Condominimums
Pre Prop C	$118,600	$140,400
12%	$126,300	$141,600
14%	$118,900	$129,900
16%	$109,300	$120,800
18%	$102,000	$110,700
20%	$96,100	$104,300
25%	$71,800	$77,800

Assuming no density bonus

More Likely — Residual Land Value > $120k/unit
Uncertain — Residual Land Value $100 to 120k/unit
Less Likely — Residual Land Value below $100K/unit

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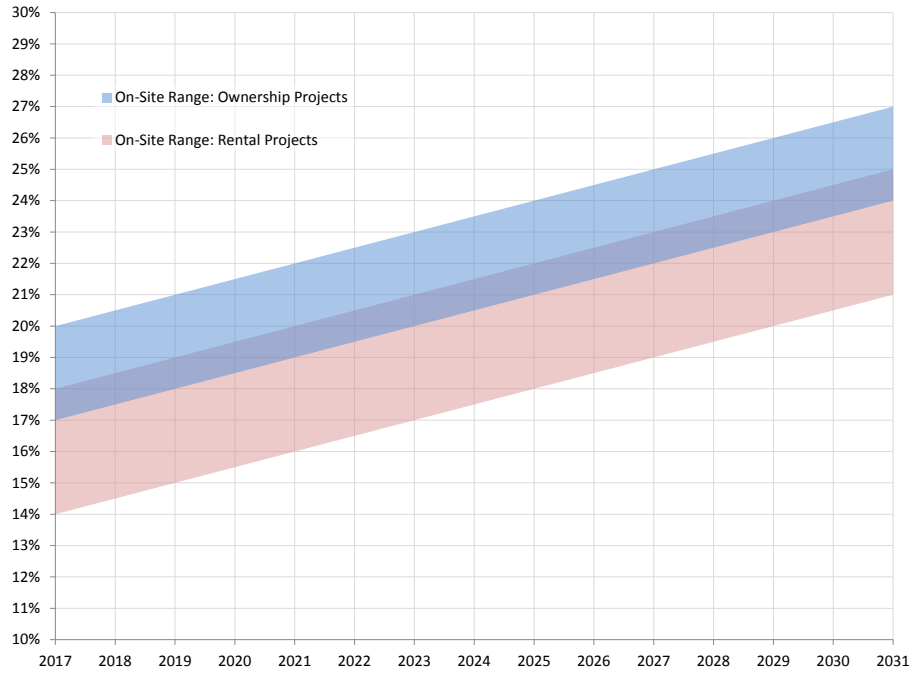
At the TAC meeting on September 7, 2016, the TAC endorsed this recommended range unanimously. TAC members differed on what they felt the specific initial requirements should be, within this range.

Recommendation 3: The City should set the Fee Option at 18-23% for Rental, 25-28% for Ownership to maintain an equivalence with Recommendation 2		Prop C, like prior versions of this policy, set both an onsite percent of units and a separate (higher) percentage of units required for offsite or fee payment. When a developer chooses the fee option, he or she calculates the number of off-site units that would be required based on this percentage, and then pays a fixed dollar amount per required unit. The exact amount is different for different unit types based on bedroom size. For example the 2016 fee for a 2-bedroom unit is $366,369. Using the current fee schedule published by MOHCD, the consulting team evaluated the off-site/fee percentage requirement that would result in a roughly equivalent economic cost to projects. For example, in a rental project an on-site requirement of 14% and a fee requirement of 18% would both result in approximately the same residual land value. Similarly, at the high end of the recommended range, an on-site rental requirement of 18% would be economically equivalent to a fee based on 23%. The recommended fee range represents a premium of 30% to 40% above the recommended on-site range. Several TAC members noted that this equivalence is not necessary and that choosing a fee level slightly higher in the range than the corresponding on-site requirement could be an appropriate way to encourage more onsite development. ***At the TAC meeting on February 1, 2017 the TAC approved this recommendation with 7 members in favor and one abstaining (John Elberling)***
Recommendation 4: The City should commit to a 15-year schedule of increases to the on-site inclusionary housing rate of 0.5% per year.		Providing predictability does not mean that requirements can never change, only that any changes should be clear well before they take effect. It is not uncommon for developers to negotiate the price of land several years before receiving building permits. There was agreement among TAC members that increased inclusionary requirements should be phased in over a period of time long enough to allow the land market to adjust. Setting a clear schedule which ramps up requirements over an extended period of time provides the greatest amount of predictability for the housing market. Preliminary analysis suggests that, if 15-year trends in housing prices and construction costs continue for the next 15 years, on average, then a 0.5% annual increase in the on-site requirement would yield a roughly even split between future increases in land value, and future additional resources for affordable housing. Adjusting the onsite requirements at 0.5% per year will ultimately increase the requirements to the range of 21.5%-25.5% for apartment projects and 24.5%-27.5% for condominium projects, as shown in the diagram below. Such an approach, would both capture an equitable share of likely future increases

		in land value for affordable housing, and promote a well-functioning land market by providing maximum certainty for developers and landowners. *Table 3:*  Because the fee/off-site requirement is higher than the on-site requirement, increasing both requirements by the same amount each year would result in a gradual increase in the incentive to select the fee option. For ownership units, the feasible Fee Option range is 1.4 times the feasible On-Site Option range. For rental units, the ratio is 1.3. If there is a policy desire to prevent the off-site/fee requirement should increase annually at 1.3 to 1.4 times the rate of on-site increase. ***At the TAC meeting on September 7, 2016, the TAC unanimously endorsed the recommendations of a 15-year phase-in of higher requirements, with a study every five years.*** ***With respect to the rate of increase, six TAC members supported the 0.5% annual increase recommendation, and two members (John Elberling and Whitney Jones) felt the annual increase should be higher, in the range of 0.75% - 1.0% per year.***
Note on Income Limits		The recommended initial range of onsite requirements discussed earlier, and the stepped increase over 15 years, assume that the income split of BMR units will continue match the ratio required in Prop C, in which 60% of the on-site units were dedicated to low-income households and the remaining 40% were for moderate-income households. For example, an on-site requirement of 18% would translate into 10.8% of on-site units for low-income households

(60% of 18%), and 7.2% of units for moderate-income households (40% of 18%).

These income limits are **not** a recommendation of the Controller's Office or its consulting team; they were used in the analysis because they were adopted in Prop C. It is important to point out that the application of those income limits to the recommended fee ranges would lead to fewer onsite units for low-income households than was the case before Prop C, which was 12%.

An alternative approach discussed by the TAC would be to set a minimum threshold of 12%, the for low-income units and gradually increase the required share of moderate income units over time until a 60%/40% split was achieved, after which point both requirements would rise together to maintain that ratio.

The consulting team evaluated the economic implications of setting a 12% floor for low-income units and determined that this alternative would only change the economics for rental projects at the low end of the proposed range. For ownership projects, even the low end of the proposed range (17%) would include 12% low-income units. Similarly, at the high end of the proposed range for rental units (18%) the prop C ratio would result in 12% low-income units. However, at the low end of the range for rental units (14%), the prop C ratio would result in only an 8% low-income requirement. The consultant's analysis determined that requiring 12% low-income units and no moderate-income units would be economically equivalent to requiring 14% split 60/40.

We make no recommendation about the desirability of either of these approaches but note the equivalency calculation in the event that policymakers chose to adopt a requirement at the low end of the proposed range.

Table 4:

	Apartments		Condominiums	
Prop C. Income Limits (a)	14%	18%	17%	20%
Alternative Income Limits	12% at 55% AMI 0% at 100% AMI	12% at 55% AMI 6% at 100% AMI	12% at 90% AMI 5% at 120% AMI	12% at 90% AMI 9% at 120% AMI

(a) Reflects 60% at 55% AMI for apartments and 80% AMI for condominiums and 40% at 100% AMI for apartments and 120% AMI for condominiums

Recommendation 5: The City should impose additional affordability requirements for any 80/20 project financed through the City's financing approval process.		It is likely that increasing the inclusionary housing requirements will encourage more project sponsors to consider developing so called '80/20' projects which utilize tax exempt bond financing to subsidize the cost of providing affordable units. All things being equal, leveraging existing public resources should be encouraged, however it should result in greater levels of affordable housing rather than simply reducing the cost of providing otherwise mandated affordability. There was not agreement within the TAC that it would be safe to assume that all future projects would take advantage of this program. As a result the analysis does not assume bond financing is used. However, because the City's approval is necessary before any project accesses tax exempt bond financing, it should be possible for the city to require additional affordable units (or deeper levels of affordability) from all projects accessing this financing in the future. ***At the TAC meeting on September 7, 2016, the TAC endorsed this recommendation unanimously.***
Recommendation 6: The City should allow projects that are utilizing the State Density Bonus to combine provision of onsite units for the base portion of the project with payment of the fee for the bonus portion of the project.		The TAC spent time carefully discussing the implications of California's Density bonus law (CA Government Code Sections 65915 – 65918) on the financial feasibility of the inclusionary housing requirements. If either the state density bonus or a local bonus program (or both) were widely implemented in San Francisco, the likely result would be higher residual land values in many locations which would support a higher inclusionary requirement. A feasibility analysis that assumed no use of the density bonus would significantly understate the level of affordable housing that could be feasibly provided by projects that are able to build greater density. However, an analysis that assumed that all projects would benefit from the bonus would overstate what is feasible and could make projects that, for any number of reasons, were unable to build the bonus density economically infeasible. Because the application of this program in San Francisco is new and largely untested there is no clear data available to the consulting team which would allow us to forecast the rate of utilization. At the same time, there was also considerable disagreement among TAC members about the likely rate of utilization. As a result, it seems impractical to design the program at this point in any way that requires predicting the rate at which projects use the density bonus program. However, while state law appears to prohibit local governments from requiring additional on-site affordable units when a project receives bonus units, it does not prohibit charging impact fees for infrastructure and City services. San Francisco's inclusionary housing requirement takes the form of an Affordable Housing Fee. The fee applies to every project but only certain projects are authorized to satisfy the program requirements through the on-site or off-site alternatives, in lieu of paying the fee. There is no reason to believe that bonus units have any different impact on affordable housing

needs than base units, so the City seems justified in requiring the same standard fee be paid on the bonus units.

Under current policy, the City allows developers to combine payment of the fee with provision of on-site or off-site units to satisfy the inclusionary requirements. Therefore, the simplest option for addressing the uncertainty related to use of the density bonus, would be to require the payment of the fee for any bonus units in projects that also include onsite units in order to be eligible for the bonus. This approach allows the City to set the on-site requirement at a level that is within the range that the analysis indicated would be feasible for projects not using the bonus while still requiring an additional proportional contribution toward affordable housing from projects using the bonus.

An example illustrates the approach. Imagine a 100-unit for-sale project consisting of 30 studio, 40 1-bedroom and 30 2-bedroom units. If the City set the inclusionary requirement for for-sale projects at 17% onsite and 25% off-site/fee (to pick one point within the recommended range), then a project choosing the onsite option (Table 5) would provide 17 Below Market Rate (BMR) units (and 87 market rate units).

Table 5:

Option 1: On-Site, No Density Bonus
83 units of Market-rate
17 units of BMR
$0 fee payment

If the same project selected the fee option (Table 6) using the 2016 MOHCD fee schedule they would owe a total of $6,922,429 based on this unit mix.

Table 6:

Option 2: Fee, No Density Bonus
100 units of Market-rate
0 units of BMR
fee payment: 25% x 30 x $198,008 + 25% x 40 x $268,960 + 25% x 30 x $366,369 $6,922,428

If the same project were to take advantage of the state density bonus they might qualify to build 35 additional units (10 studios, 15 1 bedrooms, and 10 2 bedrooms) for a total of 135. Under the proposed approach (Table 7) they would provide 17 onsite BMR units (the same number as the project with no

		bonus) but they would also pay a fee of $2,419,543. *Table 7:* **Option 3: Onsite + Fee With Density Bonus** 118 units of Market-rate (83 base + 35 bonus) 17 units of BMR fee payment: 25% x 10 x $198,008 + 25% x 15 x $268,960 + 25% x 10 x $366,369 $2,419,543 ***At the TAC meeting on February 1, 2017 the TAC approved this recommendation with 6 members in favor and 2 members opposed (John Elberling and Whitney Jones).***
Recommendation 7: The Controller and TAC should reconvene in 3 years to reconsider feasibility, density bonus, and other issues, and produce an updated report.		The Proposition C trailing legislation called for reconvening a TAC to evaluate economic feasibility every three years. The TAC discussed the frequency of updating the requirements and there was general agreement that 3 years was too long a period for adjustments to react to changing market conditions and too short a period to allow the market to adequately anticipate future requirements. As a result, the TAC recommended adopting a 15-year schedule of regular small adjustments. However because of uncertainty related to a number of key assumptions, particularly related to the scale of utilization of the State Density Bonus program, a review of this analysis in three years seems prudent. At that point, it should be clear whether San Francisco developers are routinely taking advantage of the bonus program. ***At the TAC meeting on February 1, 2017 the TAC approved this recommendation unanimously.***
Dissent Letter		On February 3rd, after the final TAC meeting, the Controller received a letter, signed by TAC members John Elberling and Whitney Jones, which expressed dissent from these recommendations. This letter is reproduced on the following pages.

Ben Rosenfeld
Controller, City of San Francisco
City Hall
San Francisco, CA 94102 February 3, 2017

RE: Inclusionary Housing Technical Advisory Committee Report Dissent

For the record, we cannot support the recommendations of Workgroup for the following reasons:

1. The **procedure was completely wrong**. The Group was asked to vote yes or no on a series of Consultant Team recommendations on specific isolated components of an Inclusionary Housing program/ordinance in sequence and isolation, rather than being presented two or more complete alternative packages to choose from. This inherently 'loaded the dice' in favor of the Team's proposals as a group and prevented real consideration of the alternatives. Since there are complex interactive interrelationships among all these components that cumulatively determine the overall financial feasibility and actual housing outcomes of the possible alternative packages, the only possible way to actually make a fully informed decision would be to consider complete Alternatives as wholes.

2. The **Alternatives' outcomes were never quantified and compared**. I believe there are at least three complete alternative packages that can and should have been identified as such, and that are demonstrably "feasible" based on the Team's analysis. These should have been evaluated as complete wholes for TAC consideration:

   A. The Existing Prop C Ordinance. The 12/19/16 Phase 2 report determined that projects utilizing the full State Density Bonus were feasible with a 26% IH requirements applied to only the base project units, as the SDB law mandates, excepting high-rise projects (which specific sub-analysis is clearly flawed – see below). Thus Prop C 25% current IH base requirement is feasible for such projects. The analysis did not evaluate projects that use only a portion of the SDB, but it is evident from the data as presented that those would also be feasible up to some lesser level of SDB utilization to be determined.

   The feasibility of Prop C's 33% fee applied to such SDB projects was not analyzed, but it appears from other fee scenario evaluations that a spread of up to 5% for rental and 8% for condos between the on-site % and the fee % is feasible. That would mean that Prop C's 33% fee for condos is feasible, but it might need to be reduced to 30% for rental.

   The actual outcome of this alternative would certainly be that nearly all developers would maximize use of the State Density Bonus to the extent practicable. As was

noted, some projects might not take the full bonus if that triggered a more expensive building code category due to increased height.

AS A RESULT, THIS ALTERNATIVE CLEARLY WOULD ACTUALLY PROUDCE THE GREATEST OVERALL AMOUNT OF NEW HOUSING OF ANY ALTERNATIVE, WITH THE MOST AFFORDABLE HOUSING AND INCLUDING THE MOST MIDDLE INCOME UNITS, AND THUS THE MAXIMUM FEE REVENUES AS WELL.

But because there was no calculation of actual housing units that would be developed by any Alternative, all things considered, by the Consultant Team as there should have been, these outcomes were not quantified.

The other key policy impact of this Existing Prop C Alternative would be its urban design impacts on neighborhood scale settings due to taller buildings resulting from widespread use of the SDB. But that is beyond the purview of the TAC.

B. The Consultant Team Alternative, which is essentially what the TAC recommended by a vote of 6-2.

The actual outcome of this alternative would certainly be that developers would have a very strong financial incentive to maximize use of the State Density Bonus to the extent practicable and so many will. This is because the "opportunity cost" of adding more market rate SDB units by paying the applicable IH fee works out to about $70,000 per market SDB unit, compared to up to $200,000 per unit land cost that the study documented to be the current market. This nets a developer $130,000 per unit less total development cost (more profit) for those extra units if they use the SDB to build more units rather than buy another development site for the same number of additional units. But the on-site IH housing is limited to only 17% of the base project units, not its SDB units. As was noted, some projects would not take the full bonus if that triggered a more expensive building code category due to increased height.

THIS ALTERNATIVE CLEARLY WOULD ACTUALLY RESULT IN THE LEAST OVERALL AMOUNT OF HOUSING PRODUCTION OF AFFORDABLE INCLUSIONARY UNITS, ESPECIALLY THE LEAST MIDDLE INCOME UNITS, OF ANY ALTERNATIVE.

But because there was no calculation of actual housing units that would be developed by any Alternative, all things considered, by the Consultant Team as there should have been, these outcomes were not quantified.

The other key policy impact of this Consultant Team Alternative would be its urban design impacts on neighborhood scale settings due to taller buildings resulting from widespread use of the SDB. But that is beyond the purview of the TAC.

C. The "Housing For All" Alternative presented on 2/1/17. The Consultant analysis demonstrated that its "equalized" 18% rental/20% condo IH on-site requirements, +5% for fee payments, are feasible for projects that do not use the SDB. And the 12/19/16 Phase 2 report determined that projects utilizing the full State Density Bonus were feasible with a 26% IH requirements applied to only the base project units, as the SDB law mandates, excepting high-rise projects (which specific sub-analysis is clearly flawed – see below). So the "un-equalized" HFA Alternative's 25% IH requirement is feasible for SDB projects. Its "sliding scale" proportional adjustment for projects that use only a portion of the SDB would very likely prove feasible within that range.

   The actual outcome of this "equalized" alternative would be that developers would have Less financial incentive to maximize use of the State Density Bonus to the extent practicable.

   THIS ALTERNATIVE WOULD ACTUALLY RESULT IN GREATER PRODUCTION OVERALL OF AFFORDABLE INCLUSIONARY UNITS THAN THE CONSULTANT ALTERNATIVE, INCLUDING MORE MIDDLE INCOME UNITS, BUT LESS THEN THE PROP C ALTERNATIVE, AND THE LEAST PRODCUTION OF MARKET-RATE HOUSING OF ANY ALTERNATIVE.

   But because there was no calculation of actual housing units that would be developed by any Alternative, all things considered, by the Consultant Team as there should have been, these outcomes were not quantified.

   The other key policy impact of this Housing For All Alternative would be that urban design impacts on neighborhood scale settings due to taller buildings resulting from widespread use of the SDB would be limited to appropriate locations. But that is beyond the purview of the TAC.

3. The **methodology** used to evaluate the IH feasibility of high rise projects **was certainly wrong**. As a matter of known fact, multiple actual high-rise developments in the City have agreed to provide on-site inclusionary housing of 25% or more on-site, some agreeing to 33%. As noted repeatedly, when actual experience is different than a model predicts, it is the model that must be wrong, not the reality. The Consultant Team refused to adjust the model.

4. The **handling of legal issues was totally inappropriate**. The main objection to the Housing For All Alternative was the verbal assertion – hearsay – by the Controller staff and OEWD staff that the City Attorney has opined it is not permissible under the new SDB law. But this "secret advice" was not provided to the TAC for review in any way. As a City-constituted entity, the TAC could have meet in executive session to hear that advice directly from the City Attorney, discussed the reasoning and the extent of its probability (given that the SDB is a poorly drafted new law with no case history) with the

CA, and would have been able to make sure the legal questions were correctly presented to start with. We have no way to know how any of this was discussed secretly. Instead, this "secret advice" was cited as a pre-emptive rationale not to even consider the Housing For All Alternative. This smacks of inappropriate manipulation of the TAC and the process, and we vehemently object to such disregard. This throws into public doubt the probity of the entire TAC process.

In sum, perhaps it should come as no surprise that a TAC process composed of 5 for-profit housing developers/financiers, 1 mega-national nonprofit developer, and 2 San Francisco community affordable housing developers finally voted 6-2 to recommend the Alternative that, of these identifiable feasible Alternatives, (1) maximizes windfall profits for developers/land owners from the new State Density Bonus Law, while (2) provides the least Affordable Inclusionary Housing for the people of our City.

We dissent.

John Elberling	Whitney Jones
President	Director of Housing Development
TODCO Group	Chinatown Community Development Corporation

Cc: TAC Members