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HOUSING SAN FRANCISCO'S WORK FORCE: STRATEGIES FOR INCREASING THE SUPPLY AND AFFORDABILITY OF HOUSING

By

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Housing San Francisco's Workforce

Strategies for Increasing the Supply and Affordability of Housing

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Executive Summary

Over the past two decades, San Francisco has experienced a rise in population and employment base that has outpaced its production of housing. The resulting housing problem can be defined as an undersupply of housing that is affordable to a range of household incomes, particularly to lower and moderate income wage earners. This problem is projected to worsen as job creation in the lower and moderate income range continues to outpace additional housing development that is affordable at these levels.

In response to this undersupply of residential housing, the market has seen home prices and rents surge and vacancy rates fall. While real estate values that exceed the cost of construction typically signal new development in a healthy economy, the supply of new units in San Francisco has been constrained below optimal levels. Lower and moderate income households compelled to seek more affordable shelter in other parts of the Bay Area are most adversely affected as well as renters who do not accrue the tax or investment benefits of homeownership. San Francisco wages must compensate for higher housing costs, lengthened commute times, and higher costs of living, challenging the ability of San Francisco industry to remain competitive with less costly regions of the country.

Housing Prices and Affordability Levels

Over the last two years the price of San Francisco's median, existing single family home increased at a greater rate than any other California metropolitan area and most cities around the country. City-wide rents have also risen dramatically, increasing by 113 percent between 1990 and 1998. Currently, residential vacancy rates are below one percent.

Large affordability gaps exist between the rental or mortgage payments a median household income can support and median housing prices:

- An average size household earning 100 percent of median income faces a rental income gap of $3,144 annually or a home purchase affordability gap of $110,000.
- A household must earn $72,000 annually (120 percent of median income) in order to afford median monthly rents while allocating 30 percent of income to housing payments. One fifth of San Francisco's population is able to afford this payment.
- A household must earn approximately $90,000 annually (150 percent of median household income) and produce a $33,000 downpayment in order to afford the median home price while allocating one third of income to housing payments. Roughly 12 percent of San Franciscans are able to afford this median home.

As rents rise and vacancy rates fall, moderate income households are increasingly priced out of San Francisco's residential market. When home prices rise, the gap between household income and the supportable mortgage widens making homeownership more difficult for a greater number of moderate income households. While local government directs scare resources toward those most underserved by the market, and above moderate income households are better able to afford rising home prices, moderate income families can be priced out of the market altogether.

Job Growth and the Need for Housing

The growth of San Francisco's housing stock has been modest compared to the increase in the City's population and jobs. Since 1990, the City's population grew by 60,000 people while net housing units grew by fewer than 8,500. Over the past 20 years, San Francisco added a net total of 23,318 units to its housing stock representing a 7 percent increase. Much of the City's new housing stock is loft and luxury condominium development and is not affordable to San Francisco's lower or moderate income households.

Regional employment projections from the Association of Bay Area Governments estimate that San Francisco will create an additional 93,000 jobs between 2000 and 2020, the majority of which will fall under the U.S. Department of Housing and Urban Development's definition of very low and low income. Approximately 23,600 new housing units will be needed to accommodate the increase in employment assuming current commute patterns. This projected job growth will continue to put pressure on the supply and affordability of housing even as supply expands at its current production rate.

The City has approximately 14,600 housing units in the supply pipeline from major area plans such as Mission Bay and Transbay Terminal as well as high density towers in the downtown area. However, this falls short of the expected housing need of 23,600 housing units in the 2000-2020 period. As most of the City's available surplus land is already in the residential pipeline, the City faces a steep production curve for the additional 9,000 units. While the City estimates that there is adequate land available for residential development under existing zoning, housing potential is not always easy to realize in San Francisco's development climate.

Options to Increase Housing Supply and Affordability

Initiatives that increase the supply of housing and enhance affordability levels for low and moderate income households will ultimately have the greatest impact on San Francisco's housing problem. Toward these goals, advocacy and financing strategies can be pursued that will assist the City's moderate income workforce to secure stable and affordable housing. The following options are outlined in the context of this report:

ADVOCACY
- Legislative
- Land Use
- Neighborhood Education

FINANCING
- Downpayment Assistance Program
- Employer Assisted Housing
- CASA Loan Program

The advocacy options address the supply of both rental and owner occupied dwellings. These include legislative advocacy in support of expanding Federal Low Income Housing Tax Credits and Private Activity Bonds, and additional construction defect litigation legislation which will serve to remove barriers to the development of more affordable, attached product in San Francisco.

Intensive land use strategies are also warranted such as a City-wide density bonus program, higher density allowances in transit intensive corridors, and changes in the way parking requirements impose additional costs in the housing purchase. Neighborhood education and advocacy in support of well designed, residential development is also needed to demonstrate public approval of additional housing production.

Financing strategies that bridge the homeownership affordability gap are important ways in which industry can create stable housing opportunities for San Francisco's moderate income workforce, promote workforce stability and facilitate assemblage. Downpayment assistance programs and shared appreciation second mortgages are reviewed as potential financing vehicles.

The three options presented include: supplementing the City of San Francisco's Downpayment Assistance Loan Program; creating employer, industry, or occupation-based housing assistance programs; and bringing the Community Assisted Shared Appreciation or CASA Home Loan Program, an innovative mortgage product that leverages public and private capital in the form of second and third mortgages, to San Francisco. Each product creates different incentives and tax consequences for the investor and beneficiary.

Through these non-exclusive options, San Francisco industry can play an important role in shaping the future of the City's housing supply and in ensuring that the City's economy is not constrained by the lack of housing options that are affordable to its current and future labor supply.

Introduction

The Housing Problem

San Francisco is currently facing twin problems of an undersupply of housing for all levels of household income and an affordability crisis that particularly affects households of lower and moderate incomes. While housing supply is growing at a modest pace, strong demand for San Francisco's limited housing stock has caused rents and home prices to soar and vacancy rates to fall. As San Francisco's economy continues to generate job growth, it will become increasingly difficult to retain the diversity of households that forms the base of its labor force.

Cities around the world have faced similar problems of managing the growth of population and urban densities. To the extent that high housing and commercial rents reflect the true social costs of additional development, companies and households that locate in these areas must bear the burden of the additional cost. However, there are cases in which high costs and restrictive housing policies overly inhibit new growth, exacerbating housing shortages and creating affordability problems for all but the highest wage earners.

A recent report by the Bay Area Council[1] points to evidence of a market failure whereby housing supply is unnecessarily scarce and costs high, particularly housing stock that is affordable to a moderate income population. The study measured housing supply production from 1988-1998 and compared net increases during this period with San Francisco County's "fair share" housing need allocation as defined by the Association of Bay Area Governments.[2]

Under State law, each Bay Area jurisdiction is assigned a minimum housing goal necessary to sustain the area's economy. The housing need takes into account market demand for housing, employment growth, commuting patterns, availability of sites, and the local type and tenure of housing. The need is distributed across the U.S. Department of Housing and Urban Development's four income categories to ensure that each jurisdiction provides an adequate distribution of housing that is affordable across the income spectrum.

While San Francisco's housing production fell short of the fair share goals in all income categories, the shortage was most acute for moderate income households.[3] The findings show that San Francisco met the following percentages of its housing need by income category:

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[1] Bay Area Council. *A Crisis in Housing*. 1999.
[2] The Association of Bay Area Governments is required by State law (AB2853) to assign each Bay Area jurisdiction a "fair share" housing need objective that is developed by averaging housing need with county census income data. The determinations represent the level of housing production needed to generate optimal vacancy rates as employment grows in a region.
[3] The study is further reviewed in the section on Housing Supply.

Income Category	Percentage of Need Met
Very Low Income	26%
Low Income	23%
Moderate Income	3%
Above Moderate Income	56%

To the extent that housing needs are not met as the San Francisco economy grows, industry will begin to lose its competitive advantage. Housing prices will continue to bid up wages and hinder workforce assemblage as workers are forced to seek more affordable housing in other parts of the Bay Area. Longer commute times will increase commuting costs and reservation wages. San Francisco will only be able to attract and retain a world-class workforce if its business leaders actively address the City's housing problems.

Report Overview

In order to better understand San Francisco's housing profile, an analysis of housing demand and supply are provided in the first sections. Housing prices, vacancy rates and employment and population growth are discussed in The Demand for Housing. Housing production trends, characteristics of the residential stock, and land available for development are reviewed in Housing Supply (additional information on type and tenure, condominium development, construction trends, and supply by neighborhood are given in Appendix One). The Housing Affordability section then analyzes housing price trends relative to household incomes and the value of other goods and services. Measures of affordability are outlined for both rental and owner occupied dwellings.

Barriers that constrain the development of housing and hinder affordability levels are discussed in the section entitled Barriers to Housing Development and Affordability. This section is not intended to be a comprehensive review, but rather to illustrate some of the challenges that developers of residential property face in San Francisco. The barriers considered in this report include the price and availability of land, the small size and infrastructure of available land parcels, land regulations that restrict the development and use of land, a lengthy and uncertain entitlement process, organized neighborhood opposition to development, construction defect litigation on attached dwellings, a lack of State and Federal financing for housing development, Federal housing policy assumptions, and a lack of enforcement of California Housing Element Law. Supply and affordability will be less constrained to the extent that these factors can be addressed.

In conclusion, Options for Increasing Housing Supply and Affordability presents financing and advocacy strategies for enhancing supply and affordability levels. The advocacy options address the supply of both rental and owner occupied units, while the financing options focus on creating first time homeownership opportunities, particularly for San Francisco's moderate income workforce.

Finally, innovative financing models that promote homeownership opportunities in the Bay Area and in other high cost areas are profiled in Appendix Two. These partnerships include a homebuyer's assistance program in Silicon Valley, employer assisted housing in Las Vegas and Hong Kong, a public/private home loan program in the Bay Area, the production of limited equity housing, and the AFL-CIO Housing Investment Trust Fund. Public sector programs such as the City of San Francisco's Downpayment Assistance Loan Program and the Mortgage Credit Certificate Program are also discussed.

The Demand for Housing

The market for residential property in San Francisco is largely driven by the region's strong economic growth and job creation. While demand is difficult to measure directly, indicators of strong demand include rising home prices, increasing rents and low vacancy rates. Typically, vacancy rates and rents move in opposite directions: When the supply of available units falls below a region's optimal vacancy rate, rents begin to rise and household mobility slows in the tight market.

A natural vacancy rate arises for a variety of reasons. For example, landlords require time to search for appropriate tenants and tenants require time to search for housing space, and often this time exceeds the advance notice that tenants are required to offer a landlord. In this case, positive vacancies are created and the search process is made more efficient by their presence. In addition, landlords require time to make leasehold improvements such that space may be held vacant longer than the implicit search time. Finally, new construction is not even in the sense that new projects may come on line producing a temporary surplus of available units, particularly in times of low interest rates and economic growth.

Persistently low vacancy rates suggest an ongoing shortage of housing. In a functioning market, the new supply of real estate depends upon the price of the real estate asset relative to the cost of replacing or constructing it. As housing construction typically takes up to 24 months to complete, there may be a significant divergence between market prices and replacement costs in the short run. However, the market should begin to supply new construction when prices exceed construction costs. As space arrives on the market, vacancy rates will rise again and rents should stabilize.

Generally, household demand for space is determined by household income, its demographics, and the cost of occupying that space relative to the cost of consuming non-housing commodities. The demand for owner-occupied housing is also influenced by mortgage interest rates. Given rising incomes in San Francisco and historically low interest rates, it is not surprising that the demand for housing—both rental and owner-occupied—has grown faster than the market supply.

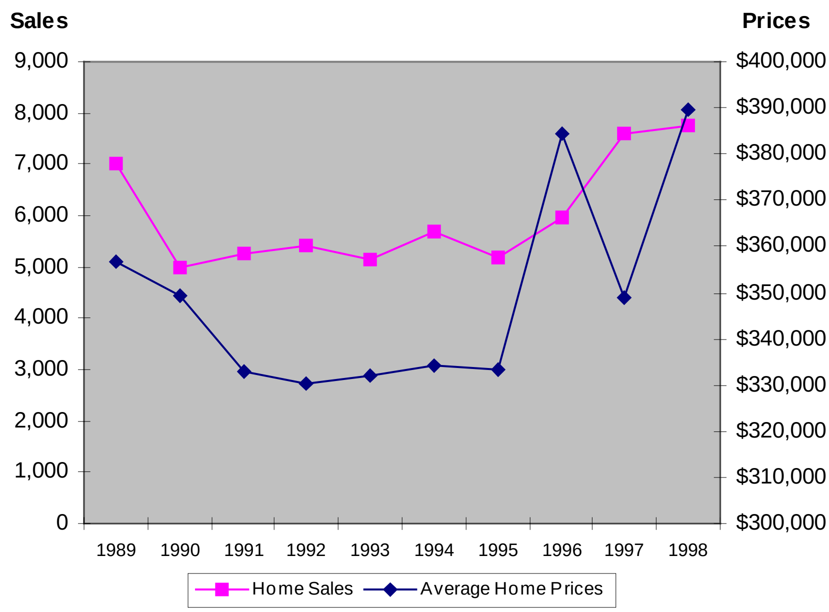
HOME PRICES

In the last two years, San Francisco's median existing single-family home prices rose 10 percent a year, a greater growth rate than other California metropolitan areas and most national urban centers.[4] The median existing single-family home price in San Francisco

[4] California Association of Realtors.

during the fourth quarter of 1998 was $330,000,[5] while the average home price rose to $390,000.[6]

Figure 1: San Francisco Existing Home Sales and Prices, 1989-1998



Note: Includes both attached and detached homes. Nominal dollars.
Source: Real Estate Research Council of Northern California.

The Real Estate Research Council of Northern California conducts a semi-annual home price survey of representative homes in an area. With the exception of a few condominiums, only single-family detached homes are included in the sample. While the sample does not purport to be statistically random, it does provide a further indication of home price trends in the area.

The appraisal survey found that San Francisco led the Bay Area in the rise in home prices with an average increase of 18 percent from October 1997 to October 1998.

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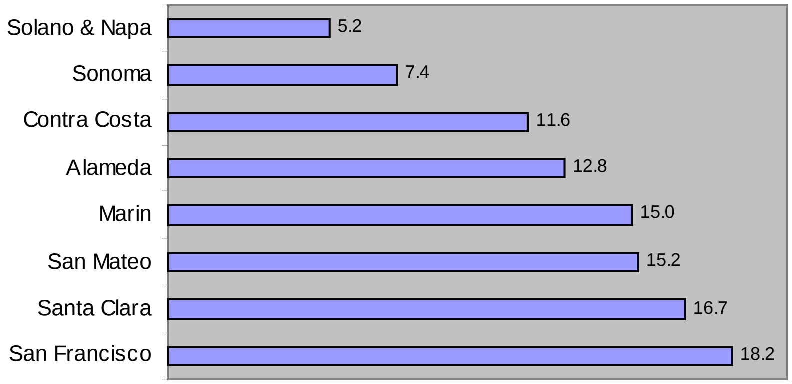
[5] Ibid.

[6] Real Estate Research Council of Northern California, *Northern California Real Estate Report, Fourth Quarter 1998*, p.57.

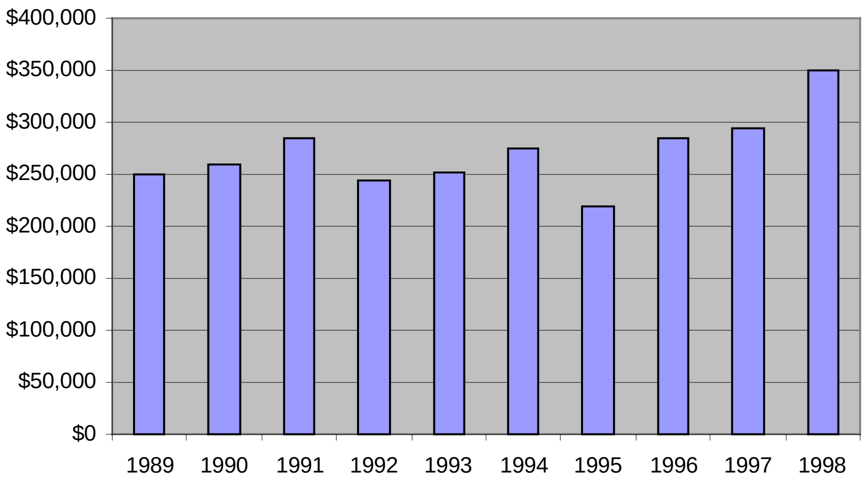
Figure 2: Annual Percent Change in Bay Area Home Prices, 1997-1998



Source: Real Estate Research Council of Northern California.

San Francisco's new home sale prices have risen to an average value of $328,000 and a median value of $318,000 in 1998.[7] The average new home sold in San Francisco has approximately 1,300 square feet of living area and sells for $243 per square foot.[8] From 1997 to 1998, the average sales price of a new condominium home rose 19 percent after remaining relatively stable since 1989 when adjusted for inflation.

Figure 3: Average Price of New Condominium Homes, 1989-1998



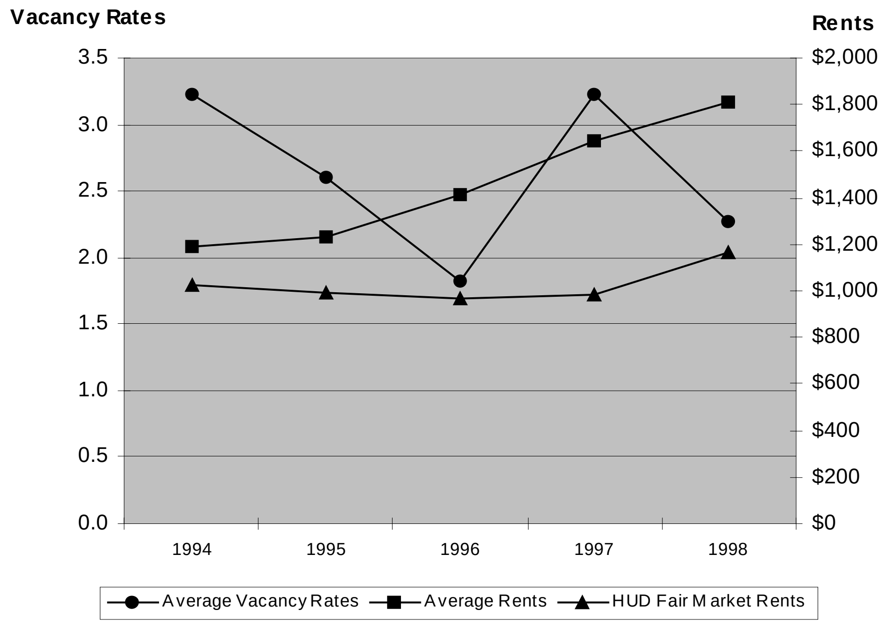
Source: Sedway Group. Nominal dollars.

[7] Construction Industry Research Board, *Characteristics of New Homes Sold*, February 1999, p.16.
[8] Ibid.

RENTS AND VACANCY RATES

Like home prices, San Francisco's rents have risen to record highs in the last two years and vacancy rates have declined. While there are many different measures of vacancy rates,[9] the San Francisco Mayor's Office of Housing estimates that residential vacancy rates are currently below one percent.

Figure 4: Average Apartment Vacancy Rates and Rents, San Francisco



Source: Average rents and vacancy rates from Real Estate Research Council of Northern California; HUD Fair Market Rents from the San Francisco Housing Authority. Nominal dollars.

According to the San Francisco Planning Department, average city-wide market rents for a two bedroom apartment rose from $928 in 1990 to $1978 in 1998, an increase of 113 percent.[10] Median rents for a two bedroom apartment are reported to be $1800. The most expensive neighborhood surveyed by the San Francisco Housing Authority was Upper Market where median rent for a two bedroom unit was $3,500 at the beginning of 1998. The least expensive neighborhoods in this survey were Bernal Heights and the Tenderloin.

Fair Market Rents published by the U.S. Department of Housing and Urban Development show an upward trend in the last year after remaining fairly stable from 1994-1997. Fair Market Rents are used to compute Section 8 payments and provide an estimate of the rent of a standardized two bedroom unit at the 40th percentile of the rent distribution.[11]

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[9] For example, census vacancy rates include units not normally considered vacant, such as incomplete newly constructed units, vacant vacation homes and executive suites which are not typically available for rent or sale by the general public.

[10] San Francisco Planning Department, *1997 Housing Inventory*, June 1998, p.26. San Francisco Housing Authority rent survey performed by MetroRent, January 17-25 1998.

[11] Some argue that Fair Market Rents are not a good summary measure of affordability in high cost areas such as San Francisco where Section 8 certificate holders face barriers attempting to rent units at these levels.

Figure 5: San Francisco Median Rents, 1998

Neighborhood	Median 2 BR Rent	Neighborhood	Median 2 BR Rent
Upper Market	$3,500	Laurel Heights	$1,800
Telegraph Hill	$2,850	Lower Pacific Heights	$1,800
Pacific Heights	$2,798	Potrero Hill	$1,800
Noe Valley	$2,600	South of Market	$1,700
Marina	$2,400	Twin Peaks	$1,620
Nob Hill	$2,385	Sunset	$1,613
Russian Hill	$2,298	Lower Haight	$1,600
Cow Hollow	$2,075	Upper Noe	$1,600
Upper Nob Hill	$1,973	Western Addition	$1,600
Glen Park	$1,850	Richmond	$1,550
Upper Haight	$1,850	Mission	$1,350
Inner Richmond	$1,800	Bernal Heights	$1,250
Inner Sunset	$1,800	Tenderloin	$980 (1 BR)

Source: San Francisco Housing Authority rent survey performed by MetroRent (January 17-25, 1998). N=828.

EMPLOYMENT AND POPULATION GROWTH

Employment and population growth are also important components of demand for residential property. Both are projected to grow for San Francisco and the Bay Area as a whole. San Francisco's 1998 population of 790,000 is projected to peak at 806,000 in the year 2010 and then gradually decline until the year 2020.[12] The anticipated household growth during the 2000-2020 period is 19,370 households.[13] The nine county population is projected to grow by 950,200 persons between 2000 and 2020, reaching a total of 7,774,000 persons and 2,838,000 households.[14] This represents the addition of 408,300 households to the region.

San Francisco will create an additional 92,700 jobs between 2000 and 2020.[15] Most of the jobs will be in the areas of business services, retail trade, and finance, insurance, and real estate (FIRE). By 2020, the Association of Bay Area Government estimates that the number of jobs in San Francisco will exceed the number of employed residents by 206,700, a significant increase from the 154,800 differential in 1995.[16]

To the extent that San Francisco housing costs remain out of reach for its workforce, households will make longer commutes from less expensive areas and will work more to maintain the affordability of their housing payments. In doing so, the reservation wages of those employed by San Francisco industry will rise as commute costs increase, and the viability of the region's transit and infrastructure will be burdened by additional growth.

[12] Association of Bay Area Governments, *Projections 98*, December 1997, p.161.
[13] Ibid.
[14] Ibid, p.30.
[15] Ibid, p.161.
[16] Ibid, p.163.

Housing Supply

Overall, San Francisco's housing production has not kept pace with the increase in population and employment. Only 8,471 housing units were added to San Francisco's stock in the 1990s compared with a population growth of 60,000 during this period. In an indication of the mismatch between employment and housing growth, the Urban Land Institute estimates that from 1995-1997 San Francisco realized a 6.8 percent net increase in jobs and only a 0.4 percent net increase in housing units.[17] Cost and site assembly barriers as well as a recession economy in the early nineties contributed to limited housing production.

Indicators of future housing development such as residential permits, construction and residential lending, and low interest rates show signs of increased production. However, much of the City's surplus land is already slated for development, and further housing production beyond smaller infill sites will be unlikely to keep pace with demand. In addition, land for housing must compete with other viable uses such as industrial land needed to sustain the City's economy.

MEETING THE DEMAND FOR HOUSING

State legislation enacted in 1980[18] requires the Association of Bay Area Governments (ABAG) to assign each Bay Area jurisdiction[19] a "fair share" housing need objective. The local share of housing needs must be considered when updating the housing element of local general plans. This analysis was last performed for the Bay Area in 1989 and projected housing need for the 1988-1995 period.

ABAG developed a formula for the fair share allocation that averages housing needs with local and county census income data to allocate an equitable fair share of housing need to each jurisdiction. The projection goals were based upon the following principles: a reduction in inflationary housing market costs; the provision of an adequate labor supply to sustain the regional economy; and a reduction in the growth in long-distance commuting. Housing needs are classified by the U.S. Department of Housing and Urban Development's income categories, and the housing income distribution seeks to avoid further concentrations of lower-income households in certain communities.

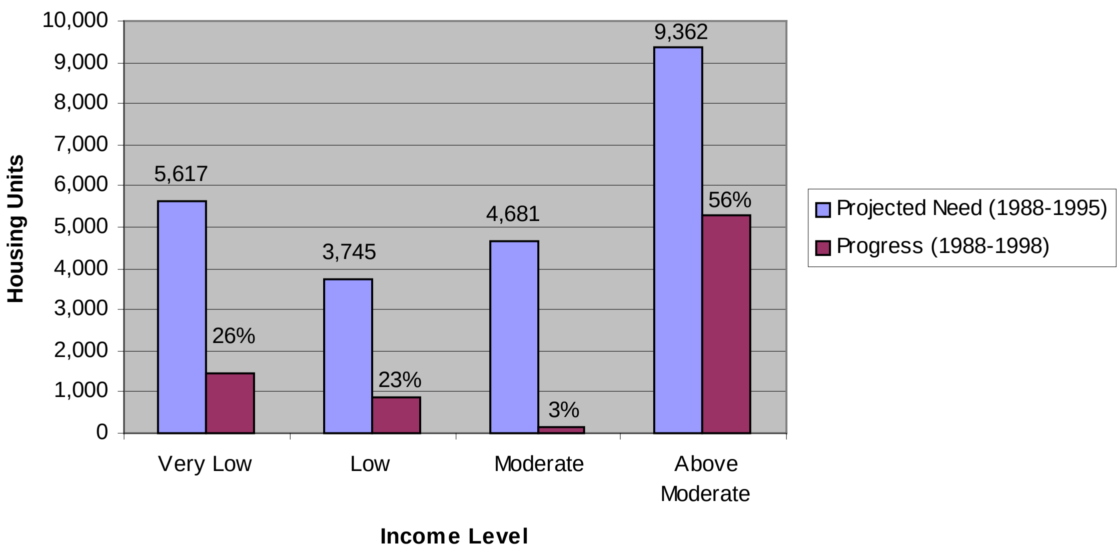
ABAG derived a total regional housing need of 284,000 units and a housing need of 23,405 units that is specific to San Francisco. The housing needs are distributed according to the following income categories: 21 percent very low; 16 percent low; 22 percent moderate; and 41 percent above moderate income. San Francisco's allocation is 5,617 units that are affordable to very low income households, 3,745 units that are affordable to low income

[17] Urban Land Institute, *Bay Area Futures*, 1997, p.38.
[18] AB 2853.
[19] 9 counties and 97 cities.

households, 4,681 units that are affordable to moderate income households, and 9,362 units that are affordable to above moderate income households.[20]

A recent report by the Bay Area Council found that the growth in San Francisco's housing supply from 1988-1998 did not kept pace with the needs projections. Only 3 percent of the fair share allowance was met for a moderate income population, and only 26 and 23 percent of the allowance was met for very low and low income households respectively.[21] In contrast, 56 percent of the projected housing need was met for the above moderate income population.

Figure 6: San Francisco Fair Share Housing Needs and Progress



Source: Bay Area Council and Association of Bay Area Governments.

The ABAG housing needs determinations represent a estimate of the amount of housing production needed to generate an optimal vacancy rate of 5 percent as employment growth occurs in San Francisco. While no community can be expected to house its entire workforce, or even the growth in the workforce in the case of San Francisco, the ABAG determinations set a goal of housing 50 percent of net incommuters into the City.

The projections represent a conservative estimate of the demand for housing; that is, the actual demand for housing if prices were more affordable. As San Francisco's housing stock becomes more affordable, demand will increase placing renewed upward pressure on rents, home prices and vacancy rates.

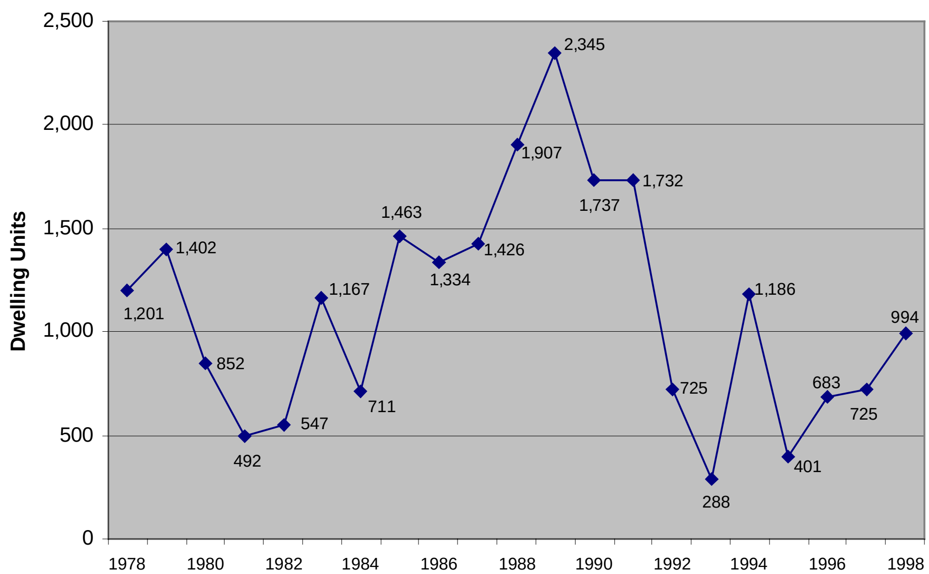
[20] Association of Bay Area Governments, *Housing Needs Determinations*, 1989, p.48.
[21] Bay Area Council. *A Crisis in Housing*. 1999.

HOUSING PRODUCTION AND STOCK

San Francisco's current housing stock is comprised of approximately 336,000 units, a net increase[22] of 7.5 percent over the past twenty years. From 1978-1998, San Francisco added a net total of 23,318 units to the housing stock, averaging 1,110 units per year.[23] Peak production occurred with the strong economy in 1989 when 2,345 units were added to the housing stock, representing a 0.7 percent addition to housing units. In 1998, the 994 net additional units represented an increase of 0.2 percent in the City's housing stock.

Production has followed a cycle that peaked in 1989 and declined to a low in 1993. While U.S. production of residential and commercial real estate typically mirrors economic cycles and is largely driven by job growth, production in San Francisco is also governed by availability of land and political support of development that may constrain the supply of new housing below its demand. During down market cycles such as the period from 1992-1996, there was increased activity in below market rate rental units as affordable housing developers took advantage of lower land prices and construction costs.

Figure 7: San Francisco Housing Production Trends, 1978-1998



Source: San Francisco Planning Department.

Unlike the surrounding Bay Area counties' stock of single family homes, San Francisco's housing supply is largely characterized by attached, multifamily dwellings. The majority of smaller units (studio and 1 bedroom units) are renter occupied, while the majority of larger units (3+ bedrooms) are owner occupied. Larger unit rental dwellings may be the closest substitutes to single family housing that the City provides.[24]

[22] Net change in housing stock reflects units added through new construction or alteration and units lost through demolition or alteration.
[23] San Francisco Planning Department, *1997 Housing Inventory*, June 1998, p.4.
[24] Additional detail on San Francisco housing stock can be found in Appendix One: Housing Stock Characteristics.

Currently, the housing stock is roughly divided among moderate density buildings (2-9 units), higher density structures (10+ units), and single family homes. As expected in an urban area where land is scarce, the distribution of housing units is moving toward a greater percentage of higher density structures as new units are added to the market.

LOFT DEVELOPMENT

A substantial amount of new construction is occurring in the area of loft or live/work development. Loft units combine open areas for working, cooking and living with a loft space for sleeping. Because loft units serve a residential purpose, the San Francisco Planning Department includes these units in the overall housing inventory for the City and has encouraged their development as a means to add to the City's housing stock. However, under San Francisco's Planning Code, loft units are a commercial use and are therefore exempt from many residential development requirements (e.g., inclusionary housing requirements, lot coverage, parking and school district contributions).

In 1997, 246 loft units were added to the housing stock, accounting for 34 percent of the construction net gain.[25] 1997 production doubled the number of loft units from 1996 levels. This type of development continues at a rapid pace, as 830 units were in the pipeline (approved by Planning, authorized for construction, or under construction) and another 1,600 units were under review by mid-1998.[26] Most of these units are targeted toward high income earners in the for-sale upscale or luxury markets.

While much of the early loft developments were conversions from industrial/commercial buildings, new loft construction using wood frame construction on in-fill sites in the South of Market and Mission districts has surged. Much of this construction has been prompted by the City's 1988 Live/Work Ordinance that encouraged the legalization of such units and the 1989 Live/Work Planning Code amendments that permitted non-arts related work use in most South of Market mixed-use districts.[27]

From 1987 to 1997, the South of Market area accommodated 69 percent (744 units) of loft unit completions and the Mission district accommodated 19 percent (203 units).[28] Of the proposed loft units, 60 percent (639 units) will be located South of Market and 23 percent (249) in the Mission district.[29]

[25] San Francisco Planning Department, *1997 Housing Inventory*, June 1998, p.15.
[26] Ibid.
[27] Ibid.
[28] Ibid, p.16.
[29] Ibid.

LAND AVAILABLE FOR DEVELOPMENT

A survey of land use by the Association of Bay Area Governments (ABAG) indicates that there is no absolute shortage of land in San Francisco or the Bay Area as a whole. While 81 percent of San Francisco's residential and commercial land was developed as of 1995,[30] there remains adequate land available for development to accommodate the residential needs of San Francisco's growing workforce. Of the City's 29,800 acres, 24,200 acres were developed by 1995, 66 percent of which is residential development and 34 percent of which is developed for commercial/industrial use.[31]

Of the 2,500 acres of land available for development (8.4 percent of land), 900 acres (36 percent) was available in 1995 for residential development and 1,600 acres (64 percent) was available for commercial/industrial development.[32] The ABAG study concludes that San Francisco could accommodate an additional 36,700 residential units according to local land use policies, 9,000 more units than the 27,700 units of projected need estimated between 1995 and the 2020 forecast period.

In a recent report, the San Francisco Planning Department estimates that there is a development potential of up to 80,000 units under current zoning regulations, over half of which are on vacant or nearly vacant sites.[33] 50,000 of these units could be in transit-served neighborhoods east of Divisadero Street, 7,000 units in the western portion of the City, and more than 21,000 units of loft housing could be developed in industrially zoned areas.

However, most of the City's surplus land is already programmed for development. Mission Bay, Hunter's Point Shipyard, South Beach and the Transbay Terminal comprise the majority of the City's available land and 10,600 units are currently in the pipeline for development. In addition, another 4,000 units in major high density towers in the downtown area and in smaller projects are currently under review.[34]

ABAG estimates that the City will need to increase its housing stock by an additional 23,600 units by the year 2020 just to accommodate projected job growth using current commute patterns. With approximately 15,000 units in the pipeline, and the majority of the City's surplus land already committed to housing production, the City's is facing a challenging production curve over the next 20 years.

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[30] Association of Bay Area Governments, *Projections 98*, December 1997, p.24.
[31] Ibid.
[32] Ibid, p.25.
[33] San Francisco Planning Department. *Zoning Options For Industrial Land: Industrial Protection Zones and Mixed-Use Areas*. April 8, 1999, p.10.
[34] Ibid.

Housing Affordability

While housing affordability has no uniform definition, a widely accepted implicit definition states that monthly housing costs for adequate housing should be no more than 30 percent of household income. As such, housing affordability can be measured as a ratio of housing payments to household income, adjusted for household size. As a result of strong demand and constrained supply of residential property in San Francisco, rents and home prices have risen faster than incomes resulting in a decline in housing affordability. In contrast, housing affordability has increased across the country as interest rates have fallen and incomes have risen.

Reduced housing affordability also affects household size by decreasing household formation rates. As affordability declines, household size increases as children stay at home for longer periods of time and residents "double up" in response to high housing costs and an economy that is not distributing wealth evenly throughout the population. In 1990, the average San Francisco household size was 2.29 persons;[35] in 1998, this average was 2.47 persons per household.[36]

HOUSING INFLATION

Housing inflation compares the price of housing relative to the price of a bundle of goods measured in the Consumer Price Index. From 1982 to 1998, Bay Area housing prices increased 126 percent faster than the prices of services and traded commodities.[37]

Rising home prices and rents most adversely affect lower income households by increasing the portion of income spent on housing payments, forcing households to consume lower quality or less housing, or displacing residents altogether from their communities. Housing prices that rise faster than incomes will also adversely affect younger households attempting to enter the labor force.

HOUSEHOLD INCOME

Each year, the U.S. Department of Housing and Urban Development publishes income limits for primary metropolitan statistical areas (PMSA) which guide the allocation of public resources towards low and moderate income households. For the San Francisco PMSA[38] the 1999 income definitions for a 2.5 person household are as follows:

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[35] City of San Francisco, *1995 Consolidated Plan*, p.21.

[36] California Department of Finance, *County/State Population and Housing Estimates, Official State Estimates*, January 1, 1998.

[37] Bureau of Labor Statistics: Consumer Price Index for All Urban Consumers; San Francisco-Oakland-San Jose; 1982-1984=100; August 1998 Housing Shelter Index=196.8; August 1998 Commodities and Services Less Shelter=155.8.

[38] The San Francisco PMSA includes San Francisco, Marin and San Mateo counties.

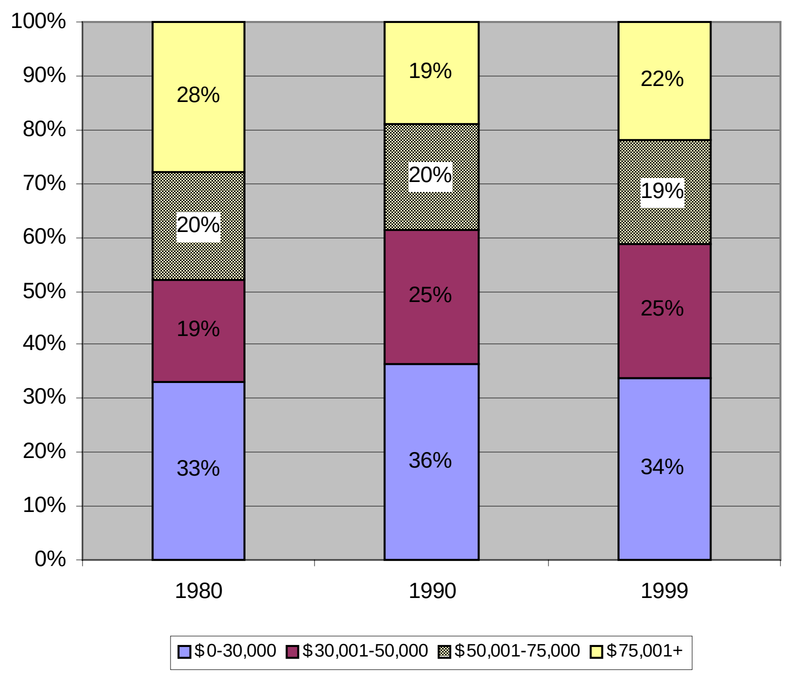
Figure 8: HUD Income Limits for San Francisco PMSA, 1999

Income Definition	2.5 Person Household Income
50% of Median (HUD Very Low)	$30,775
75% of Median (HUD Low)	$46,225
80% of Median (HUD Moderate)	$49,250
100% of Median	$61,525
120% of Median	$73,850
150% of Median	$92,325

Source: U.S. Department of Housing and Urban Development, effective 1/27/99.

As shown in the household income distribution in Figure 9, current San Francisco households are approximately 34 percent very low income, 25 percent low income, 19 percent moderate income, and 22 percent above moderate income. This is similar to the distribution of incomes in 1990, with a reduction in the portion of very low income households and an increase in households with incomes at the upper end of the distribution.

Figure 9: San Francisco PMSA Annual Household Income Distributions



Note: Nominal dollars. PMSA income includes San Francisco, Marin and San Mateo counties.
Source: Rosen Consulting Group.

MEASURES OF AFFORDABILITY

San Francisco's median annual income for a 2.5 person household is $61,525,[39] which enables a monthly rent payment of approximately $1,538 using 30 percent of income for a rent payment, including utilities. However, average city-wide market rents were $1,978 in January 1998 for a 2 bedroom apartment, and median rents were $1,800 during this same period, not including utilities.[40] This produces a rental income gap of $262 per month, or $3,144 annually (not including utilities), between median household income and median rents.

Eighty percent of median income is $49,250 for a 2.5 person household, which reduces the affordable rent payment to $1,231 for a 2.5 person household, including utilities. This produces a rental income gap of $569 per month, or $6,828 annually, not including utilities.

Figure 10: Rental Housing Affordability Guidelines, 1999

HUD Income Level	Household Size	Average Unit Size	Maximum Annual Income	Monthly Rent
Very Low Income	1	Studio	$25,350	$634
(50% of median)	2	1 BR	$28,950	$724
	3	2 BR	$32,600	$815
	4	3 BR	$36,200	$905
Low Income	1	Studio	$38,100	$953
(75% of median)	2	1 BR	$43,500	$1,088
	3	2 BR	$48,950	$1,224
	4	3 BR	$54,400	$1,360
Moderate Income	1	studio	$40,550	$1,014
(80% of median)	2	1 BR	$46,350	$1,159
	3	2 BR	$52,150	$1,304
	4	3 BR	$57,900	$1,448
Median Income	1	studio	$50,700	$1,268
(100% of median)	2	1 BR	$57,900	$1,448
	3	2 BR	$65,150	$1,629
	4	3 BR	$72,400	$1,810
Above Moderate Income	1	studio	$60,800	$1,520
(120% of median)	2	1 BR	$69,500	$1,738
	3	2 BR	$78,200	$1,955
	4	3 BR	$86,900	$2,173

Source: San Francisco Mayor's Office of Housing.
Note: Rents calculated at 30% of monthly income and include utilities. Occupancy standard is one person per bedroom plus one additional person.

In order to afford the median monthly rent of $1,800 while paying 30 percent of income to rent, a household must earn $6,000 per month or $72,000 annually. Approximately one fifth of San Francisco's population is able to afford these median monthly payments. In other words, median rents are only affordable to households earning 120 percent or more of median income.

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[39] U.S. Department of Housing and Urban Development, effective 1/27/99. Income levels for San Francisco PMSA include San Francisco, San Mateo and Marin counties. The San Francisco Mayor's Office of Housing estimates that San Francisco County median income may be 20% lower than income at the PMSA level.
[40] San Francisco Planning Department, *1997 Housing Inventory*, June 1998, p.26. San Francisco Housing Authority rent survey performed by MetroRent, January 17-25 1998.

A 2.5 person household earning 100 percent of median income can afford to purchase a $220,000 home with a 10 percent downpayment and allocating one third of income to housing payments. This home purchase affordability level is $110,000 below San Francisco median home price sales[41] and $170,000 below average home price sales[42] in the fourth quarter of 1998. Only one fifth of new homes sold in San Francisco in 1998 were under $250,000.[43]

Figure 11: Homeownership Affordability Guidelines, 1999

HUD Income Level	Household Size	Average Unit Size	Maximum Annual Income	Maximum Purchase Price
Very Low Income	1	studio	$25,350	$78,953
(50% of median)	2	1 BR	$28,950	$92,982
	3	2 BR	$32,600	$107,205
	4	3 BR	$36,200	$121,234
Low Income	1	studio	$38,100	$128,638
(75% of median)	2	1 BR	$43,500	$149,681
	3	2 BR	$48,950	$170,919
	4	3 BR	$54,400	$192,157
Moderate Income	1	studio	$40,550	$138,186
(80% of median)	2	1 BR	$46,350	$160,787
	3	2 BR	$52,150	$183,389
	4	3 BR	$57,900	$205,796
Median Income	1	studio	$50,700	$177,739
(100% of median)	2	1 BR	$57,900	$205,796
	3	2 BR	$65,150	$234,048
	4	3 BR	$72,400	$262,301
Above Moderate Income	1	studio	$60,800	$217,097
(120% of median)	2	1 BR	$69,500	$251,000
	3	2 BR	$78,200	$284,902
	4	3 BR	$86,900	$318,805
Above Moderate Income	1	studio	$76,000	$276,329
(150% of median)	2	1 BR	$86,900	$318,805
	3	2 BR	$97,750	$361,086
	4	3 BR	$108,600	$403,367

Source: San Francisco Mayor's Office of Housing.
Assumptions: 10% downpayment; 7.0% interest rate; 33% of income for housing expenses (Property Tax, PMI, Insurance and Home Owner Dues). Occupancy standard is one person per bedroom plus one additional person.

A 2.5 person household earning 80 percent of median income can afford a purchase price of $172,000 with a 10 percent downpayment and allocating one third of income to housing payments. At 80 percent of median income, this affordability gap widens to $158,000. Only 7 percent of new homes sold in 1998 were under $200,000.

In order to afford the median home purchase price of $330,000 while allocating one third of income to housing payments, a household must earn approximately $90,000 annually or 150 percent of median household income. Roughly 12 percent of San Francisco's population is able to afford this median home price.

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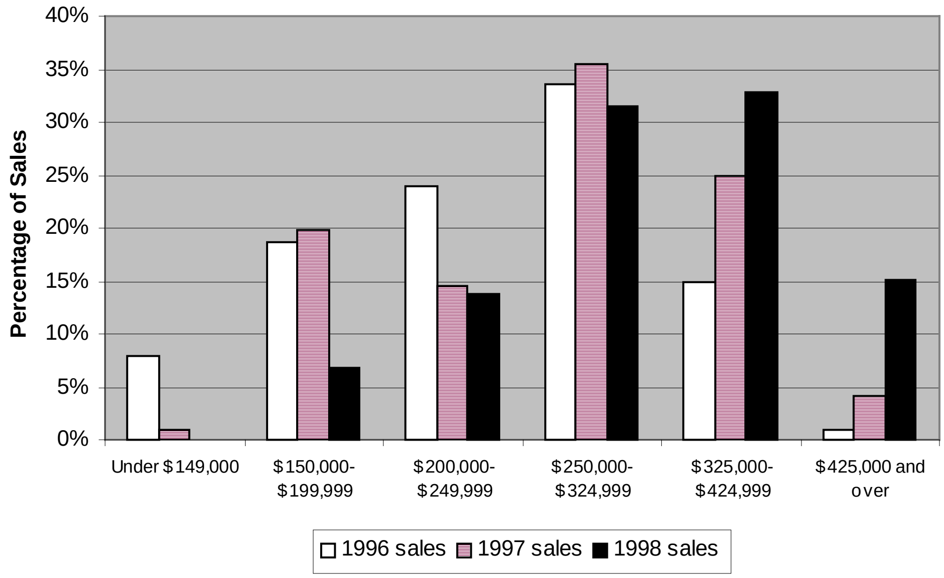
[41] The median home price in San Francisco during the fourth quarter of 1998 was $330,000. Source: California Association of Realtors.

[42] Average home price of $390,000. Source: Real Estate Research Council of Northern California, *Northern California Real Estate Report, Fourth Quarter 1998*, p.57.

[43] Construction Industry Research Board, *Characteristics of New Homes Sold*, February 1999, p.27.

Figure 12: Distribution of New Home Sales in San Francisco, 1996-1998



Source: Construction Industry Research Board. Nominal dollars.

As shown in Figure 12, the distribution of new home sales has skewed significantly in the last year towards home prices of $325,000 and above. During the 1996-1998 period, the median new home price rose from $245,000 to $318,000, an increase of 30 percent.[44]

OVERPAYING

According to California law, very low and low income households that pay more than 25 percent of their income for housing are overpaying, or living in unaffordable housing. This measure is more sensitive than the federal measure of 30 percent of income for housing. The measure is a useful indicator of the extent to which San Francisco households pay more of their income for housing.

According to an analysis by the Association of Bay Area Governments, 69 percent of lower income renter households overpay for housing in San Francisco, while 30 percent of lower-income owners overpay.[45] According to a 1991 report by the U.S. Department of Housing and Urban Development, 40 percent of very low income families in the U.S. had rent burdens that exceeded 50 percent of their income.[46] As rents and home prices continue to rise faster than incomes, the proportion of households that overpay for housing will increase.

[44] Ibid.
[45] Association of Bay Area Governments, *Housing Needs Determinations*, 1989, p.18.
[46] Wallace, James E. "Financing Affordable Housing in the United States." *Housing Policy Debate*, 6(4), 1995, Fannie Mae Foundation, p.787.

The gap between affordable and market housing prices disproportionately affects households at the lower end of the income distribution and renters who do not accrue the tax or investment benefits of homeownership. As rents and home prices rise, more low income renters overpay for housing and fewer households are able to afford homeownership even as household incomes rise.

WAGES AND EMPLOYMENT

San Francisco occupations with the greatest absolute job growth from 1995 to 2002 are listed in Figure 13 and suggest the extent to which additional housing will be needed that is affordable to lower and moderate income wage earners. These occupations account for 24,690 new jobs.

Figure 13: San Francisco Occupations with the Greatest Job Growth, 1995-2002Error! Not a valid link.[a] Computer Support Specialist wage used as a proxy for omitted data.
[b] Electrical and Electronic Engineers wage used as a proxy for omitted data.
Note: Wage data are from California Employment Development Department/Labor Market Information Division's 1996 4th Quarter Occupational Employment Statistics Survey Results for the San Francisco PMSA (Marin, San Francisco and San Mateo counties).
Source: California Employment Development Department.

Of these occupations 11 job categories,[47] or 48 percent of new jobs that will be created, fall into the very low income category for a 1 person household. Two job categories,[48] or 9 percent of new jobs, fall into the low income category. Eight job categories,[49] or 29 percent of new jobs, are moderate income and three job categories, or 14 percent, are above moderate income.

Figure 14: San Francisco Occupational Growth by Income Category

Income Category	Job Growth	Percent New Jobs
Very Low	11,770	48%
Low	2,070	9%
Moderate	7,120	29%
Above Moderate	3,310	14%
TOTAL*	24,270	100%

* Excludes Telemarketer, Solicitors jobs as income data was not available.
Source: California Employment Development Department.

High housing costs also bid up wages for otherwise comparable labor, as housing is the single largest expenditure in most household budgets. A survey of wage comparisons indicates that San Francisco's wages are higher than other major urban areas in the country.

Figure 15: Annual Median Base Salaries, 1997

	Atlanta	Boston	Chicago	Los Angeles	New York City	San Francisco
Administrative Assistant	$27,721	$31,441	$31,460	$32,994	$34,223	$35,293
Computer Programmer	$34,648	$38,791	$38,666	$40,442	$41,518	$42,865

[47] Janitors, Cleaners; Retail Salespersons; Guards and Watch Guards; Receptionists, Information Clerks; Cashiers; Waiters and Waitresses; Home Health Care Workers; Hand Packers and Packagers; Cooks, Restaurant; Maids and Housekeeping Cleaners; Maintenance Repairers, General Utility.
[48] Secretaries; Sales Agents, Financial Services.
[49] Systems Analysts, Electronic Data Processing; Computer Programmers; Computer Engineers; Accountants and Auditors; Marketing, Advertising, Public Relations Managers; Artists and Related Workers; Electrical and Electronic Engineers; Teachers, Elementary School.

Data Entry Operator	$16,920	$19,062	$18,839	$20,549	$20,975	$22,001
Engineering Technician	$33,085	$35,830	$36,379	$38,160	$38,982	$40,143
Machinist	$32,233	$35,998	$36,235	$38,247	$39,129	$40,616
Office Manager	$33,267	$36,923	$37,135	$38,793	$39,913	$40,868
Systems Analyst	$46,089	$50,524	$50,327	$52,063	$53,571	$55,106

Source: The San Francisco Partnership, *San Francisco's Business Climate: Quick Facts*, p.7. Based on data from Economic Research Institute, *The 1997 Geographic Reference Report*,

San Francisco's share of total regional jobs has declined over the last two decades as businesses have relocated along the I-680, I-80, 101, Peninsula, and Silicon Valley corridors. In 1980, 22 percent of the region's jobs were located in San Francisco; by 2020 the City's share is expected to decline to 15 percent.[50] While San Francisco's net job growth is projected to increase by 27 percent in the 1995-2020 period, it is the smallest projected job growth of all the nine Bay Area counties.[51]

[50] Association of Bay Area Governments, *Projections 98*, December 1997, p.162.

[51] Projected 1995-2020 job growth: Alameda 43%; Contra Costa 59%; Marin 36%; Napa 69%; San Mateo 35%; Santa Clara 49%; Solano 74%; Sonoma 68%. Source: Association of Bay Area Governments, *Projections 98*, December 1997, p.42.

Barriers to Housing Development and Affordability

There are many factors that inhibit the production of rental and ownership housing in San Francisco and reduce the affordability of units. Some barriers, such as high land costs, are symptomatic of normal market cycles while others are the result of market intervention and have added unusually high costs and constraints to the development process.

Though not an exhaustive account, the barriers addressed in this section are designed to give the reader an overview of some of the challenges to housing development in San Francisco. New development will be less constrained and affordability levels will be enhanced as barriers are mitigated or eliminated. Solutions are identified to the extent that potential or existing efforts are underway to address the respective barriers.

The barriers outlined in this section include:

- Price and availability of land;
- Small size and infrastructure of available land parcels;
- Land regulations that restrict the development and use of available parcels;
- Lengthy and uncertain entitlement process;
- Organized neighborhood opposition to additional development;
- Construction defect litigation on attached product;
- Lack of State and Federal financing for housing development;
- Federal housing policy assumptions that are incompatible with San Francisco's market conditions;
- Lack of enforcement of California Housing Element Law.

PRICE AND AVAILABILITY OF LAND

Barriers

San Francisco land costs are among the highest in the country due to the limited supply of available parcels. Only 900 acres (3 percent of the City's total land) of land were available in 1995 for residential development[52] and, unlike many municipalities, the City of San Francisco does not have the ability to annex additional land. Currently land prices range from \$30,000 to \$50,000 per unit for apartments and \$40,000 to \$60,000 per unit for condominiums. Heightened activity in the REIT market has recently driven up land prices for apartments.

Once Mission Bay is developed, many of the sites that remain available for development in San Francisco are small in scale and require infill development. Infill development of small sites can increase costs as it is less economically efficient than building on a featureless plot. There may also be a mismatch between development costs and the rents that the market

[52] Ibid, p.25.

will support. Assistance from the City in the form of site assemblage can defray transaction costs and provide developers with more efficient economies of scale.

Solutions

In larger parcels such as the Hunter's Point Shipyard, the City can assist in the development of residential property by providing the infrastructure improvements necessary for residential development. The costs of servicing this infrastructure—including water, sewers, and streetlights—can be a large hurdle in unlocking an area for development. How the City finances these improvements, or requires a developer to finance infrastructure, affects the timing of project development and the amount of revenue a project must generate to fulfill its financing obligations.

LAND REGULATIONS

Barriers

According to San Francisco Planning and Urban Research Association (SPUR), a large portion of San Francisco's vacant land available for development is zoned for industrial uses (M-1 light industrial and M-2 heavy industrial).[53] This is consistent with the Association of Bay Area Government's 1995 land use analysis which found that 64 percent of the land available for development was zoned for commercial/industrial use.[54]

Only loft or live/work development has been permitted in these areas which accounts for the large supply of loft construction in recent years. From 1987 to 1997, 39 percent (415 units) of loft units completed[55] were zoned for M-1 and M-2 uses, and 37 percent of loft units in the pipeline as of May 1998 were zoned for these uses.[56]

There are also restrictive height limits of 40 feet (four floors) of residential construction above retail in neighborhood commercial districts. While these regulations protect the low-scale character of many of San Francisco's neighborhoods, they also inhibit additional housing that could be built along major transit corridors that already support higher intensity land use.

Parking requirements that attempt to capture the excess social costs of owning an automobile in the private housing transaction also add substantially to the cost of residential development. A 1997 study for the San Francisco Planning Department found that housing units without parking spaces were more affordable and sold more quickly than units with parking. Using 1996 housing price data, the study found that the average value of an off-

[53] San Francisco Planning and Urban Research Association, *Zoning for More Housing: Proposed Changes to San Francisco's Planning Code and Zoning Map*, Report 362, April 1998.
[54] Association of Bay Area Governments, *Projections 98*, December 1997, p.25.
[55] Includes legalized and new units constructed.
[56] San Francisco Planning Department, *1997 Housing Inventory*, June 1998, p.17.

street parking space was $46,391 for a single family home and $38,804 for a condominium unit.[57]

The study also found that 20 percent more households could qualify for mortgages without off-street parking than could for units with parking.[58] In an indication of the strength of demand for units without parking, single family units without parking sold 5 days faster than units with parking, and condominium units without parking sold 40 days faster than units with parking.[59]

Solutions

With existing zoning controls on these parcels, the supply of land available for more conventional residential construction will be limited and only loft units will be built. To the extent that the City can identify commercially or industrially-zoned parcels in which the current or future manufacturing use is compatible with residential development (e.g., electronics, multi-media, business services), the City could promote higher density residential development in these areas.

SPUR has proposed a City-wide density bonus program that would permit builders to increase allowable density within the existing height and bulk limits. In exchange, developers would make a certain portion of the additional units above the base density limit affordable to a targeted income group. Developers would find this profitable as the marginal cost of each additional unit would fall below the price at which they could rent or sell the unit to a low or moderate income household. The City obtains affordable units while the developer gains marginal profits from the additional units.

SPUR also recognizes the opportunities for higher density housing along neighborhood commercial corridors and major transit routes such as Geary Boulevard and Third Street. In accordance with San Francisco's General Plan, which calls for increased density along transit routes, these areas already possess the infrastructure to support higher density residential development. Raising the height limits from the current 40 feet to 50 feet to accommodate an additional floor of housing in neighborhood commercial districts would also allow for a reduction in marginal land and unit costs.

Finally, SPUR recommends policy and planning changes that can reduce the housing costs associated with parking requirements. These include lowering minimum residential parking requirements in transit intensive neighborhoods and for housing that serves populations that have low auto ownership rates (e.g., seniors). Creating a separate market for parking would unbundle the cost of parking in the housing transaction and may reveal consumers' willingness to either pay or forego the cost of parking.

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[57] San Francisco Planning and Urban Research Association, *Reducing Housing Costs by Rethinking Parking Requirements*, Report 369, November/December 1998.
[58] Ibid.
[59] Ibid.

ENTITLEMENT PROCESS AND NEIGHBORHOOD OPPOSITION

Barriers

The entitlement process in San Francisco is often subject to lengthy and uncertain review by the Planning Commission which holds the power of discretionary review. Major redesigns are often required and can substantially reduce the number of units allowed for development. This process adds risk, uncertainty and cost to the land acquisition and development processes and can discourage development that would occur in the absence of such uncertain review. Development generally has fewer barriers of this type in South of Market districts or in Redevelopment areas where development is not subject to discretionary review.

San Francisco's organized neighborhood opposition to new development reflects the politics of diffused benefits and concentrated costs of additional housing in a particular neighborhood. While much of this advocacy has succeeded in preserving neighborhood character and deterring change, it has done so at the expense of housing affordability. This pattern of opposition also occurs in neighborhoods where voting records show support for affordable housing measures more generally.

Solutions

Breaking the myths surrounding additional housing and increased density is one of the most formidable challenges to increasing the supply of housing in San Francisco. A strategy must be created that promotes a livable city for San Franciscans and one in which neighbors see sound development as adding value to their neighborhood.

In response to a similar housing supply and affordability crisis in Marin County, the San Rafael Chamber of Commerce formed an Affordable Housing Committee in 1989. While the original focus provided advocacy in support of local housing projects, the Housing Committee later developed a strategic community education and outreach campaign entitled "Workforce Housing". Funded by the Marin Community Foundation and local corporations, the campaign produced print and media material designed to dispel myths about housing that is affordable to Marin's workforce.

The Housing Committee actively works with developers and neighborhoods prior to the project development process to ensure that concerns are adequately addressed. The Committee targets 50-65 percent of median household income, as 80 percent of median income is market rate due to the inflated incomes at the PMSA level. They are also working with the City of San Rafael to amend their inclusionary housing law to reflect this lower income standard. Following the lead of the Silicon Valley Manufacturing Group, the San Rafael Chamber of Commerce would like to develop an Employers' Council and a Housing Investment Trust Fund to provide financing for additional workforce housing.

In San Francisco, a Neighborhood Planning Initiative is currently underway that involves a joint effort by the Mayor's Office, the City Planning Department, and several housing, planning and environmental organizations to address San Francisco's severe housing shortage. The Initiative mitigates both neighborhood opposition and the uncertainties of the development process by advocating for area-wide neighborhood plans.

With a two-year funding commitment from the Mayor, area plans will identify housing opportunity sites in specific neighborhoods including Balboa Park, Hayes Valley/Upper Market, Central Waterfront and Northeast Mission. With neighborhood input, the plans will outline the location, type and amount of housing allowed on housing opportunity sites. A master Environmental Impact Report (EIR) will be funded for each area that addresses projected impacts and specific mitigation measures such as public transit and open space.

This proactive strategy will provide more certainty through the development process as individual projects on identified housing opportunity sites that conform to the EIR parameters will not be subject to separate environmental review. The shorter and more certain review process will foster additional development in San Francisco, especially among smaller developers of infill sites that may otherwise be deterred from the risk and uncertainty of the entitlement process.

CONSTRUCTION DEFECT LITIGATION

Barrier

Due to State laws governing construction defect litigation on attached unit dwellings, there has been extensive litigation by homeowners associations against developers of townhomes and condominiums across the State. Due to the high cost of land, attached dwellings comprise the majority of units in San Francisco and provide the most affordable opportunities for home ownership. In response to litigation, many large developers have exited these markets, further reducing the supply of units. In some cases, insurance companies have ceased providing insurance to developers of attached housing.

Solution

Last Fall, AB 1950 (Torlakson) passed through the California legislature and was signed into law by the Governor. The legislation revised the alternative dispute resolution process for construction defect disputes for condominiums and townhouses in the State. The bill's two main provisions included permission for insurers to defend suspended corporations and authorization for the Court to bind parties to settlements entered into by their counsel.

However, major compromises were made to reach agreement among the different parties and provisions for disclosure of records, timelines for settlements, and timelines for mandatory arbitration were dropped from the final legislation. The Silicon Valley Manufacturing Group's Construction Defect Litigation Reform Task Force, which was a major sponsor of the bill, believes that further legislation is still needed to produce a climate conducive to the construction of attached product in California. While

Assemblyman Torlakson will not introduce additional legislation this year, several proposals including a home warranty bill have been introduced.[60]

STATE AND FEDERAL FINANCING VEHICLES FOR HOUSING PRODUCTION

Barriers

Public financing vehicles have the ability to influence the supply of housing, particularly the production of rental units with affordability restrictions. With the devolution of housing policy from the Federal government to local governments, there has not been a concomitant provision of resources at the State level with which to leverage local dollars. In the early 1990s the State issued a General Obligation bond to finance the rehabilitation and new construction of housing, including owner-occupied housing, but there has been no new State assistance since that time. Governor Davis has taken a renewed interest in developing housing policy and resources at the State level and is investigating the appointment of a task force, with representation from the business community, to address State-wide housing needs.

Solutions

The Low Income Housing Tax Credit (LIHTC) is a primary financing vehicle for affordable rental housing production in the U.S. The tax credit provides a federal guarantee of a 10-year stream of tax credits (direct deductions from tax liability) for investment in a property that meets the following requirements:

- At least 20 percent of the units must be occupied by households with incomes at or below 50 percent of area median income (adjusted for household size); or
- At least 40 percent of the units must be occupied by households with incomes at or below 60 percent of area median income (adjusted for household size).

Rents of qualifying units are set at 30 percent of the applicable income limit. For new construction projects not financed with tax exempt bonds, tax credits are generated at a nominal rate of 9 percent a year against the qualifying tax basis of a property.[61] This nominal rate falls to 4 percent for existing properties or projects financed with tax exempt bonds. Each state is allotted a $1.25 per capita share based upon state population and is then allocated to specific projects by the state's Housing Finance Agency.

Despite high required rates of return[62] and syndication costs[63] which make this program less efficient than direct capital grants, the program raises substantial amounts of private funds

[60] Representative Dutra is carrying a home warranty bill.
[61] This basis includes total development costs including project development fees and profits.
[62] Investment returns typically average between 12-20%. Source: Rosen, Kenneth T. and Ted Dienstfrey. "The Economics of Housing Services in Low Income Neighborhoods." Berkeley Program on Housing and Urban policy, Working Paper 98-002, 1998, p.23.

for the production of affordable rental units. In California, the allocation process is highly competitive and many projects in the pipeline fail to secure tax credit financing due to oversubscription. In 1998, the House Ways and Means Committee considered a bill[64] to increase the per capita allocation of tax credits awarded to each state from $1.25 to $1.75 and index this amount to inflation. The proposed raise represents an increase in California's tax credit allocation from $1.6 billion to $2.2 billion. The bill was referred to the House Committee on Ways and Means and ultimately failed to win Congressional approval in the 105th Congress.

The 1986 Tax Reform Act also placed limits on tax exempt bond financing which is used to leverage local resources in the development of housing through the issuance of local mortgage revenue bonds (MRBs). MRBs provide a relatively inexpensive means of encouraging the creation of affordable housing in strong markets where rising rents are high enough to cover residential construction costs. Under Federal rules, a developer can obtain tax-exempt permanent financing several hundred basis points below private market interest rates in return for restricting the occupancy to the same income requirements as the LIHTC.

MRBs are particularly attractive for developers of mixed-income developments where market rate units subsidized with below-market interest rates provide a favorable internal project subsidy. In many cases, such "80-20" projects with tax-exempt financing can generate higher internal rates of return than a 100 percent market rate building with conventional financing.[65]

Since 1986, each state is authorized to issue the greater of $50 per capita or $150 million of private activity bonds for housing and other private activity uses. In 1998, Congress increased the private activity bond volume cap to the greater of $75 per capita or $225 million, but in a compromise bill delayed the full allocative increase until the year 2007.[66] Legislative efforts are currently underway to expedite the increase. Given the scarcity of resources for housing development, demand for LIHTCs and MRBs are heavily oversubscribed.

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[63] Typical syndication costs are between 25-30% of the gross equity investment raised. Source: Wallace, James E. "Financing Affordable Housing in the United States." *Housing Policy Debate*, 6(4), 1995, Fannie Mae Foundation, p.797.

[64] HR 2990 (Representative Ensign).

[65] Rosen, Kenneth T. and Ted Dienstfrey. "The Economics of Housing Services in Low Income Neighborhoods." Berkeley Program on Housing and Urban policy, Working Paper 98-002, 1998, p.27.

[66] The volume cap increase passed as part of the Omnibus Appropriations Bill (HR4328, Division J) at the end of the 105th Congress. The current volume cap continues at the $50 per capita or $150 million level until 2003. The cap increases at the rate of $5 per year from 2004-2006. The full $75 per capita or $225 million cap phases in the year 2007 and is not indexed to inflation.

FINANCING OF HIGHER DENSITY HOUSING

While development of higher density housing presents opportunities to increase the supply and affordability of housing in San Francisco, the financing structure of higher density housing increases the cost of capital of for-sale units.

Regulated by the Department of Real Estate, consumer protection measures prohibit deposits and advanced sales of units until construction is nearly complete. While horizontal subdivisions can leverage the development and sale of one parcel to finance the development of the adjacent parcel, thereby lowering absorption risk for the lender, developers of vertical, high-rise projects are unable to sell units and acquire deposits to satisfy lender requirements.

Construction costs can be driven up substantially as lenders underwrite projects as if they were rental rather than ownership and provide less construction financing as a result of lower unit values and higher absorption risk. Developers are forced to seek equity financing or mezzanine debt to bridge financing gaps, and this capital requires larger returns than conventional financing. Developers estimate that the absorption risk and commensurately higher cost of capital for vertical development can account for $50,000 of the price of a unit in San Francisco.

HOUSING POLICY

Federal housing policy that is designed to provide national assistance to tenants and homeowners is premised upon assumptions that are often incompatible with San Francisco's tight market conditions. Much Federal assistance takes the form of tenant based assistance programs, such as the Section 8 program, that rely upon the private sector accepting tenants with financial backing from the government. However, San Francisco has a large supply of upper income tenants who are able to outbid each other in the pursuit of desirable units, thereby bidding up rents of scare available units.

In addition, some Federal homeownership programs are premised upon large scale subdivision developments that provide subsidies to builders who finance the purchase of homes in their subdivisions. Homeownership programs such as Homeownership Zones provided competitive grants to communities that generated 300 or more units of housing in a 6 month period. This program relied upon the presence of a large amount of undeveloped land or abandoned housing that could be quickly acquired and rehabilitated. The Hope VI Program maintains a goal of demolishing public housing units without providing 1 to 1 replacement funding. All of these policies are based upon assumptions that do not fully benefit San Francisco's housing market.

A final impediment to increased housing production is found in the lack of enforceability of California's Housing Element Law. While State law requires each local jurisdiction to create policies and programs that enable it to meet its fair share of regional housing need for all income levels, there are no mechanisms to guarantee that its provisions are implemented. Even after the California Department of Housing and Community

Development redoubled its efforts to raise compliance levels from 19 percent in 1992, the compliance rate was only raised to 58 percent by the end of 1995.[67] The Housing Element Law requires procedural rather than substantive compliance and does not ensure that local affordable housing is actually built.

[67] Calavita, Nico, et al. "Inclusionary Housing in California and New Jersey: A Comparative Analysis." *Housing Policy Debate*, 8(1), 1997, Fannie Mae Foundation, p.118.

Conclusions and Recommendations:
Options for Increasing Housing Supply and Affordability

San Francisco industry has an interest in ensuring that the City's labor supply has adequate and affordable housing opportunities, particularly as the City's economy and labor force continue to grow over the next two decades.

Toward this goal, advocacy and financing options are outlined that increase the supply and affordability of housing for San Francisco's workforce. The policy objectives are to provide an adequate labor supply for future economic growth, reduce inflationary housing costs, and reduce commuting distances that bid up wages and increase the cost of doing business in San Francisco.

Advocacy options are discussed as vehicles to increase the supply of rental and ownership units. Increasing the supply of both types of units is important to preserve housing choice, while providing homeownership options is a key element in San Francisco's ability to retain its middle class families. The advocacy options include land use strategies, legislative support of State and Federal resources for housing development, revisions to the mediation process for construction defect litigation on attached product, and neighborhood advocacy.

The financing options focus on the affordability of homeownership. Providing these opportunities is particularly important as homeownership promotes workforce stability, fosters neighborhood investment, and enables a mechanism by which households can accumulate equity through the forced savings nature of principal payments.

While not a common part of employee benefits packages in this country, employer assisted housing programs are very common in other high cost regions of the world.[68] Some U.S. educational and health care employers have found employer assisted housing programs to be helpful in encouraging employee investment in city neighborhoods in need of revitalization. Often this assistance takes the form of a forgivable loan or downpayment and closing cost assistance. It would be useful to explore other non-exclusive options such as providing employee rental subsidies and employer built housing; however, these are not discussed within the scope of this report.

[68] Hong Kong employer assisted housing benefits are detailed in Appendix Two on Innovative Homeownership Partnerships.

ADVOCACY OPTIONS TO INCREASE HOUSING SUPPLY

Legislative Advocacy

Proposed Action: Advocating for additional State and Federal resources for housing development is an effective way to increase the supply of housing that is tied to specific affordability levels. Particularly in San Francisco, policies are needed that increase the supply of both rental and owner-occupied housing to avoid rising rents and the displacement of lower income tenants.

Advocating for resources at the State level with the new Governor, supporting the per capita increase in the Low Income Housing Tax Credit, and endorsing the immediate increase in the Private Activity Bond volume cap are ways in which the supply of affordable housing can expand across the State. In addition, supporting additional construction defect litigation legislation will further remove barriers to the development of more affordable, attached product in San Francisco.

Next Steps: Create a general Housing Committee to formulate San Francisco Chamber of Commerce policy and pursue legislative windows of opportunity.

Partners: Mayor’s Office of Housing; Silicon Valley Manufacturing Group; San Francisco industry; other state Chambers of Commerce.

Timeframe: Short term.

Strategic Land Use Advocacy

Proposed Action: The future of San Francisco’s housing stock will be less determined by the City’s limited supply of land, but rather by the intensity of its use. Supporting a City-wide density bonus program, advocating for additional permissible density along transit intensive corridors, and supporting first-best changes in the way parking is bundled with the housing transaction will assist in increasing both supply and affordability levels.

Next Steps: Continue the San Francisco Chamber of Commerce’s participation in the Housing Action Coalition to advocate for land use reforms where appropriate.

Partners: San Francisco Planning and Urban Research Association; San Francisco Housing Action Coalition.

Timeframe: Short term.

Neighborhood Education and Advocacy

Proposed Action: Neighborhood opposition to development presents one of the most formidable barriers to the additional development of housing in San Francisco. Currently there is very little public support of development projects at the Planning Commission level, while there is frequently opposition that increases development costs and delays.

Two strategies for neighborhood education and advocacy are suggested: A strategic campaign that supports well designed development and incorporates neighborhood needs, and a Workforce Housing Campaign that garners public support of housing that is affordable to San Francisco's labor force.

Next Steps: Continue strategic planning with the Housing Action Coalition and the City to implement neighborhood-specific planning efforts. Explore the feasibility of a pubic education Workforce Housing Campaign.

Partners: San Francisco Housing Action Coalition; San Francisco Planning Department; San Francisco homebuilders; San Rafael Chamber of Commerce.

Timeframe: Short term.

PROMOTING HOMEOWNERSHIP OPPORTUNITIES

Public policy often facilitates first time homeownership opportunities as a means of providing neighborhood stability and equity accumulation to households that would otherwise be priced out of the homeownership market. These programs typically attempt to surmount high homes prices and downpayment requirements. To the extent that San Francisco wishes to preserve a moderate income population that has a strong preference for homeownership, it must create new housing opportunities that include the possibility of homeownership.

There are two key ways in which the affordability gap between home prices and the mortgage that household income can support can be reduced: subsidize the mortgage interest rate and/or provide financing assistance in the form of a grant or loan. While subsidizing the interest rate lowers principal and interest payments throughout the subsidized period, it can create servicing problems for the lender.

Providing downpayment assistance at market interest rates is a more common method of providing homeownership assistance. In the case of an employer assisted downpayment, the employer could provide an outright grant that is attached to a tenure requirement, provide a loan with deferred payments until the house is resold, or issue a forgivable loan that is tied to length of employment.

In the grant scenario, the employee gets the benefit of an outright reduction in home price without the burden of assuming additional debt. However, problems may arise in the event that an employee loses or voluntarily terminates his or her job. In the deferred payment loan scenario the lender must underwrite the employer, and the employee, while benefiting from deferred repayment obligations, must also assume more debt. The third scenario of a forgivable loan presents the lowest barriers, and a motivated lender may be willing to work with the parties to reach a mutually agreeable solution. Each scenario has different tax implications for employer and employee.

Homeownership opportunities can also be expanded through a contingent interest or shared appreciation second mortgage. To the extent that this transforms the home purchase from an investment to a basic good, the buyer's equity is limited in nature. This enables affordability for the first time homebuyer while recycling the subsidy to additional households through the returned share of appreciation, but does not ensure that affordability stays with a particular unit. These types of programs generally have better distributional effects than programs that tie a subsidy to a particular unit.

In San Francisco, a downpayment assistance program would likely take the form of a shared appreciation second mortgage due to the deep subsidy needed to bridge the gap between household incomes and available mortgage credit. A 2.5 person household earning 100 percent of median income can afford to purchase a $220,000 home assuming a 10 percent downpayment and allocating one third of monthly income to housing payments. However, this home purchase affordability level is $110,000 below the median price home in the fourth quarter of 1998.

With strong growth in home prices in San Francisco, a shared appreciation, non-amortizing second mortgage can provide a return on investment for the lender, although many lenders are not willing to forgo payments until the end of the loan term. If this product could be syndicated to investors in the secondary mortgage market, the cost of the subsidy could be further leveraged in the capital markets.

FINANCING OPTIONS TO INCREASE HOMEOWNERSHIP AFFORDABILITY

Supplement San Francisco's Downpayment Assistance Loan Program

The City of San Francisco's Downpayment Assistance Loan Program targets low and moderate income first time homebuyers with subsidies of $30,000-50,000 depending on household income. The program provides a silent second mortgage with deferred principal payments in exchange for a share of the property's appreciation. This program is currently funded for a five year period with Proposition A bonds.[69]

Industry could raise financial backing to supplement the $15 million in Proposition A funds. A variation is to create a City-Industry loan pool that targets private matching funds to a

[69] San Francisco's Downpayment Assistance Loan Program is detailed in Appendix Two on Innovative Homeownership Partnerships.

moderate income population earning 80-100 percent of median income. Gap financing of approximately $30,000 could be available for households in this income range.

Target:	First time homebuyers. Households with income up to 100 percent of area median.
Pros:	Deep subsidies of $30,000-50,000 reach lower income households. Ease of implementation; program is fully developed. Public/private partnership leverages resources. Receptiveness of Mayor's Office of Housing.
Cons:	Deep subsidies limit number of households served by program. Industry is not able to fully target ownership assistance. Limited supply of homes within sales price limits. Proposition A fund allocation is for a 5 year period.
Timeframe:	Short term.

Introduce CASA Loan Program in San Francisco

The Community Assisted Shared Appreciation (CASA) Loan Program is an innovative mortgage product developed by Northbay Ecumenical Homes to assist low and moderate income first time homebuyers. The Dual CASA Loan provides non-amortizing second mortgages from private institutional investors which is then leveraged with non-amortizing third mortgages from a public investor or foundation.[70]

Like the City of San Francisco's Downpayment Assistance Loan Program, the mortgages offer deferred payments in exchange for a share in the property's appreciation. But unlike their more typical public counterparts, the Dual CASA Loans leverage public and private capital to provide maximum gap financing. The program also captures the incentives and tax consequences for each type of investor.

The CASA Home Loan and Partners programs are currently working in other Bay Area communities except San Francisco. Industry could play a lead role in working with the City and potential investors to bring this program to San Francisco. Approximately $1 million in CASA loans has the ability to leverage 30 home purchases depending upon the ratio of median income to median home price.

Target:	First time homebuyers. Households with income up to 100 percent of area median.
Pros:	Public/private partnership leverages resources. Ease of implementation; program is fully developed and replicable.

[70] The CASA Loan Program is detailed in Appendix Two on Innovative Homeownership Partnerships.

Established relationships between the developer of the CASA Loan program, Fannie Mae and industry.
Existence of a third party intermediary in the event of employee termination.

Cons: Wide affordability gap limits number of households served by program.
Potential political opposition from existing City organizations.

Timeframe: Short term.

Develop Employee Housing Assistance Programs

Industry could convene experts from mortgage lending institutions to assist major San Francisco employers in developing employee housing programs. These programs could be company-specific (e.g., potential Schwab Housing Plan), industry-based (e.g., potential Technology Sector Housing Consortium) or occupation-based (e.g., potential Teacher's Housing Initiative) and launched as part of a strategic City-wide workforce housing plan.[71]

Target: First time homebuyers.
Income eligibility to be determined by employer or industry.

Pros: Flexibility in tailoring financing to individual employer.
Employer is able to income-target ownership assistance.
Pooled resources assist a greater number of households or deepen subsidy.
Capacity to assist smaller employers with less financial capital.
Local expertise in mortgage banking community.

Cons: Limited capital investment of one employer.
Length of program development and implementation.
Program design must account for employee termination.
Difficulty of meeting each employer's investment objectives.

Timeframe: Long term.

[71] Employer assisted housing models are profiled in Appendix Two on Innovative Homeownership Partnerships.

Appendix One: Housing Stock Characteristics

BUILDING TYPE AND TENURE CHARACTERISTICS

San Francisco's housing stock primarily consists of multiple family dwellings. In 1998, 69 percent of housing units were identified as multiple dwellings, which consist of 2 or more units. This percentage has risen slightly over time.

Figure A: San Francisco Housing Distribution by Type

	1983	1988	1998
Single Family Dwellings	111,326	111,759	105,630
% of Total	35%	34%	31%
Multiple Family Dwellings	207,508	213,365	230,521
% of Total	65%	66%	69%
Mobile Homes	243	243	113
% of Total	0.1%	0.1%	0.03%
TOTAL HOUSING UNITS	319,077	325,367	336,264

Source: California Department of Finance.

In contrast, only 31 percent of housing units are identified as single family, which include both detached and attached dwelling units. These percentages are the reverse of the other 8 Bay Area counties[72] and California as a whole, where housing stock is approximately two-thirds single family dwellings and one-third multiple family dwellings.[73]

San Francisco's current housing stock is roughly equally divided into single family homes, moderate density buildings (2-9 units), and higher density structures (10+ units).[74] Most of the multiple unit dwellings consist of small duplex or four-plex units or buildings with more than twenty units.[75]

Figure B: San Francisco Multiple Unit Housing Stock, December 1997

	Total Units	% of Multiple Family Units
2-4 Units	79,926	35%
5-9 Units	37,233	16%
10-19 Units	36,776	16%
20+ Units	76,387	33%
TOTAL UNITS	230,322	100%

Source: San Francisco Planning Department.

However, the distribution of housing units is moving toward a greater percentage of higher density buildings as new units are added to the existing stock. Between 1988 and 1997, only 8 percent of new construction took the form of single family units compared to 65 percent of units in buildings with 20 or more units.[76] In the past year, San Francisco has

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[72] Alameda, Contra Costa, Marin, Napa, San Mateo, Santa Clara, Solano, and Sonoma counties.

[73] California Department of Finance, *County/State Population and Housing Estimates, Official State Estimates*, January 1, 1998.

[74] San Francisco Planning Department, *1997 Housing Inventory*, June 1998, p.11.

[75] Ibid, p.8.

[76] Ibid, p.11.

seen the development of a number of high rise structures,[77] particularly in the Rincon Hill and South Beach areas of the City.

Housing units in San Francisco also tend to be small, with the majority of units being studio, one bedroom, or two bedroom. This is particularly true of the rental stock. As Figure C indicates, the majority of small dwelling units (studios and 1 bedroom units) are renter occupied, while the majority of larger units (3+ bedrooms) are owner occupied. This shows that 3 to 4 bedroom units are the closest substitutes to single family owner occupied housing.

Figure C: Units by Number of Bedrooms and Tenure, 1990

Size of Unit	Total	% of Total	Rental	% of Total	% of Unit Type	Owner Occupied	% of Total	% of Unit Type
Studio	49,178	15%	42,452	14%	86%	1,292	.4%	3%
1 Bedroom	94,522	29%	77,931	26%	82%	9,568	3%	10%
2 Bedrooms	102,964	31%	55,049	18%	54%	41,293	13.5%	40%
3 Bedrooms	59,387	18%	19,555	6%	33%	36,971	12.1%	62%
4+ Bedrooms	22,420	7%	5,083	2%	23%	16,390	5%	73%
TOTAL	328,471	100%	200,070	66%		105,514	34%	

Note: Figures for Rental and Owner Occupied units do not include 22,887 vacant units.
Source: City and County of San Francisco, 1995 Consolidated Plan.

Units added to the housing stock since 1990 also follow this pattern. Between 1990 and 1996, 20 percent (1,461 units) of new units added were studios (which includes loft units), 23 percent (1,662 units) one bedroom units, and 32 percent (2,314 units) two bedrooms. 18 percent (1,331 units) of newly constructed units were three bedrooms, and 4 percent (278 units) were four bedrooms or more.[78] To the extent that unit size serves as an indicator of households assisted by new construction, single persons and smaller family households are better served by these construction trends than larger family households.

As indicated in Figure C, San Francisco's housing tenure is primarily renter-occupied; only 34 percent of the housing stock is owner-occupied. This represents a slight increase in the percentage of owner-occupied units, which comprised 33 percent of the housing stock in 1980.[79] This slight increase is attributable to the construction of condominium developments and owner-occupied 2-4 unit flats over the past two decades.[80]

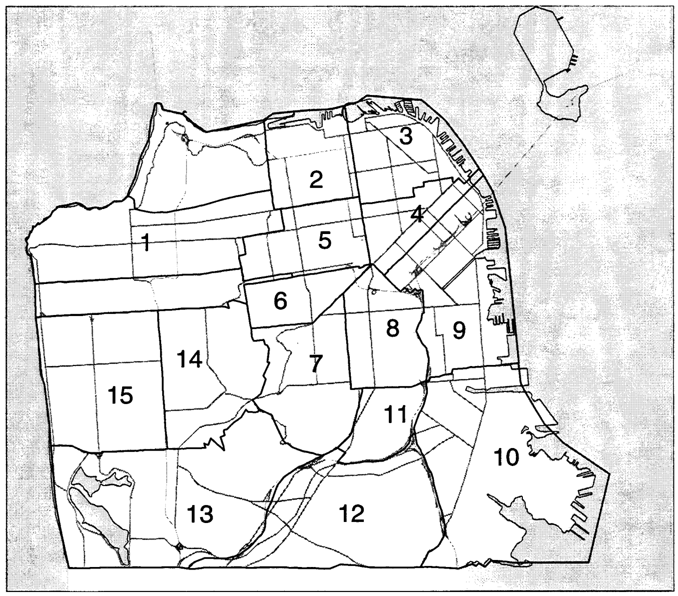
San Francisco's homeownership rate is low compared to the national average of 67 percent, and lower than California's ownership rate of 56 percent. However, the homeownership rate is comparable to New York City's rate of 33 percent. While homeownership decisions are affected by measures other than cost—school quality, access to employment, transportation—high land costs are the major factor contributing to high single family home prices, thereby reducing the affordability of this type of homeownership in the City.

[77] 15 or more floors, or 150 feet or greater.
[78] San Francisco Planning Department, *1997 Housing Inventory*, June 1998, p.12. After 1996, the San Francisco Planning Department no longer recorded new construction by number of bedrooms.
[79] City of San Francisco, *1995 Consolidated Plan*, p.13.
[80] Ibid.

High land costs are manifest in San Francisco's proportion of attached and detached dwellings. Of San Francisco's 105,630 single family housing units, only 53 percent are detached units while 47 percent are attached units.[81] No other county in California has such a high proportion of attached single family units.[82]

HOUSING SUPPLY BY NEIGHBORHOOD

Figure D: San Francisco's Planning Districts



1. Richmond
2. Marina
3. Northeast
4. Downtown
5. Western Addition
6. Buena Vista
7. Central
8. Mission
9. South of Market
10. South Bayshore
11. Bernal Heights
12. South Central
13. Ingleside
14. Inner Sunset
15. Outer Sunset

The Northeast and Richmond districts maintain the largest portion of the City's housing, representing 22 percent (73,033) of the City's total housing stock. South Central and the Outer Sunset districts lead the City in single family homes (38,123 units) with 36 percent of the citywide total. South Bayshore gained the most single family homes between 1990 and 1997 (103 homes) followed by South Central (93 homes). Downtown maintains the highest density housing with nearly 24,500 units in buildings with 10 or more units (22 percent of the citywide total). The Northeast district follows with 21,600 units (19 percent of the citywide total) in such buildings.[83]

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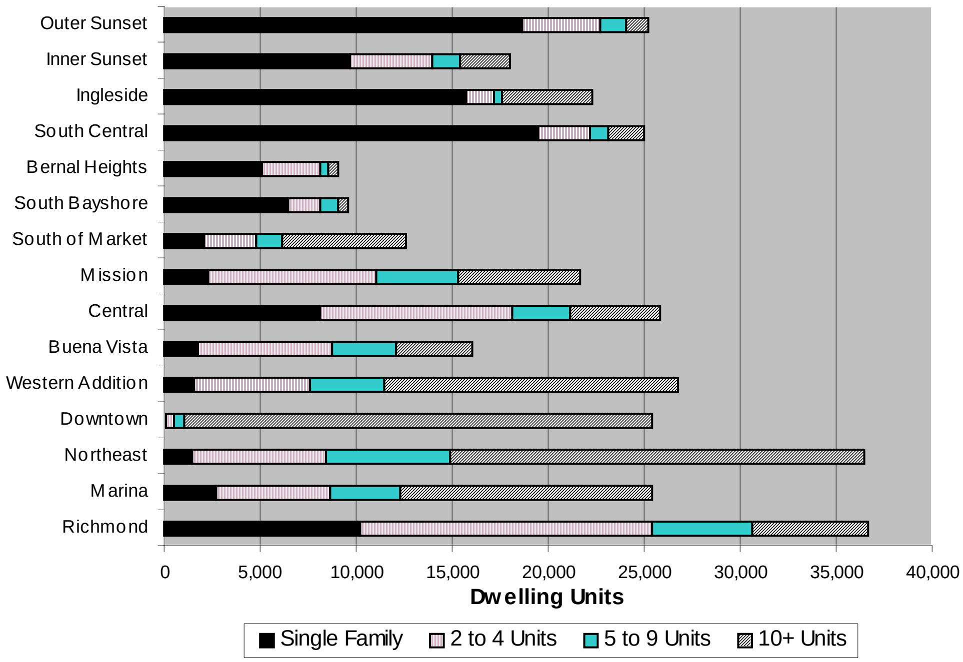
[81] California Department of Finance, *Official State Estimates*, January 1, 1998.

[82] Bay Area figures: Alameda County (11% attached; 89% detached); Contra Costa County (11% attached; 89% detached); Marin County (13% attached;87% detached); Napa County (8% attached; 92% detached); San Mateo County (12% attached; 88% detached); Santa Clara County (14% attached; 86% detached); Solano County (6% attached; 94% detached); Sonoma County (9% attached; 91% detached). Source: California Department of Finance, *City/County Population and Housing Estimates*, April 1, 1990.

[83] San Francisco Planning Department, *1997 Housing Inventory*, June 1998, p.34.

Figure E: Total Housing by District, 1997



Source: San Francisco Planning Department.

In 1997, the South of Market planning district gained 417 newly constructed units (46 percent of the total) and has led the City in new construction for the last three years.[84] This district has also led the City in new higher density buildings with 431 units added, 81 percent of which were in buildings of 20 or more units.[85]

The Mission planning district followed in new construction with 11 percent of the total newly constructed units. Between 1990 and 1997, the South of Market and Western Addition districts accounted for almost 50 percent of new construction, with the downtown planning district accounting for another 11 percent of new units constructed.[86]

The South of Market district also had the greatest net gain of housing units in 1997 (508 units) followed by Central (111 units) and South Bayshore (73 units). The districts with the most substantial net loss of housing units were the Mission (loss of 67 units) and Western Addition (loss of 62 units).[87]

[84] Ibid, p.27.
[85] Ibid, p.34.
[86] Ibid, p.27.
[87] Ibid, p.29.

Figure F: Housing Units Completed and Demolished, 1997

Planning District	Total Stock	Units Completed	Units Demolished	Net Gain in Housing Units*
Richmond	36,615	32	12	28
Marina	25,428	12	4	6
Northeast	36,418	1	5	-3
Downtown	25,467	30	0	33
Western Addition	26,770	41	95	-62
Buena Vista	16,004	10	1	1
Central	25,867	57	6	111
Mission	21,652	101	212	-67
South of Market	12,554	417	1	508
South Bayshore	9,576	78	0	73
Bernal Heights	9,094	12	0	7
South Central	24,951	56	3	38
Ingleside	22,276	25	1	20
Inner Sunset	17,983	17	2	15
Outer Sunset	25,201	17	2	17
TOTAL	335,856	906	344	725

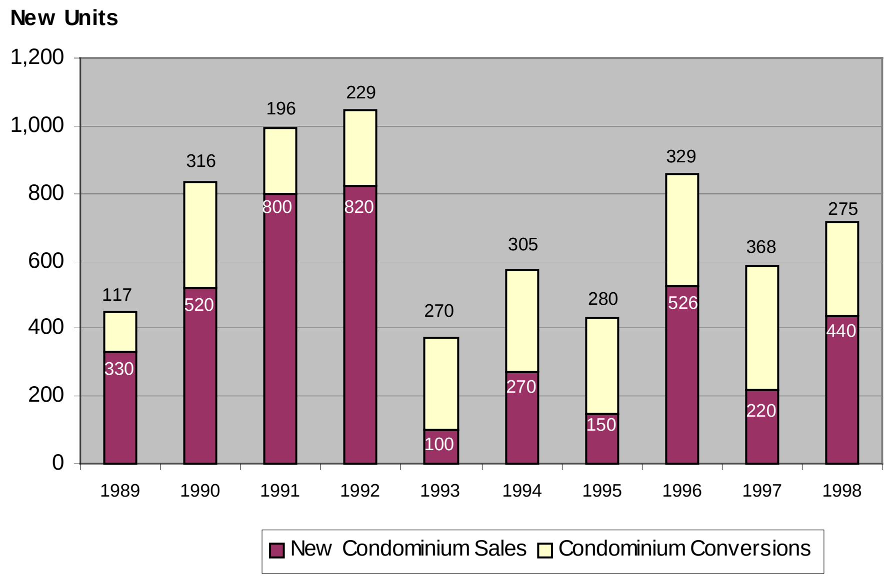
*Includes units gained/lost by alterations (data not shown).
Source: San Francisco Planning Department.

CONDOMINIUM DEVELOPMENT

New condominium activity peaked during 1991 and 1992, and while it has not recovered to its previous levels, development has remained strong since 1996. Almost half of the units recorded with the City were in buildings with 20 or more units.[88] Large multi-unit developers typically file for condominium subdivisions even though the units are initially offered for rent. This provides developers with the ability to sell the units in a strong market and to protect their investment from retroactive rent control regulations.

[88] Ibid, p.18.

Figure G: New Condominium Sales and Conversions, 1989-1998



Source: Sedway Group.

Condominium conversions are regulated by the City's Condominium Conversion Ordinance which is administered by the Department of Public Works. Since 1983, the Ordinance has limited rental unit to condominium conversions to 200 per year and to buildings with 6 or less units.[89] Half of the conversions that took place in 1997 were in buildings of two units.[90] Approval is granted through a lottery process. The Ordinance has had the dual effect of inhibiting growth in the condominium stock (due to conversions) and preserving the City's existing rental stock.

HOUSING SUPPLY PIPELINE

Residential permits, construction and residential purchase lending are indicators of future growth in the supply of housing units. All indicators show signs of increased housing production in San Francisco.

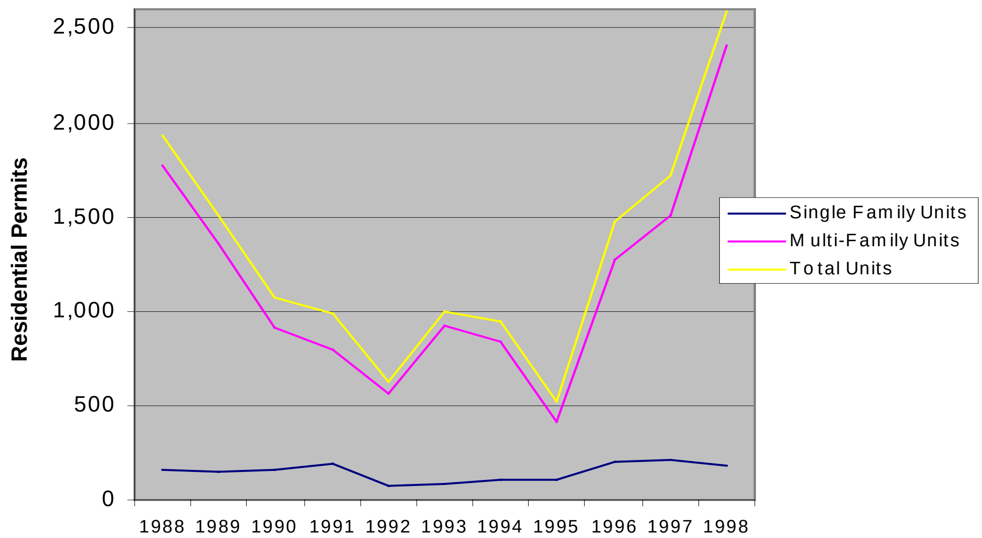
Residential permits peaked in the late 1980s and early 1990s, with a slowdown of permit issuances in the mid-1990 recessionary years. For the year 1998, total units authorized by building permits increased by 51 percent from 1997 and quadrupled from 1995.[91]

As expected, single family units comprise a small portion of total permit issuances in San Francisco; multifamily units drive the total supply growth and represent 93 percent of total

[89] In addition to the 200 conversions allotted by lottery each year, conversions are permitted if owners move into both units in a 2-unit flat and they have lived in the units for at least one year.
[90] San Francisco Planning Department, *1997 Housing Inventory*, June 1998, p.19.
[91] Real Estate Research Council of Northern California, *Northern California Real Estate Report*, Fourth Quarter 1998, p.20.

residential permit issuances in 1998. However, single family units comprise the vast majority of permits issued in other Bay Area counties.

Figure H: San Francisco Residential Permits, 1988-1998



Source: Real Estate Research Council of Northern California.

Construction lending levels in San Francisco increased by 2.5 times from 1995 to 1998 and have surpassed peak 1989 levels.[92] In the last year, this type of lending increased 129 percent in San Francisco after remaining stable from 1996 to 1997.[93]

Figure I: Construction Lending ($ millions), 1989-1998

Period	San Francisco County	Bay Area*
1989	437	5,787
1990	338	4,301
1991	124	2,195
1992	105	1,591
1993	96	1,424
1994	188	2,275
1995	145	2,350
1996	210	3,109
1997	211	3,554
1998	483	4,635

*Includes 9 Bay Area counties. Nominal dollars.
Source: Real Estate Research Council of Northern California.

Residential purchase lending rose by 17 percent from 1997 to 1998 and nearly doubled from 1995 levels.[94]

[92] Ibid, p.39.
[93] Ibid.
[94] Ibid, pp.40-41.

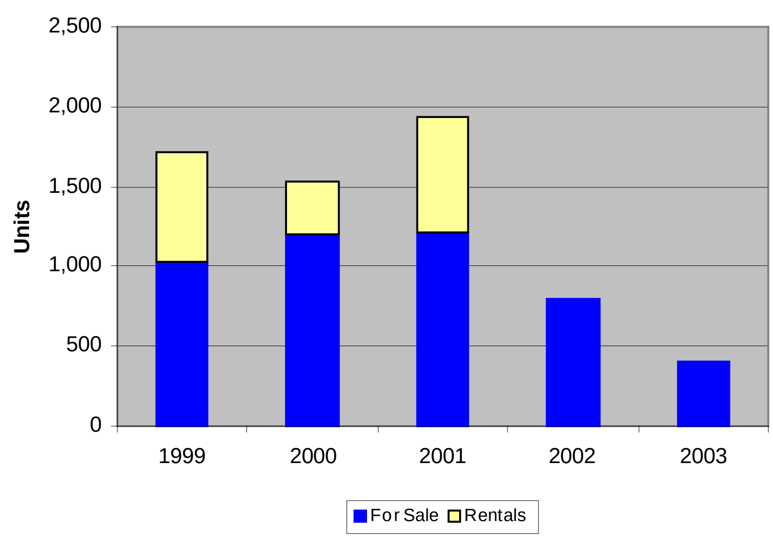
Figure J: Residential Purchase Lending ($ millions), 1989-1998

Period	San Francisco County	Bay Area*
1989	1,182	16,645
1990	1,057	13,591
1991	1,061	13,452
1992	1,133	13,762
1993	1,054	13,384
1994	1,152	14,586
1995	973	12,034
1996	1,281	17,608
1997	1,634	22,022
1998	1,911	26,993

*Includes 9 Bay Area counties. Nominal dollars.
Source: Real Estate Research Council of Northern California.

Recently there has been much more activity in the for sale condominium market than in market for rental units. As shown in Figure 8, this for sale supply is projected to continue over the next five years.

Figure K: Market Supply Pipeline, 1999-2003



Source: Sedway Group. Pipeline figures include units under construction, approved by the Planning Commission, and under Planning review. Market rate units only.

Sedway Group has analyzed the market pipeline by four categories: Luxury (homes average $600,000+, $3500+ per month for compact 2 bedroom rentals); Upscale ($400,000 homes, $2,750 rental); Middle Market ($300,000-325,000 homes, $2,500 rental); and Loft ($300,000 homes, $2,200 rental).

While production in the Luxury category has been relatively low, particularly of rental units, much of the current pipeline supply of homes and rental is targeted to this upper end market. As the Loft market becomes saturated, developers may turn increasingly to the Upscale and Middle markets for future production. The market could clearly be much deeper at lower prices.

Appendix Two: Innovative Homeownership Partnerships

PUBLIC ASSISTANCE OF HOMEOWNERSHIP

Downpayment Assistance Loan Program—San Francisco

The City of San Francisco offers homeownership assistance through the Downpayment Assistance Loan Program (DALP) which is targeted to low and moderate income first time homebuyers. Funded with Proposition A bonds, the program allocates $3 million per year over 5 years for 60-100 downpayment subsidies per year. The regulations required the a minimum of 25 percent of the funds assist households below 80 percent of area median income. However, in the first 9 months of operation two-thirds of loans were targeted to households below 80 percent of area median income.

While most downpayment assistance programs offer $2,000 to 5,000 in assistance, the DALP provides a deep subsidy of $30,000 to $50,000 per unit depending on household income.[95] The loan acts as a silent second where an income-qualified household finds a property within a sales price limit[96] and obtains a first mortgage from a participating lender. The borrower must contribute a minimum of 5 percent of the purchase price toward the downpayment of the property; the DALP will then supply a loan which is deferred for a 40 year term.

The principal and a share of the property's appreciation is due upon the end of the term or the sale of the property. The principal and shared appreciation portion are returned to the loan pool to assist other eligible households. This type of program relies on the assumptions of house price appreciation and turnover in ownership to be self-sustaining in the long run. While it is too soon to detect the extent of turnover, the assumption of appreciation is a relatively safe one in San Francisco.

While the City administers a First Time Homebuyer Program that places price limits on the resale of the property, the DALP program places no such limits upon resale. The goal of this program is to create an affordable housing opportunity for a first time homebuyer, and to allow that household to establish mortgage credit, rather than create an investment opportunity or permanently restrict the sale of the property. Programs such as the First Time Homebuyer Program that utilize City assistance or land ensure that the units themselves remain permanently affordable.

Although households at 100 percent of area median income are eligible for the City's homeownership programs, priority is given to very low and low income households and those whose housing needs are least served by the private market. Given the City's initial

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[95] Borrowers whose income is at or below 80% of median can qualify for a maximum loan of $50,000. Borrowers whose income is at or below 100% of median can qualify for a maximum loan of $30,000.

[96] Eligible properties include detached single family units, condominiums, townhouses and shared cooperative units. The maximum sales prices as of January 7, 1998 are: Studio/1BR (1 person) $192,000; 2 BRs (2 persons) $219,600; 3 BRs (3 persons) $247,000; 4+BRs (4 persons) $274,000.

success in reaching households below 80 percent of median income, it is unlikely that these limited funds will go far enough to benefit a moderate income population. In addition, affordability assistance is only effective to the extent that the supply of below market rate housing exists.

Mortgage Credit Certificate Program—San Francisco

The City of San Francisco administers the Federal Mortgage Credit Certificate Program (MCC) which provides assistance to first time homebuyers for the purchase of owner occupied single family homes, duplexes, townhomes or condominiums.

Authorized by Congress in the Tax Reform Act of 1984, the MCC reduces the federal income tax liability by 15 percent of the annual mortgage interest paid on a dollar for dollar basis. The remaining 85 percent of mortgage interest is taken as a deduction from gross income. The result is greater borrowing power with the same income. MCC benefits can also be received on a monthly basis if federal tax withholding is adjusted, resulting in greater after-tax income with which to make mortgage payments.

The City has designated certain census tracts as target areas to encourage home ownership and development of these neighborhoods.[97] Home purchase in the target areas affords greater flexibility in buyer eligibility, property purchase price and household income. However, there is a wasted interest component to the MCC to the extent that households do not itemize taxes.

INNOVATIVE HOMEOWNERSHIP PARTNERSHIPS

Flexible 97 Homebuyers Assistance Program—Silicon Valley

In response to a housing crisis that is similar to San Francisco's, the Silicon Valley Manufacturing Group (SVMG) has launched an initiative with the cities of San Jose, Cupertino and Morgan Hill to provide first time homeownership assistance.

Working in conjunction with Fannie Mae, the First-Time Homebuyers Assistance Task Force is promoting "Flexible 97," a mortgage assistance program that allows a 3 percent downpayment and a 97 percent loan to value ratio. Mortgages are made available up to the conforming loan limit of $240,000 with 3 percent down. The program is targeted to employers who can assist their employees with a portion or all of the downpayment through a loan, forgivable loan over time, or an outright grant.

This program is part of a Teachers Initiative that is working to improve teacher recruitment and retention in the valley; however, the Task Force is promoting the Flexible 97 program to other critical need employees such as police officers and fire fighters. The SVMG

[97] Areas include North of Market, South of Market, Hayes Valley, Northwest Mission, Bayview/Hunters Point and Geneva Terrace.

estimates the average teacher's salary to be $29,000-$32,000 while the average home price is $360,000.

The SVMG is also spearheading a county-wide Housing Trust Fund which will be funded with $20 million from foundations, government agencies, corporations and individuals in the valley. The Trust Fund will be used to support homeownership assistance as well as the development of affordable multifamily rental housing and homeless shelter programs.

While programs that lower the downpayment threshold may be effective in assisting households that are unable to save for a downpayment, they still create a 97 percent or greater loan to value ratio. These programs are thus limited to the extent that households cannot support this level of debt. In addition, Silicon Valley is experiencing a supply side problem that is exacerbated by construction defect liability on attached product. Thus, this program will be constrained by the need to create deeper subsidies in the form of second mortgages to further reduce loan to value ratios and to increase the supply of more affordable, attached housing.

CASA Home Loan Program—Bay Area

Northbay Ecumenical Homes (NEH) has developed an innovative home purchase finance product designed for low and moderate income first time homebuyers. The Community Assisted Shared Appreciation Home Loan Program (CASA) provides "silent" second and third mortgages to income qualified buyers after they secure a conventional first mortgage. The CASA Loan was approved by Fannie Mae in 1989. Approximately 300 loans at an average value of $25,000-30,000 have been made in the Bay Area.

The Dual-CASA Loan covers the gap between the home sales price and the buyer's purchasing ability, including the first mortgage and a required 5 percent downpayment. There are no repayment obligations for the Dual-CASA; the balance plus a shared appreciation is due upon resale, rental or refinancing (which is means tested). Due to the lack of monthly payments on the CASA loan, buyers can qualify for a first mortgage with less income as only the payment on the first mortgage is considered for loan qualification. The shared appreciation, or contingent interest, repaid to NEH is deductible as mortgage interest paid by the buyer.

Capital for CASA Loans is structured through the CASA Partners Program and comes from banking institutions, homebuilders, redevelopment agencies, and other investors who wish to create affordable homeownership opportunities while earning or maintaining a return on investment. The private institutional investor provides the "silent" second, enabling special home purchase assistance while earning a non-guaranteed rate of return in the range of 10-12 percent. Regulated banking institutions also earn Community Reinvestment Act credit in three areas—loan credit (for the first loan), investment credit (for the silent second), and service credit (depending on the nature of investor involvement). The public investor provides the silent third, assisting first time homebuyers while maintaining capital values through a share in the property appreciation.

While cities and homebuilders have traditionally provided full funding for shared appreciation second mortgages, the CASA Loan Program brings together public and private interests to further leverage each sector's investment, increasing the number of income-eligible families and/or reaching a broader segment of low to moderate income families. NEH has teamed with developers such as Kaufman and Broad and Holliday Development to bring the CASA Program to Novato, Petaluma, Rohnert Park, Danville, Pinole and Emeryville. The CASA Program will also be piloted in Santa Clara County as part of the County and Silicon Valley Manufacturing Group's efforts to develop a greater supply and affordability of housing in the valley. The Program is not currently operating in San Francisco.

NEH is partnering with Holliday Development in the Emeryville E-Lofts project to set aside 20 percent of 127 residential loft units for low to moderate income first time homebuyers. While the average sales price of a loft unit is $220,000, the average affordable price is $170,000. The CASA Loan Program is providing $50,000 per unit in gap financing in the form of silent second mortgages. Once the share of appreciation is returned to NEH upon resale, rental or refinancing, NEH can recycle those funds to finance additional first time homebuyer units or deepen the subsidy on other units.

NEH has also worked with employers in Marin County to develop employer assisted housing. Involving NEH as a third party intermediary also offers the employer loan collection advantages in the event of employee termination.

Employer Assisted Housing—Las Vegas

Bank of America's Mortgage Division and Community Development Bank are working to create employer-specific resources for low and moderate income borrowers in Nevada and Arizona. In Las Vegas, Bank of America is working with a large service-based employer to create homeownership opportunities for employees earning up to 80 percent of median income.[98] A large group of these employees earns $12 per hour which is approximately 53 percent of area median income for a family of four.

Assistance will most likely take the form of a loan at interest rates 100 to 200 basis points below market. The loan will be subject to repayment obligations after five years, although the loan will be fully amortized over the life of the mortgage. In the case of involuntary termination, there may be a revision of the note terms. In the case of voluntary termination, it is more likely that the loan will be subject to an accelerated repayment schedule or the loan interest rate may go to market rate.

Bank of America is working with both private and public sector employers to create assisted housing programs in the area. In the case of the Las Vegas employer, the corporation is motivated by obligations under the Community Reinvestment Act. However, Bank of

[98] 80% of median income is $37,500 for a family of 4 in Las Vegas, Nevada.

America is also working with a local municipality in the area that will fund employer assisted housing for either City employees or employees of City-based companies.

Employer Assisted Housing—Hong Kong

While housing benefits are unusual for all but the most senior level management in the United States, housing assistance is very common in other high cost regions of the world such as Hong Kong, Bombay and Singapore. This is primarily due to the high cost of housing and extended family living situations where employees are often reluctant to relocate for employment. Housing assistance thus becomes a valuable tool in the recruitment of employees from outside their geographic base.

In Asia, mortgage benefits are common for all different levels of employees, but especially for middle and senior management in the finance, insurance and banking industries.[99] In Hong Kong, three type of housing benefits are common: cash housing allowance or rental reimbursements; company leases; and mortgage loans. Each provides different advantages and disadvantages according to local tax law.

Cash housing allowances are offered by 23 percent of Hong Kong employers and are provided for rental or ownership properties.[100] These benefits average HK$22,400 per month (US$2,898) for senior management and HK$11,900 per month (US$1,539) for middle management.[101] Rental reimbursements are provided by 37 percent of Hong Kong employers and average 41 percent of gross annual salary.[102] Because this assistance increases monthly cash compensation, the employee's housing benefits are taxed at the salary income tax rate. The employer pays payroll and social security taxes, but is allowed a tax write-off for the employee benefits expense. Thus, housing allowances are not tax effective.

Housing assistance is also provided in the form of company leases where the employer may build or simply lease rental property. In this case, the employer signs a lease on behalf of the employee and pays 100 percent of rent. Because company leases are not a direct salary benefit, the employee is taxed at a lower rate. The employer takes the write-off and pays no payroll or social security taxes as with cash housing allowances. This form of assistance is typically offered to expatriate staff and senior management, as local labor often prefers to own a unit.

Mortgage loans are provided by 20 percent of Hong Kong employers; of those, 50 percent offer loans to only management, while 50 percent offer them to all staff regardless of their company position.[103] Mortgage benefits are used as a recruitment strategy and coordinated

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[99] Mortgage benefits are common for local employees, but less typical for expatriate employees.

[100] Watson Wyatt, *1996 Compensation Report—Hong Kong*, p.21. (Data represented as of January 1, 1996, based on local sample. The exchange rate of HK$7.73:US$1 was for January 18, 1996.)

[101] Ibid, p.28. Median compensation is HK$23,000 per month (US$2,975) for senior management and HK$8,300 per month (US$1,074) for middle management.

[102] Ibid, p.20.

[103] Ibid, p.31.

with employee mobility. Three financing mechanisms are common: employer self-funding; third party funding; and signing bonuses used for downpayments.

In the self-funding mechanism, an employer will finance the mortgage plan without going to an outside financial institution. Typically, these loans are due upon termination of employment. Employers also establish master agreements between a third party mortgage lender and the employer in which principal and interest payments are deducted directly from the employee's paycheck. An employer can choose to coordinate the transaction and/or subsidize a portion of the interest payment. For example, housing assistance can be offered as a cap on the employee's effective interest rate, leaving the employer to subsidize the difference between the market rate and the employee's effective rate.[104] Interest rate subsidies paid by the employer to a contracted bank are tax deductible by the company as an operating expense, although they are not a taxable benefit to the employee if structured properly.

Signing bonuses are also used for senior level recruits to provide cash assistance for downpayments. In Hong Kong, 30 percent downpayments are common with variable rate mortgages at 150 basis points over the prime lending rate.[105] However, a cash payment increases the effective cost as both employee and employer incur a tax liability. In Hong Kong, interest rate subsidization is a more tax effective means of providing housing loans.

Limited Equity Housing—San Francisco

From 1986-1989, BRIDGE Housing in partnership with Pacific Union developed 114 units of limited equity condominiums on the site of the former Polytechnic High School. With $5 million in City subsidies,[106] over $40,000 per unit, BRIDGE developed and then sold the units to low income households essentially at cost. Named Parkview Commons, 16 one-bedroom, 26 two-bedroom, 38 three-bedroom, and 34 four-bedroom units were developed.

Restrictions on resale existed to maintain the units' affordability. The homeowner received a share of the appreciation based upon their share of value in the original purchase price. The Redevelopment Agency also had the right of first refusal to purchase the homes at fair market value if an income-eligible borrower was not found. A lottery was held to market the units, and nearly 4,000 people applied for the 114 units.[107] The ratio of applicants to units was 40 to 1 for the two- and three-bedroom units, and 10 to 1 for the four-bedroom units. The units were all sold in Spring 1990.

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[104] In Hong Kong, mortgage interest is not tax deductible for owner occupied, non-income generating properties as it is in the United States.

[105] Source: Todd Rydstrom, International Employee Benefits consultant.

[106] The City floated two bond issues including in 1985 (with private mortgage insurance) and in 1986 (using FHA mortgage insurance) and drew upon the City's mortgage assistance program. Source: Pendall, Rolf. *The Residential Approval Process: Development Regulation in the Bay Area*. Bay Area Council. May 1993, pp.127-131.

[107] Ibid, p.131.

AFL-CIO Housing Investment Trust Fund—San Francisco

The AFL-CIO Housing Investment Trust has partnered with Fannie Mae to provide flexible mortgage financing to low and moderate income households for the purchase of existing single family homes, townhomes or condominiums. The national initiative is targeted toward 14 cities including San Francisco and Oakland. San Francisco will receive $30 million for the program.

The Housing Trust program is open to City employees, AFL-CIO members and their affiliate union members. Families that purchase new housing in the City built with union labor are also eligible. A borrower's income may not exceed 140 percent of area median income to receive below market rate financing. If the borrower's income is lower than 80 percent of area median, they are also eligible for a $2,000 grant to be used toward closing costs.

The Housing Investment Trust Fund reduces the borrower's effective interest rate by 50 basis points below the mortgage note rate for the first five years (60 payments) making mortgage payments more affordable. Currently, the effective interest rate on a 30 year loan is 6.5 percent for the first five years, with a one-time adjustment to 7 percent after the fifth year. The maximum loan amount cannot exceed $240,000,[108] which may make originations difficult in San Francisco's market. The minimum downpayment and closing cost contribution from the borrower is 3 percent of the purchase price. Borrowers may qualify for assistance from the City if additional funds are needed.

[108] This is Fannie Mae's conforming loan limit.

Appendix Three: Interviews

All interviews were conducted between January and May 1999 by the author of this report. Individuals are identified with the company or organization for whom they worked at the time of the interview.

Association of Bay Area Governments—Alex Amoroso, Regional Planner

Bank of America—Stephanie Smith, Vice President Community Responsibility, Mortgage Division

Bank of America—Andrew Loubert, Vice President and Regional Community Lending Manager, Mortgage Division

Bay Area Council—Andrew Michael, Project Manager, Capital for Communities & Sustainable Development

BRIDGE Housing—Carol Galante, President

Emerald Fund Inc.—S. Osborn Erickson, Principal

The GAP—Tamsin Smith, Director Government Affairs

Holliday Development, LLC—Richard M. Holliday, President

Northbay Ecumenical Homes—Clark Blasdell, President and CEO

Office of Assemblyman Tom Torlakson—Jennifer Gibson, Senior Consultant

Brad Paul—Housing and Development Consultant

Todd L. Rydstrom—International Employee Benefits Consultant

San Francisco Chamber of Commerce—Roberta Achtenberg, Senior Vice President for Policy

San Francisco Mayor's Office of Housing—Daryl Higashi, Deputy Director

San Francisco Mayor's Office of Housing—Joe LaTorre, Planning and Monitoring Director

San Francisco Mayor's Office of Housing—Marcia Rosen, Director

San Francisco Planning and Urban Research Association—Gabriel Metcalf, Program Director

San Francisco Planning Department—Amit Ghosh, Chief of Comprehensive Planning

San Francisco Redevelopment Agency—Olson Lee, Housing Program Manager

San Rafael Chamber of Commerce—Elissa Giambastiani, President/CEO

Sedway Group—Alan C. Billingsley, Principal

Silicon Valley Manufacturing Group—David Buckmaster, Director of Education

Silicon Valley Manufacturing Group—Linda Mandolini, Director, Transportation and Land Use

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American Electronics Association—Leslee Coleman, Executive Director

Association of Bay Area Governments—Brian Kirking, Senior Regional Planner

Association of Bay Area Governments—Paul Fassinger, Director of Research

Brown Bear Realty—Kristin Hofso

California Community Reinvestment Corporation—Sally Welch, Senior Loan Consultant

The Development Fund—Susan Phinney Silver, Deputy Director

House Committee on Ways and Means—Angela Hansen, Tax Counsel

House Committee on Ways and Means—John Harrington, Tax Counsel

Office of Assemblyman Tom Torlakson—Tina Gallegos Wong

Pacific Marketing—Paul Zeger

John M. Quigley—Chancellor's Professor of Economics and Public Policy, University of California, Berkeley

Rosen Consulting Group—Matt Anderson, Senior Vice President

Kenneth T. Rosen—Chairman, Fisher Center for Real Estate and Urban Economics, University of California, Berkeley

San Francisco Housing Authority—Tony Ucciferri

San Francisco Mayor's Office of Housing—Maggie Davis Badger, Project Manager, Single Family Programs

San Francisco Planning Department—Charlotte Barham, Project Manager

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