



**Housing Affordability:
A Study of the Housing Market in
San Diego County
October 2006**

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EXECUTIVE SUMMARY

- With San Diego's strong economy, unique geographic location, and exceptional weather, many people flock to live here, and the fact is there simply are not enough varied home types to house everyone. This inequity between the demand for housing and the supply of it have lead to a situation where eight percent of local households can afford a median-priced home.
- Housing development simply has not kept pace with population increases for a variety of reasons, including: lack of developable land, land use restrictions, high construction and development costs, construction litigation, and community opposition.
- Without an adequate housing supply, residents are forced to crowd up in homes or move further and further away causing more traffic jams on our freeways. Eventually, employers will leave or choose to not locate in San Diego if they cannot afford to pay their employees enough to live here.
- Within this paper, the San Diego County Apartment Association has sought to address the problem of housing affordability by specifying some of these obstacles to housing development and suggest thoughtful, though not necessarily all-inclusive, solutions to an issue that could severely impact San Diego County's economy.

HOUSING AFFORDABILITY

A Study of the Housing Market in San Diego County

June 2006

The Demand for Housing is Inevitable

It is estimated that San Diego County, with a current population of three million, will increase by as many as one million people between 2000 and 2030.¹ What's more, based on an average job growth rate of 3.2 percent between 1994 and 2004, it can be estimated that San Diego's economy could grow by as many as 40,625 jobs per year – or 975,000 jobs by 2030.² Conservative estimates place the average job growth rate at approximately 28,000 jobs per year. A growth range of this magnitude requires intelligent and progressive planning, especially with regard to providing housing for those anticipated new residents and workers.

This projected population growth will only add to the existing imbalance between the demand for housing and the supply of it. A common formula used by economic forecasters to predict housing need applies to the San Diego region as follows:³

$$\begin{aligned} & \text{[28,000 jobs per year/1.6 jobs per household]} \\ & = \\ & \text{17,500 needed housing units} \\ & + \\ & \text{2,500 units per year lost through demolition} \\ & + \\ & \text{2,000 units per year bought as 2nd households} \\ & = \\ & \text{22,000} \end{aligned}$$

THE TOTAL NUMBER OF HOUSING UNITS NEEDED PER YEAR

This means that **San Diego County will need an additional 22,000 new units per year in order to meet the projected demand through 2030.** When one factors in the estimated existing housing deficit of 90,000,⁴ the real housing need through 2030 is closer to 618,000 units. However, only about 14,000 new units are being built in the San Diego region per year since the 2000 census,⁵ meaning that **by 2030 San Diego will fall short by approximately 282,000 units.** This housing shortage has already pushed the price of for-sale housing in San Diego County to a rate far beyond the income levels of many San Diego households. According to a January 2006 report by the California Association of Realtors (CAR), only eight percent of local households earn the \$150,040 per year necessary to qualify for a 30-year, fixed-rate mortgage at 6.2 percent on a median-priced, single-family resale home of \$616,840 (the annual median household

¹ San Diego Association of Governments (SANDAG) *Regional Comprehensive Plan* (2004)

² Employment Development Department, State of California *San Diego County Industry Employment & Labor Force by Annual Average*. (2004 Total Labor Force, Civilian Employment: 1994 = 965,800, 2004 = 1,269,700. $1,269,700 - 965,800 = 303,900$. $303,900 / 965,800 = .3146 = 3.2\%$ growth rate. $[(1,269,700 \times .032) \times 24 \text{ years}] = 975,129.6$ jobs by 2030. $[(1,269,700 \times .032) \times 25$.

³ Market Pointe Realty Advisors

⁴ Building Industry Association of San Diego

⁵ SANDAG Regionwide Forecast Technical Advisory Working Group (May 2005)

income is \$63,400).⁶ The median price for all home types in San Diego County is \$493,000.⁷ Some residents have turned to alternative mortgage structuring such as interest-only loans to be able to afford a home, but these are risky given the fact that, until very recently, mortgage interest rates had experienced six consecutive increases.⁸ Others continue to rent, as rental rates – though not immune to ever increasing market pressure – have traditionally remained significantly lower than the costs of ownership. Recent data shows a \$2,126 difference between the average mortgage payment on a single-family residence and the average rent on a Class A apartment in San Diego.⁹

Obstacles to Housing Development

- **Land Shortage, High Land Costs & Low Density Zoning**
- **Increasing Development Fees & Construction Costs**
- **Sales Tax-Driven Land Use Decisions**
- **NIMBYism**
- **Parking & Open Space Requirements**
- **Basic Geographic Boundaries**

Land Shortage, High Land Costs, & Low Density Zoning

There are many factors contributing to the housing shortage and resulting home price acceleration. One major factor is the lack of available land upon which to build new housing units. More than 90 percent of the remaining vacant land designated for housing is planned for densities of less than one home per acre; most of which is in the rural outlying areas that, due to infrastructure needs and opposition from environmental groups and elected officials, discourages development.¹⁰ **Of the remaining vacant land planned for housing in the 18 incorporated cities, only about seven percent is planned for multifamily housing.**¹¹ Though the current City of San Diego draft Housing Element Update identifies sufficient land available zoned for 30 residential units per acre or higher for the 2005-2010 cycle, this does not address the need beyond that time and is specific to within the city's boundaries alone. The lack of developable raw land drives up the cost to purchase it, further discouraging developers and compounding the problem.

Increasing Development & Operating Costs

High development fees and exactions have contributed greatly to the housing affordability problem in San Diego County. A report by Louis H. Masotti, Ph.D.¹² called "The Case of the Smith Family House" demonstrates this by analyzing the cost of government regulation on a prototypical single-family home in Carlsbad in 1997:¹³

⁶ U.S. Department of Housing and Urban Development

⁷ *San Diego Union Tribune*/DataQuick Information Systems 7/19/05

⁸ *San Diego Union Tribune*/Freddie Mac "Mortgage Interest Rates Dip" 05/12/06

⁹ Loan amortized over 30 years at 6.27 percent interest rate. "2006 Apartment Trends: A CA Multifamily Market Overview" Marcus & Millichap Research Services, National Association of REALTORS, Reis

¹⁰ San Diego Association of Governments (SANDAG) *Regional Comprehensive Plan* (2004)

¹¹ San Diego Association of Governments (SANDAG) *Regional Comprehensive Plan* (2004)

¹² President of Louis H. Masotti, Ltd., a management, real estate and urban development consultancy since 1981. Dr. Masotti was a professor of management and urban development and director of the program in real estate management for the Graduate School of Management of the University of California at Irvine from 1992 to 1998. He is a professor emeritus of Northwestern University's Kellogg Graduate School of Management.

¹³ Note: This is one community in San Diego County and therefore costs may vary

| <u>Type of Cost</u> | <u>Lower End</u> | <u>Upper End</u> | <u>Average</u> |
|-----------------------------------|------------------|------------------|----------------|
| Direct Costs | \$27,217 | \$56,552 | \$41,886 |
| Indirect Costs | \$21,896 | \$36,734 | \$29,315 |
| Financing | \$19,800 | \$26,400 | \$23,100 |
| Soft Costs | \$1,500 | \$2,500 | \$2,000 |
| Economic Impact | \$70,413 | \$122,186 | \$96,301 |
| Impact as % of House Cost* | 19% | 33% | 26% |

*Based on an average sales price of \$371,339 (Market Profiles, 1998).

Since this study was conducted, these costs have only increased with the cost of living and to provide services.

Some jurisdictions in San Diego have implemented inclusionary housing policies as a means of ensuring that housing reserved for low-income residents is built. A 2001 study of inclusionary housing in San Diego by the University of San Diego, however, concluded that:

“It is not economically feasible for private, for-profit developers/builders to build low-income housing. Requiring them to do so as part of an inclusionary policy imposes significant costs that either must be offset through financial incentives or are passed along to market-rate renters or buyers.”

These kinds of government-imposed regulations further drive up the costs to develop housing. A housing development that cannot command a high enough rent or sales price to cover its development costs, including impact fees and affordable housing policies, is not economically justified and is rarely built. In addition to development fees, various jurisdictions require extensive review and approval processes that can greatly increase the amount of time (and therefore costs) it takes to build new housing, further discouraging private development.

The average development cost of one new apartment unit in San Diego County is more than \$200,000.¹⁴ During the second half of 2004, apartment buildings (most of them aged and in modest condition) were selling for on average between \$131,000-\$189,000 per unit.¹⁵

“Skyrocketing land prices in San Diego have made new apartment construction infeasible so that little to no new apartment product is being developed in the county today.”

~ The Daily Transcript

*“San Diego multi-family market snapshot”
October 25, 2005*

Sales Tax-Driven Land Use Decisions

Sales tax-driven land use decisions continue to disincentivize communities from building housing. As a result of legislative actions taken since the passage of Proposition 13, San Diego has placed residential development on a back burner. With the passing of this legislation, local governments no longer receive enough money from property taxes to be able to pay for local

¹⁴ MarketPointe Realty Advisors

¹⁵ Burnham Real Estate October 3, 2005 “Demand for rental units and condo conversions remains strong”

services and infrastructure. Instead, that money is sent to the state and then allocated to schools and various state programs. As a result, localities have come to rely on sales tax revenues that can be gained in large sum from big box retailers. In other words, housing does not produce the sales tax revenue that local governments need to operate, so it does not receive planning priority.

NIMBYism

What is perhaps the most significant obstacle faced by housing advocates, developers, and elected officials alike when trying to increase housing supply is community opposition. “Not In My Backyard” (NIMBY) attitudes are at the root of the housing affordability problem.

Longtime residents of San Diego have grown accustomed to the suburban sprawl of the 1960s and 1970s, and many adamantly oppose higher density development, fearing higher crime rates, reduced parking, and increased infrastructure demands will automatically follow suit. Typically a very small percentage of the overall community, this vocal segment of the population has had the ability to deter developers and influence elected officials’ attitudes and policies.

Parking & Open Space Requirements

Parking and open space requirements are now common components of housing development. When planning for future growth, it is important to remember that when dealing with a limited supply of land, not all sites can accommodate a one-size-fits-all policy, especially when dealing with urban infill and redevelopment projects. When a subjective analysis of development projects with regard to these elements is not conducted, the potential for new housing units is further diminished.

Basic Geographic Boundaries

And finally, unique geographic boundaries limit San Diego’s ability to grow; specifically, Mexico to the south, the Pacific Ocean to the west, mountains and government-protected Native American lands to the east, and Camp Pendleton Marine Corps Base to the north.

Resulting Effects

- **Crowding**
- **Outward Migration → Longer Commutes**

San Diego County residents have responded to the current housing affordability crisis in a number of ways. Many explore roommates as an option to help lessen costs or have several generations living in one home, hence the increased demand for four- to six-bedroom homes in new developments. Others, however, are moving further and further away from metropolitan centers to the outer fringes of the community where the cost of housing is less expensive. Some are even moving out of the county entirely to places such as Temecula and Imperial Valley, which had been predominately rural, undeveloped communities but have experienced unprecedented development due to this influx in recent years. Often, those who move further away also are moving further away from their places of employment, worsening traffic congestion on area highways. This trend also creates an economic hardship for San Diego as it receives no tax revenues from their properties, goods, and services expenditures.

“While the county's overall loss of population was 1,728 between July 2004 and July 2005, the more telling number is the net exodus of 43,126 people, many of them who likely headed up Interstate 15 to Riverside County, where housing prices are still considerably lower than in San Diego.”

~The San Diego Union Tribune

“County suffers rare population exodus”

March 16, 2006

Despite these recent figures, economic forecasters continue to predict future population growth and need for housing in San Diego County.

The high price of housing will ultimately discourage new employers from coming to San Diego County and current employers from expanding if their employees cannot afford to live here. In June 2005, several major employers, including Intel and Capital One Auto Finance, announced plans to transfer hundreds of positions out of the region. Although each company had its own reasons for moving, some – most recently the 135-employee kelp harvester International Specialty Products – cited the growing cost of operating in San Diego County as a reason for leaving the area. Operating costs include being able to ensure adequate housing for their workforces. Should other companies follow suit, the resulting effect could take a negative toll on the local economy.

Looking Ahead

The good news is that the building industry and employers do have an interest in building more single-family housing, condominiums and rental apartments. Increasing the supply to help meet demand will bring the cost of housing more in line with what people can afford. **The San Diego County Apartment Association recommends the following short- and long-term steps be taken to help ease the current housing affordability crisis:**

1. **Smart Growth** – This is an often used, broad term that has been interpreted in a number of ways. For purposes of this paper, the SDCAA is suggesting that each municipality achieve “smart growth” by continually planning for a minimum of a 20-year supply of housing that incorporates the following:
 - ***Change zoning to accommodate a mix of both for-sale and rental housing of varying densities.*** Many cities in the county have far too little land zoned for residential development, and of the land that is, far too much zoned for single-family development and not enough for multifamily given the current need for housing.

According to the City of San Diego’s draft Housing Element for 2005-2010, multifamily units comprised only 43 percent of the total housing stock. In order to accommodate future growth without continuing sprawl, overall densities must rise to the 12 to 16 units per acre range, which could be achieved through the establishment of density minimums. This range could incorporate a broad mix of low-density housing of the townhome variety along with a mix of higher density, multistory development where appropriate.

- **Higher density development along transit corridors and within close-in communities.** It is estimated that most of all of the San Diego Trolley stops have no residential development adjacent to them.¹⁶ People living close to public transportation systems are more encouraged to use them rather than drive an automobile, thereby helping to relieve traffic congestion.

Within transit-oriented corridors, on-site parking requirements should be significantly reduced in order to bring down development costs, and subsequently, the end price of housing, as subterranean parking spaces often cost anywhere from \$20,000 to \$50,000 per space.

- **Infill development & Redevelopment.** Due to the shortage of undeveloped land, San Diego County jurisdictions should explore opportunities to redevelop their urban cores and upgrade or rebuild the existing housing stock. City of San Diego Mayor Jerry Sanders has outlined a plan to redirect \$18 million per year of federal Community Development Block Grant (CDBG) revenues for their original intent – to support neighborhood infrastructure improvements, an important component of infill development. The county should support and utilize recent state proposals to issue bonds aimed at improving infrastructure as well.
- **Floor Area Ratios (FARs).** In the field of zoning, FAR refers to a limit on how much total space, expressed as a fraction of the total size of the parcel of land involved, may be consumed by the floor or floors of a building or buildings constructed on the parcel. Increasing FARs for new development as well as existing structures where appropriate would essentially allow for upward – not outward – growth.

2. **Incentives and Lowered Fees for Multifamily Development** – The per-unit cost of providing public services decreases as the density of a housing project increases. **Based on research done by the National Multi Housing Council, rental housing generally places fewer demands on public utilities, schools and transportation networks.**¹⁷ Though the SDCAA recognizes that new development should be financially responsible for its fair share of associated impacts on the surrounding community, it makes sense to encourage the development of multifamily housing through incentives such as lowered development fees and exactions in order to encourage higher density development and therefore lower the need for public services.

Also, requiring for-profit developers to build housing reserved for persons meeting certain income requirements or requiring an in-lieu fee to do so should be eliminated. Redevelopment is a tool used by some cities to create new income-restricted housing, allowing them to capture more property tax and state and federal dollars for projects within a designated redevelopment area. Redevelopment, therefore, allows the city to help finance the portion of a project, and possibly infrastructure, that the developer would otherwise have to take a loss on in order to keep prices affordable. Other incentives such

¹⁶ MarketPointe Realty Advisors, 2003

¹⁷ National Multi Housing Council *Growing Smarter With Apartments Toward More Livable and Prosperous Communities*

as density bonuses and long-term sourced funding would further encourage multifamily development.

- Better Land Use Decisions** – As a result of the change of property tax allocations, localities have come to rely upon sales tax revenues as a major source for discretionary funding. The result has been a fiscalization of land use decisions that has deterred localities from supporting residential development. It is recommended that the state restructure local government financing in order to encourage a jobs-housing balance.

Additionally, all 18 jurisdictions have many underutilized landholdings. **Almost half of the county's 2.69 million acres is owned by federal, state, and local governments and remains unused.**¹⁸ A comprehensive analysis of these holdings would provide estimates as to how much of this land could be sold or used for public-private partnerships to build more housing.

Within those areas owned by local governments, specific zoning should be added for multifamily rental housing construction. Compared to the cost of for-sale housing, rental units provide much of the county's affordable housing. This type of zoning would decrease the competition between apartment developers and condominium/townhome developers for multifamily land, which is important since condominium developers can generally afford to pay much more for land than apartment developers due to return from sales.¹⁹

- Community Outreach & Education** – As a result of the misconceptions surrounding multifamily housing, this type of development is often met with opposition from members of the local community. In order to dispel these myths, a comprehensive public education effort must be implemented that should include examples of successful smart growth development in comparable regions. Also key to this effort and specific to the City of San Diego, is the elimination of district voting. This concept has caused the ultimate in NIMBYism with community planning groups dictating the future of the city's housing supply based on very narrow wants and needs instead of what is best for the region as a whole.

Conclusion

San Diego remains one of the nation's least affordable places to live, due in large part to the high cost of housing. More and more, generations of San Diego residents are being forced to move elsewhere – including large numbers of the workforce.

Experience has taught us that growth and rent controls do not work. There can be no doubt that rent control creates housing shortages and would exasperate San Diego's existing supply problem. This further results in crowding within rent controlled areas and outward migration.²⁰

¹⁸ San Diego Regional Chamber of Commerce draft *Region's Housing Market in 2005: Same Problems, But Only Worse*

¹⁹ *Daily Transcript* September 8, 2005 "Lack of construction, conversions put pressure on apartment market"

²⁰ Tucker, William. "How Rent Control Drives Out Affordable Housing." CATO Institute, May 21, 1997.

It is imperative for residents, community leaders, and elected officials to come to terms with the housing demands that face us today and work together to address the future need. It is the purpose of this paper to identify factors contributing to the high cost of housing and propose wide-ranging, feasible solutions for smarter development such as:

- **Higher densities and mixed uses where appropriate**
- **Incentives and lowered fees for multifamily uses to increase housing supply**
- **Better land use decisions when planning for future growth**
- **Outreach & education so community groups, leaders and elected officials can understand the real reasons behind the affordability problems and long-term solutions.**

There are many additional jurisdiction- and project-specific ways to increase the supply of housing in the San Diego region and thereby lower home prices and lessen the effects of sprawl. Only through the cooperation of all real estate-based organizations, local governments, and community members can we truly affect change on the current cost of housing. The San Diego County Apartment Association continues to work toward this goal through its education, research, and advocacy efforts to ensure a vibrant rental housing industry in San Diego County.