Office Development Limitations and Affordable Housing in San Francisco

REMI Webinar

Ted Egan, Ph.D.
Chief Economist

CITY & COUNTY OF SAN FRANCISCO
Office of the Controller
Office of Economic Analysis

04.01.2020

Introduction

- In the past ten years, San Francisco has been among the fastest-growing large counties in the country.
- This level of growth has been unusual for a fully built-out area – especially in a city that experienced essentially no net new job growth over the previous 20 years.
- At the same time, overall levels of housing production have been low – averaging less than a 0.5% increase annually.
- Housing prices have risen rapidly. Affordable housing production in the city, while increasing, has failed to meet the benchmarks established by State law.
- In this context, the City has increasingly sought to use its regulatory powers to impose additional costs and permitting restrictions on new office development.
- This webinar reviews two economic impact reports prepared by our office on recent legislation on these topics.

Legislation Studied

- Increases to the Jobs-Housing Linkage Fee – a commercial linkage fee on new office development, used to generate funding for affordable housing. Adopted by the City in 2019.
- Balanced Development Act – a strengthening of an existing City policy to limit permitting of new office space, if the City continues to fail to meet affordable housing production targets established by the State of California. Approved by San Francisco voters last month.

1. Jobs-Housing Linkage Fee (JHLF)

- The City assesses the JHLF on new non-residential development; the fee revenue is dedicated to affordable housing programs.
- The legislation more than doubled the fee for new office development, from $28.57 to $69.60 per gross square foot.
- The JHLF is a development impact fee which, under California law, must be rationally related to a negative consequence of new development.
- A “nexus study” is legally required, in order to demonstrate that the fee charged to a project does not exceed the magnitude of the problem caused by the development.

The Nexus Study

- The study estimated the number of low- and moderate-income worker households working in new commercial space of various types, using occupational and employment density data.
- Multiplying the household numbers by the City's cost of producing a permanently-affordable housing unit, gets to an affordable housing impact, per square foot (assuming each worker household gets a permanently-affordable unit).
- For offices, this number is approximately $200/sf – well in excess of what the City has charged or proposed in this legislation. Generally fees are set below the legal maximum identified in nexus studies, because of concerns about project feasibility.
- The nexus study is not an economic impact report, in that it does not try to assess the impact of new development on relevant economic indicators such as employment, income, or housing prices.

Economic Impact Factors

- The proposed legislation is expected to affect the local economy in two major ways:

  1. The proposed fee increase will raise the development cost of office space and as a result some projects may become financially infeasible.

     As a result of that, the city would have less development, less space for workers, and less overall employment on an ongoing basis.

     To the extent development is curtailed because of the higher fee, one-time construction would decline as well.

  2. The fee increase should increase funding for affordable housing in the city. Depending on how this funding is used, it could increase construction and rehabilitation spending, and/or increase consumer spending, to the extent the revenue is used to make existing housing more affordable for low- and moderate-income households, and freeing up their income to be spent elsewhere in the local economy.

Estimating the Impact on Office Development

- A logistic regression model was built to estimate the sensitivity of office development to changes in the JHLF.
- The model found a statistically-significant negative relationship between buliding construction costs, and the likelihood of a building permit for new office construction being issues for a given parcel in a given year.
- We estimated the proposed fee increase as equivalent to a 6% increase in non-land development costs.
- The model projects that a 6% increase in development costs would lead to a 0.2% decline in overall office space in the city, equivalent to a reduction of 125,000 – 140,000 square feet per year, on average.
- Because office development is highly sensitive to the business cycle, the impact could be higher or lower in any particular year.

Office Employment and Construction Impacts

- To obtain an estimate of office employment lost due to office construction that is made infeasible by the fee increase, we used the employment density figure in the nexus study, which is 238 square feet of office space per employee.
- An average annual loss of 125,000 to 140,000 square feet of office space would lead to a loss of 520 to 585 office jobs, at that employment density.
- The annual decline in office construction spending is estimated at $61 million - $87 million per year.

Impact on JHLF Revenue

- Despite the decline in office development, the increase in the fee is projected to lead to a $8 million - $9 million increase in fee revenue, as shown in the table below. The model's projects, as a baseline, an average of 430,000 sf of new office per year, under condition. With the higher fee, that would fall to 290,000 – 305,000.

Inputs	Baseline	Under Proposed Legislation	Difference
Annual New Office Development (sf)	430,000	290,000-305,000	(125,000) – (140,000)
Applicable JHLF	$28.57	$69.60	$41.23
JHLF Revenue ($M)	$12.3	$20.2 - $21.2	$8 - $9

JHLF Economic Impact Assessment

- We project the proposed legislation will result in a net job loss of between 1,275 and 1,500 jobs, representing between 0.1% and 0.2% of all jobs in the city, on average over the next 20 years.
- The impact on the city's GDP is likewise projected to be negative, to the tune of $280-$330 million, in today's dollars.
- About 60% of the job losses will be concentrated in the office-using industries that are directly impacted by the fee. Another 25% of the losses are projected to occur in construction, with the remainder spread across other industries. No sector is projected to add jobs as a result of the proposed legislation.
- Housing prices are projected to decline, by 0.1% - 0.2%, but this is due to a proportional loss of personal income and population, not because housing would become broadly more affordable.
- The additional participants in the the expanded affordable housing programs would clearly benefit, and other low- and moderate-income residents may also benefit if the growth in affordable housing lessens competition at the low end of the private housing market.

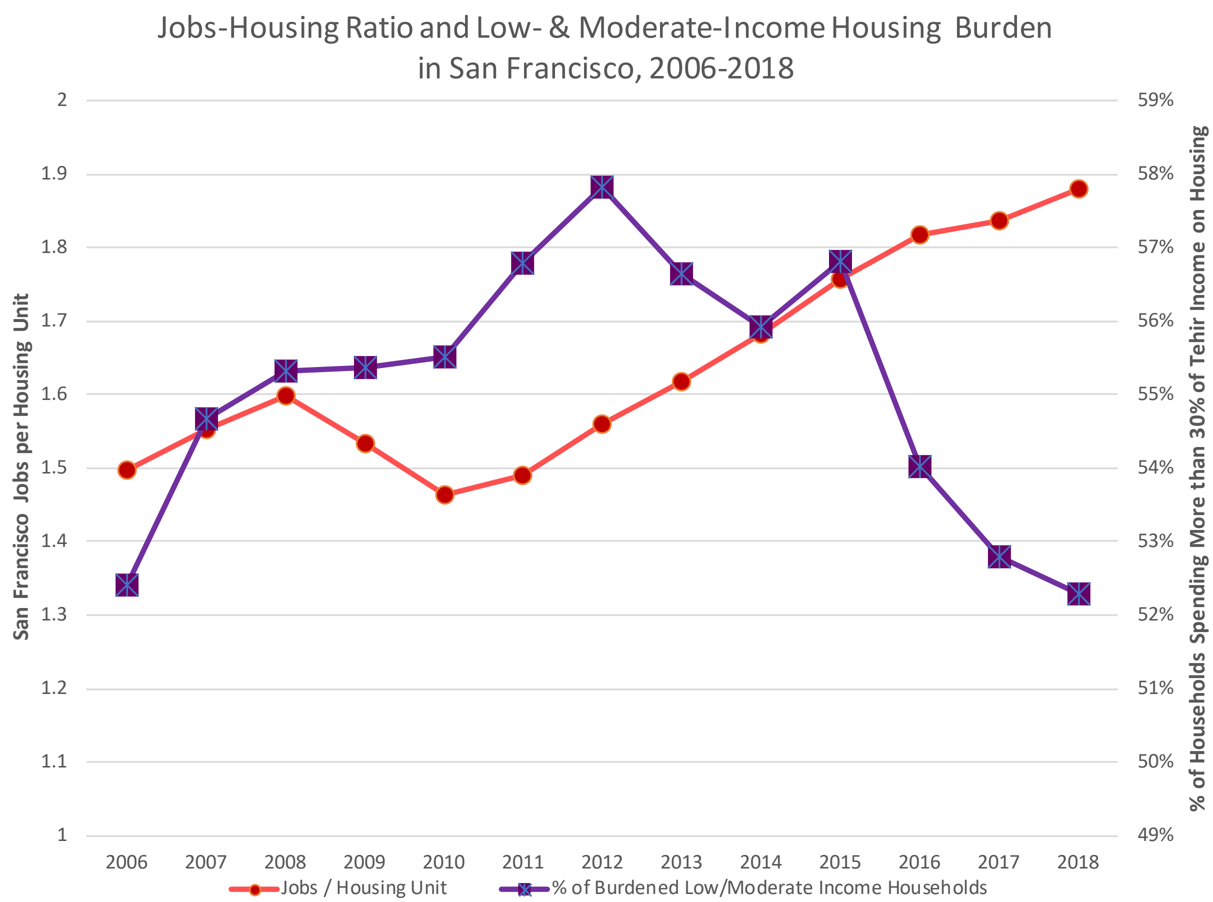
2. Balanced Development Act

- Since the 1980s, large office development in San Francisco has been subject to limitations imposed by Proposition M, which was approved by voters in 1986. Prop M applies a limit to the amount of additional new office space that the City can authorize in a year.
- Prop M established an annual *allocation* of 875,000 square feet of new office space in large development projects.
- Unused allocation is available in future years. Prop M thus ensures that the city does not add more than 875,000 of square feet of large office space per year, on average over the long term.
- The Balanced Development Act reduces the 875,000 annual allocation by a percentage equal to the percentage by which the city missed its annual affordable housing target in the prior year.
- For example, if the annual affordable housing target was 2,042 units, and 75% of that target (1,532 affordable units) was produced in that year, then the city would have missed the target by 25%. The new allocation in the next year would be cut by 25%, from 875,000 square feet to 656,250.

The Affordable Housing Requirement

- The affordable housing target referred to in the measure comes from the Regional Housing Needs Allocation (RHNA), a state program implemented by regional agencies.
- The RHNA process establishes housing production targets for California cities every eight years. The targets are broken down by the income levels of their intended residents.
- Under the measure, office allocation would be reduced unless the City produced a minimum of 2,042 affordable housing units per year for low- and moderate-income households.
- The measure does not relax any of the City's planning restrictions on housing development, and does not generate any new funding for affordable housing.
- Because new office development funds affordable housing through the JHLF, restrictions of office development will reduce funding sources for new affordable housing.

Employment Growth and Housing Affordability



Employment growth clearly grew faster than housing supply in San Francisco during the 2010s. The chart to the left shows that the city's jobs/housing ratio has risen by more than 25% since 2010.

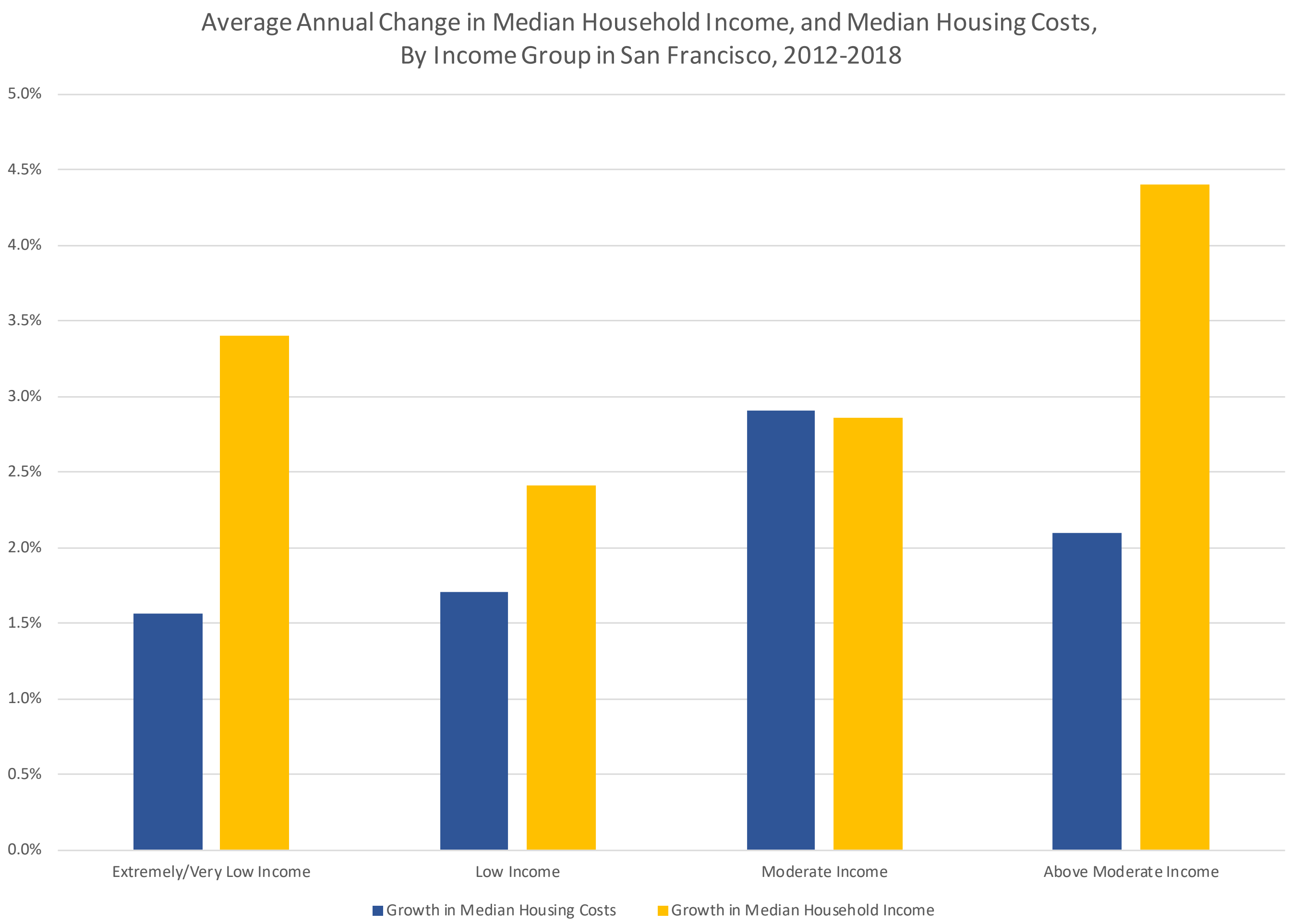
However, while the housing burden facing low- and moderate-income San Franciscans remains very high, housing appears to have become more, rather than less, affordable as the jobs-housing ratio has increased during the 2010s.

According to Census data, the percentage of low/ moderate income households in the city spending more than 30% of their income on housing has tended to decline since the end of the recession.

As shown on the next page, one reasons for this seems to be that job growth has fueled growth in household income, which has been faster than growth in housing costs, for most households in the city.

Source: Bureau of Labor Statistics; Census Bureau, *American Communities Survey*, ipums.org; Mayor's Office of Housing and Community Development.

Growth in Incomes and Housing Costs Since 2012



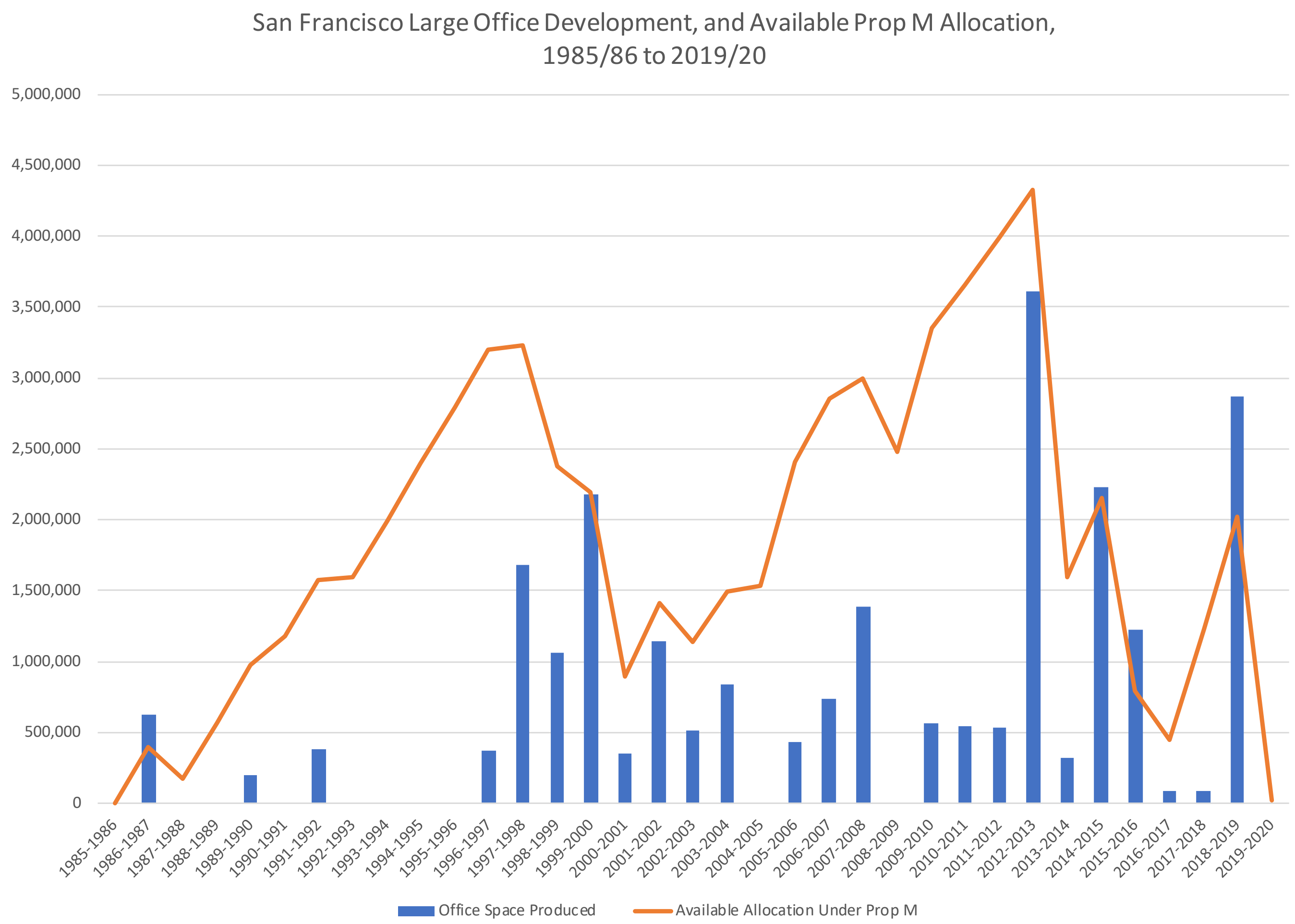
The chart to the left shows the growth in median housing costs, and median incomes, that sampled San Francisco households reported to the Census in 2012 and 2018. In the chart, households are broken out by income group. A gap where income has grown faster than housing costs indicates that housing has become more affordable to the median household in that income group sample.

Above-moderate income households, making over 120% of the area median income, have the widest gap, indicating the most growth in housing affordability.

However, extremely/very low, and low income groups also have experienced income growth exceeding their growth in housing costs since 2012. Only moderate income households, from 80-120% of the area median income, have seen essentially the same growth in housing costs and income since 2012.

Source: Census Bureau, *American Communities Survey*, ipums.org; Mayor's Office of Housing and Community Development.

Available Office Allocation Under Prop M



Prop M establishes an annual allocation for new office space, and any amount that is unused is available for projects in later years.

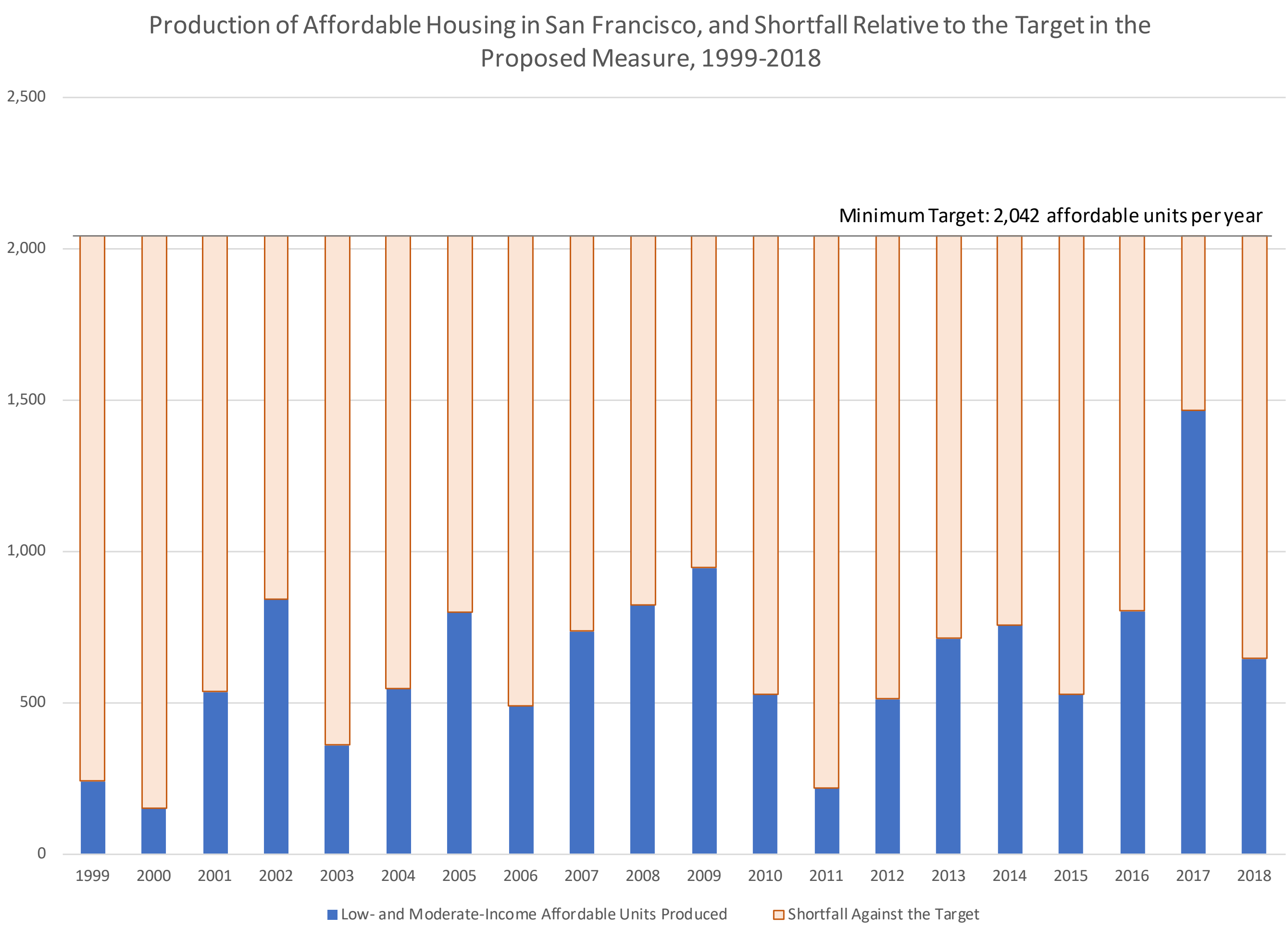
In fact, Prop M's impact on office development has been very limited until the present year, 2019-20.

In the early 1990s, there was little demand for new office space in San Francisco, and the available allocation grew. Since 1999, San Francisco has added more than 1.2 million of square feet per year of large office space, exceeding the annual allocation, because of the amount built up in earlier years.

However, by the end of the 2018-19 period, only 21,752 square feet remained. Even if the proposed measure is not enacted, Prop M is likely to constrain office development and limit job growth in the near future.

Source: San Francisco Planning Department

Affordable Housing Production Versus the Target



As stated earlier, the measure specifies that the city needs to produce a minimum target of 2,042 units of affordable housing annually to prevent further restrictions to office development and job growth.

The city has never met this target in a single year, and it substantially exceeds the city's track record producing new affordable housing. Over the past 10 years, San Francisco has produced between an average of 712 affordable housing units per year, which is 35% of the target.

If either these recent or longer-term trends continue in the future, the proposed measure would lead to a significant reduction in future office development and job growth.

Source: San Francisco Planning Department, *San Francisco Housing Inventory*, various years.

Economic Impact Factors

- If past trends continue and San Francisco continues to demand significant new office space while producing affordable housing at levels below the target in the measure, it will act to further constrain office development in the city, beyond the effects of Prop M.
- If this happens, office supply constraints will put further upward pressure on office rents in the city, and reduce employment below what it would otherwise be.
- In addition, reduced office construction will have a negative impact on the city's construction industry.
- Finally, the measure will have a fiscal impact to the City government. A reduction in office space can be expected to reduce the City's property and business tax revenues, among others, while also reducing the City's General Fund costs of servicing new development.
- Less office development would also lead to less funding for affordable housing, through the JHLF.

REMI Model Inputs

- Based on an assumption that the demand for office allocation over the next 20 years would match the
- The numbers below are obviously sensitive to this assumption – which may not hold given the higher JHLF, among other reasons.
- Given that, in REMI we modelled:
    - A reduction, relative to a baseline forecast, of 2,375 office jobs, spread proportionally across major office-using industries in the city. This job reduction will grow each year, as more office development is reduced, to a loss of 47,500 jobs after 20 years. Accompanying this is a reduction in office construction spending, estimated at $625 per square foot.
    - A reduction of $5.7 million in General Fund spending, the midpoint of the negative fiscal impact discussed on the previous page. Again, this rises over time, to $114 million after 20 years.
    - A reduction of $39 million per year in affordable housing funding through the Jobs-Housing Linkage Fee program. Unlike property and business taxes, this is a one-time fee paid when construction is completed, and this economic loss does not grow over time.

Economic Impact Assessment

- REMI estimates impacts relative to a baseline economic forecast of long-term growth. In 2040, the city's GDP would be 8.5% smaller than it would be relative to the baseline, or $23 billion less in today's dollars. Disposable personal income is expected to be 5.9% less, and the city's population would be 5.8% smaller than under the baseline.
- Similarly, total employment in the city would decline by 7.9% after 20 years, relative to the baseline forecast, which is equivalent to 91,000 jobs in 2040.
- In terms of relative job losses by industry, large office-using industries like professional services, technology, and financial services, would experience the greatest job losses, about two-thirds of the total.
- In percentage terms, lower-paying office-using industries like administrative services, real estate, and non-profits would be the hardest hit, each suffering more than 10% job loss, relative to the baseline.
- Because of multiplier effects, non-office industries like construction, retail trade, hospitality, and health care would all lose more than 2,000 jobs by 2040, again relative to the baseline.

General Lessons for Modeling

- As with all policy analysis, a careful accounting of benefits and costs is critical.
- The JHLF clearly has benefits as well as costs: the negative net impact comes from the relatively high sensitivity of office development to fee increases. If office development was less elastic relative to costs, the results could be different, so carefully assessing that is important.
- The Balanced Development Act analysis is more tilted towards negative impacts because of the finding that, in San Francisco, “unbalanced” job growth has not worsened the long-standing housing affordability crisis for low-income households. If it did, we would have needed to account for the benefit, to those households of reducing that development.
- Another convention of policy analysis (baked into REMI) is to refer to the “impact” as the delta between the control and policy forecasts. Land use debates tend to distinguish between “reduced growth” and “negative impacts” as if they were two different things, so thinking through that framing is important.