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REVISING SAN DIEGO'S  
INCLUSIONARY HOUSING POLICIES:  
COSTS VS. BENEFITS



FERMANIAN **BUSINESS &**  
**ECONOMIC INSTITUTE**

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# **REVISING SAN DIEGO'S INCLUSIONARY HOUSING POLICIES: COSTS VS. BENEFITS**

## **EXECUTIVE SUMMARY**

Housing is one of San Diego's most pressing problems. The run-up in home prices and rents underscores the inadequacy of supply. There are two sets of issues:

1. *Affordable housing*; and
2. *Housing affordability*.

*Affordable housing* is the housing that is made available to lower income households so they can afford to rent or purchase. *Housing affordability* refers to the ability of the general population to afford to rent or buy a home without special assistance. Frequently, due to the way policies have been implemented, providing more affordable housing for some reduces housing affordability for the rest.

The City of San Diego has recognized the urgency of the area's deficiency in housing and has made housing a major priority. The City Council in 2018 approved the Mayor's 'Housing SD' Plan to boost housing production and raise affordability. Much of the recent focus has been on providing more affordable housing.

The City Council is now considering changing its inclusionary affordable housing policies to generate more housing for lower income households. These policies are commonly referred to as inclusionary zoning (IZ). The Council's changes would:

- Raise the percentage of units in all rental and for-sale projects that are set aside as affordable units (IZ) from 10% to 15%
- Require that all affordable units be built onsite
- Eliminate the option for builders to pay a fee in lieu of building the affordable units
- Possibly require builders to pay the Prevailing Wage (PW) on all projects

This study analyzed what the impact such policy changes might have on the City's housing and its residents. Some of its key findings were:

- Raising the IZ requirement to 15% would raise rents on new apartments by an average of \$255 per month to about \$3,300, an increase of 8%. Adding a Prevailing Wage requirement would raise rents a total of \$735 from current levels to over \$3,700 per month, a jump of 24%.
- Raising the IZ requirement to 15% would increase new home prices by 7% to \$690,000. Requiring that Prevailing Wages be paid on all new construction would increase new home prices a total of 19% from current levels to \$769,000.

- A requirement that Prevailing Wages be paid on all homebuilding projects would raise construction costs an average of 25%.
- A 15% IZ regulation would reduce the total production of rental and for-sale new housing by 13%. Although there would be an addition of 162 affordable units, there would be a decrease of 875 market-rate units.
- Under a 15% IZ requirement, for each rental or for-sale home produced for a low-income household, five other households would no longer be able to afford new housing.
- An additional Prevailing Wage requirement would lower the total production of housing by 32% from current conditions. Only 10 additional affordable rental or for-sale homes would be produced, while more than 1,700 market-rate housing units would be lost. As a result, 172 households would be priced out of the market for each affordable unit that would be created.
- The percentage of households able to afford a rental unit would fall from 33% to 28% with 15% required inclusionary housing and to just 20% with an additional requirement of Prevailing Wages. Affordability on the for-sale side would drop from 27% to 23% or 18% under the two different changes in policy. These numbers mean that nearly 24,000 San Diego households could be priced out of the new housing market under a 15% requirement for inclusionary housing. A total of 68,000 households could no longer afford housing if Prevailing Wages were also mandated.
- With only two years remaining to meet its 11-year State goal of producing over 88,000 housing units by 2020, San Diego is likely to end with a shortfall of more than 41,000 units under current regulations. That shortfall would be even greater should the City adopt more restrictive mandates for affordable housing.
- Over the next 15 years, a 15% inclusionary zoning requirement would reduce the supply of new housing by nearly 11,000 units. Payment of Prevailing Wages would boost that loss to 26,000 new homes.
- Preventing builders from using the option of paying an in-lieu fee instead of requiring every firm to produce the affordable units themselves would deprive the City of critical funds that could be leveraged with state and federal funds. These funds have in the past been used by builders specialized in producing affordable housing.
- A 15% IZ regulation would add \$46,000 or 7% to a typical house or condo. Requiring that Prevailing Wages be paid would add another \$79,000 or 12%. The IZ/PW Factor, which represents the additional regulatory burden, would thus be \$125,000 or 19%. This would be on top of the 40% cost of regulation found in our previous study that characterized much of the San Diego region.

- Other major California cities, such as San Jose, San Francisco, Los Angeles, and Oakland, as well as Portland, Oregon have all experienced significant cutbacks in housing production or development plans with restrictive IZ policies.
- All nine City Council districts would experience substantial reductions in the amount of housing produced with changes in IZ policies. Little additional affordable housing would be generated with a 15% IZ requirement. Adding a Prevailing Wage requirement would cause a reduction in affordable housing in five of the nine regions and little or no increase in the other four.

These findings are consistent with much of the literature, which shows that IZ requirements raise the cost of developing new housing, reduce housing production, and raise rents and house prices for market-rate housing.

The proposed changes in housing policies could raise the challenges facing the City in two other major areas. By pushing people out of the City in search of more affordable housing, the policies could raise greenhouse gas (GHG) emissions and also aggravate problems that businesses currently face in filling key positions.

The key question facing policymakers is whether the provision of one additional affordable home is worth pricing five or more firefighters, police officers, school teachers, nurses, and young engineers out of the housing market.

Reducing the regulatory burden from the current 40% may be a better path towards solving the housing crisis than boosting it to nearly 60% with policies that are well intentioned but would have damaging consequences.

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## **I. INTRODUCTION AND STUDY PURPOSE**

### **Background**

The City of San Diego continues to face a housing crisis. Rents and housing prices have jumped while incomes have not kept pace. The recovery in supply from the last recession has been mediocre with housing developments often facing regulatory hurdles and local opposition. Housing affordability stands out as a major financial problem for many residents, especially for low and middle-income households. The high cost of housing, while by no means the only driver of homelessness, has contributed to the problem.

In an attempt to alleviate the housing burden on low-income residents, the City of San Diego currently requires developers of two or more housing units to either set aside 10% of units as affordable housing or pay an Inclusionary Housing Fee. Those fees are deposited into the City's Affordable Housing Fund to help meet the housing needs of the City's very low-, low-, and median-income households.

The City Council is now evaluating a proposal to boost the proportion of units set aside as affordable housing from 10% to 15%, or possibly even higher. Additionally, the set-aside units would need to be built onsite, while the alternative of paying a fee would be eliminated. Also being considered is a requirement that the Prevailing Wage must be paid on new housing projects.

### **Study Purpose**

This study analyzes the various impacts of changing inclusionary housing policies from a 10% set-aside requirement or in-lieu fee to a 15% requirement of onsite affordable units. These policies are also commonly referred to as inclusionary zoning (IZ). The study also considers the additional implications of requiring the payment of Prevailing Wages (PW).

The study evaluates the effects on both the rental and for-sale housing segments. It seeks to answer the following key questions:

- What would be the effect on rents and housing prices?
- What would be the implications for the total supply of new housing?
- What would be the impact on the number of affordable housing units produced?
- What would be the impact on the number of market-rate housing units produced?
- What would happen to housing affordability?

In exploring the dimensions of the possible implications of changes in San Diego's IZ policy, the study includes:

- Estimates of changes in the numbers of affordable and market-rate housing units produced for rent and for sale in the City as a whole along with pricing and effects on housing affordability

- Analysis of the effects on housing supply, pricing, and affordability for each of the nine City Council Districts
- Evaluation of recent trends in housing production and the City’s progress in achieving its State-mandated housing goals
- Assessment of the experience of other cities that have implemented changes in their IZ policies
- Review of the literature on IZ policies and Prevailing Wage requirements

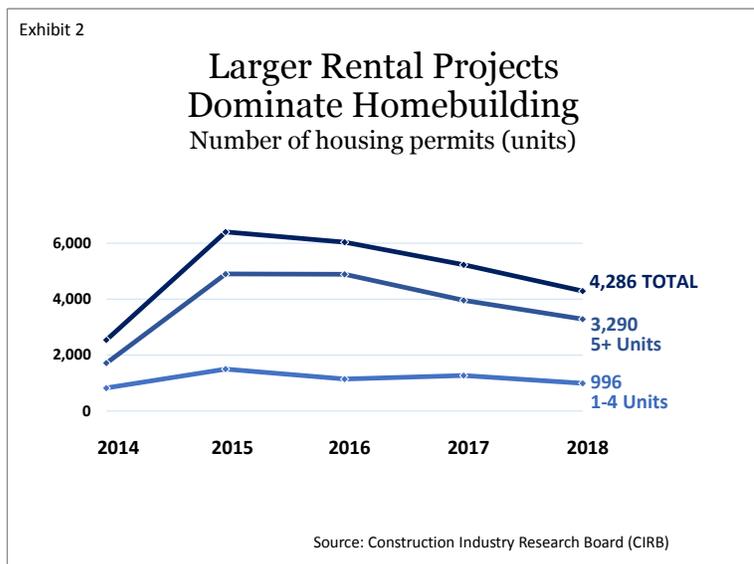
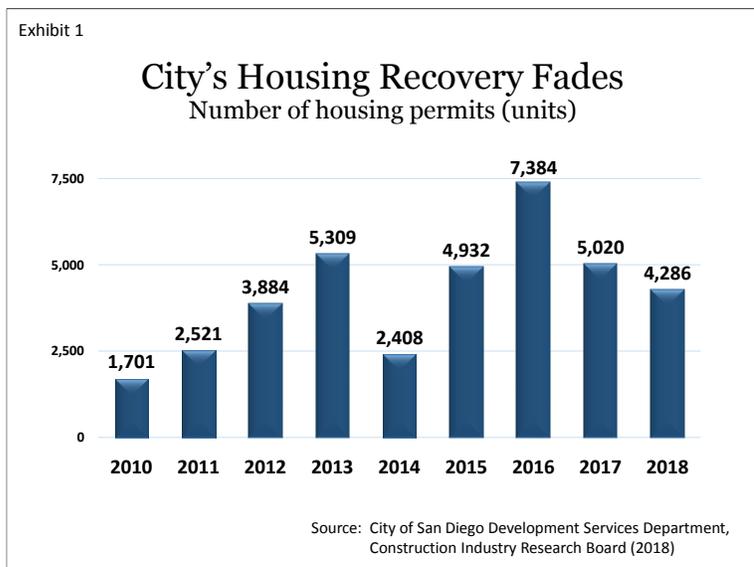
## II. HOUSING’S TRACK RECORD IN SAN DIEGO

### Recent Housing Trends

While housing production has expanded from the depths of the financial crisis and last recession, the response has lagged behind the rebound in demand. The result has been rapid increases in prices and rents.

As recently as 2010, permits for new housing construction in the City of San Diego were less than 2,000 units. They reached an average of 6,000 units in 2015-16 but have since fallen back. Housing permits totaled only about 4,300 units in the City during 2018.

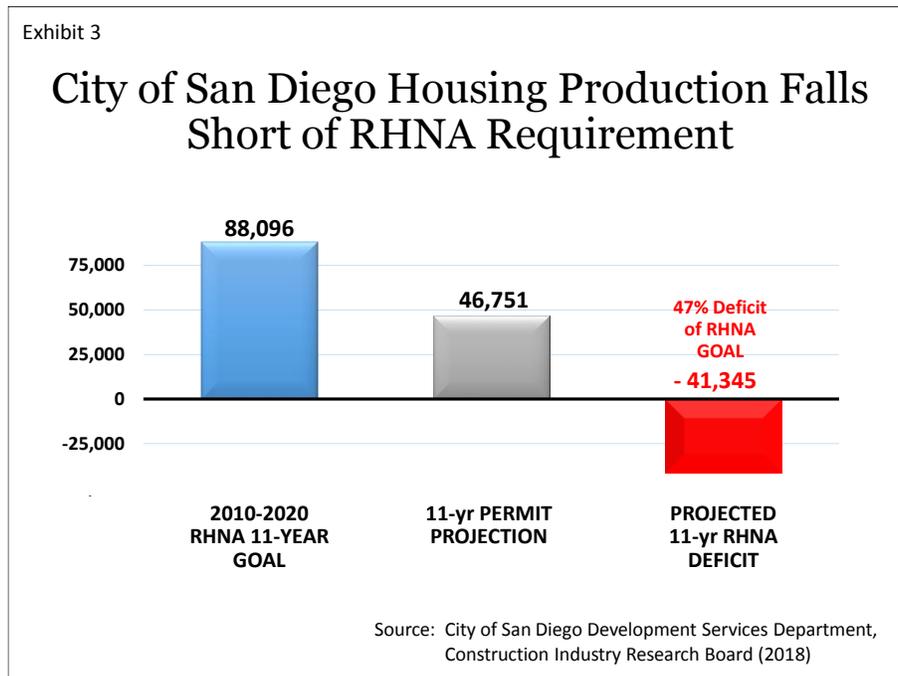
Large projects, with five or more units, have represented three-fourths of the volume on average during the past five years. These developments have generally targeted the rental market. In contrast, single-family units, together with small amounts of 2-unit and 3-4-unit complexes, typically represent the for-sale side. They have accounted for only about a quarter of the total amount of building over the past five years.



## San Diego's Housing Scorecard

The State of California requires local governments to establish housing goals in terms of production. These Regional Housing Needs Assessment (RHNA) goals for the City of San Diego were determined on the basis of such factors as projected market demand for housing, employment, availability of suitable sites and public facilities, commuting patterns, type and tenure of housing need, and other factors. The San Diego Association of Governments (SANDAG) is in charge of overseeing the RHNA plan for each of the 18 cities in the County. In October, 2011 SANDAG's Board of Directors approved the City's RHNA goals for the 11-year period, spanning January 1, 2010-December 31, 2020. The goal was to produce 88,096 housing units over that 11-year period, as measured by permit activity.

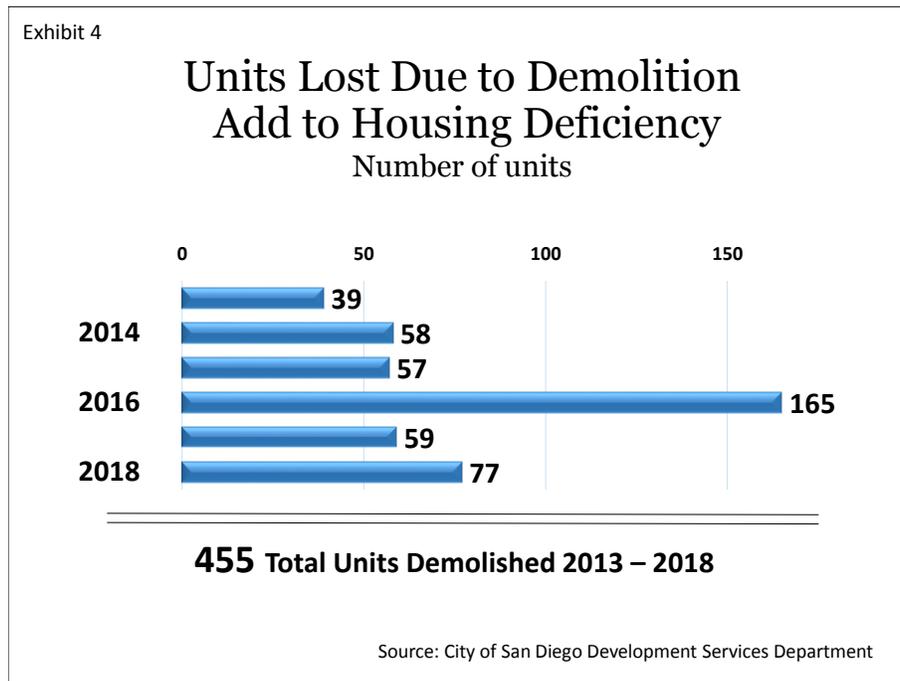
Where does San Diego stand? For the first nine years of the current RHNA cycle, the City has issued permits for about 37,500 new housing units. This is less than half of the total that has been targeted for the entire 11-year period. To meet its housing goal, the City would have to generate over 50,000 housing permits over the next two years or an average of more than 25,000 units per year. Based on the average issuance of the past two years, the City is likely to generate only about 4,600 units per year. This would mean that the City would miss its 11-year housing target by over 41,000 units, or 47%, by the end of 2020. With recent signs of slowing in the housing market, the shortfall could be even larger.



The State has not yet penalized cities for failing to achieve their RHNA targets, but this could change in the future. Perhaps more significantly, the shortfall is having an adverse effect on housing affordability, individuals' ability to remain in San Diego, the ability of businesses to compete for workers, and the opportunities for the City to retain existing or attract new companies.

## Do Not Forget About Lost Housing

Not included in the RHNA scorecard are the housing units lost each year due to demolition of old, outdated properties or those converted into other uses. While relatively small compared to the amounts of new production, they do need to be considered. Since 2013 the City has lost 455 housing units due to demolition, including 77 units in 2018.



### III. CITY RESULTS

In order to analyze the impact of changes in regulations regarding inclusionary affordable housing, prototypes developed by KMA in consultation with the City were used to model both the rental and for-sale sides of the market. A composite of rental and for-sale products was also developed to understand the implications that changes in inclusionary affordable housing policy would have on total production, the number of affordable units, and the number of market units. The results under three different cases were compared:

- Base case indicating current market conditions with as 10% inclusionary rate or option to pay an in-lieu fee
- 15% inclusionary units set aside for households earning 65% or less of the region's annual median income (AMI)
- 15% inclusionary units plus the use of Prevailing Wages in all construction work

The calculation of Prevailing Wages involves a complicated formula, but a survey of San Diego builders indicates that Prevailing Wages would add about 25% to the cost of construction.

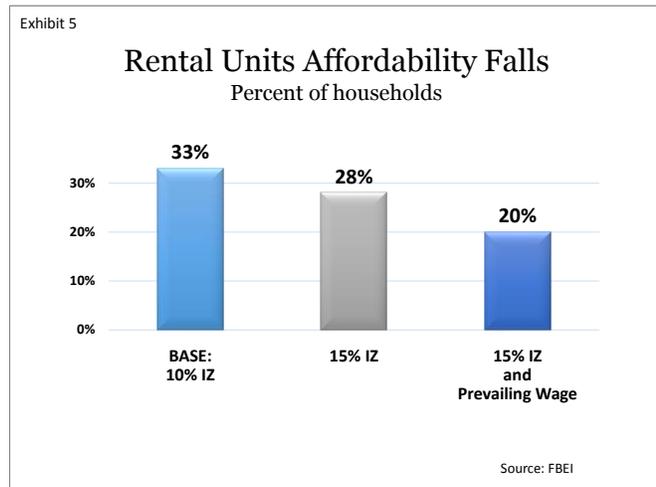
## The Rental Market

For the rental segment, the prototypes modeled included two major types of products based on the KMA descriptions and what could most likely be produced in the City:

- Garden apartments
- Stacked flats over podium parking

The results show that a lifting of the inclusionary affordable housing requirement from 10% to 15% would raise rents an average of 8.4% to nearly \$3,300 per month across the City. Total production would fall from about 4,000 to less than 3,500 units, a drop of 13.4%.

While 120 additional affordable housing units would be produced, more than 650 market-rate housing units would be lost. This means that five households would be priced out of the rental market for every additional affordable unit that would be produced. Based on their incomes, the share of households who could afford a new apartment would drop from 33% to 28%. This amounts to an additional 23,700 households who could no longer afford a new apartment.



Requiring that Prevailing Wages also be paid on all projects would boost rents a total of 24.3% from current conditions to an average of nearly \$3,800 per month. The total number of rental units would plunge an estimated 32.2%. As a result, only 7 additional affordable units would be produced than under current conditions, while 1,295 market-rate units would be lost. This means that 187 households would be

Exhibit 6

### City Total: Effects of Changes in Inclusionary Policies on Rental Housing

CITY TOTAL RENTAL	BASE 10% IZ	15% IZ	15% IZ + Prevailing Wage
Total Housing Permits	4,003	3,467	2,715
IZ Housing	400	520	407
Market Housing	3,603	2,947	2,308
Monthly Rent	\$3,023	\$3,278	\$3758

	CHANGE FROM BASE		
# Total Housing Permits	-536	-1,288	
# IZ Housing Change	120	7	
# Market Housing Decrease	-656	-1,295	
Monthly Rent Increase	\$255	\$735	
# Change in MktH/IZ, No. HH	-5	-187	
% change in total units	-13.4%	-32.2%	
% change in IZ housing	29.9%	1.7%	
% change in Mkt housing	-18.2%	-35.9%	
% change in Rent	8.4%	24.3%	
Housing Affordability Share, %	33	28	20

Source: FBEL

priced out of the market for each newly constructed affordable units. The share of households across the City who could afford a rental unit would drop from the current 33% to just 20%, implying that a total of 68,000 additional households could no longer afford a new apartment.

## The For-Sale Market

The for-sale prototypes modeled included three product types:

- Single-family dwellings
- 2-3 story townhouses
- 3-story townhouses

The increase in the inclusionary affordable housing requirement from 10% to 15% would raise new home prices 7.1% to about \$690,000. Total production would fall from about 1,400 units to about 1,200 units, a drop of 13.0%. While 42 additional affordable housing units would be produced, nearly 220 units would be lost. Similar to results for the rental segment, this would

imply that five households seeking to buy a new home would be priced out of the market for each affordable housing unit that could be produced. Affordability, measured in terms of the percentage of households who could afford a new home, would drop from 27% to 23%. This translates into an additional 22,000 households being priced out of the new home market.

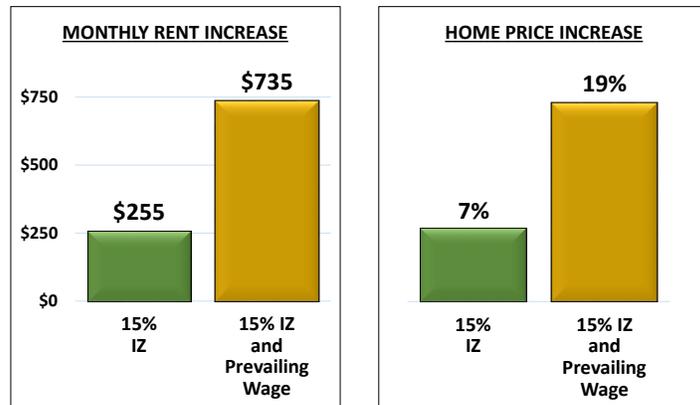
The addition of a Prevailing Wage requirement to a 15% inclusionary affordability housing regulation would raise new home prices by 19.3% from current conditions to over \$769,000. Total production would plummet 31.8% from current conditions. As a result, just 3 additional affordable units would be produced, while 439 market-rate units would be lost. This would further elevate the trade-off between affordable and market-rate housing. A total of 138 households would be priced out of

the market for each additional affordable unit produced. The share of total households able to afford a new home would fall to just 18%. This means that a total of an additional 45,800 households in the City could no longer afford a new home.

Exhibit 7

### Rents Rise and Home Prices Increase

Dollar increase from base 10% Inclusionary Housing

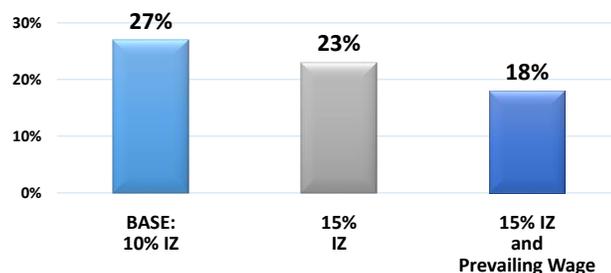


Source: FBEI

Exhibit 8

### For-Sale Units Affordability Drops

Percent of households



Source: FBEI

Exhibit 9

## City Total: Effects of Changes in Inclusionary Policies on For-Sale Housing

<i>CITY TOTAL FOR-SALE</i>	BASE 10% IZ	15% IZ	15% IZ + Prevailing Wage
Total Housing Permits	1,371	1,194	935
IZ Housing	137	179	140
Market Housing	1,234	1,015	795
Home Price	\$644,731	\$690,250	\$769,459
<b>CHANGE FROM BASE</b>			
# Total Housing Permits		-178	-436
# IZ Housing Change		42	3
# Market Housing Decrease		-219	-439
Home Price Increase		\$45,519	\$124,728
# Change in MktH/IZ, No. HH		-5	-138
% change in total units		-13.0%	-31.8%
% change in IZ housing		30.6%	2.3%
% change in Mkt housing		-17.8%	-35.6%
% change in Home Prices		7.1%	19.3%
Housing Affordability Share, %	27	23	18

Source: FBEl

### The Total Market

Combining the rental and for-sale sides of the market, what would be the likely impact of proposed changes in the City's inclusionary affordable housing regulations? Expected outcomes were calculated based on the recent and forecasted volumes of new rental and for-sale projects in the various nine City Council districts. About one-fourth of total new supply was projected to represent for-sale units versus about three-fourths for rental products.

Exhibit 10

### Few Affordable Units Produced, While Market-Rate Housing Would Plummet

Change from current policies



Source: FBEl

The City-wide results show that the total number of housing units produced annually would fall from about 5,374 potential units under current market conditions to 4,660 units should the inclusionary affordable housing requirement rise from 10% to 15%. This would be a drop of 13.3%. A total of just 162 rental and for-sale units would be added to the number of affordable housing units produced each year, while 875 fewer market-rate housing units would be produced. For each rental or for-sale home produced for a low-income household, five households would no longer be able to afford a rental or for-sale unit.

Requiring the payment of Prevailing Wages on all projects would cut the annual production of new units to just 3,650 units, a reduction of 32.1% from what could be produced under current regulations. With such a large drop in total production, even with a larger percentage of required affordable units (15% versus 10%) means that just 10 units priced for low-income households would be produced. More than 1,700 market-rate housing units for rent or for sale would not be produced. The trade-off from the proposed change in policy would be stark. For every affordable housing unit produced either for low-income households seeking to rent or own, 172 other households would no longer be able to rent or buy the home they had sought.

Exhibit 11

## City Total: Effects of Changes in Inclusionary Policies on Rental and For-Sale Housing

<i>CITY TOTAL FOR-SALE</i>	BASE 10% IZ	15% IZ	15% IZ + Prevailing Wage
Total Housing Permits	5,374	4,660	3,650
IZ Housing	537	699	548
Market Housing	4,837	3,961	3,103
<b>CHANGE FROM BASE</b>			
# Total Housing Permits		-714	-1,724
# IZ Housing Change		162	10
# Market Housing Decrease		-875	-1,734
# Change in MktH/IZ, No. HH		-5	-172
% change in total units		-13.3%	-32.1%
% change in IZ housing		30.1%	1.9%
% change in Mkt housing		-18.1%	-35.9%

Source: FBEL

### Could Builders or Landowners Absorb the Additional Costs?

The key reason that rents and prices rise while production drops traces to the increase in cost imposed by requiring higher set-asides for affordable housing and an additional possible increases in wages. One argument commonly made is that prices might not rise since builders could easily absorb the additional costs with a slight reduction in their profit margins. However, the money invested in most housing projects is generally not that of the builder or developer but rather that of lenders or providers of equity capital. These investors demand a certain rate of return. If they cannot earn that in housing, they will divert it to other purposes.

The argument is also often made that land prices are a “residual” and will adjust lower should the “upstream” costs of building rise. Landowners, however, also have choices. They typically would accept at most a 5% drop in the price of their land, with many accepting no change. Instead, they would choose to direct their land to other uses or hold it off the market until conditions become more favorable in the future.

## Critical Choices Facing the City

As the City Council of San Diego considers revising its policies on inclusionary affordable housing, it needs to consider the probable impact on the overall housing market. Reducing the annual new supply of new housing to around 3,650 units per year or less would put San Diego further behind in its efforts to achieve its housing target. The much lower production would leave the City at the end of 2020 with only about one-half or less of the 88,000 housing units mandated under its current 11-year RHNA cycle.

Over the next 15 years, a 15% inclusionary zoning requirement would reduce the supply of new housing by nearly 11,000 units. Payment of Prevailing Wages would boost that loss to 26,000 new homes.

The City also faces a critical question, which the results in this study highlight: Is providing additional *affordable housing* for a few via the proposed changes in policy worth the substantial further deterioration in *housing affordability* for the rest?

## IV. RESULTS BY COUNCIL DISTRICT

- All nine City Council districts would experience declines in the supply of both rental and for-sale housing should the requirements for increased inclusionary housing be implemented.
- A 15% inclusionary zoning requirement would cut the production of rental units between 7.5% and 23% across the different districts. Including the effect of Prevailing Wages, production declines would be 24% to 40%.
- A 15% IZ would reduce the total new supply of for-sale new housing from 7.5% in District 1 to 21% in District 4. An additional Prevailing Wage (PW) requirement could cause total reductions of close to 50% or more in Districts 4, 8, and 9.
- A 15% IZ would push rents up between 6% and 9% across the districts. The addition of a PW requirement would drive rents up a total of 23% to 25%.
- Home prices would rise between about 6.5% and 7.5% across the different districts with a 15% IZ. An additional PW requirement would raise homes prices between 18% and 21%.
- Affordability for both households looking to rent and purchase would decline. The share of households who could afford an apartment could fall below 25% in Districts 3, 8, and 9 under a 15% IZ standard. An additional PW requirement could push those numbers below 20%.
- For individuals attempting to purchase a new home, a 15% IZ requirement would result in affordability rates of less than 15% in Districts 4, 8, and 9. Only 7% of households in these districts would be able to afford a new home if Prevailing Wages were also required.

- Few new affordable housing units would be produced under the changes in inclusionary housing policies being considered. A 15% IZ would yield increases greater than 20 units in the total number of affordable rental or for-sale units only in Districts 1 and 7. If a Prevailing Wage requirement were also added, only District 1, where the median household income is one of the highest in the City at \$113,000, would see an increase of more than 10 units. Five of the districts would see lower numbers of affordable units produced, with the rest experiencing essentially no change.
- All districts would see large declines in the number of market-rate housing units on both the rental and for-sale sides. As a result, even where affordable units are produced, they will come at a high cost in terms of the loss of market-rate housing across the entire City.

Exhibit 12

## Impact of Policy Changes on Rental Housing in City Council Districts

<b>BASE 10% Inclusionary Zoning (IZ)</b>										
<b>RENTAL MODEL</b>	District 1	District 2	District 3	District 4	District 5	District 6	District 7	District 8	District 9	City Aggregate
<b>Total Housing Permits</b>										
Base 10% IZ	848	172	738	232	335	156	758	314	450	4,003
15% IZ	746	134	571	212	307	136	656	287	416	3,467
15% IZ + prevailing wage	641	109	464	158	251	98	452	217	325	2,715
<b>IZ Housing</b>										
Base 10% IZ	85	17	74	23	33	16	76	31	45	400
15% IZ	112	20	86	32	46	20	98	43	62	520
15% IZ + prevailing wage	96	16	70	24	38	15	68	32	49	407
<b>Market Housing</b>										
Base 10% IZ	764	155	664	209	301	140	682	282	405	3,603
15% IZ	634	114	485	180	261	116	558	244	354	2,947
15% IZ + prevailing wage	545	93	394	134	213	83	384	184	276	2,308
<b>Monthly Rent</b>										
Base 10% IZ	\$3,404	\$3,404	\$3,404	\$2,416	\$2,946	\$2,946	\$2,946	\$2,416	\$2,416	\$3,023
15% IZ	\$3,725	\$3,725	\$3,725	\$2,568	\$3,186	\$3,186	\$3,186	\$2,568	\$2,568	\$3,278
15% IZ + prevailing wage	\$4,238	\$4,238	\$4,238	\$2,980	\$3,668	\$3,668	\$3,668	\$2,980	\$2,980	\$3,758
<b>Change from Base 10% IZ</b>										
<b># Total Housing Permits</b>										
15% IZ	-102	-38	-167	-20	-28	-19	-101	-26	-34	-536
15% IZ + prevailing wage	-207	-63	-274	-75	-84	-58	-305	-97	-126	-1,288
<b># IZ Housing Change</b>										
15% IZ	27	3	12	9	13	5	23	12	17	120
15% IZ + prevailing wage	11	-1	-4	0	4	-1	-8	1	4	7
<b># Market Housing Decrease</b>										
15% IZ	-129	-41	-178	-29	-40	-24	-124	-38	-51	-656
15% IZ + prevailing wage	-218	-62	-269	-75	-88	-57	-297	-98	-129	-1,295
<b>Monthly Rent Increase</b>										
15% IZ	\$321	\$321	\$321	\$152	\$240	\$240	\$240	\$152	\$152	\$255
15% IZ + prevailing wage	\$835	\$835	\$835	\$564	\$722	\$722	\$722	\$564	\$564	\$735
<b># Change in MktH/IZ, No. HH</b>										
15% IZ	-5	-14	-15	-3	-3	-5	-5	-3	-3	-5
15% IZ + prevailing wage	-19	*	*	-189	-21	*	*	-87	-35	-187
<b>% change in total units</b>										
15% IZ	-12.1%	-22.1%	-22.6%	-8.7%	-8.3%	-12.3%	-13.4%	-8.4%	-7.5%	-13.4%
15% IZ + prevailing wage	-24.4%	-36.5%	-37.1%	-32.2%	-25.1%	-37.1%	-40.3%	-30.9%	-27.9%	-32.2%
<b>% change in IZ housing</b>										
15% IZ	31.9%	16.9%	16.1%	36.9%	37.5%	31.5%	29.9%	37.4%	38.7%	29.9%
15% IZ + prevailing wage	13.4%	-4.7%	-5.6%	1.7%	12.3%	-5.7%	-10.4%	3.6%	8.2%	1.7%
<b>% change in Mkt housing</b>										
15% IZ	-16.9%	-26.4%	-26.9%	-13.8%	-13.4%	-17.2%	-18.2%	-13.5%	-12.7%	-18.2%
15% IZ + prevailing wage	-28.6%	-40.0%	-40.6%	-36.0%	-29.3%	-40.6%	-43.6%	-34.8%	-31.9%	-35.9%

\* Declines in both IZ and Market housing

Source: FBFI

Exhibit 13

# Impact of Policy Changes on For-Sale Housing in City Council Districts

<b>BASE 10% Inclusionary Zoning (IZ)</b>										
<b>SALES MODEL</b>	District 1	District 2	District 3	District 4	District 5	District 6	District 7	District 8	District 9	City Aggregate
<b>Total Housing Permits</b>										
Base 10% IZ	364	43	220	100	180	84	189	78	113	1,371
15% IZ	336	39	198	79	161	70	154	63	94	1,194
15% IZ + prevailing wage	287	32	161	43	139	55	120	37	62	935
<b>IZ Housing</b>										
Base 10% IZ	36	4	22	10	18	8	19	8	11	137
15% IZ	50	6	30	12	24	10	23	9	14	179
15% IZ + prevailing wage	43	5	24	6	21	8	18	6	9	140
<b>Market Housing</b>										
Base 10% IZ	327	39	198	90	162	75	170	71	101	1,234
15% IZ	285	33	169	67	137	59	131	54	80	1,015
15% IZ + prevailing wage	244	27	137	37	118	46	102	31	53	795
<b>Home Price</b>										
Base 10% IZ	\$726,790	\$726,790	\$726,790	\$609,155	\$662,623	\$650,839	\$650,839	\$609,155	\$609,155	\$644,731
15% IZ	\$781,530	\$781,530	\$781,530	\$649,663	\$711,155	\$699,558	\$699,558	\$649,663	\$649,663	\$690,250
15% IZ + prevailing wage	\$875,660	\$875,660	\$875,660	\$719,319	\$798,846	\$784,330	\$784,330	\$719,319	\$719,319	\$769,459

<b>Change from Base 10% IZ</b>										
<b># Total Housing Permits</b>										
15% IZ	-28	-4	-22	-21	-19	-14	-36	-15	-19	-178
15% IZ + prevailing wage	-76	-11	-59	-57	-42	-29	-69	-42	-50	-436
<b># IZ Housing Change</b>										
15% IZ	14	2	8	2	6	2	4	2	3	42
15% IZ + prevailing wage	7	0	2	-4	3	0	-1	-2	-2	3
<b># Market Housing Decrease</b>										
15% IZ	-42	-6	-30	-23	-25	-16	-40	-17	-21	-219
15% IZ + prevailing wage	-83	-12	-62	-53	-44	-29	-68	-39	-48	-439
<b>\$ Home Price Increase</b>										
15% IZ	\$54,740	\$54,740	\$54,740	\$40,507	\$48,533	\$48,719	\$48,719	\$40,507	\$40,507	\$45,519
15% IZ + prevailing wage	\$148,870	\$148,870	\$148,870	\$110,164	\$136,223	\$133,491	\$133,491	\$110,164	\$110,164	\$124,728
<b># Change in MktH/IZ, No. HH</b>										
15% IZ	-3	-4	-4	-12	-4	-8	-10	-10	-7	-5
15% IZ + prevailing wage	-12	-28	-29	*	-16	*	*	*	*	-138
<b>% change in total units</b>										
15% IZ	-7.7%	-9.8%	-9.9%	-20.9%	-10.6%	-16.8%	-18.8%	-19.5%	-16.5%	-13.0%
15% IZ + prevailing wage	-21.0%	-26.7%	-27.0%	-56.8%	-23.0%	-34.8%	-36.5%	-53.1%	-44.7%	-31.8%
<b>% change in IZ housing</b>										
15% IZ	38.4%	35.3%	35.1%	18.6%	34.1%	24.7%	21.9%	20.7%	25.3%	30.6%
15% IZ + prevailing wage	18.5%	10.0%	9.5%	-35.3%	15.4%	-2.2%	-4.8%	-29.6%	-17.1%	2.3%
<b>% change in Mkt housing</b>										
15% IZ	-12.8%	-14.8%	-14.9%	-25.3%	-15.6%	-21.5%	-23.3%	-24.0%	-21.1%	-17.8%
15% IZ + prevailing wage	-25.4%	-30.7%	-31.0%	-59.2%	-27.3%	-38.4%	-40.1%	-55.7%	-47.8%	-35.6%

\* Declines in both IZ and Market housing

Source: FBEL

Exhibit 14

## Impact of Policy Changes on Rental and For-Sale Composite Housing in City Council Districts

<b>BASE 10% Inclusionary Zoning (IZ)</b>										
<b>COMPOSITE MODEL</b>	<b>District 1</b>	<b>District 2</b>	<b>District 3</b>	<b>District 4</b>	<b>District 5</b>	<b>District 6</b>	<b>District 7</b>	<b>District 8</b>	<b>District 9</b>	<b>City Aggregate</b>
<b>Total Housing Permits</b>										
Base 10% IZ	1,212	216	958	332	515	240	947	392	563	5,374
15% IZ	1,082	173	770	291	468	206	810	350	510	4,660
15% IZ + prevailing wage	929	141	625	201	389	153	573	253	387	3,650
<b>IZ Housing</b>										
Base 10% IZ	121	22	96	33	52	24	95	39	56	537
15% IZ	162	26	115	44	70	31	121	53	77	699
15% IZ + prevailing wage	139	21	94	30	58	23	86	38	58	548
<b>Market Housing</b>										
Base 10% IZ	1,091	194	862	299	464	216	852	353	507	4,837
15% IZ	919	147	654	247	398	175	688	298	434	3,961
15% IZ + prevailing wage	789	120	531	170	331	130	487	215	329	3,103

<b>Change from Base 10% IZ</b>										
<b># Total Housing Permits</b>										
15% IZ	-130	-42	-188	-41	-47	-33	-137	-42	-53	-714
15% IZ + prevailing wage	-283	-74	-333	-131	-126	-87	-374	-139	-176	-1,724
<b># IZ Housing Change</b>										
15% IZ	41	4	20	10	19	7	27	13	20	162
15% IZ + prevailing wage	18	0	-2	-3	7	-1	-9	-1	2	10
<b># Market Housing Decrease</b>										
15% IZ	-171	-47	-208	-52	-66	-40	-164	-55	-73	-875
15% IZ + prevailing wage	-302	-74	-331	-128	-133	-86	-366	-137	-178	-1,734
<b># Change in MktH/IZ, No. HH</b>										
15% IZ	-4	-11	-11	-5	-4	-6	-6	-4	-4	-5
15% IZ + prevailing wage	-17	*	*	*	-19	*	*	*	-101	-172
<b>% change in total units</b>										
15% IZ	-10.8%	-19.6%	-19.7%	-12.4%	-9.1%	-13.9%	-14.5%	-10.6%	-9.3%	-13.3%
15% IZ + prevailing wage	-23.4%	-34.5%	-34.8%	-39.6%	-24.4%	-36.3%	-39.5%	-35.4%	-31.3%	-32.1%
<b>% change in IZ housing</b>										
15% IZ	33.9%	20.6%	20.5%	31.4%	36.3%	29.1%	28.3%	34.1%	36.0%	30.1%
15% IZ + prevailing wage	14.9%	-1.8%	-2.1%	-9.4%	13.4%	-4.5%	-9.3%	-3.1%	3.1%	1.9%
<b>% change in Mkt housing</b>										
15% IZ	-15.7%	-24.1%	-24.1%	-17.2%	-14.2%	-18.7%	-19.2%	-15.6%	-14.4%	-18.1%
15% IZ + prevailing wage	-27.6%	-38.2%	-38.4%	-42.9%	-28.6%	-39.8%	-42.9%	-39.0%	-35.1%	-35.9%

\* Declines in both IZ and Market housing

Source: FBFI

Exhibit 15

## New IZ Policies Could Hurt Housing in All Districts

Change in housing units from current policy

15% IZ			15% IZ + Prevailing Wage		
	Affordable	Market-Rate		Affordable	Market-Rate
District 1	41	-171	District 1	18	-302
District 2	4	-47	District 2	0	-74
District 3	20	-208	District 3	-2	-331
District 4	10	-52	District 4	-3	-128
District 5	19	-66	District 5	7	-133
District 6	7	-40	District 6	-1	-86
District 7	27	-164	District 7	-9	-366
District 8	13	-55	District 8	-1	-137
District 9	20	-73	District 9	2	-178
City Aggregate	162	-875	City Aggregate	10	-1,734

Source: FBEI

Exhibit 16

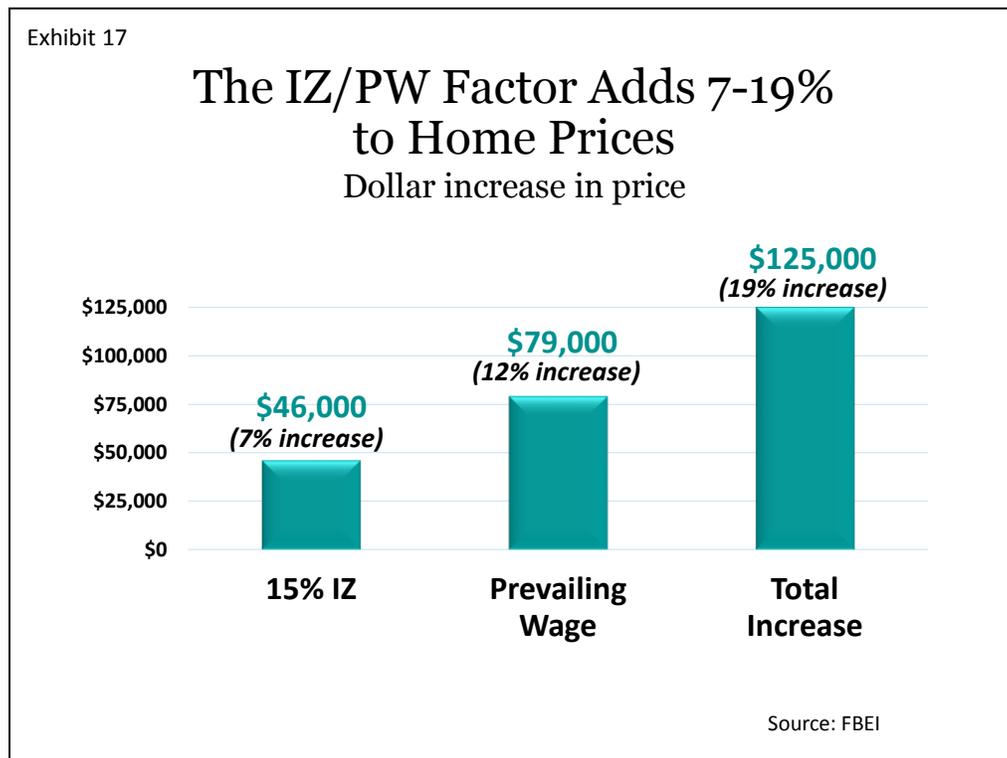
## Housing Affordability Shares Decline across All Districts

Rental Units Affordability share, %				For-Sale Units Affordability share, %			
	Base 10% IZ	15% IZ	15% IZ + Prevailing Wage		Base 10% IZ	15% IZ	15% IZ + Prevailing Wage
District 1	41%	36%	31%	District 1	36%	33%	28%
District 2	25%	20%	16%	District 2	19%	17%	14%
District 3	22%	17%	14%	District 3	16%	15%	12%
District 4	29%	27%	20%	District 4	17%	13%	7%
District 5	52%	47%	39%	District 5	43%	38%	33%
District 6	38%	33%	24%	District 6	29%	24%	19%
District 7	33%	29%	20%	District 7	25%	20%	16%
District 8	25%	23%	17%	District 8	15%	12%	7%
District 9	21%	20%	15%	District 9	13%	11%	7%
City Aggregate	33%	28%	20%	City Aggregate	27%	23%	18%

Source: FBEI

## V. THE IZ/PW FACTOR

Raising the requirement to provide inclusionary affordability housing would drive up home prices significantly in the City. Increasing the inclusionary zoning percentage from 10% to 15%, prohibiting the option to pay an in-lieu fee, and requiring that all inclusionary housing be built onsite would add another \$46,000 or 7% to the cost of a typical house or condo. Requiring that Prevailing Wages (PW) be paid would add another \$79,000 or 12%. The IZ/PW Factor, which represents the additional tax or regulatory burden, would thus be \$125,000 or 19%. This would be on top of the 40% cost of regulation found in our previous study that characterized much of the region.<sup>1</sup>



The inability to choose to pay an in-lieu fee would also deprive the City of a critical source of funding for affordable housing. Since San Diego's Inclusionary Housing Program began, more than \$133 million has been collected in fees. Over 2,500 affordable units have been built with inclusionary fees and there are 907 additional affordable units in the pipeline.<sup>2</sup> In recent years, these funds have been leveraged with state and federal sources to fund affordable housing. These funds have in the past been used by builders specialized in producing affordable housing.

<sup>1</sup> "Opening San Diego's Door to Lower Housing Costs." Fermanian Business & Economic Institute at PLNU, 2015.

<sup>2</sup> "Comparison of Inclusionary Housing Programs." Office of the Independent Budget Analyst, City of San Diego. July 27, 2018.

## VI. EXPERIENCE OF OTHER MAJOR CITIES

Many cities throughout the country have enacted various measures to boost affordable housing. Although details of various programs vary widely, the results of several cities in California or on the West Coast are instructive.

### ➤ **Portland**

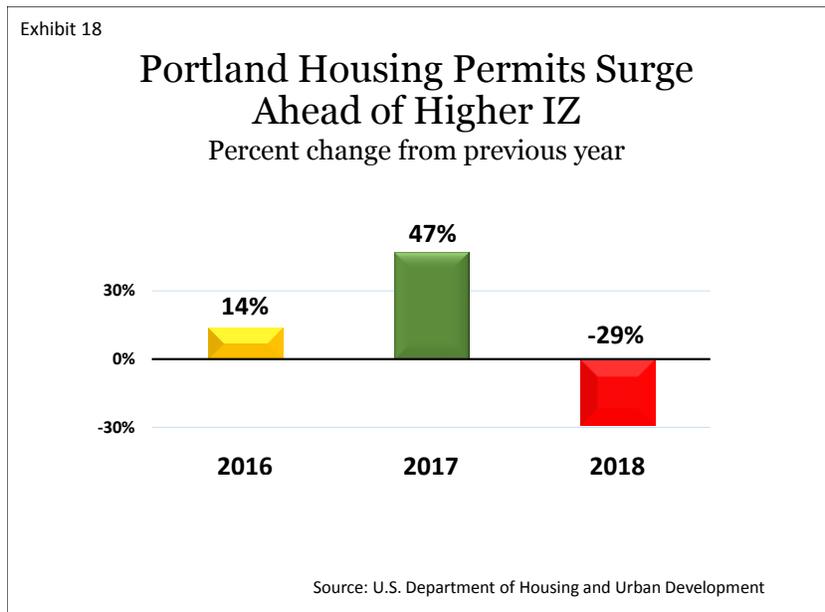
#### Background

In December, 2016 the City of Portland approved a mandatory citywide inclusionary zoning policy. This policy applies to all developments with 20 or more dwelling units. It requires that 20% of units be affordable for households making less than 80% of the median family income. Incentives offered by the city to offset the costs include:

- A ten-year property tax exemption and construction excise tax exemption on affordable units
- A density bonus
- Setting aside of 10% of building units for families making 60% of medium family income in exchange for additional incentives

#### Analysis

The measure went into effect on February 1, 2017, causing a surge in housing permits as builders viewed the incentives to be insufficient to offset the higher costs. By the day of implementation, the inventory of housing had swelled to a 3-4 year supply.<sup>3</sup> For the full year of 2017, the number of housing unit permits surged by 47%, but was then followed by a steep 29% drop in 2018. Many projects that were permitted in 2017 have been abandoned and many others may never be used. In response, the City of Portland in early 2018 offered additional incentives for projects permitted before the new inclusionary housing policies were implemented with the hope of activating some of those idle permits.



<sup>3</sup> "Portland's Inclusionary Zoning Law." City Commentary. Joe Cortright. September 2017.

➤ **Los Angeles**

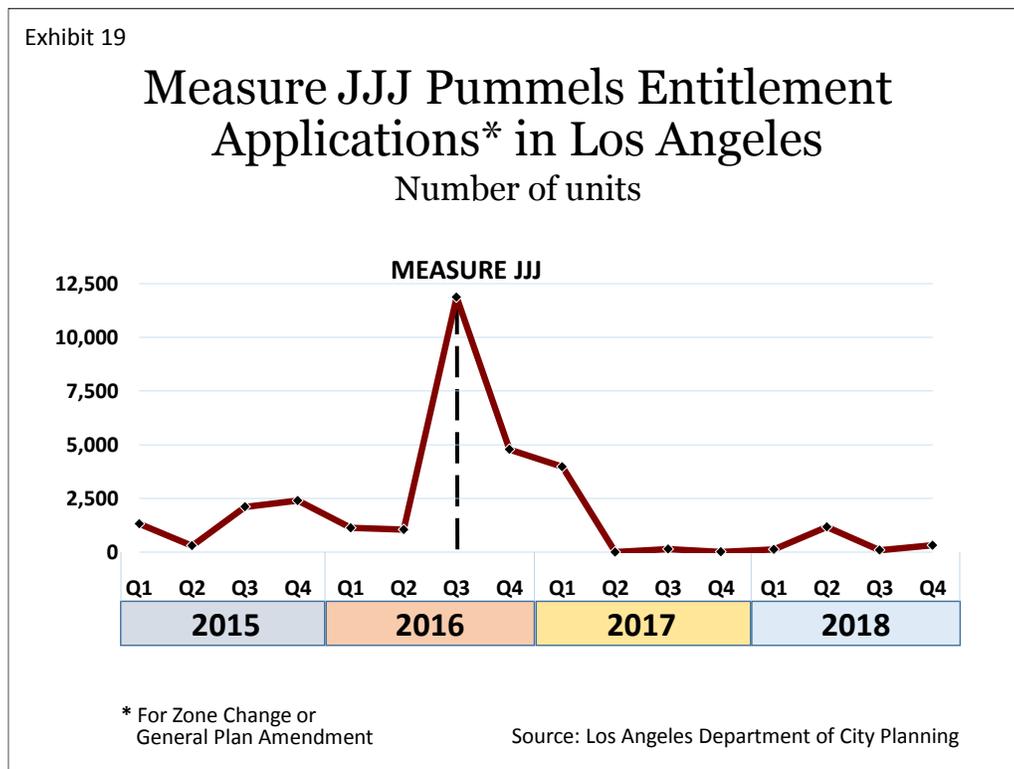
Background

The City of Los Angeles initially utilized a mixed-income housing ordinance for housing development, but in November, 2016 voters approved Measure JJJ. This measure sought to limit all General Plan Amendments and zone changes to projects that met the ballot measure’s affordable housing and workforce requirements. The workforce requirements include local hire, employment of transitional workers, and increased wage provisions.

Analysis

According to its Housing Progress Reports, published for 2018,<sup>4</sup> the City of Los Angeles has experienced a steep falloff in applications for zone changes or General Plan Amendments (GPAs) following a spike prior to the run-up to the election. There was another brief pickup prior to the establishment of new linkage fees in the middle of 2018, followed by a subsequent falloff. For all of 2018, applications for zone changes or GPAs were down 59% from the prior year.

According to the City’s Progress Report, 30% of projects subject to Measure JJJ have terminated, withdrawn, or are not expected to progress.<sup>5</sup>



<sup>4</sup> “Housing Progress Report.” Los Angeles Department of City Planning, November 2018 and February 2019.

<sup>5</sup> “Housing Progress Report.” Los Angeles Department of City Planning, November, 2018.

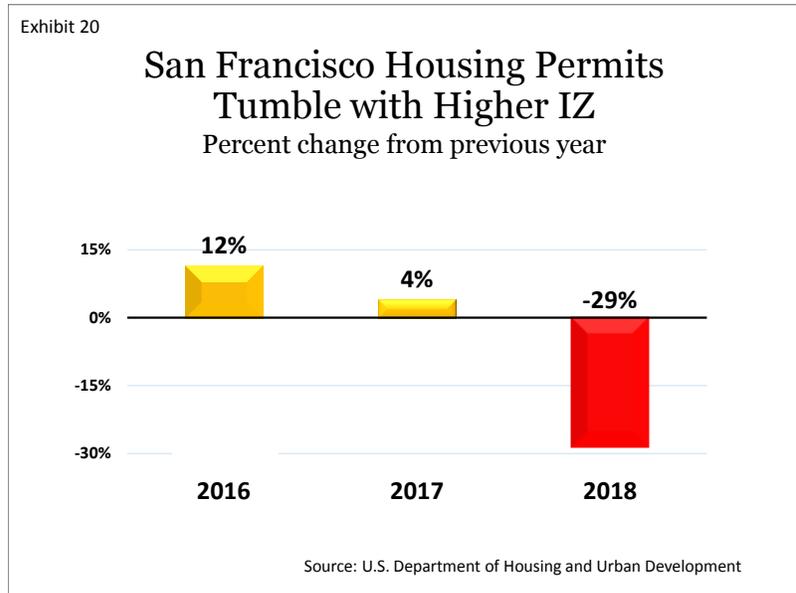
➤ **San Francisco**

Background

San Francisco’s inclusionary housing program, started in 1992, was made mandatory in 2002 and then significantly amended in the fall of 2017. For large rental projects, builders must set aside 19% of their units for low- to middle-income households. For large for-sale projects, 21% of units must be designated as affordable. If the affordable units are built off-site, the comparable percentages are 30% and 33%. If builders choose to pay fees instead, the fee rate is 30% for rental properties and 33% on for-sale projects.

Analysis

While the new policy has only been in effect for one year, there already has been a steep decline in the number of housing unit permits. Following increases of 12% and 4% in 2016 and 2017, respectively, permits plummeted by 29% in 2018.



➤ **San Jose**

Background

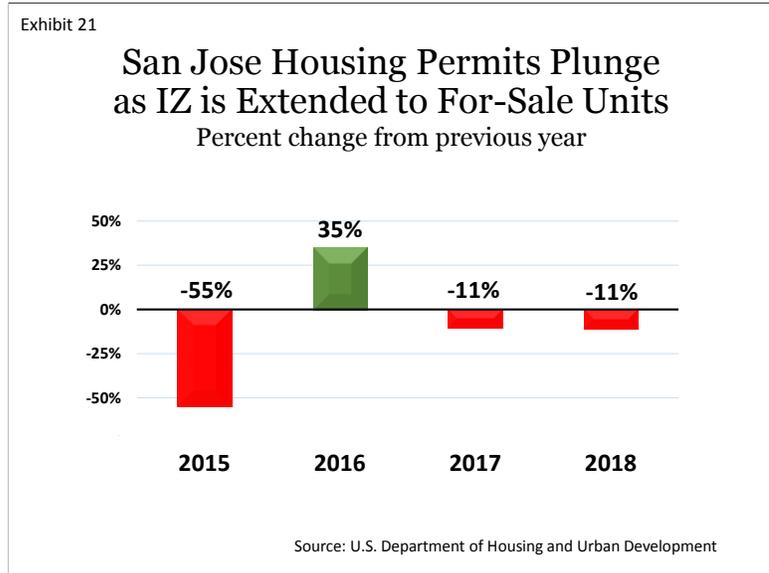
The Inclusionary Housing Ordinance of the San Jose Municipal code was originally adopted in January 2010, but was held up by court challenges. In 2015, the California Supreme Court allowed the part of the ordinance covering for-sale units to go into effect. At the end of 2017, passage of AB 1505 in California extended the coverage to rental units.

The program requires that all residential developments with 20 or more units (for-sale or rental) set aside 15% of their units for affordable housing. If affordable housing is built off-site, the requirement rises to 20%. Developers may pay an in-lieu fee instead of building affordable units. That fee is currently \$167,207 per home on the for-sale side and \$125,000 per unit for rental properties.<sup>6</sup>

<sup>6</sup> “Inclusionary Housing Ordinance.” CityofSanJose.gov, February, 2019.

## Analysis

Following the Court's approval for the coverage of for-sale projects, San Jose housing permits plunged by 55% in 2015. Ahead of a possible extension to rental units, permits rebounded by 35% in 2016, but dropped by 11% in 2017 and 2018 as California extended the inclusionary housing provision's extension to rental properties at the end of 2017.



## ➤ **Oakland**

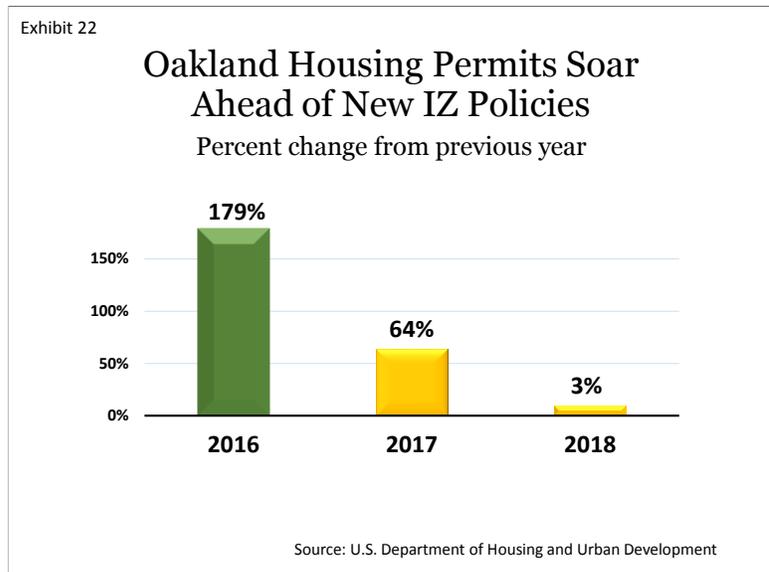
### Background

In May, 2016 the Oakland City Council adopted development impact fees for affordable housing, transportation, and capital improvement. The Affordable Housing Impact Fees went into effect in September, 2016 and were established to be phased in over a 3-year time period.

Affordable housing fees for fiscal year 2019 range from \$1,000 to \$23,000 per unit depending on housing type (single-family, townhouse, or multi-family).

Alternatively, developers may provide on-site affordable units, ranging from 5-10% depending on income levels (10% if affordable units are for moderate-income or low-income households and 5% if they are for very low-income households).

Affordable units can be provided off-site provided they are located within one-half mile of the development project.



## Analysis

Prior to Oakland's implementation of inclusionary housing policies, housing permits nearly tripled in 2016. They rose a further two-thirds in 2017, but by less than 3% in 2018 as the fees were totally phased in at midyear.

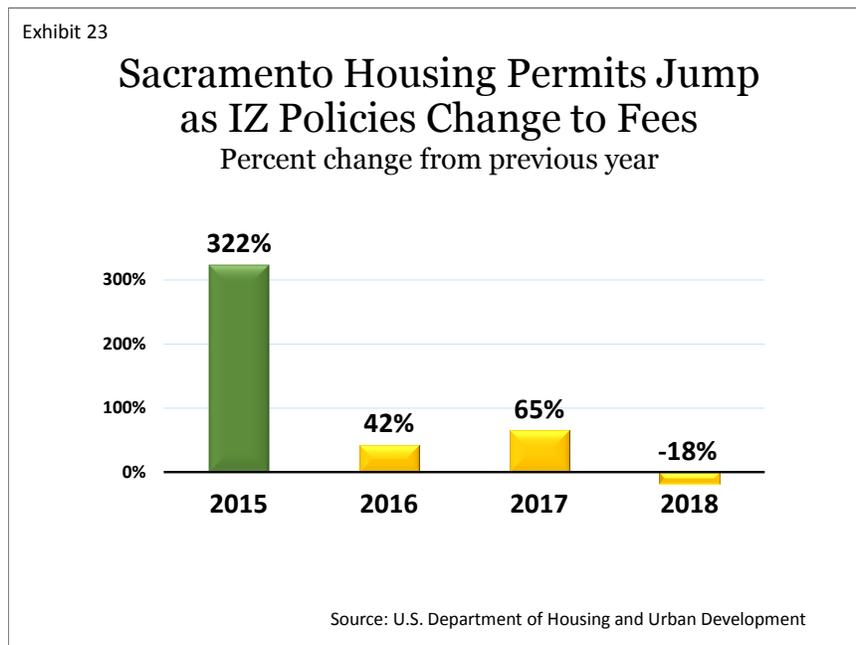
### ➤ **Sacramento**

#### Background

In 2015 the Sacramento City Council modified its Mixed Income Housing Ordinance to a fee-based policy<sup>7</sup>. Prior to 2015 Sacramento required 5% of total dwelling units to be affordable to low-income households earning up to 80% of AMI and 10% for very low-income households with incomes up to 50% of AMI. The fee is \$2.85 per square foot for housing units up to a certain density. For multi-unit dwellings, the fee is reduced to \$0 per square foot at 40 dwelling units per acre to encourage greater density. Dwellings located in a specified housing incentive zone are charged \$1.23 per square foot. The only exemption to these fees is for projects that have at least 10% of the dwelling units that are affordable for no less than 30 years.

#### Analysis

Sacramento saw its housing permits more than quadruple in 2015 as builders responded favorably to a change to a fee-based inclusionary housing policy. Permits continued to rise significantly in the following two years before decreasing in 2018.



<sup>7</sup> "Comparison of Inclusionary Housing Programs." The City of San Diego Office of the Independent Budget Analyst Report. July 2018.

## VII. SUMMARY OF RECENT LITERATURE

(See Appendix for full literature review)

### **Inclusionary Housing**

The first part of the literature review examines studies that analyzed the impact of Inclusionary housing policies. Some key findings are listed below:

- Increasing the inclusionary requirements 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.<sup>8</sup>
- Inclusionary housing is the third most constricting policy and worsens affordability. It causes families to be pushed out of job markets in search of affordable housing, creates an increase in displacement, and impacts the environment by elongating commutes.<sup>9</sup>
- Inclusionary housing requirements affect the cost of developing new housing and changes housing production, which impacts housing prices facing all renters and purchasers of market-rate housing at all income levels.<sup>10</sup>
- One study found that the elimination of the San Diego redevelopment agency in 2012 seemed to indicate a 6% rise in homelessness. The study recommends the State bring back the redevelopment funding for affordable housing and related infrastructure. Locally, the study recommends lowering the cost to develop affordable homes through reforms that shorten entitlement-processing times, create more certainty, and reduce unnecessary or duplicative regulatory barriers.<sup>11</sup>
- Multiple studies argued that California's high housing prices are caused by zoning and other land use controls. In one study, the authors conclude that because measures of zoning strictness are highly correlated with high prices, government regulation must combat the issues of zoning to reduce the cost of housing in California.<sup>12</sup> Another study finds that each additional regulation reduces a city's housing stock by 0.2% per year, and the number of new homes built each year is reduced by an average of 4% per restriction per year.<sup>13</sup>

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<sup>8</sup> Inclusionary Housing Working Group: Preliminary Report September 2016. City and County of San Francisco Office of the Controller. September 2016.

<sup>9</sup> Solving the Housing Affordability Crisis: How Policies Change the Number of San Francisco Households Burdened by Housing Costs. Bay Area Council Economic Institute. October 2016.

<sup>10</sup> Modifying Inclusionary Housing Requirements: Economic Impact Report. City and Council of San Francisco, Office of Economic Analysis. May 2017.

<sup>11</sup> San Diego County's Housing Emergency and Proposed Solutions. California Housing Partnership Corporation. May 2018.

<sup>12</sup> The Impact of Zoning on Housing Affordability. National Bureau of Economic Research. March 2002.

<sup>13</sup> Why California is so expensive: It's not just the weather, it's the regulation. Kristoffer Jackson. 2016.

- A study by the Urban Land Institute cites the single most important factor for an inclusionary housing policy to achieve its goals is a significant and sustained level of market-rate development in the local market. In most cases jurisdictions will need to also provide development incentives to ensure the feasibility of development projects affected by an inclusionary housing policy.<sup>14</sup> This finding is echoed in a Lincoln Institute of Land Policy study, which indicates the risk that poorly designed inclusionary requirements could slow the rate of building and ultimately lead to higher housing costs. Policymakers can avoid this by offering developers flexibility in how they comply and by calibrating requirements and incentives so that the net economic cost imposed on these projects is not too great.<sup>15</sup>

## Prevailing Wage

The second part of the literature review examines studies that evaluated the impact of Prevailing Wage policies. Some key findings are listed below:

- Multiple studies agreed that mandated prevailing wage rates would increase the cost of housing. Based on location and type of housing, a range of cost increases were cited from \$42,900 to \$90,000 per home. A range of percentage increases were cited from 9% to 46%.
- According to one source, prevailing wages could also increase monthly rents by as much as \$460.<sup>16</sup>
- One study provided an analysis of multi-family projects over a 10-year period subject to Los Angeles Measure JJJ and found 64% of them were between 1-50 units, indicating small developers will be the hardest hit by the increased costs.<sup>17</sup>
- Another study stated that home price increases caused by prevailing wage regulations would mean a household would need another \$15,700 to \$17,200 in annual income to qualify for a single or multi-family unit and \$15,800 more for renting the median multi-family unit.<sup>18</sup>
- The California Housing Consortium finds that on average the total construction costs increase 26% when prevailing wages are present, with a corresponding cost increase of \$49,370 per unit and a per square foot increase of over \$58.<sup>19</sup>
- A study by The Beacon Hill Institute discusses how federal prevailing wage law is anticompetitive and costly to taxpayers due to U.S. Department of Labor's use of data from its Wage and Hour Division instead of statistically more accurate data from its Bureau of Labor Statistics.

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<sup>14</sup> The Economics of Inclusionary Development. Urban Land Institute. 2016

<sup>15</sup> Inclusionary Housing: Creating and Maintaining Equitable Communities. Lincoln Institute of Land Policy. 2015.

<sup>16</sup> Olsen, Kristin. "Prevailing Wage rule for home builders would impoverish California." The Modesto Bee. June 8th, 2017.

<sup>17</sup> Measure JJJ: Affordable Housing and Labor Standards Related to City Planning Initiative Ordinance. Beacon Economics. October 2017.

<sup>18</sup> Regulation & Housing: Effects on Supply Costs & Poverty. California Center for Jobs & the Economy – California Business Roundtable. May 2017.

<sup>19</sup> Labor Requirements May Not Produce Intended Results. California Housing Consortium.

## **VIII. POLICY PERSPECTIVES**

Housing is unique in the way our society's underserved are addressed. The producers of housing (developers and homebuilders) are charged with the primary responsibility of providing and subsidizing housing for those individuals. In contrast, in the case of hunger, for example, food manufacturers are given no such mandate. The government, through its SNAP program, and private non-profit organizations are mainly responsible for providing food for the needy. The government also bears the primary responsibility for insuring that lower income households have access to health care and education.

Policymakers need to consider who should bear the cost of providing housing to lower income households. Should it be homebuilders, employers, or taxpayers? The current model of putting the burden on homebuilders results in higher housing prices and rents for middle and higher income households.

More generally, policymakers have three options in achieving any desired objective:

- They can subsidize the endeavor or give various incentives
- They can mandate certain actions
- They can refrain from either "carrots or sticks"

With housing, inclusionary affordable housing policies have often involved mandates (such as certain percentages of housing set aside for lower income households) that are partially offset with incentives (such as allowing higher density). These policies, however, have come at the expense of driving up the cost of housing for middle income households and reducing the overall supply of new housing. An alternative approach might be to just allow builders to construct more housing.

Public policies also need to be ultimately evaluated on results rather than intent. Many policies are well intended but may produce unintended consequences or yield results that are counterproductive. That appears to be the case with the proposals to increase inclusionary affordable housing policies. They are unlikely to produce any significant increases in affordable housing, while reducing the production of market-rate housing and driving up rents and home prices.

## **IX. CONCLUSIONS**

The City of San Diego has recognized the urgency of the area's deficiency in housing and has made housing a major priority. The City Council in 2018 approved the Mayor's 'Housing SD' Plan to boost housing production and raise affordability. This Plan contains important elements, such as calling for an updating of Community Plans, updating the Land Development Code, and improving the review process for new housing projects.

Much of the recent focus of housing policy has been on expanding the amount of housing affordable to lower income households. While important, the cost of these programs has been passed on to buyers of market-rate housing. This means that middle class households have largely been priced out of the market.

Our 2015 study found that the regulatory burden contributed about 40% of the cost of housing region wide. It was even slightly higher for the City of San Diego. That study made a number of recommendations to help rein in these expenses.

Link to study: <https://drive.google.com/open?id=0B8G4fuB2iZEEMWZKeV9GdmFtOG8>

Although the City has made significant efforts to reduce some of these costs, new costs have appeared from storm water regulations, climate action plan requirements, as well as a 2020 statewide solar mandate. The base regulatory cost for the City of San Diego is still likely about 40%. The combined impact of a 15% inclusionary affordable housing requirement plus a Prevailing Wage requirement would raise the total regulatory burden to 59%.

Such an increase would overturn efforts by the Mayor and City Council to truly address San Diego's housing crisis. Also, by making housing less affordable, the policies under consideration could raise the challenges facing the City in two other major areas. Pushing people out of the City in search of more affordable housing could lead to longer commutes and counter the City's efforts to reduce greenhouse gas (GHG) emissions. Alternatively, these people could find work closer to their new homes, exacerbating the problems that San Diego firms are now experiencing in filling key positions.

The key question facing policymakers is whether the provision of one additional affordable home is worth pricing out five or more firefighters, police officers, school teachers, nurses, and young engineers from the housing market.

Reducing the regulatory burden from the current 40% may be a better path towards solving the housing crisis than boosting it to nearly 60% with policies that are well intentioned but would have damaging consequences.



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## APPENDIX A: Methodology

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The effects of a change in inclusionary affordable housing policy were modeled in the following way.

Costs estimates of increasing the percentage of units to 15% that must be set aside to accommodate households earning 65% of the area's average median income (AMI) and requiring that units be built onsite with no option to pay an in-lieu fee were developed. The additional impact of requiring that the Prevailing Wage be paid was also estimated.

Based on prototypes studied by KMA in its analysis for the City and consideration of what would be most feasible, the following three product types were analyzed on the rental side:

- Garden apartments
- Stacked flats over podium parking

The following prototypes were analyzed on the for-sale side:

- Single-family dwellings
- 2-3 story townhouses
- 3-story townhouses

Land costs in various parts of the City were used to produce the costs elements in addition to the costs of materials and labor, various fees, and the cost of capital. The impact on rents and housing prices for various property types were then produced for each Council District.

The impact on the number of units that could be potentially demanded based on affordability of rental and for-sale properties was then modeled for each of the nine City Council Districts. Each of the prototypes was modeled separately and a blended or aggregated property type was also analyzed based on expectations for the mix of types of housing that would be most feasible in each Council District. Affordability in each District was based on the distribution of household incomes in each District as provided by the nationally-recognized demographics research firm, Claritas.

This evaluation allowed the calculation of affordability, as measured in terms of the share of households that could afford the different types of property types under different inclusionary housing policies. It also allowed estimates to be made of the maximum amount of construction that could take place in each area. The impact on the numbers of affordable units was calculated based on 15% of the total, while market-rate housing was based on 85% of the total. To derive the combined impact of the rental and for-sale housing segments in each District, estimates were made of the share of each type based on recent production totals and income levels. This allowed estimates to be produced of the total impact on housing production in each Council District.

City-wide estimates of the impact of changes in inclusionary affordable housing requirements were developed by summing the impact on rental and for-sale units across all nine Districts. City-wide impacts on rents and housing prices were calculated based on weighted-averages across the Districts, where relative weights were based on the distribution of households, recent production trends, and income levels.

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## **APPENDIX B: Literature Review – Inclusionary Housing**

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- **Inclusionary Housing Working Group: Preliminary Report September 2016.**  
*City and County of San Francisco Office of the Controller. September 2016.*

In June of 2016, San Francisco voters passed Proposition C, a charter amendment that would make significant changes to the city's established inclusionary housing program. The Controller's office commissioned three consulting groups to engage in three research tasks:

- (1) Estimate how overall market rate and affordable housing production would change the city with the new inclusionary requirements.
- (2) Find how various inclusionary housing provisions would affect residual land value as well as prevailing land prices in San Francisco.
- (3) How other cities are approaching the design of their inclusionary housing programs.

The Implications of Inclusionary Housing Changes that the study found were:

- (1) For each one percentage point change in the city's inclusionary requirement (e.g., from 17% to 18%), an additional 175 Below Market Rate (BMR) units would be constructed over the next 15 years. In addition, the total number of housing units in the city is projected to decline by approximately 1.8%. The decrease in total housing units will likely result in an increase in average housing prices. Reducing the construction of new housing in San Francisco by about 18% would increase housing prices and rents by about 2%.
  - (2) If the city established an inclusionary policy that averaged 17% and increased at .5% per year, the city would have 852 more BMR units in 15 years than it would with the pre-prop C requirements. This policy choice would raise housing prices by 1.48% and the total cost to moving households would be approximately \$1.8 billion a year.
  - (3) Increasing the inclusionary requirements 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.
- **Solving the Housing Affordability Crisis: How Policies Change the Number of San Francisco Households Burdened by Housing Costs.** *Bay Area Council Economic Institute. October 2016.*

This study focuses on the top ten policies that increase affordability and the top ten policies that worsen affordability. The study finds that inclusionary housing is the third most constricting policy and worsens affordability. While the intentions of inclusionary housing

may have been positive, an increase from the base 12% on-site requirement to 17% creates a housing burden for 2,196 households in the bay area. This pushed families out of the job markets in search of affordable housing, an increase in displacement, and an impact on the environment by elongating commutes.

In 2016 voters voted in favor of Proposition C, which would increase the rate of the bay area's inclusionary housing programs. The study found that at a rate increase of 25% (the highest increase that was being considered), an additional 5,408 households would be unable to afford to live in San Francisco. In addition, this would yield a reduction in the housing supply by 7,849 units. This reduction in market-rate unit development across the city yields an overall price increase of 3.57%. This price increase would shift 7,536 households into an unaffordable housing cost-to-income situation.

- **Modifying Inclusionary Housing Requirements: Economic Impact Report.** *City and Council of San Francisco, Office of Economic Analysis. May 2017.*

The study looked at the economic impacts of changing the inclusionary housing requirements established by Proposition C in the bay area and found that:

- (1) Changing inclusionary requirements affects the cost of developing new housing in San Francisco. On the margin, higher requirements could make some projects unfeasible, and lower requirements could facilitate projects that had been marginally unfeasible. Changing housing production in this way affects housing prices facing all renters and purchasers of market rate housing in the city at all income levels.
- (2) Changing inclusionary requirements would also change the number of, and/or funding for, affordable housing units. This would reduce the subsidy that low and moderate-income households receive from this housing and put upward pressure on the housing burden facing those households.

- **Nearly One-Fourth of Funds Meant to Bankroll Affordable Housing Went to Other Causes.** *Lisa Halverstadt, Voice of San Diego. October 2018.*

The article found that over the last 15 years, San Diego developers have given the city about \$120 million from inclusionary housing programs. However, not all fees collected from market rate developers have built actual homes. Former San Diego State University Planning Professor Nico Calvita, who advocated for the 2003 inclusionary policy, said he never considered the possibility that those funds might finance things other than housing projects. The details are listed below:

- (1) Spending over the last 15 years (2004-2016)
  - a. **Housing Projects:** \$64,240,119.00
  - b. **Transitional Housing Projects:** \$3,221,031.00
  - c. **Administrative Costs:** \$8,452,907.00
  - d. **Homebuyer Loans:** \$8,596,826.00

- (2) What is budgeted for this year (2018)
  - a. **Housing Projects:** \$41,529,328.00
  - b. **Transitional Housing Projects:** \$4,468,188.00
  - c. **Administrative Costs:** \$1,423,741.00
  - d. **Homebuyer Loans:** \$500,000.00

- **The City of San Diego Housing Action Plan.** *Office of Councilman Georgette Gomez. 2016.*

The study starts by discussing San Diego's barriers to increasing housing affordability such as income, wages, permit processing times, low housing vacancy rates, high land costs, etc. Then the study recommends seven major initiatives to improve housing affordability in San Diego.

- (1) Increase affordable and middle income housing stock
  - a. Consider waiving or reducing development impact fees for rental units affordable for housing at or below 65% average median income (AMI) or 80% AMI.
  - b. Promote companion units and micro/single room occupancy units.
  - c. Revise the city's inclusionary housing program to incentivize developers to build affordable housing units instead of paying the in-lieu fee.
- (2) Preserve existing affordable housing
  - a. Designate a preservation coordinator responsible for conducting inventory of at-risk apartments, assess the cost of replacement versus preservation, and maintain a list of entities qualified to preserve at-risk apartments.
  - b. Facilitate sales to qualified developers.
  - c. Strengthen regulatory protections.
- (3) Provide innovative housing solutions for the homeless
  - a. Conduct an interim housing solutions study to house individuals in San Diego, including the best practices from other cities.
- (4) Identify public lands for housing opportunities
- (5) Create statewide floor-area-ratio incentives in transit priority areas
  - a. This will stimulate development of new residential units by providing flexibility for projects and provide housing in a variety of unit sizes.
- (6) Seek grant opportunities for new housing development
  - a. Develop a cross-department grant coordinator who would be responsible for developing an on-going list of integrated infrastructure projects in close proximity of transit-supportive housing opportunities for qualifying grants.
- (7) Develop an affordable housing measure for the November 2018 ballot

- **City of San Diego, Housing Inventory Annual Report.** *The City of San Diego. 2018.*

The purpose of this study is to provide an overview of the process toward the goals outlined in the General Plan Housing Element adopted by the San Diego City Council in 2013. The report demonstrates that while the city is actively taking steps to increase housing production, the market is still not keeping up with demand. This is especially true in very low and low-income housing, and even more so in moderate-income housing according to this report. The solutions offered by this study are:

- (1) **New construction:** Increasing San Diego's housing supply is critical to addressing the current housing crisis.
  - (2) **Permitting and entitlements:** Because the entitlement process is an extensive process that does not ensure immediate development of units, it can impede timely housing production. Updates in the municipal code of a community plan could help streamline the process.
  - (3) **Data tracking:** In a typical year, the city issues 46,000 permits, 4,000 code enforcement cases, conducts 97,000 project reviews, and handles 137,000 construction inspections. Tracking this data more efficiently can lead to more transparency.
  - (4) **Rehabilitation and preservation:** In addition to the construction of new housing units as a way to address affordability, the San Diego Housing Commission works to maintain affordable housing options through the rehabilitation and preservation of existing affordable housing units. Putting more emphasis on actively seeking and preserving these affordable housing units is vital to reducing housing costs.
- **California's High Housing Costs: Causes and Consequences.** Mac Taylor, Legislative Analyst's Office. March 2015.

This study discusses high housing costs throughout California. The cost of housing is higher than it has ever been, but also higher than anywhere else in the country. Due to currently limited housing options and the lack of new ones, California is facing serious problems that will be problematic to its citizens but also economy. The study offers the following recommendations:

- (1) **Aim to build more housing in coastal cities, densely:** The greatest need for additional housing is in California's coastal urban areas. The study therefore recommends the legislature to focus on what changes are necessary to promote additional housing construction in these areas.
- (2) **Recognize targeted roles of affordable housing programs:** While the scale of these programs could never meet the magnitude of new housing required, the study recommends that legislatures consider how targeted programs could supplement more housing construction. This could then help by assisting those with limited access to market-rate housing.

- **San Diego County's Housing Emergency and Proposed Solutions.** California Housing Partnership Corporation. May 2018.

The study finds that the elimination of redevelopment in 2012 seemed to indicate a 6% rise in homelessness. To afford living in San Diego a renter needs to earn over three times the local minimum wage. Additional findings are that the County needs over 100,000 more affordable units to meet current demand. Furthermore, it was found that San Diego's lowest income renters spend 69% of their income on rent, leaving little left for food, transportation, healthcare, savings, or other essentials. When these housing costs are factored into the poverty rate of San Diego, it rises from 13.3% to 20.4%. The study has the following recommendations to combat these issues:

(1) Statewide Policies

- a. Immediately invest \$1 billion of the state's budget surplus to finance the development of permanently affordable rental housing and another \$1 billion for supportive housing for the homeless.
- b. Bring back the redevelopment funding for affordable housing and related infrastructure at an initial amount of \$1 billion annually

(2) Local Recommendations

- a. Place revenue measures on city and county ballots to allow voters to approve affordable housing bonds.
- b. Prioritize the use of public land for affordable housing.
- c. Fully implement local policies to fund and develop affordable homes such as inclusionary ordinances and related in-lieu fees, commercial linkage fees, and single-room occupancy (SRO) replacement ordinances.
- d. Lower the cost to develop affordable homes through reforms that shorten entitlement-processing times, create more certainty, and reduce unnecessary or duplicative regulatory barriers.

- **The Impact of Inclusionary Zoning on Development.** Nicholas Brunick. March 2002.

This study discusses the benefits of inclusionary housing as well as a criticism of the policy. The benefits include providing affordable homes to low- and moderate-wage workers, stimulating economic development, and supporting smart growth principles in the protection of the urban core. The major criticism of inclusionary zoning is that it could further exacerbate the shortage of affordable housing. If less housing is being built and more people are chasing fewer homes, the price of housing will increase. In addition, the author believes that inclusionary zoning could also harm a community's tax base and economic development as developers take their private investment elsewhere. The community would thus lose not only the developers' capital, but also the property tax revenue that comes from new homebuyers who move into the units built by developers.

- **The Impact of Zoning on Housing Affordability.** National Bureau of Economic Research. March 2002.

This study focuses on the price of housing being significantly higher in only some places of the United States. In those areas, the authors argue that high prices are caused by zoning and other land use controls, making housing more expensive. The evidence the authors find through their model suggests that there is a huge gap between the price of land implied by the gap between home prices and construction costs and the price of land implied by the price difference between homes on 10,000 square feet and homes on 15,000 square feet. The authors conclude that because measures of zoning strictness are highly correlated with high prices, government regulation must combat these issues of zoning to reduce the cost of housing in California.

- **Why California is so expensive: It's not just the weather, it's the regulation.** Kristoffer Jackson. 2016.

This study looks to explain why California is so expensive. While geographic characteristics certainly play a role in restricting development in some California communities, local regulatory regimes create an equally difficult obstacle for developers to overcome. California cities' reliance on land-use regulation increased precipitously from the mid-1980s to the early 1990s. Unsurprisingly, the most highly regulated communities back then – in the southern coastal region and in the San Francisco Bay area – still are at the top of the list today.

The author then compares the rate of construction in cities that implement more land-use regulations to the cities that implement the least amount of it. The author finds that each additional regulation reduces a city's housing stock by .2% per year. In addition, the number of new homes built each year is reduced by an average of 4% per restriction per year.

The author concludes by discussing how regulation reduces residential development overall. One of the most restrictive regulations in parts of California puts caps on the number of residential building permits available, which reduces construction for single-family homes by 30%, while restrictions on the number of new lots for new homes can cause multifamily construction to fall by 45%. Ultimately, land use policies should be the primary focus in the quest for affordable housing in California.

- **The Economics of Inclusionary Development.** Urban Land Institute. 2016.

This study focuses on multifamily rental development and the implications of inclusionary housing on mixed-use and for-sale housing development. A growing number of cities in the United States and Canada are turning to their zoning authority as a means to generate new development of workforce housing units, which are in decreasing supply in many communities. The single most important factor for an inclusionary housing policy to achieve its goals is a significant and sustained level of market-rate development in the local market. If a community is not experiencing a material amount of new development,

an inclusionary housing policy will not generate a meaningful number of new workforce housing units. In most cases, jurisdictions will need to provide development incentives to ensure the feasibility of development projects affected by an inclusionary housing policy. The principle incentives are direct subsidies, density bonuses, tax abatements, and reduced parking requirements. Individually and in combination, these incentives can substantially enhance the feasibility of development projects affected by an inclusionary housing policy. Each incentive has strengths and limitations that derive from the local real estate development environment. In the right market conditions and with the optimal availability of development incentives, inclusionary housing policies can generate development of new workforce housing units. Four factors determine development feasibility and the success of inclusionary housing policies:

1. Public Policy: Policy – including zoning, density, and design requirements – must allow the developer to build a profitable product.
2. Market Feasibility: The developer must see sufficient demand for space to support a profitable project.
3. Capital: Developers must be able to access the resources for development, including equity investment, bank loans, or other sources of funds.
4. Land: The developer must be able to control the site with reasonable acquisition costs.

In addition, the factors that determine feasibility are based on a set of calculations that assess whether the project has sufficient demand to cover its construction and operating costs and can provide financial returns for the effort and risk undertaken by the developer and its sources of funding.

The study then offers ways for optimizing the effectiveness of incentives for inclusionary housing development. While there are many ways to make inclusionary housing policies better and more effective, optimizing the effectiveness depends heavily on local market (and submarket) conditions and development product type. Below is what the study recommends:

1. Create development incentives such as direct subsidies, tax abatements, density bonuses, and reduced parking requirements.
  2. Give developers the ability to opt out of an inclusionary commitment by making a payment to the jurisdiction in lieu of meeting the requirement to provide below-market units on site.
- **Inclusionary Housing: Creating and Maintaining Equitable Communities.** Lincoln Institute of Land Policy. 2015.

The evidence summarized in this report strongly supports the idea that local inclusionary housing policies can fairly and effectively tie production of affordable housing to the construction of new market-rate real estate development. Many communities have created their policies through a similar process of studying and understanding the housing need and the full spectrum of available tools, educating and engaging the public, researching the market economics, and engaging with the real estate community.

According to this study, there is some risk that poorly designed inclusionary requirements could slow the rate of building and ultimately lead to higher housing costs because developers are not able to pass on the cost of compliance to tenants and homebuyers. Policymakers can avoid this unintended consequence by offering developers flexibility in how they comply and by calibrating requirements and incentives so that the net economic impact on projects is not too large. The most common incentive is the right to build with increased density. When developers can build more units, the extra income can offset the costs of providing affordable units and the result will be a smaller (if any) reduction in land value. Other common incentives include parking or design waivers, zoning variances, tax abatements, fee waivers, and expedited permitting.

In addition, the study states that inclusionary housing is one of the only housing strategies that effectively integrates lower-income households into higher-income, higher-opportunity locations. It cites a 2012 study by Heather Schwartz and her colleagues at the RAND Corporation that mapped the locations of affordable units created by inclusionary policies in 11 cities. This RAND study found that the typical inclusionary unit was in a neighborhood where only 7 percent of the population lived in poverty (half the national average for all neighborhoods). Children in these inclusionary units were assigned to schools with state test scores ranking in the 40th to 60th percentile and with lower-than-average numbers of students eligible for free lunches.

- **Portland IZ Update.** Jennifer Shuch, HFO Investment Real Estate Research Analyst. 2018.

In December 2016 the City of Portland approved a mandatory citywide inclusionary zoning policy. This policy applies to all developments with 20 or more dwelling units. It requires 20% of units to be affordable for households making less than 80% of the median family income. Incentives offered by the city to offset the costs include:

- A ten-year property tax exemption and Construction Excise Tax (CET) exemption on affordable units.
- A density bonus of 3.0 floor area ratio.
- Setting aside 10% of building units for families making 60% of medium family income in exchange for additional incentives.

When the inclusionary zoning went into effect, developers expressed concern that the incentives were not enough. Since the recession, there has been a shortage of 10,000 construction companies in Oregon. Additionally, rising interest rates in Portland and Portland's 1% construction tax raise the overall cost of constructing apartments.

The current results from inclusionary zoning have not been encouraging. The construction of affordable units under Portland's inclusionary zoning policy depends on the willingness of developers to build projects in the city. If developers begin to look less favorably on Portland, there will not be enough housing units, let alone affordable ones.

- **Portland's Inclusionary Zoning Law: Waiting for the other shoe to drop.** Joe Cortright. September 2017.

In December 2016 the City of Portland adopted one of the nation's most sweeping inclusionary zoning requirements. Most new multifamily housing projects will be required to set aside 20% of their units for families earning less than 80% of area medium income (or 10% for families earning less than 60%).

When Portland's Bureau of Planning and Sustainability released a short report describing the results after the first six months under the ordinance they found that 60 new affordable units would be created (if they move through the permitting process and are actually approved). However, there were no new private apartment projects of more than 20 units submitted for land use review. Additionally, city officials are worried that some developers are purposefully avoiding the ordinance by building projects with 19 or fewer units.

- **Portland weighs changes to key affordable housing policy.** Elliot Nijus. October 2018.

In October 2018, Portland City Officials were proposing significant changes to its year-and-a-half old Inclusionary Housing ordinance. The Housing Bureau recently recommended a delay for a scheduled increase in the number of affordable units required, and its leaders are weighing bigger tax breaks to developers in an attempt to spur more apartments to be built.

Currently, there have been 291 rent-restricted units in 33 private, for-profit developments. Projects backed by the Portland Housing Bureau or nonprofit affordable housing developers bring the total to 362. 57 projects, totaling 6,300 total units have been proposed and are in the early stages of the permitting process.

- **Portland Real Estate Market Still Adjusting to Inclusionary Housing.** Jared Brey. Next City. April 2018.

In early 2018 Portland's city council decided to backtrack and reenact its old incentive program for development projects. The program, called MULTE, offers tax breaks for multifamily projects that set aside 20% of units for reduced rate rent. There have not been enough affordable units built, so the city has decided to implement these incentives to try to encourage housing growth.

- **Apartment Construction is drying up. Is affordable housing measure to blame?** Elliot Nijus. The Oregonian. March 2018.

Before the Inclusionary Housing policy was enacted in late 2016, the city permitted an average of 3,200 apartments a year over the five years from 2012-2016. In 2017, the number went up to 6,250. However, in the year after the policy went into effect, developers sought permits for only 12 projects that met the 20-unit threshold, totaling just 654 units.

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## APPENDIX C: Literature Review – Prevailing Wage

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### Overview

According to the California Department of Industrial Relations, the prevailing wage rate is the basic hourly rate paid on public works projects to a majority of works engaged in a particular craft, classification, type, or work within the locality and in the nearest labor market area. Below are the impacts on California housing in regards to increases in prevailing wage rates:

- According to a report by the California Center for Jobs and The Economy, a project of the California Business Roundtable, Government mandated prevailing wages would **raise new home prices by as much as \$79,000 per unit.**<sup>20</sup>
- Beacon Economics found that premium labor cost mandates could **increase California housing prices by as much as 46%.**<sup>21</sup>
- Beacon Economics also found prevailing wages could also **increase monthly rents by as much as \$460.**<sup>22</sup>
- Estimates from the building Industry Association indicate that the proposal would **boost the cost of a 2,000 square-foot home in San Diego County by almost \$90,000.**<sup>23</sup>
- The Business Council of San Joaquin County says that prevailing wages would **increase the cost of a 1,500 square-foot home there by \$75,000.**<sup>24</sup>
- The National Association of Home Builders found that **for every \$1,000 added to the price of a California home, more than 15,000 households are forced out of the market.**<sup>25</sup>
- According the Beacon Hill Institute, **taxpayers pay \$8.6 billion a year more for public construction projects with prevailing wages.**<sup>26</sup>
- Different research institutes that say the percent cost increases in housing when prevailing wages are increased on residential construction:<sup>27</sup>
  - UC Berkeley: **9% - 37%**
  - The California Institute for County Government: **11%**
  - National Center for Sustainable Transportation: **15%**
  - San Diego Housing Commission: **9%**
  - Beacon Economics: **46%**

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<sup>20</sup> Olsen, Kristin. "Prevailing Wage rule for home builders would impoverish California." The Modesto Bee. June 8<sup>th</sup>, 2017.

<sup>21</sup> Olsen, Kristin. "Prevailing Wage rule for home builders would impoverish California." The Modesto Bee. June 8<sup>th</sup>, 2017.

<sup>22</sup> Olsen, Kristin. "Prevailing Wage rule for home builders would impoverish California." The Modesto Bee. June 8<sup>th</sup>, 2017.

<sup>23</sup> Jackson, Kerry. "Prevailing Wage would make California's housing crisis worse." Press Enterprise. April 30<sup>th</sup>, 2017.

<sup>24</sup> Jackson, Kerry. "Prevailing Wage would make California's housing crisis worse." Press Enterprise. April 30<sup>th</sup>, 2017.

<sup>25</sup> Jackson, Kerry. "Prevailing Wage would make California's housing crisis worse." Press Enterprise. April 30<sup>th</sup>, 2017.

<sup>26</sup> The Prevailing Mismeasure of Wages. The Beacon Hill Institute.

<sup>27</sup> Dillon, Liam. "Here's how construction worker pay is dominating California's housing debate." The Los Angeles Times. May 12<sup>th</sup>, 2017.

- **Measure JJJ: Affordable Housing and Labor Standards Related to City Planning Initiative Ordinance.** *Beacon Economics. October 2017.*

The Build a Better LA Affordable Housing and Development Initiative or Measure JJJ, was on the Los Angeles Ballot in November 2016, which sought to limit all General Plan amendments and zone changes to projects that met the ballot measure’s affordable housing requirements and workforce stipulations. The workforce requirements include local hire, employment of transitional workers, and increased wage provisions.

Proponents of the ballot measure claimed that it would increase affordable housing stock, pay “prevailing wages,” and require contractors to employ local workers. Housing projects over 10 units that do not conform to Los Angeles’ General Plan would have the following significant costs added to them in order to be approved:

- **Prevailing wage rate costs:** prevailing wages, which are almost double the market rate wages across job classifications, would drive up total project costs 46%.
- **Affordability premium costs:** this type of zoning in CA would cause a 20% increase in housing costs and reduced residential production by 7%.
- **Administrative and compliance costs:** Los Angeles contractors found 93.8% believed local hiring would likely add costs to projects and may cause the displacement of current workers (43.8%) or result in significant safety concerns on the project site because of inadequate training (68.8%).

Measure JJJ’s potentially could substantially reduce residential construction and would further accelerate increases in home price and rents in Los Angeles.

Additionally, Beacon Economics’ analysis examined a 10-year history of permitted multi-family projects and found that 63.2% of projects seeking an entitlement subject to this ballot measure were between 1-50 units. Historical permitting data indicates small developers will be the hardest hit by measure JJJ because of the increased costs.

Beacon Economics’ also found increases in costs for various occupations in Los Angeles:

Occupation	Mean Hourly Wage	Prevailing Wage	Percent Increase
Carpenter	\$26.16	\$55.77	113.2%
Drywall and Ceiling Tile Installer	\$27.65	\$55.95	102.4%
Roofer	\$24.72	\$46.54	88.3%
Heating, Air Conditioning, and Refrigeration Mechanics and Installers	\$26.05	\$63.76	144.8%

As the cost of construction increases, the projects would become unfeasible and unable to receive construction financing. If adopted, measure JJJ would have the effect of stifling a valuable subset of residential construction, and make a dire housing situation much worse.

- **Measure JJJ Giving Developers Pause.** *GlobeSt.com. July 2017.*

It has been more than half a year since Measure JJJ passed, an initiative that requires developers to allocate a portion of the property to affordable housing. According to the Los Angeles real estate company CBRE, Measure JJJ is a major concern for developers looking at potential land sites, and none want to take the risk of higher costs with Measure JJJ. Laurie Lustig-Bower, an executive VP at CBRE says:

“This may drive developers away from L.A. City to other markets where Measure JJJ isn’t in effect,” she says. “If the land is already zoned or entitled and you don’t need to ask for anything additional, then you won’t trigger JJJ.”

Demand for housing is high in Los Angeles, and the city needs more supply; however, Lustig-Bower says that developers will likely go outside of the city to build more housing with Measure JJJ in place.

- **Regulation & Housing: Effects on Supply Costs & Poverty.** *California Center for Jobs & the Economy – California Business Roundtable. May 2017.*

This report analyzes the potential effects from recently adopted and currently proposed regulations that would require all housing in California to be built while paying workers at prevailing wage levels along with other regulations and policies. The following information was found:

- Drawing from a series of public, academic, and construction industry sources from 2016, requiring builders to pay government determined prevailing wage rates would raise the median price of a new home by \$42,900 to \$79,000, the price of a new multifamily development by \$47,000 to \$86,500, and the monthly rent for those units by \$250 to \$460.
- New homes would increase \$63,600 to a total of \$553,500, units in multi-family developments \$69,600 to \$589,600, and monthly rents by \$370. For comparison, U.S. Census data shows the 2016 median new home price nationally (all units) was \$315,500.
- To afford this cost increase alone, a household would need another \$15,700 in annual income to qualify for a single-family home, \$17,200 more for buying the median multi-family unit, and \$15,800 more for renting the median multi-family unit.
- Over time, this factor alone would push housing price up by 13% primarily in inland regions, but much higher in coastal regions.
- Increasing costs at this rate is likely to bring currently approved developments to a halt due to project economics, reducing the level of new housing in California from its current level of about 100,000 units a year to only minimal residual construction of affordable units that are financed by public funds.
- Combining both direct and indirect effects of Prevailing Wages, the annual drop in home construction would result in a \$15.5 billion loss to state and local revenues. The impact to state revenues would be \$2.6 billion of this amount.

- In 2015, it was found that 52.9% of all California renter households were cost burdened, a level that would increase to an estimated 61.9% because of price increases from a prevailing wage requirement.

- **Labor Requirements May Not Produce Intended Results.** *California Housing Consortium.*

This study looks at three instances where prevailing wages create difficulties for the community.

1. Where prevailing wages are not determined, commercial wages apply, even for small projects. This creates artificial inflating of development costs.
2. Union contracts for construction workers can cover several counties at a time. The approach for determining prevailing wages has created unintended consequences where inflation as much as 300% in some counties over the wage needed to afford to live locally occurs.

County	Housing Wage <sup>i</sup>	Area Median Income <sup>ii</sup>	Residential Plumber Basic Wage/Wage with Benefits	Basic wage as % of Housing Wage	Residential Drywall Installer/Lather Wage/Wage with Benefits	Basic wage as % of Housing Wage
Imperial	\$12.37	\$19.83	\$38.86/\$56.55	314%	\$22.10/\$39.75	179%
Inyo	\$14.21	\$24.23	\$38.86/\$56.55	273%	\$22.10/\$39.75	155%
Kern	\$12.29	\$19.83	\$38.86/\$56.55	316%	\$22.10/\$39.75	180%
Los Angeles	\$22.19	\$21.80	\$38.86/\$56.55	175%	\$22.10/\$39.75	100%
Mono	\$20.96	\$27.33	\$38.86/\$56.55	185%	\$22.10/\$39.75	105%
Orange	\$25.46	\$29.35	\$38.86/\$56.55	153%	\$22.10/\$39.75	87%
Riverside	\$18.17	\$21.88	\$38.86/\$56.55	214%	\$22.10/\$39.75	122%
San Bernardino	\$18.17	\$21.88	\$38.86/\$56.55	214%	\$22.10/\$39.75	122%
San Diego	\$22.17	\$25.55	\$38.86/\$56.55	175%	\$22.10/\$39.75	100%
San Luis Obispo	\$19.40	\$25.94	\$38.86/\$56.55	200%	\$22.10/\$39.75	114%
Santa Barbara	\$23.58	\$25.94	\$38.86/\$56.55	165%	\$22.10/\$39.75	94%
Ventura	\$23.02	\$30.05	\$38.86/\$56.55	169%	\$22.10/\$39.75	96%

3. In some 3.oth
3. In other cases, prevailing wages have created pockets of inflated wages. For example, in Fresno County the prevailing wage rates exceed those in Los Angeles and San Diego counties, while Fresno’s housing wage is 40% lower.

Overall, the study finds that on average, the total construction costs increase 26% when prevailing wages are present. In addition, there is a corresponding cost increase of \$49,370 per unit and a per square foot increase of over \$58. The study concludes by saying lawmakers must consider whether wages exceeding 150% of what is required to live in the community are in the public interest.

- **The Prevailing Mismeasure of Wages.** *The Beacon Hill Institute.*

This study found that the federal prevailing wages adds 22% to the cost of labor on public construction projects and 9.91% to overall construction costs. As a result, taxpayers pay \$8.6 billion a year more for public construction projects than they would

have to pay if unbiased measures were used. The federal government and 31 states require the payment of a prevailing wage for all workers employed directly on site for government-funded construction projects over a certain dollar threshold. Adopted in Congress in 1931, the Davis-Bacon Act (DBA) enforces the prevailing wage at the federal level and serves as the basis for prevailing wages in the states.

The study then discusses how the law is anticompetitive and costly to taxpayers. As currently implemented, the law does not even accurately measure the prevailing wage. Rather, it is biased upward to reflect what the construction trades want to impose as a wage, rather than the wage that accurately prevails for given trade in a given metropolitan area. This is seen in the fact that the U.S. Department of Labor, which has the job of determining the prevailing wage, does not use the unbiased and statistically accurate data published by its Bureau of Labor Statistics (BLS). Rather, it uses data published by its Wage and Hour Division (WHD), whose methods are generally unreliable and, if anything, biased upward. In its study, BHI compared the estimates reported by the WHD to the estimates reported by the BLS for a sample of nine occupational categories accounting for 59% of all construction workers across 80 metropolitan areas.

BHI found that, on average the DBA prevailing wage is almost \$4.43 per hour, or more than 22%, above the BLS average wage when wages are weighted according to the number of workers in each trade and each metropolitan area. In the Nassau-Suffolk, New York metropolitan area, brick masons and block masons make at least \$24.17 per hour more than they would make if the prevailing wage were calculated using BLS methods. In Poughkeepsie-Middleton, New York, plumbers, pipe fitters and steamfitters get a premium of \$26 per hour. Steel and metalworkers in Bakersfield, California get a premium of \$16.37.

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## APPENDIX D: References

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