CITY COUNCIL SPECIAL MEETING
November 13, 2023

WORK SESSION
CitySpace, 100 Fifth Street NE

6:00 PM City Council Work Session

I. Call to Order/Roll Call

II. Presentation of Work Session Topic – "Draft Zoning Ordinance - Affordable Housing and Accessory Dwelling Unit (ADU) Manual"
James Freas, Director of Neighborhood Development Services

III. Council Discussion

IV. Adjournment

This is an in-person meeting with an option for the public to view electronically by registering in advance for the Zoom webinar at www.charlottesville.gov/zoom. The meeting may also be viewed on the City's streaming platforms and local government Channel 10. Individuals with disabilities who require assistance or special arrangements to participate in the public meeting may call (434) 970-3182 or submit a request via email to ada@charlottesville.gov. The City of Charlottesville requests that you provide a 48-hour notice so that proper arrangements may be made.

The meeting notice was published simultaneously to the public and the governing body on 11/03/23.

CITY OF CHARLOTTESVILLE
"A Great Place to Live for All of Our Citizens"

Department of Neighborhood Development Services

Memorandum

To: City Council

From: James Freas, Director, Neighborhood Development Services

Date: November 13, 2023

Re: Affordable Dwelling Unit Ordinance

CC: Sam Sanders, City Manager
Planning Commission

The Affordable Dwelling Unit (ADU) requirements of the Charlottesville Development Code, found in section 4.2.2, is an important part of how this new code implements the Comprehensive Plan and Affordable Housing Plan. The ADU section is an example of "inclusionary zoning" and implements a direct recommendation of the Affordable Housing Plan. The following provides an overview of the section and identifies some key policy issues for discussion.

Background

Inclusionary zoning refers to a set of requirements in a zoning ordinance that mandates or incentivizes the inclusion of affordable units as part of a residential development project. As a tool to facilitate the creation of affordable housing, it is used throughout the country. Under Virginia law, inclusionary zoning is referred to as Affordable Dwelling Unit zoning and in 2021 the State passed special legislation allowing Charlottesville to develop its own ADU zoning rules.

Inclusionary zoning responds to two related public policy objectives. One is the dramatic and continual need for affordable housing. Government funds are insufficient to fund the task of producing the necessary amount of affordable housing so inclusionary zoning serves as an additional tool, relying primarily on internal subsidies within an otherwise market-rate development project, to fund the creation of affordable units. Second is the public benefits of economically integrated neighborhoods. Research into this topic has shown that economic integration can lead to greater educational and economic attainments for low-income households.

As a concept, inclusionary zoning has been around for around 50 years and over that time practitioners and researchers have identified a number of best practices. Among these is a recognition that the required number of affordable units, the level of affordability, and other characteristics of the requirements must be tailored to the local development market based on economic analysis of that market. Providing affordable units is expensive and requiring too many units or units at too deep a level of affordability can result in many development projects

becoming infeasible and no units being created. With that same understanding, it is essential to revisit that market analysis and the requirements on regular intervals to make sure the requirements remain in line with the capacity of the market. The proposed ADU Manual sets this review at every two years minimum.

Another important aspect of inclusionary zoning is offering an in-lieu fee option. This choice creates some flexibility where affordable units may not represent public policy objectives (see student housing discussion below) or other circumstances unique to a given project. Generally, the calculation of in-lieu fees is either based on the construction costs of a new unit or the increment of lost revenue between a market-rate unit and a required affordable unit. The choice of which of these fee structures to use has significant implications for whether developers are incentivized to produce units or pay the fee, as discussed below.

Finally, it should be noted that managing an inclusionary zoning program requires dedicated staff to ensure compliance. Staff must review proposed affordable units and associated policies and processes in the initial applications and must monitor compliance over time so that units are maintained as affordable as required.

Proposed ADU Rules

Charlottesville's proposed ADU requirements are that any project of 10 or more units outside of the Residential Districts (R-A, R-B, R-C) must provide 10% of those units as affordable to households earning up to 60% of AMI. Rental projects are required to be affordable for 99 years while the Planning Commission's recommendation is that ownership units be affordable for only the first buyer. The ADU requirements are found in section 4.2.2 (attachment 1).

Beyond the base requirements described above, there are three main components of the ADU rules. 1) how the affordable rate is determined; 2) the standards for how the units may be constructed; and 3) the bonus provisions. The Affordable Dwelling Unit Monitoring and Procedures Manual provides greater detail on how these standards and requirements are applied.

Section 4.2.2.C.1.b. describes how the affordable rate is determined, whether that is an affordable rent or an affordable cost of purchase. In each case, that rate is based on what would be affordable to a household earning 60% of AMI, inclusive of related housing costs such as utilities. This total rate must be no more than 30% of that income. The proposed text offers a different method of calculation for student housing (see discussion below), which is on a per bedroom basis. Every third required affordable unit must be made available to housing voucher holders, and in those cases, the rent collected is based on the voucher standards.

The following sections c and d relate to requirements that the required affordable units be equivalent to market rate units and built concurrently. The idea here is to ensure that the affordable units are generally the same as and indistinguishable from the market rate units so that there is not a sense of separation or stigma within the community. The concurrency

requirement ensures that required affordable units are built at the same rate as the market rate units.

Finally, there are two types of bonuses offered within the ADU rules. The first is for bonus height as defined in the district standards in exchange for the required affordable units targeting households of 50% of AMI. The second bonus applies in the Residential Districts (R-A, R-B, R-C) and grants additional units as defined in the district standards where all of the bonus units are affordable.

Analysis and Policy Questions for Discussion

The ADU section of the Development Code is complex, and given its significance to the City's overall objectives, there are, not surprisingly, many different perspectives on the details of how it should work. These are important policy questions for the Council to consider moving forward and are presented below.

Term of Affordability, Rental vs. Ownership

One of the significant components of the proposed ADU program is that units are required to be affordable for 99 years, which is effectively to make them perpetually affordable. Approximately 30% of such programs nationally have this requirement and the reason is simple as the policy goal is to establish an effectively permanent affordable housing component to each project.

The Planning Commission's recommendation includes the distinction that the 99-year standard should only apply to rental projects and that ownership units should only be affordable to the first buyer allowing that buyer to capture full market value at resale of the property. Such a distinction is uncommon in similar ordinances nationally. The policy question is simple and relates to the objective identified above of whether the City is seeking to permanently add to the ownership affordable housing stock or whether the City has a greater interest in creating a wealth building opportunity for the first low-income household buyer. Concern has been expressed about the ability of owners of restricted affordable units to gain equity and wealth-building opportunities where there is a long-term affordability requirement, but research has indicated that owners do gain a wealth-building opportunity from these units. In practice, the affordability restriction requires that the unit be sold to another qualifying low-income household, thereby preserving through time the mixed income aspect of the community established through the ADU requirements.[1]

Flexibility in Design Standards and Concurrency

Another important idea found in the ADU requirements is that required affordable units should be equivalent to market rate units and built concurrently. This requirement includes the concept that the required affordable units should be distributed throughout a project rather

[1] See page 34, "Inclusionary Housing: Creating and Maintaining Equitable Communities"; Lincoln Institute of Land Policy.

than concentrated in one location. The policy objective is to ensure that the required affordable units are not distinguishable and stigmatized. Qualifying residents of these units should not be identified as being low-income households by living in an identifiable required affordable unit.

The Planning Commission recommended that, where affordable housing bonus projects are being constructed in the Residential Districts (R-A, R-B, R-C), that there be some flexibility to this standard, recognizing that such projects might take a variety of forms (small multi-family, townhouses, small single unit, etc.) and that some flexibility in the design and concurrency standards might be required in order to make a project work.

Fee-in-lieu Options

A fee-in-lieu option for affordable housing requirements are common in these types of ordinances, giving some flexibility towards the goal of affordable housing production in the City.[2] There are two primary methods used to calculate these fees, one based on the cost of producing a new affordable unit and the other based on the increment or affordability gap between the revenue from a market-rate and affordable unit. Very simply, the production cost approach results in a very high fee and therefore steers development projects towards producing the unit rather than paying the fee which the increment calculation approach generally equalizes the cost of producing the unit or paying the fee, leaving other factors to influence whether an affordable unit is provided or not. The currently proposed ADU program recommends the production cost fee approach, reasoning that the City's primary interest is in development projects providing on-site affordable units. This is an important policy decision.

The ordinance also provides for a fee-in-lieu for fractional units. Where the calculation of the number of required units results in a fraction of .5 or greater, the ordinance requires a unit to be produced. For fractions less than .5, the ordinance requires an equivalent fee. The intent of this fee structure is to reduce the extent to which development projects "game the system" by setting their unit counts to avoid fractions. The practical result of this "gaming" is typically to reduce the overall number of units and therefore works against the City's housing production goals. By having this fee-in-lieu for fractional units, there is less incentive to "game the system" and the City potentially gets both units and some funding towards the production of affordable units elsewhere. Importantly, this fee-in-lieu calculation must use the increment calculation approach as in this case, the City is not trying to incentivize a unit to be produced and using the production cost approach would be punitive, working against the goal of this section.

Student Housing and the Fee-in-lieu

Making a policy decision on how student housing will be addressed in the ADU program is essential where such housing is a significant component of new construction. The decision here

[2] See page 28, "Inclusionary Housing: Creating and Maintaining Equitable Communities"; Lincoln Institute of Land Policy.

is whether the City would prefer that student housing projects provide affordable units for students or pay the fee-in-lieu. There are pros and cons to each approach.

The ordinance as currently drafted includes a provision requiring student housing projects to provide affordable student housing. The draft is modeled on a program from Minneapolis. The benefit of this approach is that low-income students do not contribute to the displacement of low-income city residents from lower cost housing. On the other hand, a legitimate argument could be made that the University should be directly assisting such students in finding housing options. There is also some added complexity in monitoring these student affordable units and most student housing projects prefer the fee-in-lieu.

Where student housing is required to pay the fee-in-lieu, the benefit is that funding is available to support the creation of more affordable units. In this option, where the policy direction is not to create affordable units as part of student housing projects, the fee-in-lieu should be calculated using the increment approach. Where the City is not actively seeking an affordable unit, the production cost approach would be punitive.

Overall, it is not recommended that a non-student oriented affordable unit be required in specialized student housing projects.

Affordable Housing Bonus in the Residential Districts

Each of the Residential Districts includes an Affordable Housing Bonus of additional allowed units where all of the bonus units are affordable according to the standards of section 4.2.2. In R-A (and RN-A) the bonus allows a maximum of 6 units while R-B and R-C allow a maximum of 12 units. This allowance creates the opportunity for deed restricted affordable units in all neighborhoods of the City. As such projects would generally not be financially feasible as a stand-alone project, most development projects of this nature would involve an affordable housing developer utilizing some form of outside subsidy.

As noted above, the intent of this bonus is to create an opportunity. Staff acknowledges that projects using this bonus may be rare, but where this bonus does not exist, the opportunity for deed restricted affordable units at 60% AMI or less in the Residential Districts becomes much less. Because the bonus allows a project with a substantial amount of affordable housing to have greater density, it gives some competitive advantage to affordable housing projects over market rate projects, essentially boosting the land area competitively available for affordable housing development. The two significant factors limiting the development of deeply affordable housing are the availability of subsidies and the availability of land. The policy question becomes whether that opportunity outweighs concerns for 6 or 12 unit projects in these districts.

Conclusion

Staff looks forward to discussing the Affordable Dwelling Unit section of the Development Code and the different policy issues to be discussed. This section is central to the overall Cville Plans

Together effort. If there are further questions or issues Council would like to discuss, please email staff so that all may be prepared. James Freas, Director of NDS, Antoine Williams Housing Program Manager in the Office of Community Solutions, Kyle Talente, Principal with RKG Associates, and Sunshine Mathon, Executive Director of Piedmont Housing Alliance and a member of the Housing Advisory Committee will be present during the meeting to discuss the issues above and answer questions.

Attachments

Section 4.2.2. from the Council Hearing Draft dated November 7, 2023.

DRAFT Affordable Dwelling Unit Monitoring and Procedures Manual

City of Charlottesville Inclusionary Zoning Feasibility Analysis and Zoning Rate of Change Analysis, RKG Associates, August, 2023.

“Inclusionary Housing: Creating and Maintaining Equitable Communities”; Lincoln Institute of Land Policy. 2015.

4.2.2. Affordable Dwelling Units

A. Intent

1. To promote the creation and preservation of affordable housing suitable for meeting the current and future needs of the locality.
2. To ensure that any project choosing to include 10 or more residential units will implement the affordable housing goals of the adopted Comprehensive Plan and Charlottesville Affordable Housing Plan.
3. To provide an incentive for the development of residential projects of any size that implement the affordable housing goals of the adopted Comprehensive Plan and Charlottesville Affordable Housing Plan.

B. Applicability

1. Affordable Dwelling Unit Requirement

a. Any project exercising the option to build 10 or more residential dwelling units must provide affordable dwelling units that meet the standards of this Section, except projects that meet one of the following exemptions.

b. The following projects are exempt from providing required affordable dwelling units:
i. Projects with 9 or fewer residential dwelling units; and
ii. Projects in zoning districts Residential A (R-A), Residential B (R-B), or Residential C (R-C).

2. Affordable Dwelling Unit Bonus

The affordable dwelling unit bonus applies to any project where a developer chooses to meet the standards of this Section in order to receive a bonus to the maximum allowed dwelling units per lot and the maximum allowed building height.

C. Standards

1. General

All affordable dwelling units must meet the following requirements and the standards of the Affordable Dwelling Unit Monitoring and Procedures Manual:

a. Term of Affordability
i. For-rent affordable dwelling units must be income-restricted for a minimum of 99 years. Deed restrictions for affordable dwelling units must be recorded in the Charlottesville Land Records.
ii. For-sale affordable dwelling units must be sold to a qualified purchaser who earns 60% of the area median income or below. The dwelling unit must include a deed restriction granting the City of Charlottesville or a qualifying non-profit organization a right of first refusal to purchase the dwelling unit upon its first resale in accordance with the requirements of the Affordable Dwelling Unit Monitoring and Procedures Manual.

iii. When a project demonstrates the affordability goals of the Comprehensive Plan and Affordable Housing Plan and the intent of this Section are met, the Administrator may accept modifications to these requirements consistent with the guidance of the Affordable Dwelling Unit Monitoring and Procedures Manual.

b. Determining the Affordable Rent or For Sale Unit Cost
i. Rental units are to be priced to be affordable to a household having a gross annual

income at the required household income limit expressed in terms of the percent of AMI. Monthly housing costs, inclusive of rent, utilities, one parking space (where provided), and any other amenity cost, must not exceed 30% of the applicable household income limit. If utilities are separately metered, the maximum allowable rent will be reduced to reflect the tenant's payment of utilities. Maximum affordable rents based on Department of Housing and Urban Development (HUD) standards are provided in the Affordable Dwelling Unit Monitoring and Procedures Manual.
ii. For sale units are to be priced to be affordable to a household having a gross annual income at the required household income limit expressed in terms of the percent of AMI. The monthly housing costs, inclusive of mortgage principal and interest, private mortgage insurance, property taxes, condominium or homeowner's association fees, hazard insurance, and one parking space (where provided) must not exceed 30% of the applicable household income limit.
iii. For student housing rented by the bedroom, the per bedroom rent for units with two or more bedrooms, will be set to 60% of the affordable rent of an efficiency or 1-bedroom unit. Where utilities are separately metered, the utility allowance will be set at 60% of the utility allowance for an efficiency or 1-bedroom unit. For this section, student housing must use rental agreements that lease on a per bedroom basis and be located within 1/2-mile of the University of Virginia campus as determined by the Administrator.
iv. In the case of renters using a Section 8 voucher or other rental assistance program, the project may collect the fully allowed rental reimbursement amount even if the total rent for the unit exceeds the maximum allowable rent, so long as the household using the rental assistance is not paying more than 30% of the household's monthly income.

c. Equivalency of Units
i. Affordable dwelling units must reflect the composition of the overall project units in number of bedrooms, exterior appearance, and overall quality of construction.
ii. Affordable dwelling units must include the same interior features as the other units in the same building, but appliances and finishes need not be the same make, model, or style, so long as they are new and of good quality.
iii. Affordable dwelling units must be evenly distributed throughout the project and not concentrated on particular floors, building sides, or locations.
iv. Affordable dwelling units must be comparable in size to the other units with the same number of bedrooms. The average floor area of the affordable dwelling units must not be less than 80% of the average floor area of the other units with the same number of bedrooms.
v. All affordable dwelling units must have the same access to property amenities and building access points provided to other units.

d. Concurrency
Affordable dwelling units are required to be built concurrently and proportionally with other units in the project. If a project is to be built in phases, affordable dwelling units must be developed during each phase until all affordable dwelling units have been constructed.

e. Monitoring
All affordable dwelling units used to meet the requirements of this Section are subject to an annual monitoring requirement as detailed in the Affordable Dwelling Unit Monitoring and Procedures Manual.

2. Affordable Dwelling Unit Requirement

a. Any project where affordable dwelling units are required must meet one of the following standards, or a combination of both of the standards:
i. A project must provide 10% of all residential units to households at or below 60% AMI; or
ii. Instead of constructing all of the units on-site, the developer must pay an in-lieu fee to the City in the amount determined based on the construction cost of building an ADU, as determined by the City. The costs are provided in the Affordable Dwelling Unit Monitoring and Procedures Manual.

b. Fractional Units
i. If the calculation of the required number of affordable dwelling units to be provided results in a fraction of a unit greater than or equal to 0.5, the project must provide one affordable dwelling unit.
ii. If the calculation of the required number of affordable dwelling units to be provided results in a fraction of a unit less than 0.5, the project may provide an affordable dwelling unit or pay the in-lieu fee according to the formula described in the Affordable Dwelling Unit Monitoring and Procedures Manual. The amount of fee is reduced to correspond to the percent of a unit required.

c. Housing Choice Vouchers
i. For every 3 ADUs that are required, at least one of those units must be made available to a household receiving a housing voucher or other rental assistance program.

3. Affordable Dwelling Unit Bonus

Any project where the developer chooses to meet the following standards is allowed to use the bonus specified by the zoning district:

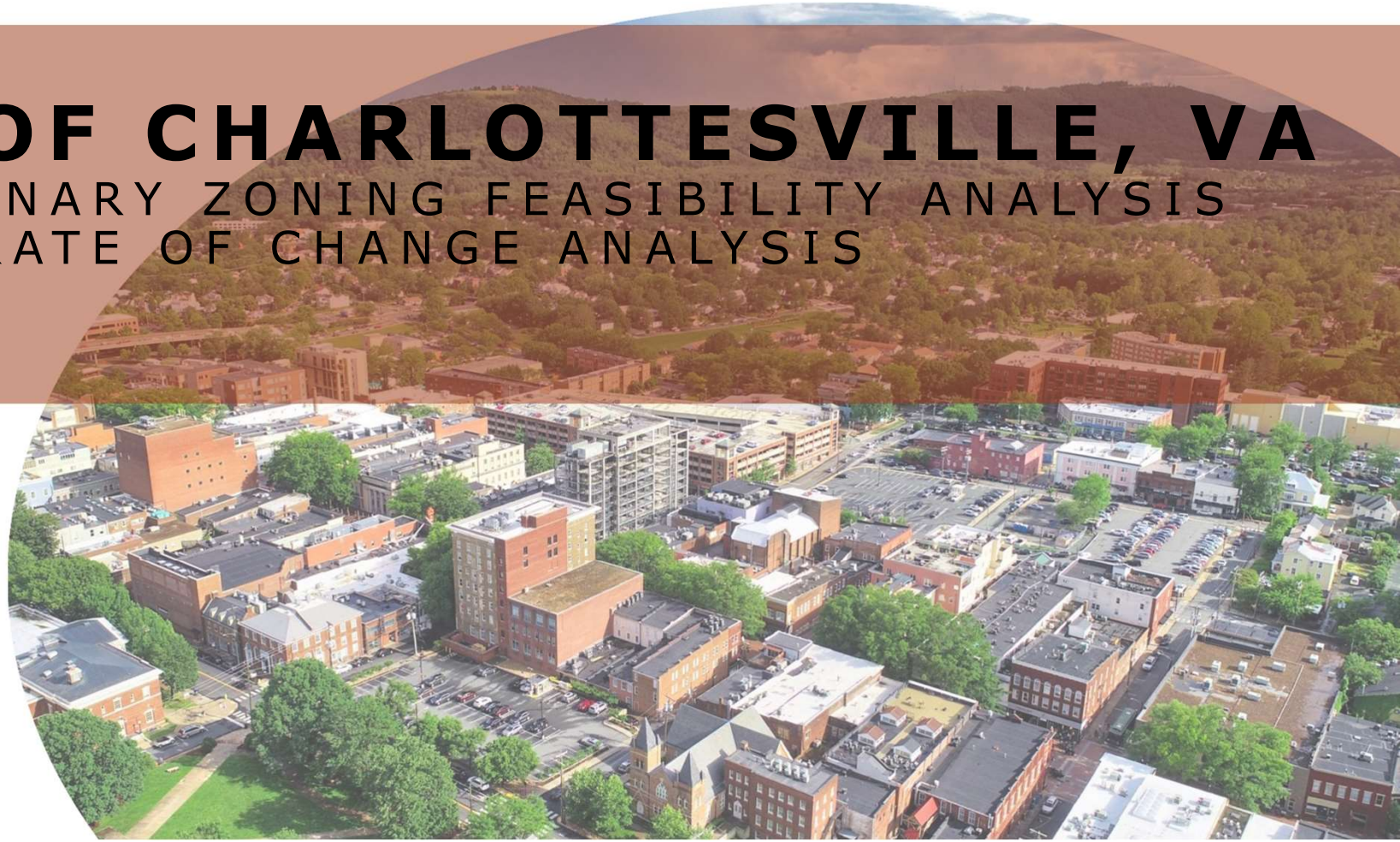
a. Bonus in Residential Districts
i. In Residential A (R-A), Residential B (R-B), and Residential C (R-C) zoning districts, a project must provide 100% of all bonus units to households at or below 60% AMI.

ii. When a project demonstrates the affordability goals of the Comprehensive Plan and Affordable Housing Plan and the intent of this Section are met, the Administrator may accept modifications to the equivalency of units and concurrency requirements in *4.2.2.C. Standards*.
iii. Projects in the Residential A (R-A) district are exempt from the equivalency of units and concurrency requirements in *4.2.2.C. Standards*.

b. Bonus in All Other Districts
i. In any zoning district other than Residential A (R-A), Residential B (R-B), and Residential C (R-C), a project must provide 10% of all residential units to households at or below 50% AMI or provide an in-lieu fee according to the formula described in the Affordable Dwelling Unit Monitoring and Procedures Manual.
ii. To qualify for the bonus height, a project must have a residential use for a minimum of 40% of the total floor area.

CITY OF CHARLOTTESVILLE, VA

INCLUSIONARY ZONING FEASIBILITY ANALYSIS
ZONING RATE OF CHANGE ANALYSIS



RKG ASSOCIATES INC

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INTRODUCTION

BACKGROUND

The City of Charlottesville is seeking to better understand the market and financial realities of its proposed zoning changes. Specifically, the City seeks to understand [1] the financial realities of its proposed inclusionary zoning (IZ) recommendation[1] to require projects with ten or more units to provide 10% of those units at a price point affordable to households earning 60% of the Area Median Income (AMI) and [2] the potential rate of change that may occur with the proposed R-A, R-B, and R-C zoning districts encouraged by the potential change in value due to the new zoning policies and allowances.

[1] Under Virginia law, and in Charlottesville's proposed zoning ordinance, an IZ program/ordinance is referred to as an Affordable Dwelling Unit (ADU) program/ordinance. This report will use the term IZ.

PROCESS - ANALYSIS

The model enables the City to test a series of prototypical developments to understand the financial implications of the proposed zoning ordinance changes.

For the IZ policy analysis, RKG tested specific scenarios and development typologies to determine the relative financial feasibility impact in relation to current market conditions, the proposed IZ policy, and the proposed bonus density recommendation (an additional two floors of housing in exchange for a 10% unit set-aside at 50% of AMI). RKG modeled projects in five distinct subareas of the City, defined through empirical and market analysis, to test potential changes across the city's unique housing submarkets.

For the rate of change analysis, RKG modeled different development programs across four unique subareas for each zoning category (R-A, R-B, and R-C) including an assessment of the proposed bonus density recommendation (additional units in exchange for making 100% of the units price controlled to a maximum of 60% AMI).

The importance of this analysis cannot be understated, as setting the appropriate parameters for any residential zoning ordinance is key to ensuring housing development accommodates various income levels across the city while minimizing impact on future development activity.

PROPOSED IZ POLICY

SET ASIDE

Projects including more than 10 units are required to designate 10% of the total number of units on-site as income controlled. Any fractional units (e.g., an 11-unit development would require 1.1 income-controlled units) is required to round up to the next whole unit (2 units in this case).

AMI

All income-controlled units are required to be priced affordably (pay less than 30% of gross income less utility allowances) for households earning 60% of Area Median Income (AMI).

BONUS DENSITY

Projects willing to commit to a 10% set aside at 50% of AMI would be entitled to two additional floors of residential development. This is contingent on meeting the other site requirements (e.g., setbacks).

PAYMENT IN LIEU

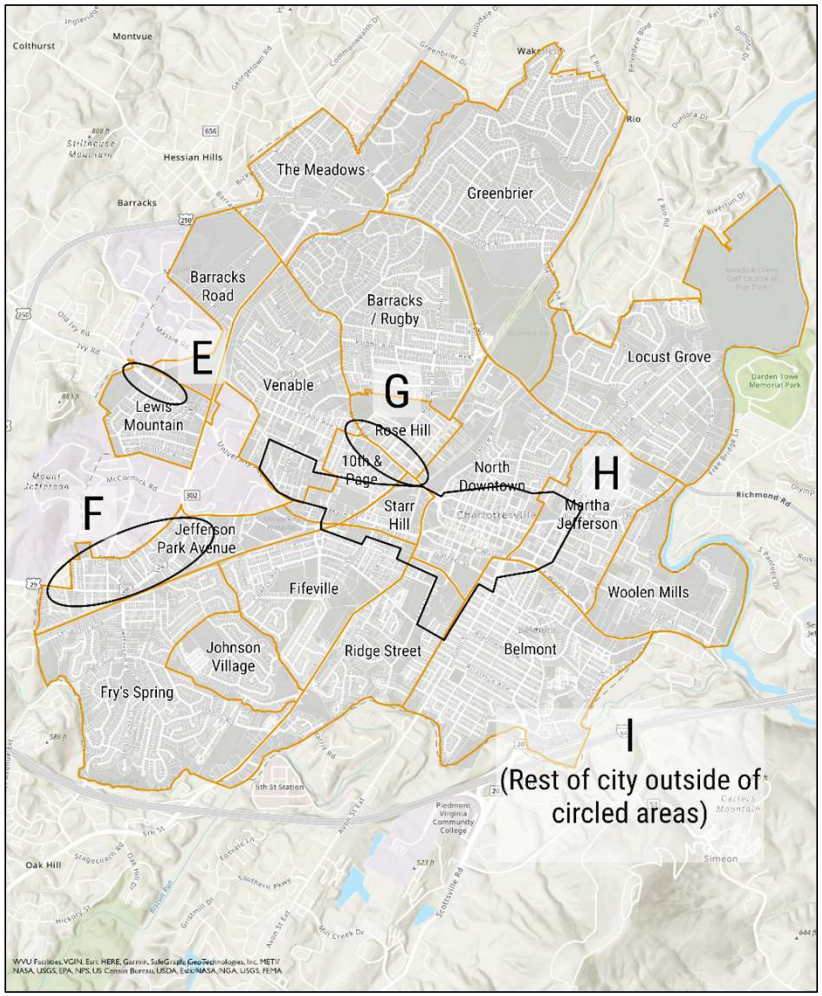
Developers have an option to provide a financial contribution to the City's Housing Trust Fund in lieu of providing on-site units. The current proposed payment in lieu (PIL) values are:

Unit Type	Rental Units	Owner Units
Studio Units	$195,000	N/A
1-Bedroom Units	$260,000	$165,000
2-Bedroom Units	$360,000	$230,000
3-Bedroom Units	$405,000	$435,000

SUBAREA BOUNDARY MAP
INCLUSIONARY ZONING

RKG Associates research indicates that multifamily rental income performance varies within the City. Most notably, zoning districts located closest to downtown Charlottesville achieve the greatest rental incomes (on a per square foot basis) than other areas of the City. Areas denoted as “E” and “F”, proximate to the University of Virginia, have the next highest rent capture. Area “I”, effectively rental zones in the rest of the City, have the lowest rent capture in the City.

To this end, the analysis separated these areas to better understand the financial feasibility calculations for rental properties. In effect, the assessment measures whether the proposed zoning changes vary based on location in Charlottesville.



PROPOSED RESIDENTIAL POLICY

ZONING DISTRICTS

The proposed zoning allocates former single-family districts into three distinct districts called R-A, R-B, and R-C. Each district has its own regulations regarding building mass, setbacks, etc.

R-A

Properties located in the R-A district are allowed to have up to three dwelling units if the lot is vacant or the existing structure is removed. As a bonus, R-A parcels can accommodate four units if the existing dwelling is preserved and the new structure can abide by development requirements. A different bonus of six units is being considered, with all six units being required to be priced for households earning at 60% AMI.

R-B AND R-C

Like R-A, the rules for maximum number of units are determined by whether development is new, infill, or redevelopment. A similar bonus density for affordability also is available.

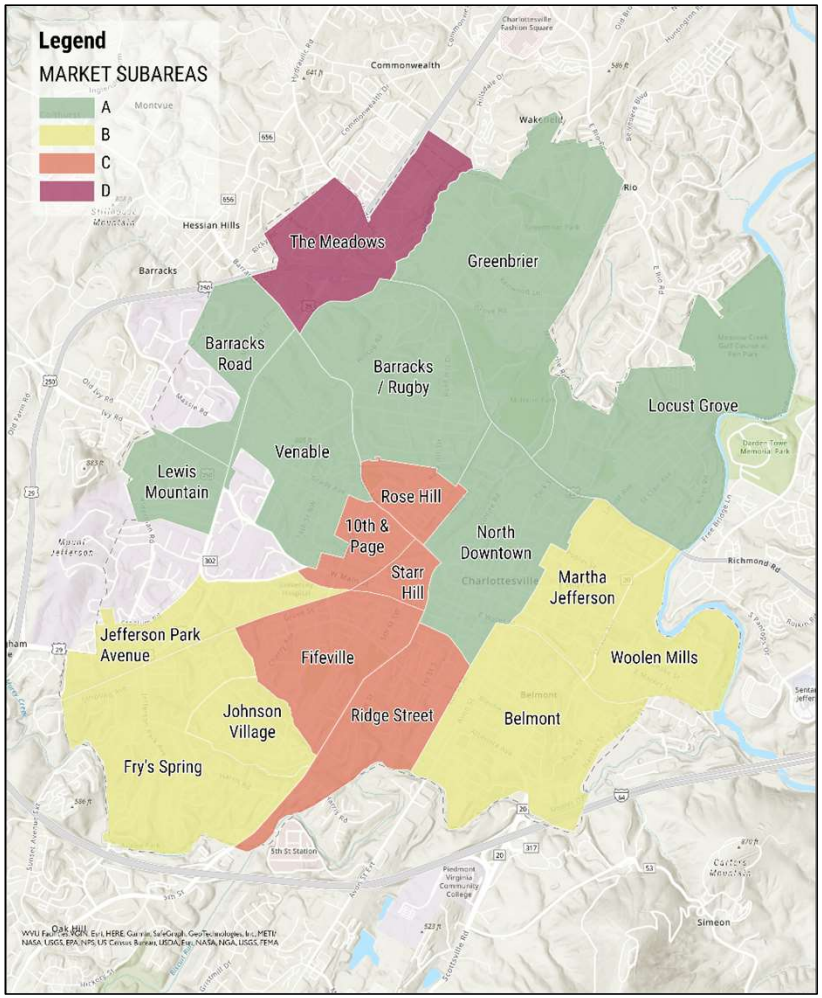
The following table details the maximum for each zoning district.

Zoning District	Maximum Units Demolition	Maximum Units Infill	Maximum Units 100% Affordable
R-A District	3	4	6
R-B District	6	8	12
R-C District	8	8	12

SUBAREA BOUNDARY MAP
RATE OF CHANGE

Like the rental analysis, RKG Associates research indicates that homeownership values vary within Charlottesville. RKG used the City's established neighborhood boundaries to create four distinct subareas for assessment. Area "A", locates in the northern part of the City, has the highest housing values (per square foot) for new construction units. Area "B" follows area "A". The historically African-American neighborhoods near downtown and The Meadows have the lowest home values, on average.

These differences are important to analyze separately for the Rate of Change analysis, as the value created by allowing 3-unit (R-A), 6-unit (R-B) and 8-unit (R-C) structures on previously single-family lots will impact the potential for speculation much differently based on potential value creation and existing home values.



METHODOLOGY

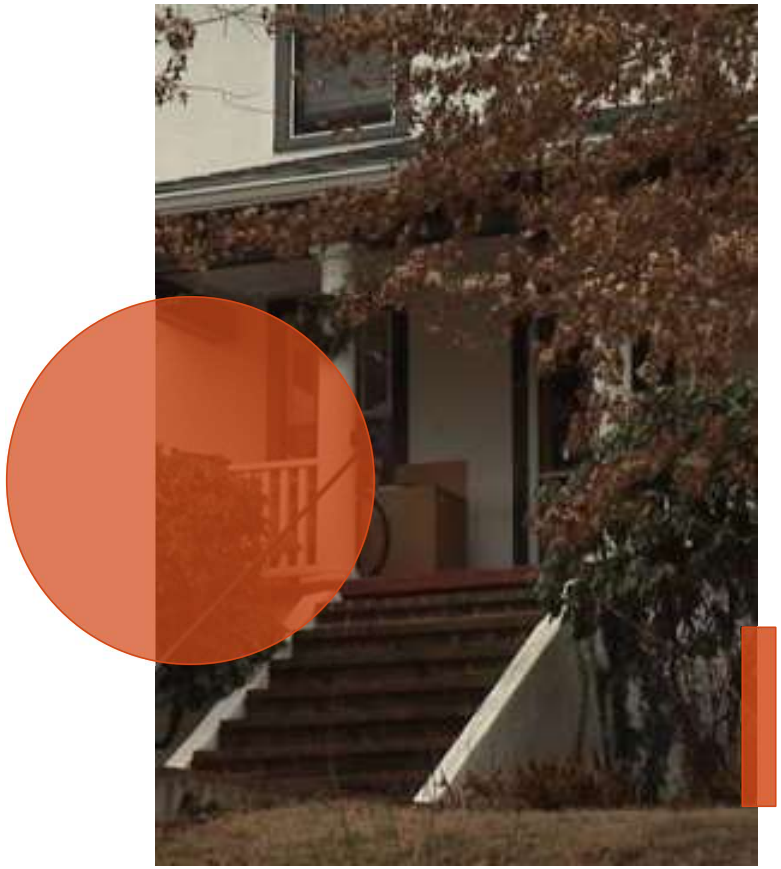
METHODOLOGICAL OVERVIEW

THE FINANCIAL FEASIBILITY MODEL IS A PROFORMA-BASED EXCEL MODEL THAT IS DESIGNED TO TEST THE FINANCIAL IMPACT OF POTENTIAL POLICY CHANGES AGAINST THE FINANCIAL RISK/REWARD OF A POTENTIAL INVESTMENT.

RKG's financial feasibility model uses locally-sourced data to determine how changes to Charlottesville's zoning code (both the Inclusionary Zoning component and the transition from traditional single-family designations) could impact the financial performance of a potential project. At its most basic level, the model is designed to capture construction and operational costs and compare those to potential revenues to determine if the project will meet or exceed local return expectations.

The model has the capability to test variations across nearly all data points to test the sensitivity of dozens of variables on financial feasibility. This includes variability in construction costs, land costs, operational costs, development type and size, location within the City, and more. The model is also set up to test changes in affordability metrics such as the percentage of affordable units, target AMIs, unit thresholds, and more.

While the model is a powerful tool to understand the impacts of changes to the zoning code and the sensitivity of modifying assumptions, it is not intended to be the only analytic or policy tool the City of Charlottesville should consider as it weighs changes to its zoning policies.



METHODOLOGY
MODELING INPUTS

All financial feasibility modeling is based upon three principal components: construction costs, operational revenues, and operational costs. Each component relies upon several market-based and financial inputs for the model to be effective.

RKG Associates' approach to model building focuses on using locally-derived inputs so that findings are relevant to the community/study area being considered. To this point, RKG conducted a comprehensive analysis of all facets of financial feasibility of residential development in the City of Charlottesville.

The primary inputs for which local data was derived include, but is not limited to:

Construction Costs
- Soft costs – design and preparation
- Hard costs – materials and construction
- Land costs – physical location

Operation Costs
- Financing costs – debt and equity to pay for the project
- Marketing, management, repairs, property taxes

Operational Revenues
- Rental rates and sale prices
- Parking revenue

METHODOLOGY
CONSTRUCTION COSTS

To determine hard costs for construction and parking, RKG interviewed several for-profit and non-profit developers, as well as referencing Marshall & Swift Valuation Services data to build out customized per square foot construction costs for stick, stick over podium, and steel frame construction typologies.

Similarly, RKG collected information on construction costs for two types of parking costs: surface lots and structured podium parking.

Lastly, a land cost analysis was conducted by RKG on recently completed residential projects to understand the land price per unit developers have paid. RKG used interview data from for-profit and non-profit developers to verify the research.

METHODOLOGY
OPERATIONAL COSTS

Development financing is possibly the most important element of any real estate deal. Different types of financing are available depending upon the scale of the project.

Through interviews with for-profit and non-profit developers, RKG gained an understanding around debt, operational costs, and vacancy assumptions used in developer proformas.

Additionally, information on financial return expectations was obtained and used as a benchmark for the financial feasibility model to understand the impact policy changes may have on a projects financial return metrics.

METHODOLOGY
REVENUES

RKG collected rental rate data for residential projects completed since 2018, which included pricing for efficiency (studio), one-bedroom, two-bedroom, and three-bedroom apartments.

The market rental rates were used as a baseline for the analysis and compared to information obtained from developer interviews.

The sales values of housing units were determined through a combination of market research and utilizing the City's property sales database to parse the most recent sales values by bedroom count.

The results were used to set baseline assumptions around sale prices in the model.

MODELING INPUTS

DEVELOPMENT ASSUMPTIONS
HARD AND SOFT COSTS

Hard construction costs vary by building construction type:

- Stick
- Stick over podium
- Steel
- Ownership (Condo and TH)

Soft costs average around 15% of hard costs.

Parking is expensive, ranging from an average of $22,000 per space for surface parking to $50,000 per space for structured parking

Construction Assumptions

Hard Construction Costs (PSF)	Apartment	Condo/Townhouse
Stick	$230	$175
Stick Over Podium	$300	N/A
Steel Frame	$400	N/A

Soft Costs (% of Hard Cost)	
Soft Costs	15.00%

Parking Costs (Per Space)	
Surface	$22,000
Structured Aboveground	$50,000
Structured Belowground	$100,000

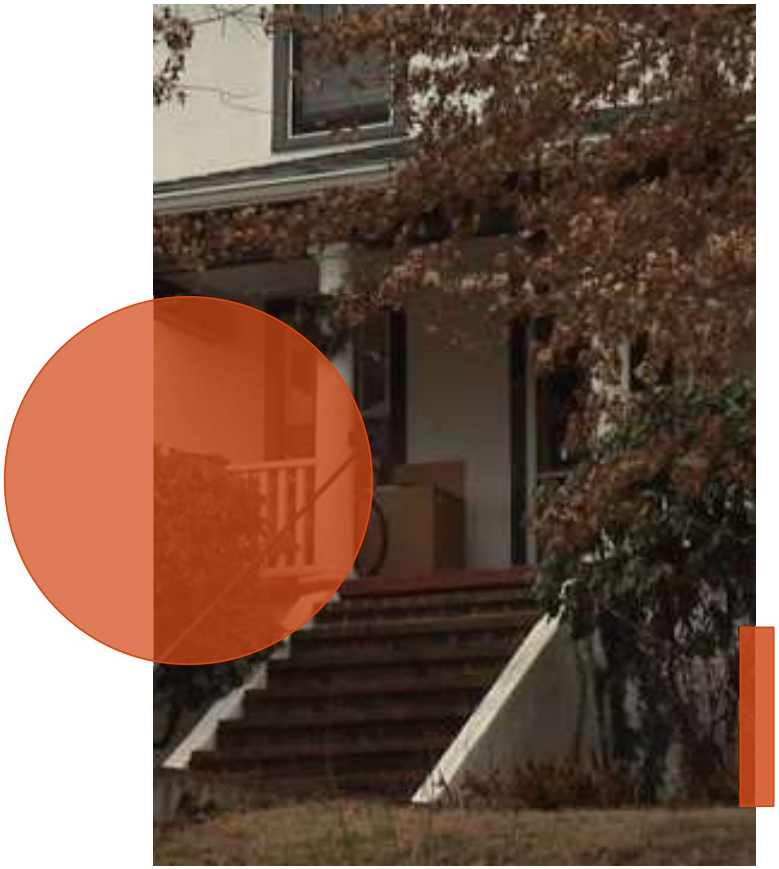
Note: Values are based on data collected from stakeholders.

OPERATING EXPENSES

Operating expenses are the cost of a property owner to market, maintenance and manage a rental property.

Operating costs do not vary for market rate or income-controlled units, as costs do not change dramatically based on a tenant.

Vacancy and collection loss for new construction projects are consistent throughout Charlottesville, with most impacts reflecting turnover (time between tenant occupation).



Operating Expenses (As a % of Rental Revenue)	
Operating Expenses (Market Rate)	25%
Vacancy & Collection Loss	5%

Note: Values are based on data collected from stakeholder interviews.

Source: Developer Interviews, RKG Associates, 2022

DEVELOPMENT ASSUMPTIONS FINANCIAL

Changing interest rate environment makes financing a project more difficult. Recent increases in interest rates have adversely impacted new development

Larger developers can attain better rates than smaller developers.

Equity requirements average around 20%

Developer returns vary depending on the type of metrics they use, with owner development and renter development having different metrics.

Financial Assumptions

Financing Costs	
Interest Rate	6.00%
Equity Required	20%

Expected Financial Return	Average
Internal Rate of Return (Rental)	12.00%
Internal Rate of Return (Ownership)	20.00%
Return on Cost	5.50%

Note: Values are based on data collected from stakeholder interviews.

REVENUE ASSUMPTIONS
OWNERSHIP SALE PRICES PER SF

RKG used the City's property assessment database and Multiple Listing Service (MLS) data to analyze sales prices by neighborhood for new construction product built in the last five years.

Sales prices varied substantially, with the more traditional suburban area of the City (Area A) commanding the highest prices per square foot.

Price differential between new construction and existing stock is substantial.

Neighborhood	Condominiums	Townhomes
Area A	$570	$325
Area B	$370	$285
Area C	$300	$255
Area D	$300	$255

Note: In cases where data points were unavailable, RKG is showing the average price of the City adjusted to the study area
Source: RKG Associates, 2023

REVENUE ASSUMPTIONS
MARKET RATE RENTS PER SF

RKG conducted a market survey using online databases and information provided by multifamily developers/operators to analyze rents by neighborhood for new construction product built in the last five years.

Based on interviews with developers, rent on new product is generally priced at a premium between 10% and 15% above the market. The financial feasibility analysis accounts for this.

Neighborhood	Studio	1BR	2BR	3BR
Area E	$2.75	$2.90	$2.50	$2.10
Area F	$2.75	$2.90	$2.50	$2.10
Area G	$3.00	$3.10	$2.90	$2.40
Area H	$3.00	$3.10	$2.90	$2.40
Area I	$2.40	$2.45	$2.35	$2.00

Note: In cases where data points were unavailable, RKG used the average price for the City adjusted to the that study area
Source: RKG Associates, 2023

MODEL OUTPUTS

THE CORE FUNCTION OF THE IDP MODEL IS TO UNDERSTAND HOW CHANGES IN POLICY IMPACT FINANCIAL RETURNS COMPARED TO MARKET EXPECATATIONS.

FINANCIAL ANALYSES

The model measures three financial outcomes using three different metrics; Return on Cost (ROC), Internal Rate of Return (IRR), and Land Values. Each measure represents a decision point for those involved in the transactions that make residential development financially feasible:

- ROC – Investors/Developers
- IRR – Developers/Operators
- Land Values – Property Owners

For a project to move forward, each group must have confidence that their investment requirements and return expectations can be met. Each group is measuring the risk/reward of a given project compared to other opportunities that may be in Charlottesville, elsewhere in Virginia, or in other markets across the United States.

It is important to recognize that for a project to move forward, it requires support from all three groups.

PROJECT EXAMPLES

To test the financial implications of the Inclusionary Zoning policy, the model was constructed with data local to different subareas across the City recognizing that revenue assumptions vary depending on where a project is located.

To highlight these differences, this report provides examples of how different development and location assumptions can impact financial feasibility including:

- Selected neighborhoods that have varying development typologies and market factors (e.g., price points)
- Impacts of smaller (25 units) and larger (200 units) projects in each study area
- Using different development assumptions based on project size and location

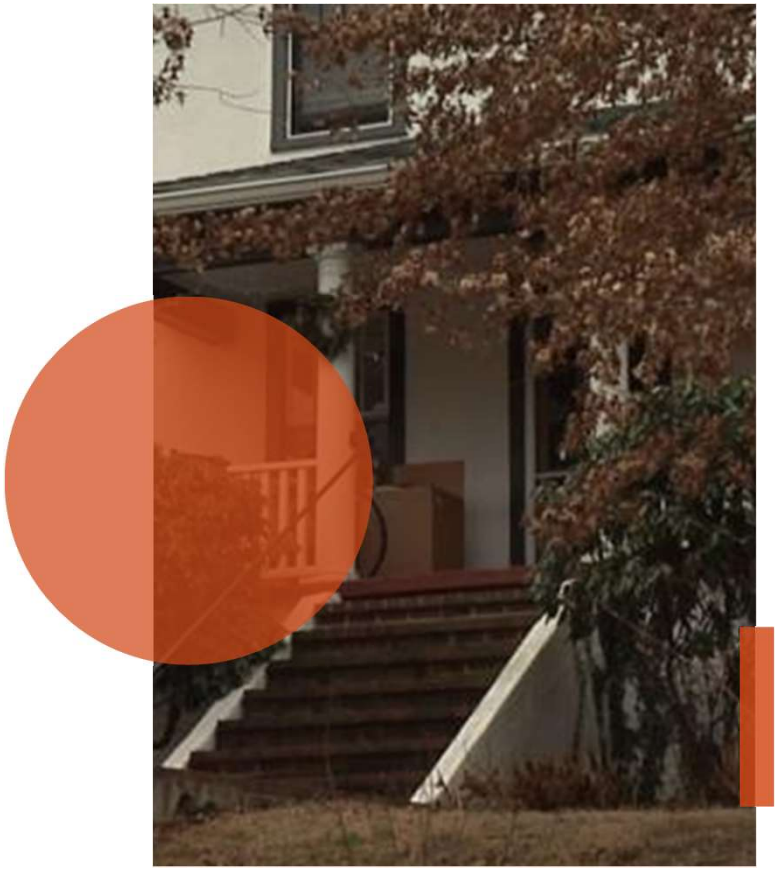
IMPLICATIONS

THE FINANCIAL FEASIBILITY MODEL IS LIMITED BY ITS INPUTS.

Given the complexity of development projects in diverse communities like Charlottesville, it is difficult to model every possible nuance or special situation that may create unique outcomes for a project. This particularly true for legacy-owned parcels and student-targeted development. To this point, this model uses averages and typical development scenarios based on recent development trends. The model is sensitive to changes in these underlying assumptions, so in the future if costs and revenues deviate from normal averages, we may anticipate outcomes in the model to change as well.

FINANCIAL PERFORMANCE IS JUST ONE FACTOR IN THE DECISION-MAKING PROCESS OF DEVELOPERS.

It is important to acknowledge that the financial performance of a project is one of many factors developers and investors consider when looking at a deal. Developers also assess project risk and feasibility based on ease of process and permitting, flexibility in zoning, location and amenities, strength of the market, and strategic value. Given the variability and difficulty of assessing all these additional factors, the model focuses primarily on the financial aspects of the project.



INCLUSIONARY ZONING ANALYSIS

INCLUSIONARY ZONING ANALYSIS

The financial feasibility analysis conducted by RKG provides key insights regarding the relative impact on financial feasibility resulting from the proposed Inclusionary Zoning (IZ) policy.

To that end, RKG modeled multiple prototypical development scenarios by calibrating the model with market-tested assumptions and tested the findings against real world examples.

The financial model calculates the basic go/ no-go decision a developer must make about a potential project. The decision to pursue a project comes down to overall financial return and risk exposure.

The model tests Internal Rate of Return (IRR) and Return on Cost (ROC) metrics. The rental analysis focuses on the IRR metric, as it was proven to be the most difficult to reach market return expectations (noted through feedback to currently be 15% preferred, 12% minimum).

The market scenario analysis provides an assessment of how a project would perform (financially) based on market averages for acquisition, construction, operation, and reversion.

The analysis presents the performance of projects when using the proposed set aside rate (10%) at the proposed Area Median Income (AMI) target rate of 60%.

RKG tested the development feasibility across several scenarios testing project size (number of units), construction typology (wood frame, podium), and proposed policy conditions (bonus density).

While the following pages detail the results, the universal implication is that the greater the set-aside requirement and lower target AMI, the greater the financial strain on a development project.

WOOD FRAME CONSTRUCTION

Multifamily rental development in areas E, F, G, and H are financially feasible under the proposed IZ policy guidelines (10% unit set aside at 60% of AMI) for projects that can be built using wood-frame construction (less than 5 floors total). While the IZ policy reduces the IRR, the project remains above the 12% minimum threshold.

Areas G and H perform better given their higher rent rates than Areas E and F. To this point, these areas could support up to a 15% set aside at 60% AMI and remain financially feasible.

The proposed bonus density strategy also works if the development can remain below 5 stories (e.g., in MX-3).

For Area I, multifamily development is not feasible due to the much lower rental rates captured in this area. The data indicate a development would require a lower price point for land (identified as $40,000 per unit) to reach the target threshold.

IRR	Market Rate Development			
	10 Units	25 Units	50 Units	100 Units
Area E/F	14.7%	14.5%	14.7%	14.7%
Area G/H	18.8%	18.7%	18.8%	18.8%
Area I	11.0%	10.9%	11.0%	11.0%

IRR	Proposed IZ Policy (10% at 60% AMI)			
	10 Units	25 Units	50 Units	100 Units
Area E/F	14.0%	12.4%	12.8%	12.5%
Area G/H	18.3%	16.2%	16.7%	16.3%
Area I	10.8%	9.1%	9.4%	9.0%

IRR	Bonus Density (10% at 50% AMI with 2 Floors)			
	10 Units	25 Units	50 Units	100 Units
Area E/F	12.5%	11.8%	12.3%	12.1%
Area G/H	16.4%	15.7%	16.3%	16.0%
Area I	9.4%	8.4%	8.9%	8.7%

PODIUM CONSTRUCTION

Transitioning from wood frame construction ($230 PSF) to podium construction ($300 PSF) without any appreciable increase in revenue creates substantial financial hardship for new multifamily development in Charlottesville.

This also holds true for projects that want to use the bonus density feature that will require them to switch from wood frame construction (5 stories) to podium construction (7 stories). Effectively, the cost of construction increase will render the taller development infeasible.

The analysis for steel-frame construction ($400 PSF) has similar, albeit worse, results for development feasibility.

Anecdotally, the cost of construction for buildings over 5 stories has reached a point where even student-targeted rental housing—which generates substantially higher PSF rent levels than more traditional rental developments—currently is not financially feasible without some mitigating cost offset (e.g., lower land prices).

IRR	Market Rate Development			
	10 Units	25 Units	50 Units	100 Units
Area E/F	5.3%	5.1%	5.3%	5.3%
Area G/H	9.9%	9.7%	9.9%	9.9%
Area I	0.8%	0.6%	0.8%	0.8%

IRR	Proposed IZ Policy (10% at 60% AMI)			
	10 Units	25 Units	50 Units	100 Units
Area E/F	4.6%	2.7%	3.0%	2.6%
Area G/H	9.1%	7.2%	7.5%	7.1%
Area I	0.4%	-1.6%	-1.4%	-1.9%

IRR	Bonus Density (10% at 50% AMI with 2 Floors)			
	10 Units	25 Units	50 Units	100 Units
Area E/F	3.0%	1.8%	2.5%	2.2%
Area G/H	7.6%	6.5%	7.1%	6.9%
Area I	-1.1%	-2.8%	-2.0%	-2.3%

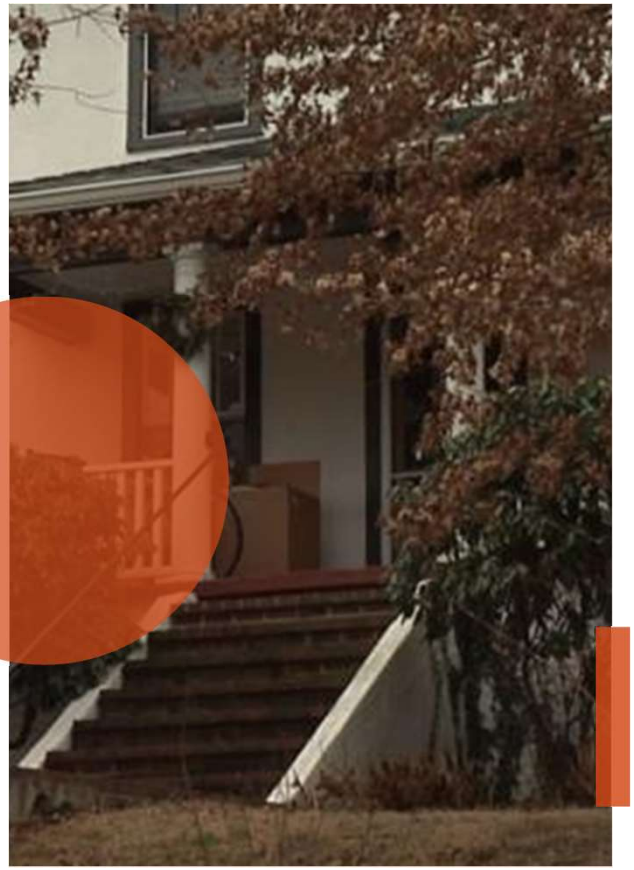
IMPLICATIONS

The proposed Inclusionary Zoning policy is appropriate in the City's traditional rental development areas.

The modeling indicates that requiring 10% of units at 60% of AMI is financially feasible in the areas surrounding Downtown, UVA, and along Route 29 (Area E). While the policy does have a slight negative financial impact on projects, the analysis indicates wood frame projects within Areas E, F, G, and H remain financially feasible.

The Downtown area could support greater affordability requirements.

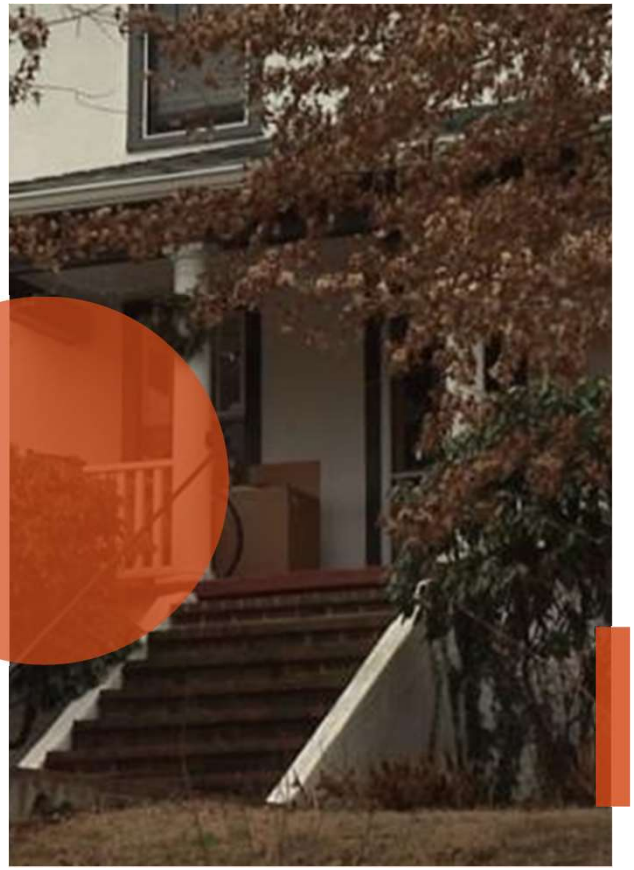
Due to the higher rent thresholds achieved in Areas G and H, the analysis indicates these areas could support a set aside rate of 15% and maintain financial feasibility (based on current conditions). Effectively, the higher rent capture can support a larger affordability requirement (either higher set aside or a lower AMI at 10% set aside). This would require the City to establish a tiered IZ policy based on location within Charlottesville.

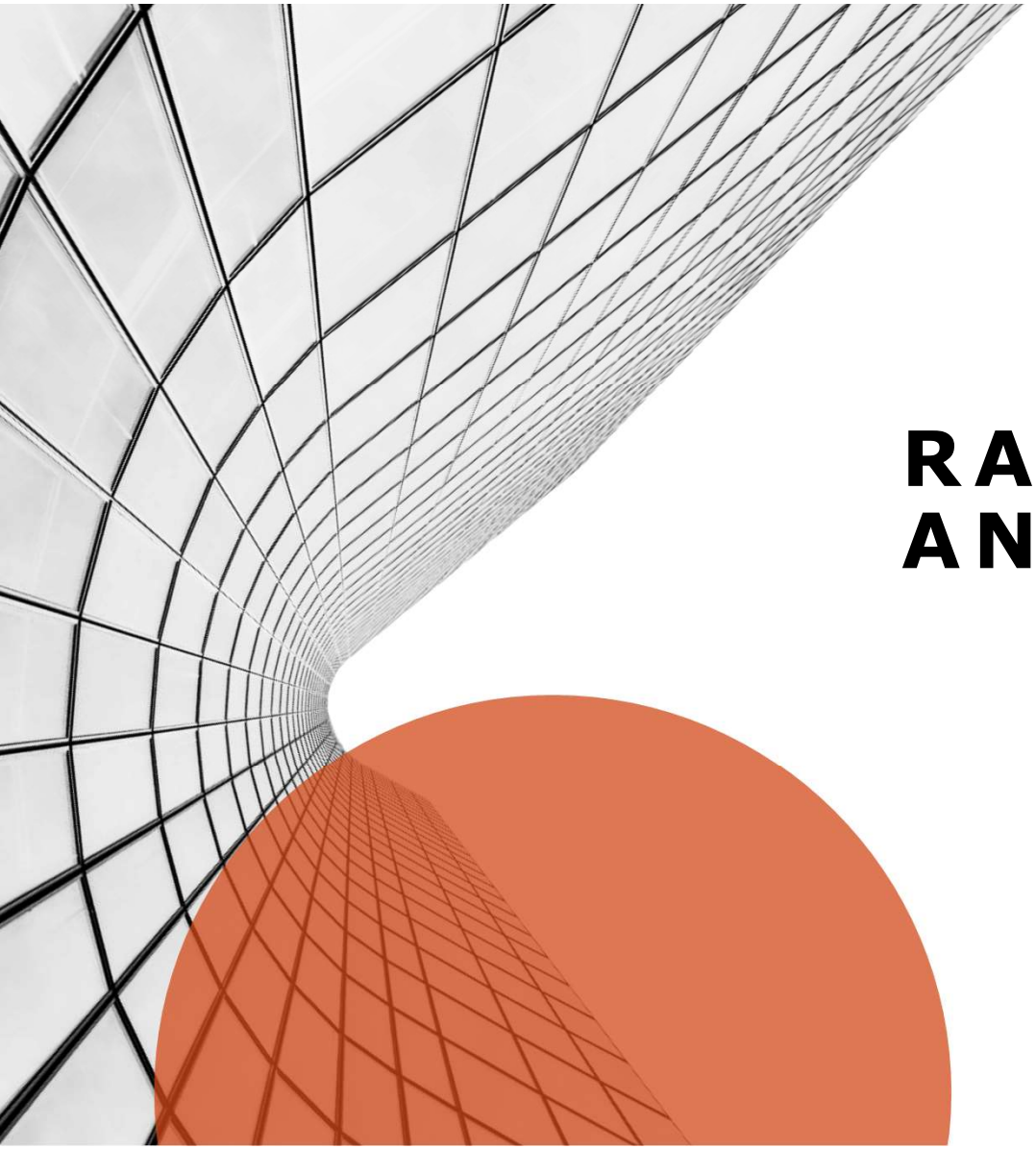


IMPLICATIONS

Concrete and steel construction is not supportable.

As noted, the cost differential for concrete and steel construction is prohibitively high in Charlottesville based on the likely revenue capture. In effect, the cost of buildings has exceeded the rent capacity for most projects. While RKG recognizes that specialty projects (e.g., senior care) that command much higher rent levels than a 'traditional' rental project could succeed, the average multifamily project is infeasible under current market conditions without some cost or revenue intervention.





RATE OF CHANGE ANALYSIS

RATE OF CHANGE ANALYSIS

The City is considering revamping its single-family (SF) zoning designations to allow for small, multi-unit structures. The proposed policy realigns the code into the zones R-A, R-B, and R-C. The introduction section details the maximum unit allowances in these areas *if the parcel can accommodate the other policy requirements (e.g., property setbacks).*

As part of this assessment, the City leadership requested that an updated analysis be done to determine the potential rate of change—or likelihood that an owner/investor will want to convert a single-family dwelling parcel into a multi-unit dwelling parcel—within these differing zones.

The rate of change analysis was performed in two phases

The first effort was to determine the value of a parcel to an investor/owner interested in executing on the multi-unit option. This effort uses the financial feasibility model to determine feasibility through isolating the land value. In short, the financial feasibility model provides a likely value that the typical parcel within R-A, R-B, and R-C would attract from a multi-unit investor.

The second effort is identifying how many parcels within R-A, R-B, and R-C that are valued below these new value thresholds and therefore would potentially be sold for infill (maintaining the existing unit) or redevelopment (demolishing the existing unit).

Like the IZ analysis, the rate of change analysis separated Charlottesville into four submarkets due to the value differential of the typical SF house.

DEMOLITION SCENARIO

The first scenario follows the base zoning where the existing structure is demolished and replaced with the maximum number of units (R-A is 3, R-B is 6, R-C is 8).

For Area A, the land value is strongest for an ownership development, consistent with the valuation and rent threshold data presented earlier in the document. Effectively, Area A has a much stronger ownership market than it does a rental market.

For Area B, valuation is higher as a rental development than if it was sold for an ownership development.

For Areas C and D, rental income thresholds are much higher than ownership unit values, making a redevelopment that includes rental units as more valuable to a potential investor.

These projected values are then compared against existing property values within each subarea within each of the proposed zoning district boundaries.

LAND VALUE	Rental Replacement Units		
	R-A	R-B	R-C
Area A	$271,826	$525,322	$702,228
Area B	$338,341	$658,351	$885,434
Area C/D	$446,298	$874,266	$1,160,294

LAND VALUE	Condominium Replacement Units		
	R-A	R-B	R-C
Area A	$848,698	$1,276,735	$1,702,313
Area B	$170,013	$362,995	$483,993
Area C/D	$56,300	$121,744	$162,324

INFILL SCENARIO

The second scenario follows the base zoning where the existing structure is retained, and additional units are built in an adjacent/adjoining structure. The maximum number of units for these scenarios are one higher for R-A and R-B. R-C is not proposed to offer an additional unit for retaining the existing structure.

Land values increase in zoning districts R-A and R-B accordingly due to having an additional revenue unit and eliminating the demolition costs (however, rehabilitation costs are considered).

This scenario would create greater value for an investor/developer.

LAND VALUE	Rental Replacement Units		
	R-A	R-B	R-C
Area A	$506,069	$702,228	$702,228
Area B	$588,921	$885,434	$885,434
Area C/D	$745,891	$1,160,294	$1,160,294

LAND VALUE	Condominium Replacement Units		
	R-A	R-B	R-C
Area A	$851,157	$1,702,313	$1,702,313
Area B	$241,997	$483,993	$483,993
Area C/D	$81,183	$162,325	$162,325

AFFORDABLE BONUS SCENARIO

The current zoning allows for an affordable housing bonus density that increases the maximum number of units of 100% of the units are income-controlled at 60% of AMI. The analysis shows that requiring 100% affordability at 60% of AMI renders all land valueless and would even require additional subsidy above getting the land for free.

LAND VALUE	Rental Replacement Units		
	R-A	R-B	R-C
Area A	($25,497)	($349,004)	($349,004)
Area B	($25,497)	($349,004)	($349,004)
Area C/D	($25,497)	($349,004)	($349,004)

RKG ran the analysis assuming only 50% of the units would have to be income controlled. It produced the following land values for a rental project (Areas E and F). Area G and H are slightly higher, while Area I is lower. Ownership projects still would create a negative land value

- R-A = $256,152
- R-B = $259,681
- R-C = $512,304

LAND VALUE	Condominium Replacement Units		
	R-A	R-B	R-C
Area A	($512,824)	($1,016,413)	($1,016,413)
Area B	($512,824)	($1,016,413)	($1,016,413)
Area C/D	($512,824)	($1,016,413)	($1,016,413)

UNIT VALUATION

The second step is to identify those parcels with a current value below the likely market valuation for each property based on the new zoning allowances in R-A, R-B, and R-C.

Based on the proposed boundaries for R-A, R-B, and R-C, there are 11,763 parcels located within these proposed designations.

	R-A	R-B	R-C	Total
Area A	3,236	774	129	4,139
Area B	3,697	842	544	5,083
Area C/D	2,082	210	249	2,541
Total	9,015	1,826	922	11,763

RKG Associates then parsed these parcels based on their current market value in comparison to the maximum value created by the rezoning for each subarea and each zoning group. The allocation was as followed

- Those valued at or above the created value
- Those 0% to 25% less than the created value
- Those 25% to 50% less than the created value
- Those more than 50% less than the created value

UNIT VALUATION

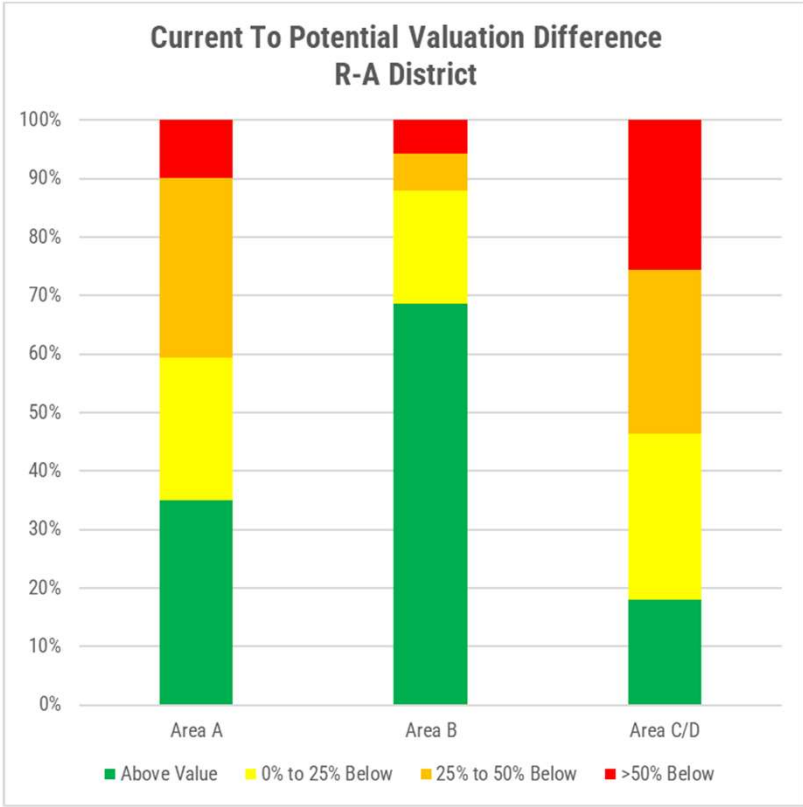
Parcels within Areas C and D (the sensitive neighborhoods within Charlottesville) have a much lower existing value compared to the potential value, on average. This means these parcels are more likely to be purchased for infill/redevelopment into market rate rental/ownership housing than Area A and Area B.

Based on the data analyzed for this effort, Areas C and D are 1.5x as likely to change than Area A and more than 4-times more likely to change than Area B. Based on consumption patterns, the rate of change in zoning district R-A for each Area is:

Area A – 2.22% annually (72 parcels annually)

Area B – 0.79% annually (29 parcels annually)

Areas C/D – 3.36% annually (70 parcels annually)



UNIT VALUATION

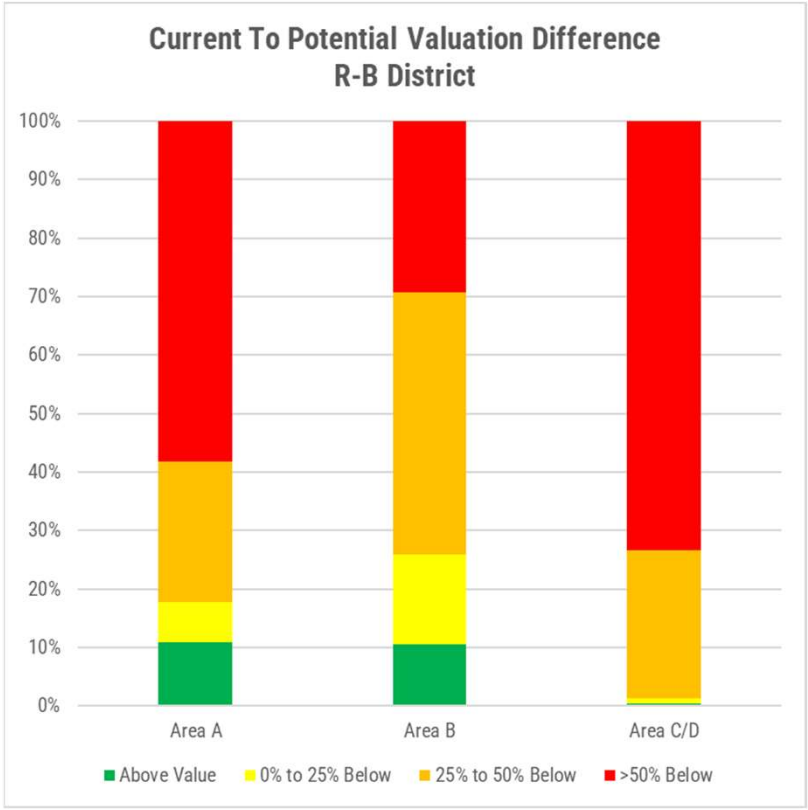
For zoning classification R-B, the additional allowed housing units create higher residual land values for redevelopment. As a result, the number of parcels where the new zoning will create a higher value than as the current use has gone up. As a result, the rate of change for R-B is much higher (4.39% annually to 7.00% annually) than in the R-A district.

Like the R-A analysis, the relatively higher land values in Areas A and B result in a comparatively lower rate of change Based on consumption patterns, the rate of change in zoning district R-B for each Area is:

Area A – 5.76% annually (45 parcels annually)

Area B – 4.39% annually (37 parcels annually)

Areas C/D – 7.00% annually (15 parcels annually)



UNIT VALUATION

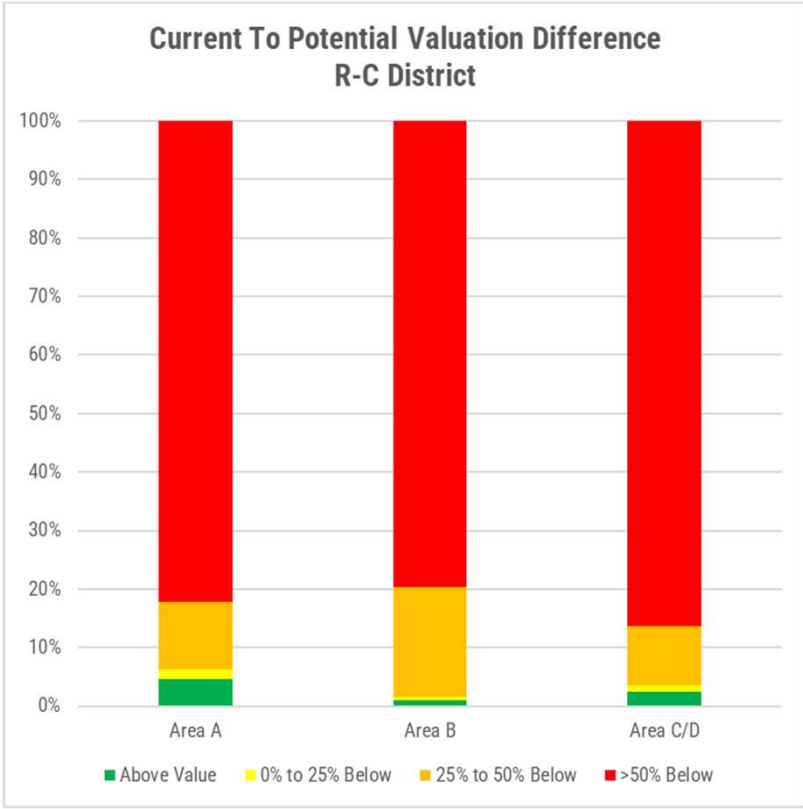
Allowing eight units by right on parcels previously used as single-family lots creates substantial market value (as rental or ownership). As a result, more than 80% of parcels in zoning classification R-C will become substantially more valuable for redevelopment. Unlike R-A and R-B, the value created exceeds existing values similarly across all four study areas.

Based on consumption patterns, the rate of change in zoning district R-C for each Area is:

Area A – 7.10% annually (9 parcels annually)

Area B – 7.22% annually (39 parcels annually)

Areas C/D – 7.36% annually (18 parcels annually)



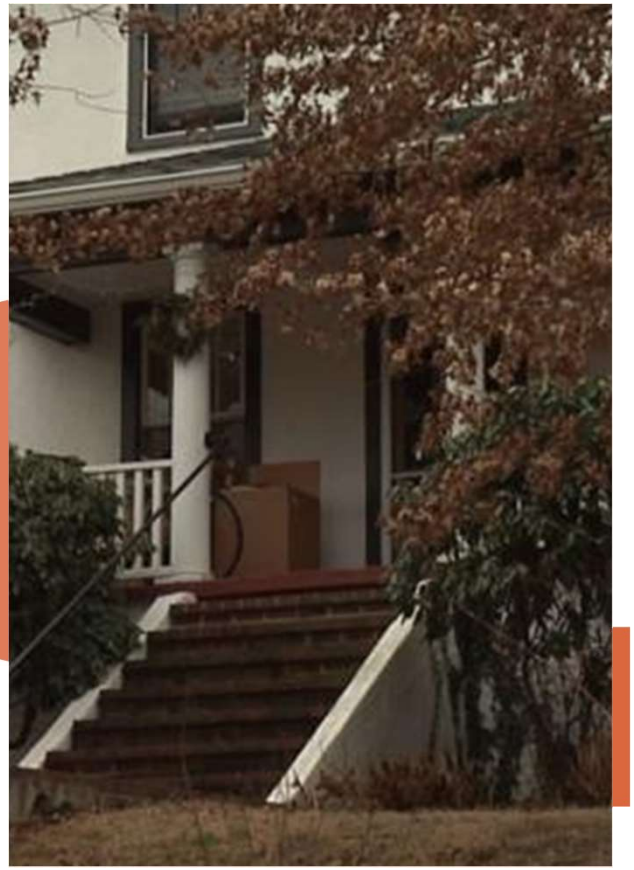
IMPLICATIONS

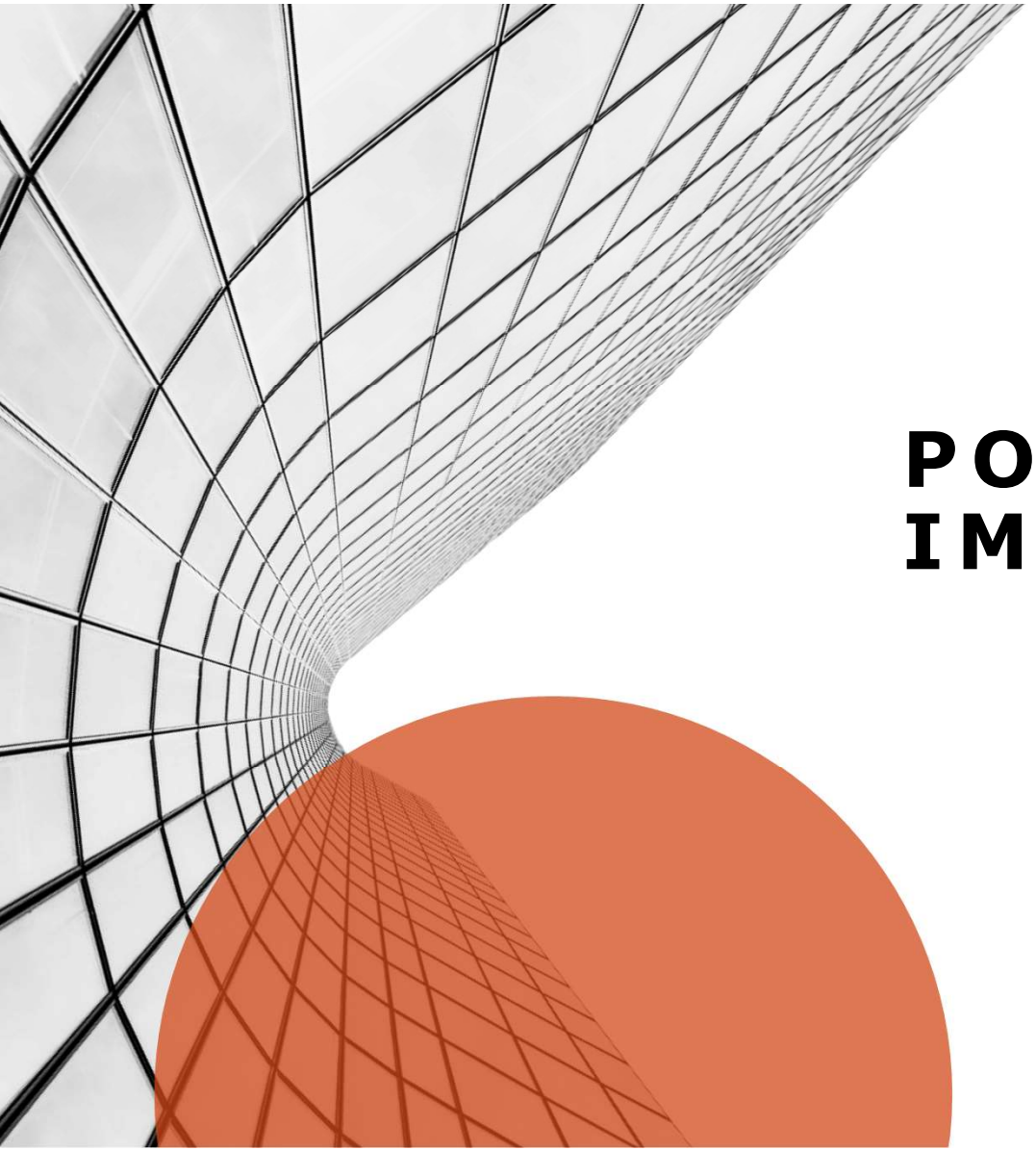
The new zoning classifications will have an impact on the current development patterns.

The data indicate that the new zoning groups will create value for several parcels within Charlottesville above their current value as single-family homes. The value creation varies substantially, with R-A having the least impact on value and R-C having the greatest. This is consistent with the development allowances, as R-C allows eight units by right compared to three units for R-A.

Rate of change analysis does not consider physical capacity of parcels.

It is important to note that the rate of change analysis currently assumes that no subdivision of the lot will occur. Based on the proposed zoning, a lot with an existing structure is considered to be developable. However, it is likely that some lots are not large enough to accommodate a 'full-sized' unit, or unit that meets the average size of recent construction. While micro units are popular, and continue to increase in popularity, having to develop smaller-than-average units would impact revenue, and therefore price. To this point, the existing analysis should be considered aggressive, with actual rates of change likely being lower.





POLICY IMPLICATIONS

CONSIDERATIONS

Partial Unit Rule – How to address partial unit calculations

The current zoning policy requires that any partial unit calculation be rounded up to the next unit. Under this formula a 10-unit development would be required to provide 1 income-controlled unit, but an 11-unit development would be required to provide 2 income-controlled units. This will create a financial disincentive for developers to build projects that require 'additional' income-controlled units above the ratio of 1 unit out of every 10 built.

To this point, RKG Associates recommends the City consider changing the policy recommendation from 'round up' to calculating the partial unit as a payment into the City's Housing Trust Fund. In these cases, the partial unit (0.1 units in the 11-unit example above) would be calculated as 10%, requiring a 10% payment of the calculated value provided to the developer by allowing that unit to be market rate instead of affordable.

In this instance, RKG Associates recommends using a value gap analysis approach to determine the partial unit value (described later in this section). This fairly reduces the financial burden of the 'round up' approach by collecting the pro rata share of a unit that the development would be required under the 10% set aside rule.

Payment In Lieu– How to address developers who want to opt out of delivering units on-site

There may be instances where developers will request to provide a cash payment instead of delivering the income-controlled units within their development. Reasons for this vary, but ultimately work against delivering new income-controlled units given the City's lack of remaining undeveloped land.

In these instances, RKG Associates recommends the City use a total construction cost approach (described later in this section) to determine what the financial contribution to the City's Housing Trust Fund must be for each income-controlled unit not delivered on-site.

The total construction cost approach provide the City with sufficient funds for land acquisition and development of a new unit, which will be required to deliver an income-controlled unit elsewhere within Charlottesville.

CONSIDERATIONS

Value Gap Calculation Approach

The value gap is the difference between the value of a market rate unit and that of an affordable unit. The value of a rental unit is determined by the net operating income and the capitalization rate; for an ownership unit it is determined by the sales value of the unit. In the case of affordable units, the amount of rent or sale price is limited to the target income threshold of the inclusionary zoning policy. This results in lower revenue for a developer. This loss of revenue translates into a loss of value (hence, the value gap) and negatively impacts the overall financials of a developer because the cost of construction and land to build either an affordable or market rate unit are essentially the same. As part of the modeling process, an option was created to utilize the difference in value due to the loss of revenue in determining the fee amount to charge for fractional units. A table showing current gap calculations is included at the end of this narrative.

RENTAL

$$\frac{NOI_{MR} - NOI_{IC}}{\text{CAP RATE}}$$

OWNER

$$PRICE_{MR} - PRICE_{IC}$$

MR – Market Rate
IC – Income-Controlled

Construction Cost Approach

The construction cost approach focuses on the costs to build a housing unit. This includes land acquisition, land development and soft costs (e.g., design and engineering), approval process, and the hard construction costs for development. A table showing construction cost calculations is included at the end of this narrative.

CONSIDERATIONS

Housing Voucher Considerations – Blending the IZ with voucher units

Communities (e.g., Boston, MA) have been incorporating housing choice voucher requirements into their inclusionary zoning policies. Creating a dedicated set aside for housing vouchers benefits both the community (creates more diverse, lower-cost housing) and the development community (voucher payments often match or exceed target AMI rent thresholds). The following table compares Charlottesville's FMR thresholds for vouchers with the 60% of AMI calculations.

	50% AMI	Voucher	60% AMI
Studio	**$1,055**	**$1,223**	**$1,271**
1 Bedroom	**$1,123**	**$1,231**	**$1,354**
2 Bedroom	**$1,269**	**$1,471**	**$1,531**
3 Bedroom	**$1,413**	**$1,829**	**$1,706**

As seen, using vouchers exceeds 50% AMI threshold revenues and is consistent with 60% AMI thresholds. This means including vouchers could serve much lower income households while having no, or even positive (using bonus density), financial feasibility impacts.

Financial Incentives – Maximizing the City' leverage with the new zoning requirements.

The use of financial incentives already exist in Virginia and the City of Charlottesville. Both the city and state provide financial support for certain housing projects (e.g., LIHTC projects), and are making direct and indirect contributions (e.g., reduced cost of publicly-owned land) to increase the production of price-diverse housing.

However, the City's financial tools have been exclusively used to augment other state and federal grant funds. With the new IZ requirements, the City can choose to invest in into private-sector projects. Most notably, the feasibility analysis reveals that achieving lower income thresholds (than 60% AMI) are more financially obtainable than higher set asides. Using City resources to 'buy down' the 60% AMI IZ units to something lower may more cost beneficial than investing in new construction LIHTC projects. The City can use existing programs, or even consider tax abatements, to increase the reach of the IZ without greater risk of market disruption.

CONSIDERATIONS

Approval Processes – The cost of gaining approvals from the City

Based on feedback from local real estate professionals, the development approval and permitting process in the City can be long and expensive depending on where a project is located, the size and complexity of the project, and if there is any neighborhood opposition to the project. It was noted that soft costs for construction can constitute as much as 20% of hard costs (between $46 to $80 PSF) for a project. This is a sizable percentage of total construction costs on a per square foot basis and is one of the few cost metrics the City can influence.

Finding ways to reduce those costs through these zoning changes, streamlining approval processes, and more proactive neighborhood planning that sets expectations for residents about future development can have a substantial impact on development costs, and therefore financial feasibility.

Maintaining the IZ Policy – Impacts of time on the feasibility findings

The results of this analysis vary (in some cases greatly) from the analysis performed in 2021. Development costs, operational expectations, interest rates, market pricing all change frequently. For example, the Median Income for a family of 4 in the Charlottesville region increased approximately 25% since 2021, going from $93,700 in 2021 to $123,300 in 2023. In this instance, a household (of 4 persons) earning 60% of AMI could afford a monthly rent (and utilities) payment of $1,405.50 in 2021. In 2023, the monthly rent payment would be $1,849.50.

This change in income thresholds impacts maximum rent levels for income-controlled units, which impacts financial feasibility and other calculations like value gap.

To this point, the City needs to update its IZ policy requirements and guidelines no more than every two (2) years to ensure the policy [1] does not create financial infeasibility over time, [2] promote outcomes undesirable to the city (e.g., making payments in lieu financially beneficial over delivering units on-site), and [3] ensures the goals and objectives of the policy still reflect the City's priorities and shifting opportunities.

RENTAL HOUSING VALUE GAP CALCULATIONS COMPARED TO MARKET RATE RENTS

AREAS E/F

	30% Affordable NOI	40% Affordable NOI	50% Affordable NOI	60% Affordable NOI	70% Affordable NOI	80% Affordable NOI	90% Affordable NOI	100% Affordable NOI	110% Affordable NOI	120% Affordable NOI
Studio	($133,871)	($103,931)	($73,991)	($44,051)	($14,111)	$15,828	$45,768	$75,708	$105,648	$135,588
1BR	($204,696)	($174,756)	($144,816)	($114,876)	($84,936)	($54,996)	($25,056)	$4,884	$34,824	$64,763
2BR	($266,720)	($236,780)	($206,840)	($176,900)	($146,960)	($117,020)	($87,081)	($57,141)	($27,201)	$2,739
3BR	($340,033)	($310,093)	($280,153)	($250,213)	($220,273)	($190,333)	($160,393)	($130,454)	($100,514)	($70,574)
Average	($236,330)	($206,390)	($176,450)	($146,510)	($116,570)	($86,630)	($56,690)	($26,751)	$3,189	$33,129

AREAS G/H

	30% Affordable NOI	40% Affordable NOI	50% Affordable NOI	60% Affordable NOI	70% Affordable NOI	80% Affordable NOI	90% Affordable NOI	100% Affordable NOI	110% Affordable NOI	120% Affordable NOI
Studio	($153,904)	($123,964)	($94,024)	($64,084)	($34,144)	($4,204)	$25,736	$55,675	$85,615	$115,555
1BR	($226,050)	($196,110)	($166,170)	($136,230)	($106,290)	($76,350)	($46,410)	($16,471)	$13,469	$43,409
2BR	($319,227)	($289,287)	($259,347)	($229,407)	($199,467)	($169,527)	($139,587)	($109,648)	($79,708)	($49,768)
3BR	($397,952)	($368,012)	($338,072)	($308,132)	($278,193)	($248,253)	($218,313)	($188,373)	($158,433)	($128,493)
Average	($274,283)	($244,343)	($214,403)	($184,463)	($154,524)	($124,584)	($94,644)	($64,704)	($34,764)	($4,824)

AREA I

	30% Affordable NOI	40% Affordable NOI	50% Affordable NOI	60% Affordable NOI	70% Affordable NOI	80% Affordable NOI	90% Affordable NOI	100% Affordable NOI	110% Affordable NOI	120% Affordable NOI
Studio	($105,825)	($75,885)	($45,945)	($16,005)	$13,934	$43,874	$73,814	$103,754	$133,694	$163,634
1BR	($161,130)	($131,190)	($101,250)	($71,310)	($41,370)	($11,430)	$18,510	$48,450	$78,390	$108,329
2BR	($241,626)	($211,686)	($181,746)	($151,806)	($121,867)	($91,927)	($61,987)	($32,047)	($2,107)	$27,833
3BR	($315,103)	($285,163)	($255,223)	($225,283)	($195,344)	($165,404)	($135,464)	($105,524)	($75,584)	($45,644)
Average	($205,921)	($175,981)	($146,041)	($116,101)	($86,161)	($56,222)	($26,282)	$3,658	$33,598	$63,538

OWNERSHIP CONDOMINIUM HOUSING VALUE GAP CALCULATIONS COMPARED TO MARKET RATE VALUES

AREA A

	30% Affordable NOI	40% Affordable NOI	50% Affordable NOI	60% Affordable NOI	70% Affordable NOI	80% Affordable NOI	90% Affordable NOI	100% Affordable NOI	110% Affordable NOI	120% Affordable NOI
Studio	($540,894)	($504,905)	($468,915)	($432,926)	($396,936)	($360,947)	($324,957)	($288,968)	($252,978)	($216,989)
1BR	($705,425)	($666,865)	($628,305)	($589,745)	($551,184)	($512,624)	($474,064)	($435,504)	($396,944)	($358,383)
2BR	($696,112)	($652,410)	($608,709)	($565,007)	($521,306)	($477,604)	($433,902)	($390,201)	($346,499)	($302,798)
3BR	($819,511)	($770,668)	($721,825)	($672,982)	($624,139)	($575,296)	($526,453)	($477,611)	($428,768)	($379,925)
Average	($690,486)	($648,712)	($606,938)	($565,165)	($523,391)	($481,618)	($439,844)	($398,071)	($356,297)	($314,524)

AREA B

	30% Affordable NOI	40% Affordable NOI	50% Affordable NOI	60% Affordable NOI	70% Affordable NOI	80% Affordable NOI	90% Affordable NOI	100% Affordable NOI	110% Affordable NOI	120% Affordable NOI
Studio	($346,235)	($310,246)	($274,256)	($238,267)	($202,278)	($166,288)	($130,299)	($94,309)	($58,320)	($22,330)
1BR	($391,164)	($352,604)	($314,044)	($275,483)	($236,923)	($198,363)	($159,803)	($121,243)	($82,682)	($44,122)
2BR	($419,869)	($376,167)	($332,466)	($288,764)	($245,063)	($201,361)	($157,659)	($113,958)	($70,256)	($26,555)
3BR	($450,897)	($402,054)	($353,211)	($304,368)	($255,525)	($206,682)	($157,839)	($108,996)	($60,153)	($11,310)
Average	($402,041)	($360,268)	($318,494)	($276,721)	($234,947)	($193,174)	($151,400)	($109,626)	($67,853)	($26,079)

AREAS C/D

	30% Affordable NOI	40% Affordable NOI	50% Affordable NOI	60% Affordable NOI	70% Affordable NOI	80% Affordable NOI	90% Affordable NOI	100% Affordable NOI	110% Affordable NOI	120% Affordable NOI
Studio	($245,957)	($209,967)	($173,978)	($137,988)	($101,999)	($66,009)	($30,020)	$5,970	$41,959	$77,949
1BR	($279,263)	($240,703)	($202,143)	($163,583)	($125,022)	($86,462)	($47,902)	($9,342)	$29,218	$67,779
2BR	($320,104)	($276,403)	($232,701)	($189,000)	($145,298)	($101,596)	($57,895)	($14,193)	$29,508	$73,210
3BR	($380,402)	($331,559)	($282,716)	($233,873)	($185,030)	($136,187)	($87,344)	($38,502)	$10,341	$59,184
Average	($306,432)	($264,658)	($222,884)	($181,111)	($139,337)	($97,564)	($55,790)	($14,017)	$27,757	$69,530

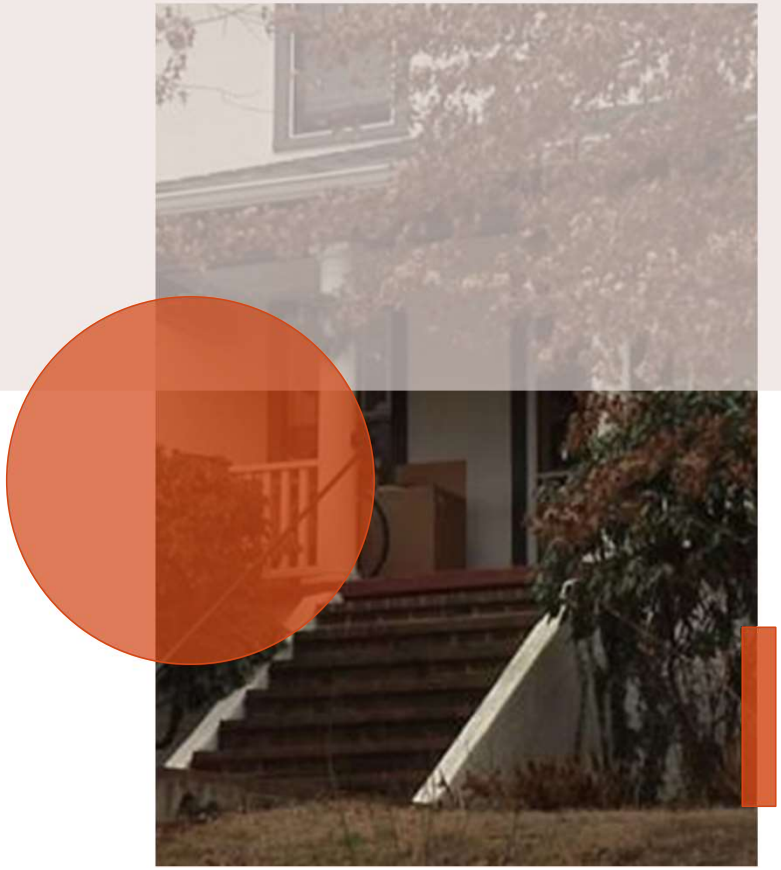
CONSTRUCTION COST CALCULATIONS

RENTAL CONSTRUCTION COSTS

	Average Square Footage	Construction Cost Per Foot	Total Cost Per Unit
Studio	525	$350.76	$184,152
1BR	715	$350.76	$250,797
2BR	1,050	$350.76	$368,303
3BR	1,560	$350.76	$547,339
Average	963	$350.76	$337,648

OWNERSHIP CONDOMINIUM CONSTRUCTION COSTS

	Average Square Footage	Construction Cost Per Foot	Total Cost Per Unit
Studio	975	$332.83	$324,510
1BR	1,088	$332.83	$362,120
2BR	1,243	$332.83	$413,709
3BR	1,452	$332.83	$483,138
Average	1,189	$332.83	$395,869



Charlottesville Zoning Impact Analysis

July 2023

RKG ASSOCIATES INC

Inclusionary Housing

Creating and Maintaining Equitable Communities

RICK JACOBUS

POLICY FOCUS REPORT

NATIONAL COMMUNITY LAND TRUST NETWORK CORNERSTONE PARTNERSHIP LINCOLN INSTITUTE OF LAND POLICY

POLICY FOCUS REPORT SERIES

The Policy Focus Report series is published by the Lincoln Institute of Land Policy to address timely public policy issues relating to land use, land markets, and property taxation. Each report is designed to bridge the gap between theory and practice by combining research findings, case studies, and contributions from scholars in a variety of academic disciplines, and from professional practitioners, local officials, and citizens in diverse communities.

ABOUT THIS REPORT

After decades of disinvestment, American cities are rebounding, but new development is driving up housing costs and displacing lower-income residents. Roughly 500 communities in the United States have developed inclusionary housing policies, which require developers of new market-rate real estate to provide affordable housing. For cities struggling to maintain economic integration, inclusionary housing is one of the most promising strategies to ensure that the benefits of development are shared widely. But policies must be designed with care to suit local conditions and guarantee that requirements do not overburden development. Through a review of the literature and case studies, this report details how local governments are realizing the potential of inclusionary housing by building public support, using data to inform program design, establishing reasonable expectations for developers, and ensuring long-term program quality.

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Front Cover (clockwise from top left):
Inclusionary housing developments in Chapel Hill, NC; San Francisco, CA; Chapel Hill, NC; and Carrboro, NC. *San Francisco photo is courtesy of Tenderloin Neighborhood Development Corporation; all North Carolina photos are courtesy of Community Home Trust.*

Back Cover:
Pacifica Cohousing Community, Carrboro, NC. *Courtesy of Community Home Trust.*

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Executive Summary

Redevelopment of the former Mueller Airport in Austin, Texas, will include more than 4,600 new homes and apartments, 25 percent of which will be affordable to lower-income families.
Credit: Garreth Wilcock

After decades of disinvestment, American cities are rebounding, but new development is often driving housing costs higher and displacing lower-income residents. For cities struggling to maintain economic integration, inclusionary housing is one of the most promising strategies available to ensure that the benefits of development are shared widely. More than 500 communities have developed inclusionary housing policies, which require developers of new market-rate real estate to provide affordable units as well. Economically diverse communities not only benefit low-income households; they enhance the lives of neighbors in market-rate housing as well. To realize the full benefit of this approach, however, policies must be designed with care.

Inclusionary housing is not a new idea. Successful programs have evolved over the years as policy makers and housing officials learned hard lessons about what works and what doesn't. This report draws from these lessons to highlight major challenges that inclusionary programs face and to outline the ways that communities address those problems.

Empirical research on the scale, scope, and structure of inclusionary programs and their impacts is limited. The valuable research that does exist is often inaccessible or lost in dense academic journals or consultant reports. This report captures and digests the lessons from these sources and makes them readily available to local policy makers. It also draws heavily on an empirical project conducted in 2014 by the National Housing Conference's Center for Housing Policy (CHP) and the National Community Land Trust Network, which resulted in the Lincoln Institute working paper "Achieving Lasting Affordability through Inclusionary Housing" (Hickey, Sturtevant, and Thaden 2014).

Policy makers are understandably concerned that affordable housing requirements will stand in the way of development. But a review of the literature on the economics of inclusionary housing suggests that well-designed programs can generate significant affordable housing resources without overburdening developers or landowners or negatively impacting the pace of development.

Nevertheless, inclusionary housing policies can be controversial and thus require broad local support. Several case studies describe the process through which communities have reached out to key stakeholders, including partners in the real estate community, to build endorsement for these programs.

Research into the very real benefits and limitations of mixed-income development suggests that the creation and preservation of affordable homes in asset-rich neighborhoods is one of the few successful strategies for overcoming economic segregation. It also demonstrates that integration within each new market-rate development does not always make sense. Successful economic integration requires careful attention to a number of policy design choices.

Every community must consider key legal concerns as well. While cities must take care to develop policies that fit within standards outlined by the federal or state judiciary, courts have generally supported a community's right to require affordable housing. Ultimately, there is almost always a path to a legally defensible inclusionary policy.

Inclusionary housing programs also require significant staffing to oversee the development process and to steward units after they are built, to ensure long-term affordability. This report highlights essential roles for staff or third-party contractors, describes common mechanisms for funding this work, and explains ways that local stakeholders can monitor a program to ensure that it is having the intended impact.

Recommendations address the following questions:

- What can local governments do to maximize the impact of inclusionary housing?
- What can states do to support local inclusionary housing policies?
- What can the federal government do to support inclusionary housing policies?

In most cities, the need for affordable housing has never been more urgent. For many jurisdictions across the country, now is the time to consider adopting robust inclusionary housing policies that build permanently affordable housing stock and create inclusive communities.

CHAPTER 1

An Introduction to Inclusionary Housing

In Williamsburg, Brooklyn, the developer of this luxury tower called the Edge (background), where condos sell for $400,000 to $3 million, also built the Edge community apartments (foreground) where units rent for as little as $886 per month. *Credit: NYC Department of City Planning*

Brooklyn in the 1970s was a rough place. It would have been hard to imagine that one day it would be one of the most expensive communities in the country. Over the past 40 years, hundreds of thousands of people have worked very hard to make Brooklyn a better place: artists have painted murals, parents have volunteered at local schools, neighbors have patrolled streets to combat crime, and the City of New York has invested billions of dollars in housing and infrastructure projects to improve struggling neighborhoods. It has worked. As a result, however, many of those people who labored so hard to change Brooklyn could not afford to stay there. The *cost* of making Brooklyn what it is today was borne by the community at large and the City itself, but the economic *benefit* of this investment accrued primarily to a small number of property owners.

When people work to make our cities better places, they indirectly contribute to higher housing costs. Public investment, in particular, makes a big difference. When we build new infrastructure or transit systems, we see dramatic and immediate increases in the price of surrounding properties because these areas become more attractive places to live. Ideally, everyone would benefit from improved cities, but in reality the costs and benefits of improvement are not shared equally.

Lower-income residents looking for a new home soon face a choice among several undesirable options:

The Chicago Community Land Trust maintains a reserve of permanently affordable homeownership options for working families. *Credit: Chicago Community Land Trust*

extreme commute times, overcrowding, substandard housing, or rents or mortgages that are so high they deplete resources for other essentials. Displaced families are not the only ones who suffer—everyone loses when economic diversity deteriorates. Unequal access to housing drives sprawling development patterns; worsens traffic congestion; pollutes air quality; increases taxpayer dollars spent on basic infrastructure; and decreases racial, cultural, and economic diversity (Ewing, Pendall, and Chen 2003).

Recognizing that this basic dynamic will not change naturally, more and more communities have been consciously seeking to promote mixed-income development. Instead of accepting the assumption that economic growth must automatically lead to economic exclusion, they have been developing local policies that seek to increase economic inclusion.

Inclusion Is Possible

The Washington, DC, area is home to some of the most prosperous and fastest-growing suburban communities in the country. In Fairfax County, Virginia, the expansion of the DC Metro created a once-in-a-lifetime opportunity to build a new transit-oriented community in Tysons Corner. In a suburban area that housed fewer than 20,000 people in 2010, the county has planned a 24-hour urban center that will be home to more than 100,000 people and 200,000 jobs. Fairfax County will work with developers to ensure that 20 percent of all residential units in Tysons Corner are affordable for people who earn between 50 and 120 percent of the area's median income. In addition, new commercial development projects will pay a fee to fund affordable housing units (Fairfax County Board of Supervisors 2010).

Across the Potomac River, Montgomery County, Maryland, has had a similar program in place since the early 1970s. It has created more than 14,000 homes for lower-income families that are integrated into some of the area's most expensive neighborhoods. A 2005 study found that this strategy had succeeded in promoting racial integration throughout the county (Orfield 2005). A later study found that the children living in affordable housing produced by the program were not only able to attend higher-quality schools than other children in lower-income families, but they also performed higher in school (Schwartz 2010).

These programs—and hundreds of others like them—show that, with concerted effort, it is possible for communities to grow in ways that create and maintain meaningful economic diversity.

A Definition

Inclusionary housing refers to a range of local policies that tap the economic gains from rising real estate values to create affordable housing—tying the creation of homes for low- or moderate-income households to the construction of market-rate residential or commercial development. In its simplest form, an inclusionary housing program might require developers to sell or rent 10 to 30 percent of new residential units to lower-income residents. Inclusionary housing policies are sometimes referred to as "inclusionary zoning" because this type of requirement might be implemented through an area's zoning code; however, many programs impose similar requirements outside the zoning code.

Inclusionary housing refers to a range of local policies that tap the economic gains from rising real estate values to create affordable housing—tying the creation of homes for low- or moderate-income households to the construction of market-rate residential or commercial development.

Many programs partially offset the cost of providing affordable units by offering developers one or more incentives, such as tax abatements, parking reductions, or the right to build at higher densities. Most programs recognize that inclusion of affordable units on-site within market-rate projects may not always be feasible, so they allow developers to choose among alternatives, such as payment of an in-lieu fee or provision of affordable units off-site in another project.

While early inclusionary housing policies imposed mandatory requirements applicable to all new residential development in a city or county, more recent programs have developed a wider variety of structures in response to differing local conditions and needs. Some programs have taken a voluntary approach, requiring affordable units only when developers choose to utilize incentives. Other programs have been

The City of Santa Fe, New Mexico, requires that 20 percent of all new developments be affordable to buyers earning 80 percent or less of the area median income. *Credit: John Baker Photography*

designed to apply only to targeted neighborhoods, where zoning has been changed to encourage higher-density development.

Another trend has been to apply inclusionary policies to commercial real estate as well. Often called "commercial linkage" programs, "jobs housing" linkage programs, or affordable housing "impact fees," these programs generally collect a fee per square foot from all new commercial development to fund new affordable housing production. Some jurisdictions have responded to legal obstacles by adopting linkage or impact fees that apply to new residential development as well. Whereas a traditional inclusionary zoning program would require on-site affordable units or allow payment of an in-lieu fee as an alternative to on-site development, these newer programs require every project to pay a fee, and some offer on-site development as an alternative to payment of the fee.

Because most inclusionary programs are at least partly motivated by a desire to create or preserve mixed-income communities, preservation of affordability is essential. Early inclusionary housing programs frequently imposed very short-term affordability requirements. As communities saw these units revert to the market rate, most have moved to require affordability periods of 30 years or longer. Inclusionary housing programs tend to create relatively small numbers of affordable units each year because they rely on new development. If these units remain affordable for long periods of time, however, a community can expect to gradually build a large enough stock of affordable homes to make a difference.

Prevalence of Programs

The 2014 Network-CHP Project identified 512 inclusionary housing programs in 487 local jurisdictions in 27 states and the District of Columbia. Concentrations in New Jersey and California account for 65 percent of all programs. Inclusionary housing programs were found in most parts of the country; Massachusetts, New York, Colorado, Rhode Island, and North Carolina have 10 or more local programs each (figure 1).

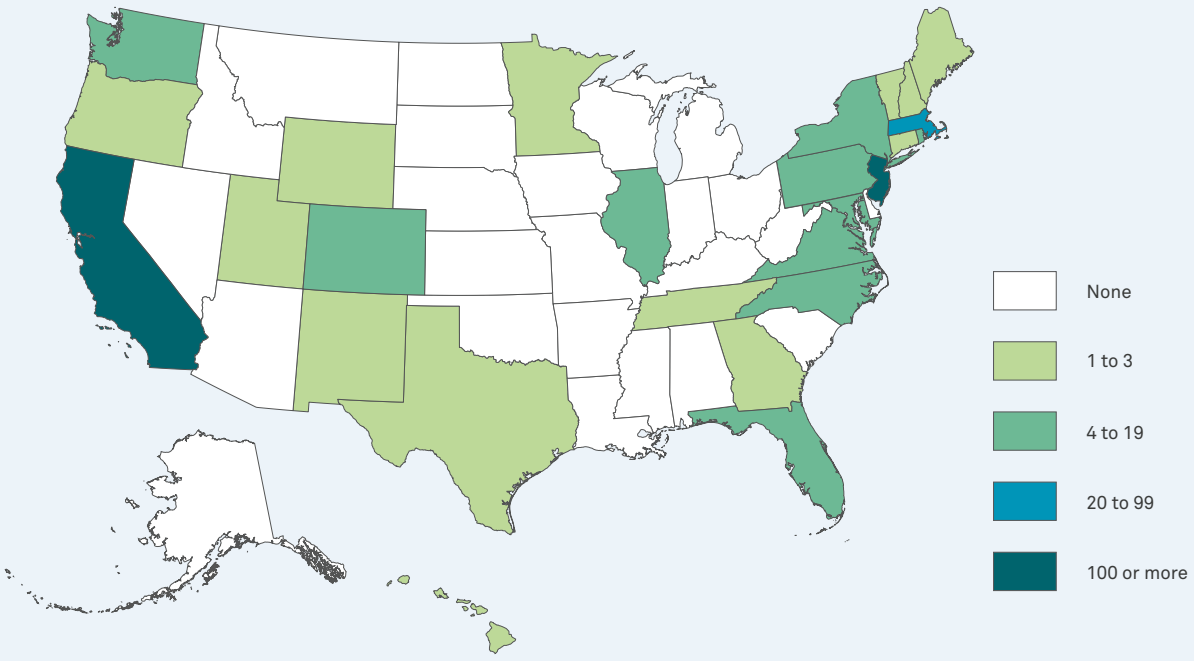
There is no national data on the rate at which inclusionary housing programs are producing new affordable units. A 2006 study found that California's inclusionary programs produced 30,000 affordable units over a six-year period (Non-Profit Housing Association of Northern California 2007). The Innovative Housing Institute later surveyed 50 inclusionary programs distributed across the country and reported that they had produced more than 80,000 units since adoption (Innovative Housing Institute 2010). While these numbers are significant, inclusionary housing programs alone are not producing a sizable share of the national affordable housing stock. The Low Income Housing Tax Credit (LIHTC) program, by comparison, has produced two million units since 1987 (U.S. Department of Housing and Urban Development 2015).

In most cities, inclusionary housing is just one tool in a suite of local policies intended to address the affordable housing challenge. A study of 13 large cities showed that nearly all those with inclusionary programs also manage the investment of federal housing funds and issue tax-exempt bonds to finance affordable housing. Most also used local tax resources to finance a housing trust fund, and many had supported land banks and community land trusts as well. About half those cities took advantage of tax increment financing, and a growing minority established tax abatement programs that exempt affordable housing projects from property taxes. While the exact mix of programs differed from one city to the next, every city employed multiple strategies (OTAK and Penninger Consulting 2014).

In communities that have long-established and well-designed programs, however, inclusionary housing can be an important source of affordable units. Brown (2001) found that inclusionary housing accounted for half of the affordable housing production in Montgomery County, Maryland. And Mukhija and colleagues (2010) found that inclusionary programs in Southern California were producing about as many units annually as the LIHTC program was creating.

Figure 1

Concentration of Inclusionary Programs Throughout the United States



Source: Hickey, Sturtevant, and Thaden (2014). An online directory of these programs is available at http://cltnetwork.org/topics/deed-restricted-or-inclusionary-housing-programs.

Untapped Potential

The research summarized in this report clearly shows that inclusionary housing is a tried and tested strategy that can make a real impact on the affordable housing crisis, but it also shows that inclusionary housing has yet to reach its full potential. Most existing programs were adopted within the past 10 years, and many of the communities that could benefit from inclusionary policies have yet to implement them. Where inclusionary policies are in place, details in the design and implementation make a large difference in overall effectiveness. However, the evidence presented below suggests that inclusionary housing is likely to play a more significant role in our national housing strategy in the coming decade.

Faced with declining federal and state resources for affordable housing and growing populations within cities and urban cores, communities need to take full advantage of every potential tool. Inclusionary housing programs produce a modest yet steady supply of new affordable housing resources. Because these programs generally preserve long-term affordability, the pool of local inclusionary units can grow steadily into a significant share of the local housing stock. As importantly, inclusionary housing is one of the few proven strategies for locating affordable housing in asset-rich neighborhoods where residents are likely to benefit from access to quality schools, public services, and better jobs. Communities across the country are increasingly investing in the creation of new transit-oriented urban neighborhoods, and inclusionary housing policies are one of the only ways to ensure that these places develop in an equitable manner. Equitable development benefits not only lower-income households; integrated, inclusive, and diverse communities enhance the lives and outcomes of all residents.

Equitable development benefits not only lower-income households; integrated, inclusive, and diverse communities enhance the lives and outcomes of all residents.

In San Mateo, California, six of the Amelia development's 63 town houses sell for below-market rates to lower-income residents. *Credit: Sandy Council*

CHAPTER 2

Understanding the Economics

Two blocks from the MIT subway stop in Cambridge, Massachusetts, the Third Square apartment complex offers 56 permanently affordable units. *Credit: City of Cambridge*

The adoption of inclusionary housing has almost always been controversial. This type of intervention into the private market raises some real economic concerns that must be taken seriously and addressed with care. This chapter explains the economics of inclusionary housing requirements by addressing the most common questions about local inclusionary policies:

- Is it fair to ask one group (developers) to solve a broad social problem?
- Will developers pass on the cost to tenants and homebuyers?
- Will inclusionary policies prevent new development and make the housing problem worse?
- Can inclusionary housing work in every type of housing market?

Fairness

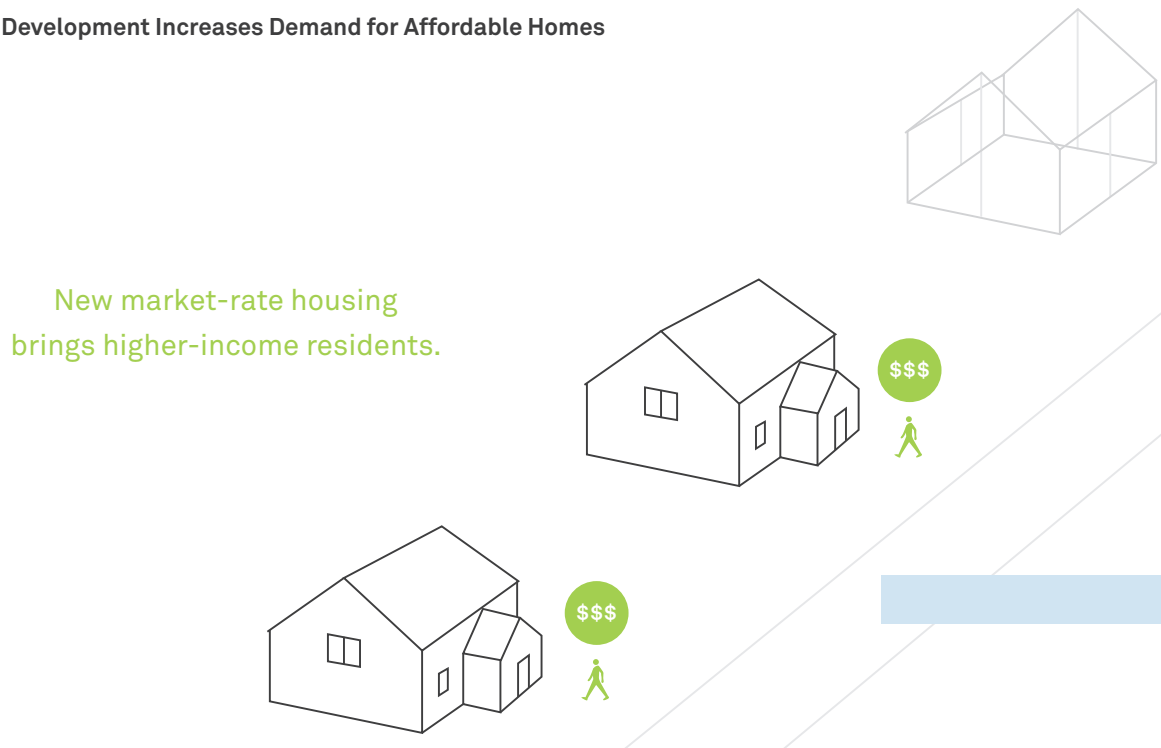
Inclusionary housing policies should not make developers responsible for resolving all the affordable housing needs within a jurisdiction. What is fair is to ask them to compensate for the economic impacts of their developments and to share a portion of the profits they make on the public's investment in the places they develop.

It might stand to reason that development of housing—any kind of housing—would lead to lower housing prices. In most urban areas, however, the opposite occurs. Construction of new residential real estate impacts the price or rent of existing homes in two different ways simultaneously. As the basic notion of supply and demand suggests, the addition of new units in a given market will inevitably put some downward pressure on the cost of existing units. But the larger effect tends to be upward pressure on housing costs because new homes are primarily built for higher-income residents. A 2015 study commissioned by the *Wall Street Journal* found that 82 percent of new rental housing in the United States was luxury housing (Kusisto 2015). Not only do the new units command higher rents, but also the new residents who can afford them spend money in ways that create demand for more lower-wage workers in the area. This, in turn, creates more demand for housing and ultimately raises housing costs. Figure 2 illustrates this cycle.

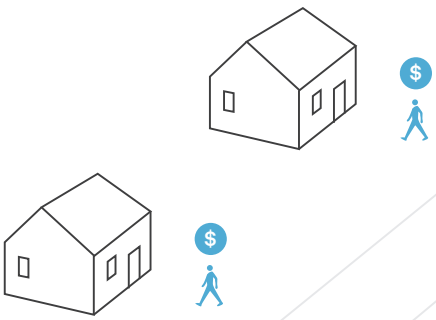
Modest price increases in a region can translate into very acute increases in specific neighborhoods. For example, new luxury housing may cause dramatic upswings in the price of residential real estate in formerly distressed central neighborhoods, but the lower costs resulting from increased supply may be apparent only at the suburban fringe of the region.

Figure 2

Market Development Increases Demand for Affordable Homes



New lower-wage workers generate added demand for affordable housing.



Increased spending generates new jobs in the area.

Seattle's South Lake Union, Part One

In the mid-1990s, Microsoft cofounder Paul Allen made a $20 million loan to finance a proposed park in a warehouse district known as South Lake Union in Seattle, Washington. When voters rejected the proposal, Allen was stuck with 11 acres of unimpressive real estate. But he saw potential and quietly began purchasing more land until his Vulcan Real Estate had amassed a portfolio of over 60 acres—more than one-third of all property in the area. Allen lobbied the city to invest in a fixed-rail streetcar line, which opened in 2007, to connect South Lake Union to Downtown Seattle. When Amazon decided to relocate its headquarters to South Lake Union, Vulcan developed the property and later sold it for $1.2 billion (Jones 2012).

In 2013, the Seattle City Council considered rezoning South Lake Union, but it faced a dilemma. At that point, Vulcan had developed fewer than half its properties, and the company sought to change the zoning code to allow for construction of 40-story towers as part of a mixed-use urban development. However, the new towers would block views and strain public infrastructure citywide. The upzoning would create a massive financial windfall for one man, while its negative impacts would affect residents throughout the city.

One likely impact was particularly troubling to many Seattle residents: the project's potential to worsen the already acute challenge of rising housing costs. New office and laboratory space would allow for many new jobs that would inevitably translate to higher housing demand and costs.

South Lake Union provides a somewhat exaggerated example of the dynamic seen in most growing cities: private developers and landowners benefit disproportionately from public investments such as transit and other infrastructure. New development creates both costs and benefits, but both are unevenly distributed. Inclusionary housing programs recapture some share of the benefits to help the people who disproportionately bear the costs. While inclusionary housing won't solve the housing challenge, it is both fair and appropriate to expect new development to contribute to the solution.

These inclusionary homeowners in South Lawndale, Illinois, won prize money to redecorate their living room through the Chicago Community Land Trust's Extreme Makeover contest. *Credit: Chicago Community Land Trust*

Absorbing the Costs

Generally, developers do not pass on the costs of inclusionary housing to tenants and homebuyers. The local real estate market sets the prices of market-rate units, and developers of one project can't change the overall market price or rent. Therefore, the costs associated with construction of inclusionary housing are either absorbed by modest declines in land prices or reductions in developer profits, or some combination of the two.

To understand this process, we need to think about housing prices in the market in general. There are basically three elements to the price of any new house: (1) the land; (2) the cost of building the house (including fees, permits, construction, and everything else); and (3) the developer's profit.

Because buyers can choose to purchase existing homes, builders of new units are basically stuck with the market price or rent. When the market rises, builders don't sell for the same price that they had intended; rather, they charge the new market price and earn extra profits. When the market falls, things happen in reverse. In the short term, developer profits suffer. But in the long term, land prices will drop because developers avoid projects that won't earn profits.

Over time, builder profits will return to "normal" because land prices will rise to capture the higher prices. If builders can earn "extra" profits, landowners will have a lot of builders competing for their land and will be able to sell at higher prices to developers willing to settle for more modest profits.

When a city imposes inclusionary housing requirements, it may increase a developer's costs. But developers can't really pass those costs on to homebuyers or tenants, because new units must still be competitively priced in the overall market. Instead, over time, land prices will fall to absorb the costs of the inclusionary housing requirements. Any incentives offered by a community would reduce the degree of land price reductions.

Impacts on New Development

While we don't need to worry that developers will pass the costs of inclusionary housing requirements on to residents, there is still a risk that these policies could lead to higher prices. If the costs are great enough, they could push land prices so low that some landowners would choose not to sell at all. If this happened, less housing would be built and prices would rise.

There seems to be agreement that inclusionary programs could theoretically diminish the supply of housing and therefore increase prices, but there is no agreement about how often this happens or how significant the impact is. A study by the libertarian Reason Foundation concluded that the production rate of market-rate homes fell following the adoption of inclusionary housing policies (Powell and Stringham 2004). Basolo and Calavita (2004) critiqued this study, pointing out that jurisdictions are most likely to adopt inclusionary housing policies toward the peak of the economic cycle, weakening the argument that inclusionary housing causes production to fall. A follow-up study by researchers at the University of California, Los Angeles, carefully compared the data for communities with and without inclusionary housing in Southern California and concluded that the adoption of inclusionary policies had no impact on the overall rate of production (Mukhija et al. 2010).

The most rigorous study to date was conducted by researchers at the Furman Center at New York University (Schuetz, Meltzer, and Been 2009), who studied inclusionary programs in the Boston and San Francisco metropolitan areas. In the towns around Boston, inclusionary requirements modestly decreased the rate of housing production relative to the rates in nearby towns, slightly raising the market price of residential real estate. But in the San Francisco area, inclusionary programs had no impact on production or prices, suggesting that it is possible to develop inclusionary programs that don't impact market prices. These same programs were also able to create more affordable units than their counterparts did in the Boston area.

Seattle's South Lake Union, Part Two

The Seattle City Council faced a major dilemma when it considered increasing the affordable housing requirements for South Lake Union. While Paul Allen's Vulcan Real Estate claimed to support the goal of creating affordable housing, it also contended that any increase in the city's requirements would be financially infeasible (Tangen 2008). Supporting this concern, a study by a local consultant concluded that more aggressive policies would likely depress land values by 8 to 17 percent (Fiori 2012). A different local consultant performed a similar analysis and concluded that—even with the more aggressive affordable housing requirements—the upzoning would increase land values to 13 times their current levels (Spectrum 2013). Unable to choose between dueling consultants, the city council enacted a very modest increase in the housing requirements even as they approved a dramatic increase in height limits.

This case illustrates that, even in a very strong market like Seattle, it is difficult for policy makers to evaluate technical economic claims. In fact, the two South Lake Union studies painted a very similar picture of the economics of the proposed policy. But one failed to look at the *value* added by incentives for developers and focused only on the *cost* of providing affordable housing; the other considered both the cost and value that was being provided by increasing height limits.

Seattle's city council eventually commissioned a new, detailed economic feasibility study, which found, for example, that the increased density of a high-rise rental project in the city's downtown added $4.5 million to the value of the land, while the affordable housing requirement recaptured only about $3.2 million of that increase (David Paul Rosen & Associates 2014). Ultimately, the results of that study helped the council commit to a stronger housing requirement without concern that it would overly burden developers.

Inclusionary housing policies can create affordable units without decreasing development or increasing prices. But programs must be strategically designed and carefully run, or local policy makers will find themselves caught in the middle of a highly technical debate over real estate economics.

Offsetting Opportunity Costs

When incentives are offered, it is meaningless to talk about the cost of providing affordable housing in isolation. The whole economic picture must be taken into account. At the heart of this difference in approach is a concept known as "residual land value," which is vital for designing policies that appropriately allow communities to share in the benefits of new construction without stifling development.

"Residual land value" refers to the idea that landowners end up capturing whatever is left over after the costs of development. When the cost of construction rises, it might impact developer profits in the short term, but higher costs will then cause all developers to bid less for development sites. As land prices fall, developer profits tend to return to "normal" levels.

When a city requires developers to provide affordable housing, developers are likely to earn less than they would have if they had been able to sell or rent the affected units at market value. This forgone revenue represents the "opportunity cost" of complying with the affordable housing requirements (figure 3). It is fairly easy to calculate this "cost" for any given mix of affordable housing units, and, if these requirements are predictable in advance, they should roughly translate into corresponding reductions in land value over the longer term.

However, most inclusionary housing programs don't simply impose costs; rather, they also attempt to offset those costs (at least, in part) with various incentives for the developers. The most common incentive is the right to build with increased density. When developers can build more units, the extra income can offset the costs of providing affordable units and the result will be a smaller (if any) reduction in land value.

Land values don't change overnight, and some communities have carefully phased in inclusionary requirements with the expectation that, when developers can see changes coming, they will be in a better position to negotiate appropriate concessions from landowners before they commit to projects that will be impacted by the new requirements. Similarly, some program designs are likely to have a clearer and more predictable impact on land prices than others. More universal, widespread, and stable rules may translate into land price reductions more directly than complex and fluctuating requirements with many alternatives.

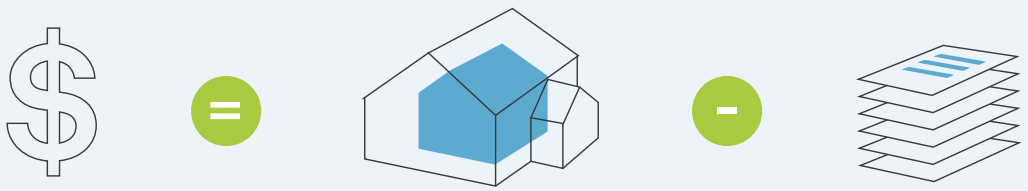
Suiting the Market

Inclusionary housing may not be suitable in every type of housing market, but it can work in more places than many people realize. Inclusionary programs are tools for sharing the benefits of rising real estate values, and, as a result, they are generally found in communities where prices are actually rising. In many parts of the United States, land prices are already very low, and rents and sales prices would often be too low to support affordable housing requirements even if the land were free. In these environments, policies that impose net costs on developers are unlikely to succeed (though some communities nonetheless require affordable housing in exchange for public subsidies).

The types of communities where rising housing prices are a real and growing problem are quite diverse, and many of them are not high-growth central cities like Seattle. In California, one-third of inclusionary programs are located in small towns or rural areas. Wiener and Bandy (2007) studied these smaller-town inclusionary programs and found that many were motivated

Figure 3

Market Development Increases Demand for Affordable Homes



Net Cost to Development
(or Reduction in Land Value)

"Opportunity Cost" of Providing Affordable Units

Value of Any Incentives

by the influx of commuters or second-home buyers entering previously isolated housing markets.

While inclusionary policies are clearly relevant in a wide range of communities, the appropriate requirements can differ from one market to another. In communities where higher-density development is not practical, higher affordable housing requirements may not always be feasible, but lower requirements may still be effective. San Clemente, California, requires only 4 percent of new units to be affordable. But because the city was growing so rapidly, it produced more than 600 affordable homes between 1999 and 2006 (California Coalition for Rural Housing 2009). Wiener and Bandy (2007) also found that many smaller jurisdictions relied heavily on in-lieu fees, and some set fees at very modest levels.

Smaller communities with inclusionary housing programs must address unique considerations, such as limited staff capacity and administration costs. Outsourcing and multi-jurisdiction collaborations can make smaller programs easier to implement, but in some localities the benefits of an inclusionary housing policy will not adequately offset its costs.

Conclusion

It is entirely reasonable to ask real estate developers to help address the pressing need for more affordable housing, because developers and landowners benefit financially from the conditions that give rise to the shortage of decent, well-located homes for lower-income residents. But inclusionary programs need to be designed with care to ensure that their requirements are economically feasible. While developers are not able to pass on the cost of compliance to tenants and homebuyers, there is some risk that poorly designed inclusionary requirements could slow the rate of building and ultimately lead to higher housing costs. Policy makers can avoid this unintended consequence by offering developers flexibility in how they comply and by calibrating requirements and incentives so that the net economic impact on projects is not too great. At some level, inclusionary housing can be implemented in most housing markets, but the stronger the local real estate market, the greater the potential for inclusionary housing to make a meaningful difference.

CHAPTER 3

Building Support for Policy Adoption

A family gathers outside their inclusionary home in the Old Las Vegas Highway development in Santa Fe, New Mexico. *Credit: John Baker Photography*

Winning broad public support for a new inclusionary housing ordinance is essential to both the short-term prospects of adopting a strong ordinance and the long-term success of the program. Inclusionary housing raises complex and sometimes controversial issues, so it is important to explain to local stakeholders why inclusionary housing is an appropriate response to real local housing challenges. Carefully studying the economics and engaging private real estate developers seem to help minimize opposition and improve the quality of the policy being proposed.

Understanding Housing Needs and Tools

Many local inclusionary ordinances appear to have grown out of much broader efforts to document housing needs and develop local affordable housing strategies. A broad-based community process that builds support for the goal of increasing the supply of affordable housing and considers the limitations of available tools often leads local stakeholders to conclude that inclusionary housing is one of the most promising options for addressing a growing problem.

That is what happened in Stamford, Connecticut. During the latter part of the 1990s, housing affordability became a growing concern for many residents. A local nonprofit, the Housing Development Fund, organized a conference on creating affordable housing in the summer of 2000. Stamford's mayor, Dan Malloy, later established an affordable housing task force of leaders representing the community, businesses, and government to explore new strategies. The city hired Alan Mallach, the former housing director in Trenton, New Jersey, to work with the task force and the city to create an affordable housing strategy. After many meetings, the group agreed on an ambitious strategy that was presented to the community during an Affordable Housing Summit in May 2001 and in a report published the following September (Mallach 2001). The task force agreed on the need to create more mixed-income development, and consultants recommended a citywide inclusionary housing policy as a key strategy for achieving this goal. During the next year, the zoning board worked to design the inclusionary housing policy and program, and in 2003 Stamford established a mandatory policy.

Appealing to the Public

Wherever housing costs are rising, the public is likely to be concerned and want to see local government take action to preserve affordability. But it can be challenging for policy makers to connect the important technical details of any proposed inclusionary policy with broad public values. Many ordinances have been adopted without significant efforts to educate and engage the public, but it is harder to pass a strong policy if leaders focus only on the details. Appealing directly to the public helps to garner political will for reaching widely shared goals.

When officials in Arlington County, Virginia, conducted a poll of 1,700 local residents, they found that "requiring affordable housing units when developers build or renovate housing" was one of the most popular among several housing strategies. Seventy-two percent of county residents supported this strategy, and only 24 percent opposed it (Frederick 2014).

A nearly decade-long effort led by the Non-Profit Housing Association of Northern California (NPH) shows how broader public outreach can make a difference. NPH supported inclusionary housing campaigns in 20 jurisdictions and published a 77-page *Inclusionary Housing Advocacy Toolkit* designed to help local advocacy campaigns better communicate with the public (Non-Profit Housing Association of Northern California 2003). The toolkit helped local neighborhood and faith-based organizations engage with this complex issue and led to the successful adoption of 14 new inclusionary policies. These activities created a widespread sense that inclusionary housing is a normal part of the development landscape throughout the San Francisco Bay Area (Stivers 2014).

In Denver, Colorado, City Councilwoman Robin Kniech discovered the power of direct appeal when she led a yearlong process to update the city's inclusionary housing ordinance (IHO). Kniech lost a key committee vote after developers convinced some of her colleagues that the city should study the issue further. After the loss, Kniech appealed directly to voters through an op-ed in the *Denver Post* titled, "What Can

Wherever housing costs are rising, the public is likely to be concerned and want to see local government take action to preserve affordability. But it can be challenging for policy makers to connect the important technical details of any proposed inclusionary policy with broad public values.

Denver Do When a Hot Housing Market Hurts?" (Kniech 2014a). In a subsequent interview, she said, "Very few of my constituents understood the technical issues involved, but they were almost universally supportive of our goals. . . . We won in the media coverage because our city is changing in ways that most people are not comfortable with, and everyone liked the idea that the council was taking that seriously" (Kniech 2014b). After publication of her op-ed, Kniech won strong support from Denver's mayor, and the new ordinance passed the city council by a safe margin.

Researching Market Feasibility

In a number of communities, economic feasibility analyses have been a useful technical tool to help policy makers get the details right. They have also been a vehicle for building public support for an inclusionary policy. Typically, this kind of analysis involves staff or consultants researching development economics and demonstrating that local projects can safely support the costs associated with provision of affordable housing without adversely affecting construction or housing values.

Salinas, California, is a farming town in one of America's most productive agricultural regions. But the area is also located near the California coast, sandwiched between vacation communities such as Monterey and bedroom communities in Silicon Valley. It was no surprise when, in the early 2000s, rising housing prices began displacing the town's historic working class. Salinas had adopted a relatively weak inclusionary housing ordinance in 1992, but by 2002 rapidly rising prices convinced some local policy makers that a higher requirement might be appropriate. They wondered how high they could reasonably go.

Salinas hired Bay Area Economics (BAE) to evaluate the economic feasibility of inclusionary requirements for 15 to 40 percent of new residential units. BAE built a complex financial model that enabled the city to understand how changes in these requirements might impact the overall profitability of likely development projects. They modeled five different types of residential development, including single-family detached homes, town houses, and multifamily rentals. They chose prototypes that were similar to projects that had recently been completed and interviewed local developers to verify their assumptions.

BAE determined that a typical local project provided profit equal to roughly 10 percent of the total development cost. Then they evaluated the feasibility of various designs for the inclusionary housing requirements. Designs that yielded profits at or above 10 percent of development cost were considered "feasible." Some project types were feasible with a 35 percent affordable housing requirement, and others could support only 20 percent. BAE concluded that an ordinance requiring 20 percent affordable units would be generally feasible for the vast majority of projects (Bay Area Economics 2003). This analysis gave the city the confidence it wanted to pass an update to their ordinance unanimously in 2005.

It is important to keep in mind that when a study like this one shows below-normal development profits, that result could imply only a short-term problem. Over time, developers should be able to negotiate lower prices from landowners. Therefore, some studies also evaluate the likely longer-term impact of proposed requirements (and incentives) on land values.

Any kind of feasibility study is necessarily somewhat imperfect, but the goal is to give policy makers a general sense of the likely impact of proposed housing requirements and incentives on land prices and development profits. Ultimately, a detailed feasibility study is the only way to address legitimate concerns about whether affordable housing requirements could do more harm than good.

Engaging Private Developers

In some communities, private developers, homebuilders, and others in the real estate industry have been outspoken opponents of inclusionary housing programs. In other areas, these same parties appear to have accepted or become key advocates for more effective programs. A concerted effort to engage and listen to the real estate development community can make a program stronger and more effective, and it can also win support or neutralize opposition from a powerful set of stakeholders.

While it would be unrealistic to expect developers to champion policies that increase their costs or

In North Cambridge, Massachusetts, four units are priced below market rate in the 7 Cameron Avenue development, connected by a greenway to bustling Davis Square in Somerville. *Credit: City of Cambridge*

administrative burdens, developers can be supportive of inclusionary housing for a number of reasons. First, public opposition to development is a key risk faced by developers and providing affordable housing can help win public support for development. Second, inclusionary housing requirements can also garner support for higher-density development, which is often more profitable. Third, in communities that sometimes demand affordable housing as a condition of approval for high-profile projects, a formal inclusionary ordinance can make requirements more predictable, thus reducing a developer's risks. Inclusionary requirements, when coupled with development-by-right rules or expedited processing, can also reduce delays and financial risk for developers.

In Chapel Hill, North Carolina, a college town of 60,000 people in the state's research triangle area, the town council passed a resolution in 2005 calling for formal consideration of an inclusionary housing program. A council-appointed task force included a range of stakeholders, including advocates for lower-income families and private real estate representatives, who helped develop the inclusionary ordinance and recommended its adoption. It was passed in June of 2010.

Prior to adoption of the mandatory policy, Chapel Hill began to negotiate routinely with developers to secure commitments for affordable housing whenever projects requested zoning changes. The specific requirements varied from project to project, however, so reaching agreements became burdensome for the town and developers. Council member Sally Greene, who ran for office promising to enact inclusionary housing, reported that throughout the process "opposition from the development community wasn't substantial, and the chamber of commerce was supportive. Developers needed something that was standardized. They need to know what the rules are, but they are willing to work with us. They're willing to build upon what was accomplished in the past and give this a try" (Greene 2014).

Conclusion

Little has been written about the process through which local communities develop and adopt inclusionary housing policies. Nonetheless, many communities have created their policies through a similar process of (1) studying and understanding the housing need and the full spectrum of available tools; (2) educating and engaging the public; (3) researching the market economics; and (4) engaging with the real estate community.

The Veloce Apartments is a transit-oriented development with 64 affordable units in Redmond, Washington. *Credit: City of Redmond*

CHAPTER 4

Designing a Policy

Affordable homes for seasonal ski resort workers and others are made possible by the inclusionary housing ordinance in Park City, Utah. *Credit: ULI Terwilliger Center for Housing*

Given that no two communities are exactly alike, no two inclusionary housing policies should be identical either. But, regardless of their location, policy makers must consider a number of standard questions in order to create a program that suits local conditions. While every policy should address each of these considerations, the answers will differ considerably from place to place.

Key questions include:

- Should affordable housing units be required for all projects or only for projects that voluntarily elect to access certain benefits?
- What income group should the program serve?
- Should requirements apply across the whole jurisdiction or only to targeted neighborhoods?
- What is the set-aside requirement (i.e., the share of units that must be affordable)?
- Should builders be allowed to pay a fee in lieu of providing affordable units on-site, and, if so, how much should it be?
- Should developers be allowed to provide the required affordable units at off-site locations?
- Should developers receive any incentives or cost offsets to reduce the economic impact of providing affordable units?
- Do affordable units have to be comparable in design to market-rate units?
- How long must regulated units remain affordable?

Program Structure: Mandatory or Voluntary

Traditionally, most inclusionary housing programs mandate the provision of on-site affordable units in market-rate developments. A small number of voluntary programs are structured to offer incentives in exchange for affordable units.

Communities with a mandatory inclusionary housing program simply require that some percentage (usually 10 to 30 percent) of new units built be affordable for low- or moderate-income households. These communities may also offer developers incentives such as increased density to offset the cost of providing the affordable units, but the developer has no choice about *whether* to provide them.

Other communities offer developers a choice. Under these voluntary inclusionary housing programs (sometimes called "incentive zoning" programs), developers receive certain valuable bonuses, such as the right to build at higher density, in exchange for providing affordable homes.

Mandatory programs are more common: 83 percent of the 512 programs identified by the 2014 Network-CHP Project were mandatory (Hickey, Sturtevant, and Thaden 2014). The Non-Profit Housing Association (2007) found that voluntary programs in California produced significantly fewer homes than mandatory programs, in part because most California programs offered only fairly modest density bonuses. In communities where development density was a hot-button issue, elected officials were unwilling to increase heights significantly. However, voluntary programs have some notable political and legal advantages. In a few states where mandatory affordable housing requirements are prohibited by law, programs that offer bonus density or other incentives in exchange for voluntary production of affordable housing may be allowed. Even where state law allows mandatory requirements, the idea of trading density for affordable housing may be more acceptable politically than outright requirements.

The more recent trend toward urban infill and transit-oriented development has given rise to a new breed of voluntary programs that appear promising. A number of cities have adopted inclusionary requirements that apply only to targeted areas that benefit from significant upzoning. However, there is no guarantee that a voluntary program will produce a significant volume of affordable housing, even when the incentives are potentially significant.

A study of Seattle's voluntary incentive zoning program found that, for many projects, lower-density alternatives were more economically attractive than higher-density options, due to the high cost of steel frame construction. Thus, even without any affordable housing requirements, most developers were unlikely to take advantage of the density bonus that Seattle offered (David Paul Rosen & Associates 2014). The les-

son seems to be that, for a voluntary program to work well, the incentives have to be very valuable.

Identifying Beneficiaries

Because it is not possible for cities to meet all local housing needs, it is necessary to prioritize certain income groups or geographic areas. Some cities prefer to target one particular need that is not met by the market or other publicly funded programs, and other jurisdictions prefer to address some of the need across all incomes.

Income targets should be based on a clear analysis of local needs and should consider both supply and demand for housing at different price points. Inclusionary housing programs tend to serve low- and moderate-income households (those that earn between 60 and 120 percent of the local median income). Many cities face more acute housing needs at lower incomes, and some choose to design their programs to generate at least some units affordable to very low- and extremely low-income residents (earning less than 50 or 30 percent of median income). Figure 4 documents how selected cities target different income groups.

Cities that want to create units for lower-income residents have a number of options. Common strategies are to (1) allow developers to provide fewer units with deeper affordability; (2) pay developers or give them additional incentives to deepen the affordability

Figure 4

Income Targeting in Selected Programs

Data Source: Hickey, Sturtevant, and Thaden (2014).

level; (3) add additional subsidy to rent or sell units at alternative affordability levels; and (4) accept in-lieu fees and partner with nonprofits to build housing with deeper affordability.

For example, Arlington County, Virginia, conducted a careful study of local housing needs that compared U.S. Census Bureau data on the distribution of local households by income with data on rents and home prices. Not surprisingly, the study found that the number of households earning less than 30 percent of the median income was three times greater than the number of affordable units available. It also found shortages of affordable housing for households earning up to 80 percent of median income, and an adequate supply of affordable homes for households earning above 80 percent of median income (Sturtevant and Chapman 2014). Based on this analysis, the county's Affordable Housing Working Group recommended targeting their inclusionary program to serve households earning 60 percent of median income or less.

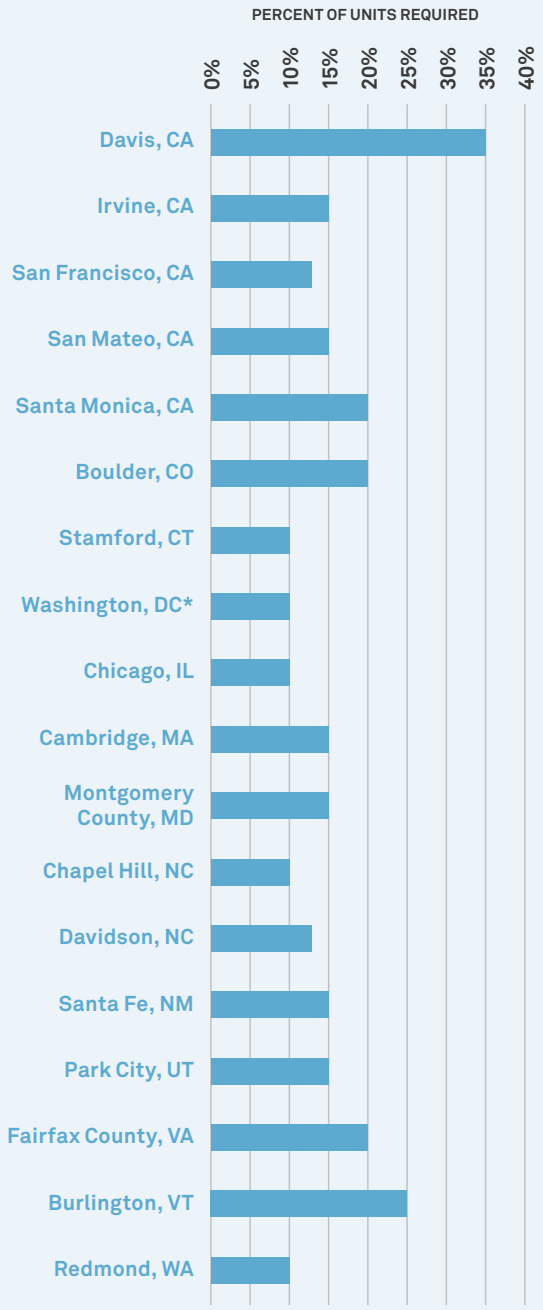
Geographic Targeting

Some inclusionary housing programs apply the same requirements uniformly across an entire jurisdiction, some programs apply requirements only to targeted neighborhoods expected to experience significant growth, and others vary requirements by neighborhood.

For instance, Burlington, Vermont, requires 15 percent affordable units citywide, but it requires 25 percent of units to be affordable in higher-cost waterfront areas. On the other hand, a few cities such as Chapel Hill, North Carolina, have done the opposite and lowered their requirements in the highest-density areas because higher-density construction can be significantly costlier. Using a different approach, Fairfax County, Virginia, varies requirements by construction type rather than by neighborhood. The requirements range from 5 percent in developments with structured parking

Figure 5

Set-Aside Requirements in Selected Programs



**Washington requires the greater of 8 to 10 percent floor area or 50 to 75 percent of the bonus density.*

Source: Hickey, Sturtevant, and Thaden (2014).

to 12.5 percent in single-family and low-rise multifamily developments with a sliding-scale density bonus.

Geographically targeted programs such as these may be more complex to design and administer, and they still may fail to capture all the important fine-grained differences among projects. It is also worth noting that most citywide inclusionary requirements automatically compensate for some differences in neighborhood market conditions. For instance, it may be more expensive to build in high-cost neighborhoods, but a density bonus is worth more where the home prices or rents are higher.

The Set-Aside Requirement

Every inclusionary housing program should also consider how much of a city's affordable housing needs developers should be expected to meet. Typically, cities establish this basic requirement as a percentage of the units or square footage area of each development that must be set aside to be rented or sold at affordable prices on-site (figure 5).

Many cities then allow developers to choose among one or more alternative methods of satisfying the requirement, such as paying a fee or producing off-site units. Some cities allow developers to build fewer units if they serve a higher-need population. In any case, the baseline performance option sets the economic bar against which other alternatives are evaluated, so it must be appropriate for local market conditions.

In a neighborhood of single-family homes, this duplex in Redmond, Washington, is affordable on the left side and market-rate on the right. *Credit: City of Redmond*

Increasingly, cities commission economic feasibility studies to bring real market data to bear on this essential question. Traditional inclusionary housing programs are designed around the assumption that units will be provided on-site even if the program allows payment of fees as an alternative. These programs generally evaluate the economic feasibility of their performance requirements and then set in-lieu fees so they are economically comparable to (or slightly more expensive than) the performance requirements. Alternatively, fee-first impact or linkage programs study the economic feasibility of the fee and then design a performance alternative requirement (i.e., on-site construction of affordable units) that is economically comparable.

In-Lieu Fees

It's a challenge to design requirements that work equally well for every potential real estate project, so most cities offer developers a menu of alternative ways to satisfy their affordable housing requirements. The most common alternative is to pay a fee in lieu of on-site production. In-lieu fees are generally paid into a housing trust fund and used (often along with other local funding sources) to finance affordable housing developed off-site.

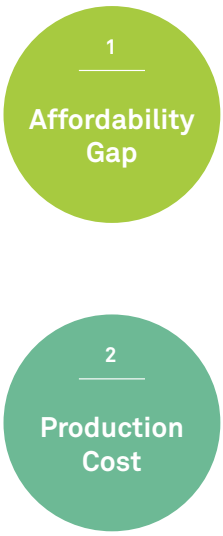
Jurisdictions use multiple formulas to set fee levels (figure 6). A key factor that often shapes those decisions is whether a jurisdiction wants to encourage on-site performance or collect the revenue to leverage other sources of funding to build affordable units off-site. All other things being equal, the higher the fee, the higher the chance that developers will choose to build units on-site. A number of communities have made the mistake of setting in-lieu fees far below the cost of on-site performance, and this practice has resulted in poor overall performance of the affordable housing program.

Over time, a city's preference for fees relative to on-site units may evolve according to changes in the market or other factors. Somerville, Massachusetts, created its inclusionary program at a time when local nonprofit developers did not have the capacity to build large quantities of affordable housing. Consequently, the city set its fees very high. According to the city's inclusionary administrator, "It was a very punitive formula aimed at discouraging developers from taking this option" (Center for Housing Policy 2009, p. 6). As the nonprofit development community matured and built capacity, the city decided that it preferred receiving trust fund revenue and lowered its fees. By adjusting its program approach in response to changing local conditions, Somerville was likely able to produce more units than would have been generated by either approach applied consistently.

Under the right circumstances, off-site production with in-lieu fees can result in more affordable homes than on-site production, but increased production

Figure 6

Approaches to Setting the In-Lieu Fee



Linkage Fee Programs

Linkage fees (sometimes called impact fees) are an alternative to traditional inclusionary zoning programs. Although the name is similar, linkage fees should not be confused with in-lieu fees. In some states, communities can charge developers a fee for each square foot of new market-rate construction and use the funds to pay for affordable housing. These programs are actually structured to require fees rather than units on-site. Initially, commercial linkage fees were developed to apply to commercial projects where an on-site housing performance requirement would be impractical or even undesirable. More recently, as state prohibitions on rent control have been interpreted to prohibit inclusionary programs that require affordable rents, a number of communities have converted traditional programs to those based on a housing linkage fee or impact fee.

A small number of "fee first" programs require payment of fees but offer as an alternative the provision of on-site units "in lieu" of paying the required fees. In these cases, the programs are almost identical to traditional inclusionary housing programs, but they are designed around a different legal rationale.

To enact an affordable housing linkage fee on commercial or residential development, cities generally conduct a "nexus" study, which evaluates the extent to which new development projects contribute to the local need for affordable housing and estimates the maximum level of fees that would offset this impact of these projects.

There are a number of advantages to linkage fees. Like in-lieu fees, they offer flexibility and can leverage other sources of funding. However, because land is likely to be more affordable and easier to obtain in lower-income neighborhoods, a reliance on fees may further economic segregation. Another disadvantage is that linkage fee programs may generate fewer resources for affordable housing than traditional programs would.

An informal analysis by the Non-Profit Housing Association of Northern California found that among Bay Area jurisdictions that replaced traditional on-site performance-based programs with impact fees, all adopted impact fees were less than the in-lieu fees of their prior programs. The reason was that, while the in-lieu fees had been based on the cost of providing an affordable housing unit, the impact fees were based on a nexus study. Most cities chose to set their impact fees well below the maximum fee suggested by their nexus studies to avoid possible legal challenges.

is not automatic. Effective use of fees relies on the presence of a number of key resources, which are not necessarily available in every community. These include the availability of other locally controlled financing sources to leverage inclusionary housing funds, the capacity of public agency staff, the availability of local nonprofit or private partners with affordable housing development experience, and the availability of land for development of affordable housing. Even when all these elements are present, successful off-site strategies require careful attention to where units are located if a program aims to achieve some level of economic integration.

Many cities have written these fees as specific dollar amounts in their ordinances. Over time, a fixed fee will drop in relation to inflation and the cost of providing affordable housing. Some communities keep fixed fees current by enabling the city council to annually approve a change to the fee calculation, but these yearly approvals can be a challenging source of local controversy. In response, a number of communities have begun to index their fees to allow for regular increases (and potentially decreases) in response to market conditions. Santa Monica, California, annually increases its in-lieu fee according to an index that takes into account annual changes in the cost of construction and local land values.

This inclusionary home in the Sand River Cohousing community was developed through the Santa Fe Homes Program in New Mexico. *Credit: Pauline Sargent*

CAN FEES BE MORE EFFICIENT?

Through the incentive zoning program in Seattle, Washington, developers who provide on-site affordable units receive bonus density in certain targeted areas. In most zones, however, the program gives developers the option to pay an in-lieu fee instead. Between 2002 and 2013, in every case where developers had this choice, they chose to pay the fee because it was far less costly than producing on-site affordable units.

Cornerstone Partnership analyzed data from Seattle's Office of Housing to better understand the outcomes of these trade-offs (Jacobus and Abrams 2014). Consistent with earlier studies, Cornerstone found that the city took several years to spend the fees received. However, by investing this money in nonprofit projects, the city was able to leverage these funds with state and federal resources to produce significantly more units than would have been provided in on-site projects. Cornerstone found that the additional $27 million of in-lieu fees enabled the city to finance 616 additional units that would not have been built without the inclusionary funds.

Additionally, this local money enabled the city to bring in $97 million in federal and state funds that otherwise were unlikely to be invested in Seattle. Furthermore, Cornerstone's analysis found that Seattle invested the fees primarily in projects located downtown and in other higher-cost central neighborhoods—the same neighborhoods where the projects paying the fees were located (Jacobus and Abrams 2014).

Other cities may have a hard time matching Seattle's performance in this regard. Seattle has relatively high capacity both within its Office of Housing and among its network of nonprofits, without which lower rates of leverage would be expected. Even in Seattle, limited land in central locations is likely to make it increasingly difficult over time to continue relying exclusively on fees to achieve meaningful economic integration.

The "opportunity cost" of providing units on-site (i.e., what the developer gives up by selling or renting for less than market value) is higher for higher-priced units, but the in-lieu fee is likely to be the same for all projects. As a result, when a single fee is set according to expected average costs, there will be a natural tendency for higher-end projects to prefer paying the fee and lower-end projects to prefer on-site production (figure 7).

In many communities, this tendency is not a problem, but some communities have found that it leads to further concentration of affordable housing in lower-income neighborhoods. Nevertheless, some jurisdictions have effectively designed programs so that fees advance economic integration, and others have found ways to create more affordable homes without increasing segregation.

Off-Site Development

Another common alternative to on-site housing performance is the right to build mandated affordable units on another site. Generally this is done by constructing

a dedicated project where all the units are affordable. A 2004 survey found that two-thirds of programs in California allowed developers to do off-site construction (California Coalition for Rural Housing 2004). When done well, off-site production can provide flexibility to developers and increase production. However, cities need to develop guidelines to ensure that off-site properties are located in appropriate neighborhoods, built to a high standard of quality, and well maintained over the long term.

Santa Monica, California, has one of California's older inclusionary housing programs. It allows developers the option of providing units off-site, but only when doing so will result in additional public benefit. Specifically, Santa Monica requires that builders provide 25 percent more affordable units in off-site projects than would have been required on-site. To promote economic integration throughout the community, off-site projects must be located within a quarter mile of a market-rate project, though projects up to one mile away are allowed if they will not result in overly concentrated affordable housing.

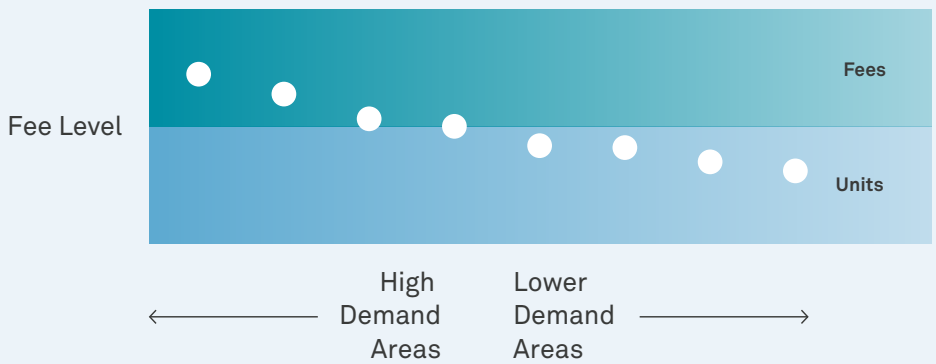
LEVERAGING OTHER AFFORDABLE HOUSING RESOURCES

Many jurisdictions prohibit developers from using scarce federal, state, and local affordable housing funds on the same affordable units as those required by the inclusionary program. A city could end up with no increase in affordable housing units as a result of such "double-dipping."

In general, cities are more cautious about using funds that are highly limited. For example, many cities will allow developers to utilize tax abatements but prohibit the same projects from applying for housing grant funds. A second general guideline is that access to external funding should be balanced against the burdens required or requested of a developer. In many communities, developers are allowed to access affordable housing subsidies only when doing so enables them either to provide more affordable units or to serve more lower-income households than would otherwise be required.

Figure 7

In-Lieu Fees and Economic Integration



NONPROFIT PARTNERSHIPS AND LAND DEDICATION

While direct off-site development can be challenging for both cities and developers, a number of communities have found that encouraging off-site production through partnerships with nonprofit housing developers facilitates implementation and may produce more affordable housing. Nonprofit developers often have considerable expertise in both building and managing affordable housing. They are skilled at combining various funding sources to get the most possible units. A well-run nonprofit is also likely to be a good steward of the units, protecting the affordability in perpetuity and potentially reducing the monitoring and enforcement burden on city staff.

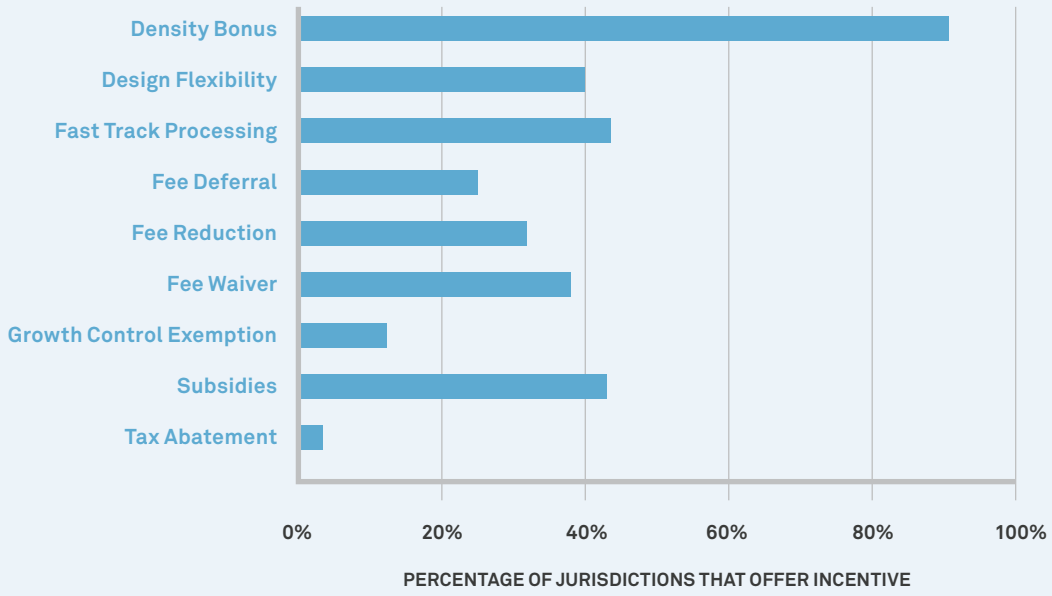
However, there are limits to the benefits of such partnerships. For example, nonprofits often do not have the seed funding to do predevelopment work or to purchase land. A number of cities have designed their off-site production rules to encourage these partnerships. A few, including New York City, allow off-site development only if there is a nonprofit partner that will own the off-site project.

Incentives

The Non-Profit Housing Association of Northern California (2007) and Hickey, Sturtevant, and Thaden (2014) found that most communities offer significant incentives to developers to offset the cost of providing affordable housing units. The most common incentive is the ability to build with increased density, but other common incentives include parking or design waivers, zoning variances, tax abatements, fee waivers, and

Figure 8

Developer Incentives



Source: Non-Profit Housing Association of Northern California (2007).

Park City, Utah, utilized in-lieu fees from its inclusionary zoning program to build the Snow Creek Cottages, which are deed restricted to maintain affordability. *Credit: Rhoda Stauffer*

expedited permitting (figure 8). While a small number of communities seek to offer incentives to fully offset the cost of providing affordable units, incentives are seen as a way to reduce but not eliminate the economic impact on development in most programs.

These incentives are sometimes criticized as "giveaways" to developers. Calavita and Mallach (2009) point out that incentives generally come at a real cost to the public sector. If inclusionary housing requirements are modest enough to be absorbed by land prices, then any incentives merely move the cost from landowners back onto the public. Incentives such as tax abatements and fee waivers reduce revenues available to jurisdictions, just as cash subsidies would to development projects. Even planning incentives such as density bonuses, which appear free, result in increased infrastructure and other public costs.

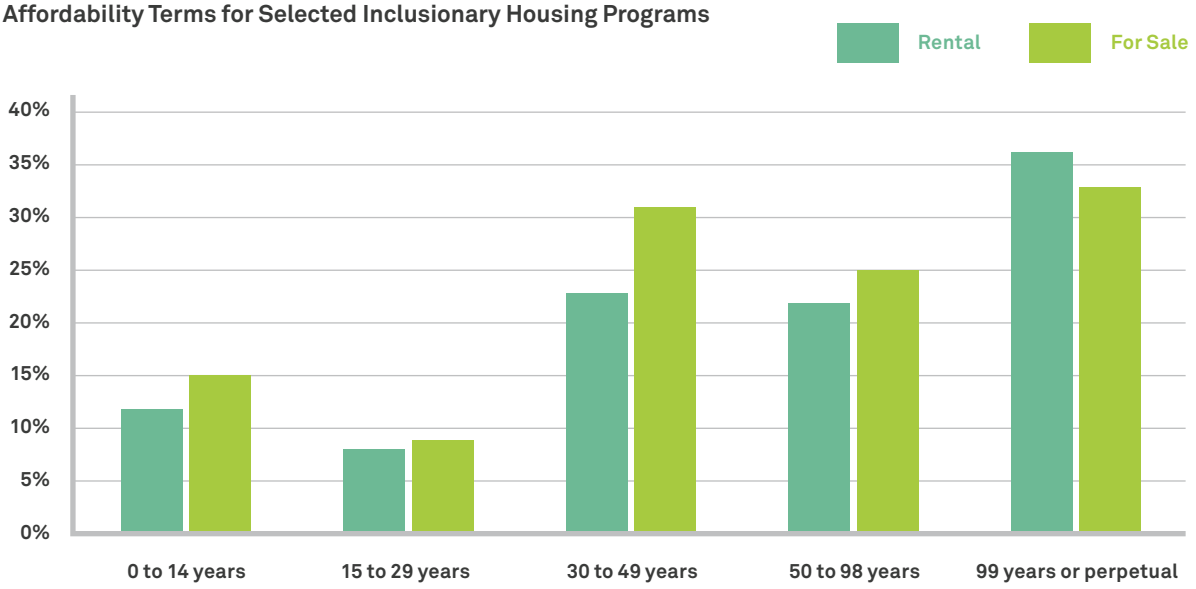
When communities base inclusionary requirements on detailed feasibility studies, it becomes clear how incentives can play a role in maximizing the impact of an inclusionary housing program. If the goal of an inclusionary requirement is to enable developers to earn "normal" profits while capturing some share of "excess profits" for public benefit, any incentive a city can offer to make development more profitable enables the imposition of an inclusionary requirement higher than would otherwise be feasible. However, communities have to carefully weigh the costs and benefits of each incentive and evaluate them relative to the cost of meeting specific affordable housing requirements.

Design Standards

It is difficult to design and implement inclusionary housing policies with appropriate standards to ensure quality affordable housing, given developers' under-

Figure 9

Affordability Terms for Selected Inclusionary Housing Programs



Includes 330 inclusionary housing programs for which affordability term data is available. Source: Hickey, Sturtevant, and Thaden (2014).

standable desire to minimize costs. Some cities have insisted that affordable units be identical in every respect to market-rate units, but it can be hard to defend the public policy rationale behind requiring granite countertops and luxury ranges in affordable units. On the other hand, providing developers with no standards has its own risks. One California developer sold affordable units without any kitchen cabinets (Jacobus 2007a).

An additional concern is the location of affordable units in market-rate developments. There might not be a clear public benefit in requiring that a proportional share of units with waterfront views are affordable, but some standard regarding where affordable units can be located is clearly appropriate.

Many communities develop specific minimum standards. Some programs require that affordable homes be externally identical to market-rate units, but others provide developers with a list of specific requirements regarding minimum unit size and amenities. So long as affordable units meet these standards, they can be different or less costly to build than market-rate homes.

Affordability Preservation

In booming housing markets, it would do little good to require affordable homes or apartments without providing a mechanism to ensure that the units remain affordable over time.

Between 1973 and 2005, Montgomery County, Maryland, created more than 12,000 affordable homes through its widely copied inclusionary program. Because the affordability of those homes was regulated for only 10 years, however, by 2005 only 3,000 of those units were still affordable (Brunick and Maier 2010). If inclusionary programs are to create and preserve mixed-income communities, long-term restrictions are vital for a program to have a lasting impact. After all,

if homes expire out of a program and return to market rate after a few decades, the program won't actually increase the stock of affordable housing.

Well-designed inclusionary housing programs are able to offer homebuyers meaningful and safe asset-building opportunities while concurrently preserving a sustainable stock of homes that remains affordable for future generations.

The overwhelming trend has been for inclusionary housing programs to adopt very long-term affordability periods (figure 9). In 2005, Montgomery County amended its program to require 30 years of affordability for new projects, and to administrate a new 30-year restriction each time a property is sold. A recent national study found that more than 80 percent of inclusionary housing programs require units to remain affordable for at least 30 years, and one-third of those require 99-year or perpetual affordability (Hickey, Sturtevant, and Thaden 2014). Even programs with 30-year affordability restrictions frequently aim to preserve affordability in perpetuity by "resetting the clock" on each transaction and by maintaining the preemptive option to buy back the unit upon transfer.

It is not entirely clear who benefits from shorter-term restrictions. For homeownership projects, a developer forced to sell units with 15-year restrictions faces the same economic cost as selling units with 99-year restrictions. For rental properties, the economics are a bit more complex. An investor might pay more for a property with rent restrictions that expire after 15 years than for one with 99-year restrictions, but the difference might be slight. In other words, the length of affordability makes a big difference to the long-term impact of the program but only a small difference on the front end.

Policy makers sometimes feel that they are forced to choose between preserving affordability and offering wealth-building opportunities to homeowners. However, research strongly suggests that well-designed inclusionary housing programs can achieve both goals.

A team from the Urban Institute studied economic outcomes for buyers in seven homeownership programs with long-term affordability restrictions and found that sellers were able to experience significant equity accumulation even when the resale prices were restricted to preserve affordability (Temkin, Theodos, and Price 2010). For example, the typical owner of an inclusionary unit in San Francisco, California, received $70,000 when he sold the home. Even with the strict price restrictions on resale, the typical owner earned an 11.3 percent annual return on the home investment—far more than would have been earned through other investment options (Temkin, Theodos, and Price 2010).

Well-designed inclusionary housing programs are able to offer homebuyers meaningful and safe asset-building opportunities while concurrently preserving a sustainable stock of homes that remains affordable for future generations.

Conclusion

Communities that are developing inclusionary housing programs must take the time to consider carefully each of the issues described above. Because real and important political and market conditions differ from place to place, there is no single best approach that should be used everywhere. However, that does not mean that each jurisdiction has to reinvent the wheel. Inclusionary housing is a well-tested local policy, and much has been learned about how to make it work in a variety of contexts.

CHAPTER 5

The Challenges of Economic Integration

In San Francisco, 1400 Mission is a 100 percent affordable apartment complex built by the nonprofit Tenderloin Neighborhood Development Corporation. *Credit: Tenderloin Neighborhood Development Corporation*

The desire to create and sustain more mixed-income communities has been a key motivation behind many inclusionary housing programs. The evidence suggests that most inclusionary programs are able to deliver affordable housing efficiently and at the same time integrate those units into areas of economic opportunity that other affordable housing programs have difficulty reaching. At the extremes, however, communities are sometimes forced to choose between housing the greatest number of households and integrating that housing into the greatest range of environments.

Does support for this general goal of economic integration imply that we need to ensure integration into every project? To address the more extreme cases, it is important to look closely at the motivation for polices that promote economic integration, the research on the effectiveness of mixed-income housing, and the pros and cons of each approach (table 1). Recent experiences in San Francisco and New York City offer insights into the challenges of meeting broad goals and expectations with a single policy.

Mixed Income, Mixed Results

Since the mid-1980s, a broad consensus among scholars and urban planners has emerged in support of the idea that housing policies should encourage the creation of more mixed-income communities. The work of William J. Wilson (1987) highlighted the serious and compounding challenges that result from overconcentration of urban poverty and suggested that social isolation of people in high-poverty neighborhoods

Table 1

Comparison of On-Site and Off-Site Production

	ADVANTAGES	DISADVANTAGES
ON-SITE	• Ensures access to high-opportunity neighborhoods • Is easier to enforce design quality • Has low risk of ongoing maintenance problems • Provides integration in the same building, which can be symbolically important and help build public support	• Can be difficult to monitor scattered units • May produce fewer family-sized units • May not be economically feasible for all project types • Is harder to incorporate very low-income or special needs residents
OFF-SITE	• Can be more cost-efficient (i.e., can often produce more total units) • Can leverage other affordable housing subsidies to produce additional units or serve lower-income residents • Can design and operate properties to meet the needs of the local population (e.g. family units, amenities, social services, etc.)	• May concentrate affordable units in lower-income areas • May produce lower-quality buildings • May lead to lower-quality long-term maintenance • Presents risks of "double-dipping," whereby developers reduce their costs by relying on scarce affordable housing subsidies

might lead to the creation of an "underclass" that is very hard to escape. While the supposed "culture of poverty" does not appear to explain the results, there is clear evidence that even better-off residents suffer significant social and economic disadvantages when they live in neighborhoods with very high concentrations of poverty.

In one example, the Pew Charitable Trusts' Economic Mobility Project followed 5,000 families to determine whether children moved up or down the income ladder relative to their parents. Surprisingly, the study found that the poverty rate in the neighborhood where children grew up strongly predicted their economic mobility as adults, even more strongly than differences in their parents' education levels or occupations (Sharkey 2009).

It is easy to see that children who live in distressed communities face tougher odds. But what we haven't

Case Study: San Francisco

San Francisco's Central Market neighborhood has been changing. One of the most high-profile changes has been a new, 19-story luxury apartment building called NEMA, located directly across the street from Twitter's new headquarters. NEMA is billed by its developer as not simply upscale but "inspirational" living because of the wide range of high-end amenities, from 24/7 spa treatments to dog walking services. Like other recent developments, NEMA was required to rent 12 percent of its 750 units to low-income residents at affordable prices.

To document this program, filmmaker Michael Epstein followed one of the lower-income families that moved into NEMA. After falling on hard times, the Ramirez family had been living in a van under the Golden Gate Bridge and then briefly in a homeless shelter before moving into the gleaming new NEMA tower. And yet Yesenia Ramirez describes her family's new living situation as "awkward." The building has no other children, but it does have a "doggie spa" (Epstein 2014).

Next door to San Francisco's NEMA apartment tower, another residential tower is being built by the nonprofit Tenderloin Neighborhood Development Corporation (TNDC). Like the affordable units at NEMA, this project also resulted from San Francisco's inclusionary housing program. But in the TNDC project, all of the 190 apartments will be affordable to low- or moderate-income families. Where NEMA offers mostly studio and one-bedroom units, TNDC's project has mostly two-bedroom and even some three-bedroom apartments. TNDC was able to build this project with financial support from the developer of a nearby 650-unit luxury condo project that elected to take advantage of the off-site production option under San Francisco's inclusionary program (Conrad 2014). This off-site partnership will produce far more affordable units than the developer would have been required to provide on-site.

This kind of compromise has been controversial in San Francisco, where many housing advocates are understandably concerned that developers will see the off-site option as a loophole, allowing them to provide substandard housing in undesirable locations. On-site inclusion of affordable units within market-rate projects seems to work well most of the time, and it remains the city's preferred outcome. Most of the city's inclusionary residents comfortably blend into market-rate projects where the cost of affordable and market-rate units are not quite so far apart. Collecting fees or creating off-site projects might be less efficient in many of these cases. But luxury projects like NEMA, where the benefits of inclusion decline as the costs increase, make it clear that on-site units may not always be the best option.

been able to prove before is whether those underprivileged neighborhoods attract families who would face challenges anywhere, or whether it is something about the places themselves that negatively affects the kids.

A new study from Harvard University (Chetty and Hendren 2015) has added very strong new evidence to support the conclusion that the places themselves matter. Economists studied children who moved from "worse" to "better" neighborhoods and found that kids who grew up in better neighborhoods earned more as adults when compared to kids who didn't move or who moved to a worse neighborhood. And the effect grew over time. The younger kids were when they moved, the greater the gains. Similarly, the researchers found that younger siblings in families that moved experienced better economic outcomes relative to their older brothers and sisters who spent less time in the better neighborhood before entering adulthood. This research suggests that housing policies encouraging greater economic integration will lead to better economic outcomes for lower-income children.

Concentrated poverty was clearly an outcome of the housing policies of the mid-twentieth century. But by the end of the century, many housing programs explicitly began seeking to create more mixed-income communities. A range of mixed-income housing programs and policies has been studied widely, and while the results are sometimes contradictory, the evidence paints a fairly consistent picture of both the potential and the limitations of mixed-income housing.

On the positive side, lower-income residents appear to benefit socially and economically from mixed-income communities. In a series of carefully designed experiments, inner-city public housing residents were offered housing vouchers that would enable them to rent market-rate apartments for no more than they had been paying in public housing. Families that moved to neighborhoods with low poverty levels saw

Case Study: New York

In 2009, New York City made a set of changes to its zoning rules—including one that would allow developers of inclusionary projects to concentrate their affordable units in separate buildings on the same lot. Separating the affordable units in this way was considered more economically efficient and enabled these developers to access additional tax benefits. While many cities prohibit this practice, New York's inclusionary program is voluntary. After considering the alternative—developers opting out of the program—city leaders decided that the benefit of more voluntary units would outweigh any negative consequences.

Five years later, this obscure change of policy made national headlines because of the placement of a single door on one property. Several developers had already taken advantage of the new policy without apparent controversy. But an approved development on Riverside Boulevard came under intense public scrutiny because it featured two doors—one on Riverside Boulevard for buyers of the luxury condos selling for up to $25 million, and one on 62nd Street for the tenants paying as little as $850 a month.

The *New York Times* referred to the second door as a "poor door" and called the practice "distasteful" (Bellafante 2014). A state assemblywoman said, "It looks and smells like discrimination" (Navarro 2014). Somehow, in a city that had long allowed off-site development, the idea of separating affordable residents within a site had seemed like an acceptable compromise. But the *image* of mixed-income buildings with two different doors touched a raw nerve with the public.

physical and mental health improvements and increased self-esteem and motivation. The studies also showed that those who moved to higher-income areas were more likely to be employed, although their wages were no higher than those of residents who relocated in low-income neighborhoods (Levy, McDade, and Dumlao 2011).

Integration of lower-income residents into middle- and upper-income *neighborhoods* can be very valuable, but integration in the same *building* may offer few additional benefits.

Many policy makers pursued mixed-income housing policies in the hope that social interactions between lower-income and higher-income residents would lead to better access to jobs or other resources for lower-income residents. The research clearly suggests that these hopes are not realistic. Explaining her opposition to "poor doors," Manhattan Borough President Gale Brewer described her aspirations for inclusionary housing to the *Wall Street Journal*: "I'm hoping that as time goes on, people will share play dates, and I hope that they'll do BBQs together" (Kusisto 2014).

The Urban Institute reviewed dozens of studies of housing programs that promoted mixed-income communities and found little evidence of any meaningful social interaction between lower-income and higher-income neighbors in mixed-income developments. It also found no evidence that lower-income residents reliably benefitted from the employment connections or other "social capital" of their higher-income neighbors (Levy, McDade, and Dumlao 2011). Even among members of the same income and racial groups, this kind of social interaction among neighbors appears to be rarer than is often imagined.

Integration of lower-income residents into middle- and upper-income *neighborhoods* can be very valuable, but integration in the same *building* may offer few additional benefits.

Ensuring Access to Opportunity

This research result does not mean that on-site performance is not a key way to achieve the real benefits that economic integration does offer. Inclusionary housing programs with on-site performance requirements may be one of the very few successful strategies available for integrating lower-income housing into high-opportunity neighborhoods at all.

Recent research has shown just how hard it is to achieve economic integration through traditional affordable housing strategies. A 2012 New York University study found that the vast majority of subsidized affordable housing was located in neighborhoods with poor performing schools. The schools nearest to public housing projects had a median state test score ranking in the 19th percentile (81 percent of schools performed better). Low Income Housing Tax Credit projects did slightly better; their nearest schools ranked in the 30th percentile. But even families with portable housing choice vouchers ended up in locations where the nearest school had a median rank in the 26th percentile. For a variety of reasons, these families who should have been able to rent anywhere ended up in neighborhoods where 75 percent of kids qualified for free lunch at school (Ellen and Horn 2012). Decades after embracing "deconcentration of poverty" as a federal housing policy goal, most federal programs don't appear to be achieving meaningful economic integration.

By contrast, the results of another 2012 study suggest that inclusionary housing programs have been more successful in achieving this goal. Heather Schwartz and her colleagues at the RAND Corporation mapped the locations of affordable units created by inclusion-

ary policies in 11 cities. They found that the typical inclusionary unit was in a neighborhood where only 7 percent of the population lived in poverty (half the national average for all neighborhoods). Children in these inclusionary units were assigned to schools with state test scores ranking in the 40th to 60th percentile and with lower-than-average numbers of students eligible for free lunches. Noting the stark contrast with other affordable housing programs, the authors concluded that "while [inclusionary housing] programs serve relatively more-advantaged families than other subsidized housing programs, the degree of access [inclusionary housing] provides to low-poverty neighborhoods is still remarkable" (Schwartz et al. 2012, p. 15).

Local policy makers have to struggle with how much importance to place on integrating lower-income households into higher-income neighborhoods. While we should be careful not to expect significant social mixing, the real economic and health benefits from living in higher-opportunity locations are sufficient to justify policies that promote integration. But for a variety of reasons it is very difficult to build affordable housing in higher-opportunity neighborhoods. Inclusionary housing is one of the only housing strategies that effectively integrates lower-income households into higher-income, higher-opportunity locations.

Frazer Court in Redmond, Washington, offers six affordable units to families making 80 percent of the area's median income. *Credit: City of Redmond*

CHAPTER 6

Addressing Legal Concerns

by Ben Beach

A father and daughter anticipate construction of their affordable home in the Old Las Vegas Highway development in Santa Fe, New Mexico. *Credit: John Baker Photography*

State and Federal courts have repeatedly upheld inclusionary housing measures, which have been adopted by hundreds of jurisdictions across the country. While some state laws have substantially limited the options available to local policy makers, in any jurisdiction there is almost always a path to an effective, legally defensible inclusionary policy. This chapter addresses four of the most important legal considerations for inclusionary housing programs: (1) takings standards; (2) on-site performance requirements; (3) linkage or impact fees; and (4) fees collected in lieu of providing required units on-site. It also looks at policy and priority differences among states.

Takings Standards

The legal issue most commonly implicated by inclusionary housing measures is known as "takings," derived from the prohibition in the U.S. Constitution against taking private property without just compensation. Courts confronted with a takings challenge to an inclusionary housing measure may apply one of two quite different standards. One standard, set forth by the U.S. Supreme Court in the *Penn Central* case, should apply to generally applicable land use controls, such as a simple mandatory inclusionary housing ordinance that merely requires on-site inclusion or off-site production of affordable units. To be considered a taking under the *Penn Central* precedent, a local ordinance would have to be so drastic in its effect that it is functionally equivalent to a "classic taking," in which the government directly appropriates private property.

In a pair of cases known as *Nollan* and *Dolan*, the Supreme Court outlined a stricter standard for exactions—development conditions imposed ad hoc or through negotiation as part of the land use approval process. These cases center on the "unconstitutional conditions" doctrine, which limits the government's authority to condition the grant of a privilege or benefit (such as a building permit) when a proposed condition contains a mandate (such as a requirement to dedicate land to the public) to give up or refrain from exercising a constitutional right. Under the *Nollan/Dolan* standard, such a requirement must (1) have an "essential nexus" to the impact of the development that is being mitigated by the condition (i.e., there must be a clear relationship between the impact of the development and the required mitigation); and (2) the condition must be "roughly proportional" to the impact that the development is likely to have on the problem that the condition is intended to mitigate. The Court recently clarified that the *Nollan/Dolan* analysis applies to conditions imposed in the development approval process that take the form of monetary fees (*Koontz v. St. Johns River Water Management District*).

While a number of cases have established some clear guidelines, the exact treatment of various inclusionary housing policies is still being considered by courts across the country, and it may be some time before all the relevant issues are resolved. Two important questions can help make sense of the confusion: (1) Is the measure in question imposed ad hoc or is it generally applicable? and (2) Is the purpose of the measure to mitigate a project's impact or instead to accomplish a legitimate regulatory goal under the jurisdiction's police power?

It is clear that generally applicable on-site affordable housing requirements can be structured as expressions of a jurisdiction's police power to regulate land use. If so, they should be evaluated under the *Penn Central* standard when subject to a federal takings challenge. To date, no court has used the *Nollan/Dolan* standard to review a generally applicable mandatory inclusionary zoning ordinance.

It is also clear that measures imposed ad hoc should be evaluated under *Nollan/Dolan*. And it is somewhat likely that linkage fees or impact fees designed as mitigations will be evaluated under *Nollan/Dolan*, or some other standard examining the relationship between the cost of compliance and the impact of the project on the problem. What is less clear is how the courts should treat fees charged in lieu of on-site performance, which seem to be quite different from traditional land use regulations.

Which of these standards a court chooses to apply in evaluating a challenge to an inclusionary housing measure has significant implications for policy making. First, the *Nollan/Dolan* standard requires extensive documentation to establish the appropriateness of the measure in question. Second, the proportionality requirement places an upper limit on the level of fees charged, which is almost certainly well below any upper limit imposed by the *Penn Central* standard. Under *Penn Central*, a land use regulation can significantly constrain the potential uses of a property

regardless of whether or how much a given development would contribute to a social problem—as long as the regulation advances a legitimate government purpose and leaves the property owner with *some* profitable use of the property.

Recently, the California Supreme Court addressed several of these issues in a case involving a takings challenge to the City of San Jose's inclusionary housing ordinance, *Cal. Bldg. Indus. Assn. v. City of San Jose*, 61 Cal. 4th 435 (2015). The ordinance required that developers of residential projects with 20 or more new, additional, or modified dwelling units set aside 15 percent of on-site for-sale units as affordable, or meet one of the alternative performance requirements, such as providing affordable housing off-site or paying an in-lieu fee. The court concluded that the ordinance should be treated as a traditional land use control, not as an exaction, and should be reviewed under the deferential standard reserved for such controls. The court observed that the city's legitimate purposes in adopting the ordinance were to increase the supply of affordable housing and to distribute affordable housing across economically diverse neighborhoods. The court clarified that the "unconstitutional conditions" doctrine applies only in cases where the condition at issue, if imposed directly by the government, would amount to a taking because it required conveyance of a property interest. San Jose's inclusionary housing ordinance, the court determined, did not require the subject developer to convey property to the public, but instead operated as a *price control* on housing reviewable under *Penn Central*.

On-Site Performance Requirements

Citywide or neighborhood-wide inclusionary requirements, where properly drafted, should be entitled to great judicial deference as generally applicable exercises of the local government's authority to regulate land use under its police powers (*Euclid v. Amber Realty Company; Village of Belle Terre v. Boraas*). The legitimate purposes of inclusionary housing ordinances may include accommodating a community's projected needs for affordable housing, addressing the effects of prior exclusionary zoning, providing equal opportunity to all income levels, providing housing for the workforce, addressing the dwindling supply of land, and affirmatively advancing integration and other fair housing goals (California Affordable Housing Law Project/Public Interest Law Project 2010). Unlike a housing impact fee, for example, inclusionary housing ordinances are not principally intended to mitigate the impact of particular development projects and should not be described as such.

It is sometimes argued that inclusionary housing requirements should be evaluated under the *Nollan/Dolan* standard instead. The California Supreme Court's approach to the question of which standard to apply has been widely used in other states. Under that approach, generally applicable land use controls, even when applied to development through the mechanism of the land use approvals process, are considered police power legislation. The more rigorous *Nollan/Dolan* review is reserved for measures imposed on individual development projects on an ad-hoc basis (*Ehrlich v. City of Culver City*). It is thus advisable for local jurisdictions to adopt citywide or neighborhood-wide inclusionary requirements that are generally applicable, rather than those imposed ad hoc during the land use approval process.

A jurisdiction may want to undertake an economic feasibility study to support any contemplated inclusionary housing requirement. Such a study should aim to satisfy the *Penn Central* test by showing that the proposed requirements do not completely disrupt economic returns from the project in question. A feasibility study should factor in any subsidy or other economic value contributed by the local government to the projects through upzoning or other regulatory relief. Jurisdictions should not rely on a nexus study to support generally applicable on-site performance

requirements, because doing so might imply that the inclusionary requirements were intended to mitigate project impacts rather than advance legitimate police power objectives.

Local jurisdictions can take these additional steps to help strengthen the legal defensibility of their inclusionary housing requirements: (1) include a goal in the community's comprehensive or general plan that future growth of the community must include a specified percentage of affordable housing; (2) make clear that any on-site performance requirement is an exercise of the city's police power, advances a legitimate government interest, and is not intended to mitigate the impact of development; (3) make administrative waivers available; and (4) consider including a periodic review of the on-site performance affordable housing percentage in light of market conditions.

Linkage and Impact Fees

In general, federal and state courts have repeatedly upheld impact fees (and other similar development fees) against challenges maintaining that they are takings. However, courts are likely to apply the *Nollan/Dolan* standard in evaluating such fees.

In *Commercial Builders of Northern California v. City of Sacramento*, the ninth circuit court upheld Sacramento's commercial linkage fee ordinance against a takings challenge. The challengers argued that Sacramento failed to show that the nonresidential development on which the fee was imposed generated a need for affordable housing proportionate to the burden created by the fee. The court rejected this argument, reasoning that the ordinance "was implemented only after a detailed study revealed a substantial connection between development and the problem to be addressed" (*Id.* at 875).

Local jurisdictions contemplating adoption of linkage or impact fees would be well-advised to commission a nexus study, which demonstrates the relationship between a contemplated fee and the impact of the development that the fee is intended to mitigate. Commonly, these studies use well-established industry methodologies to calculate the contribution of a set of projects (residential or commercial) to worker in-migration and the ensuing need for new affordable housing. Such studies are designed to help localities meet the *Nollan/Dolan* test by establishing both the "essential nexus" and "rough proportionality" required by the court in those cases.

In-Lieu Fees

Is an in-lieu fee the kind of fee imposed in the development approval process that is subject to *Nollan/Dolan*? In development fee cases, courts have followed the California approach of distinguishing between legislative measures and those imposed on an ad hoc basis. "With near uniformity, lower courts applying *Dolan* . . . have expressly declined to use *Dolan's* heightened scrutiny in testing development or impact fees imposed on broad classes of property pursuant to legislatively adopted fee schemes" (*Rogers Mach. v. Wash. County*). As long as the in-lieu fee requirement is structured to allow for negligible discretion in calculation and application, the fee should not be subject to *Nollan/Dolan,* because it is not ad hoc or negotiated (*San Remo Hotel v. City and County of San Francisco*).

However, California courts have further determined that even a generally applicable formulaic development impact fee must still bear a "reasonable relationship" to the impacts the fee is intended to mitigate (*Ehrlich v. City of Culver City*), a standard somewhere between *Penn Central* and *Nollan/Dolan* in its deference to local authority. In the event that a court views an in-lieu fee as an impact fee (rather than as a land use control) and applies such a standard, the local government still has a strong defense available. An inclusionary in-lieu fee is customarily structured to cover the cost of developing affordable units that

would otherwise have been included on-site in the project. That "loss" of on-site units is precisely the impact the fee is intended to mitigate. Thus, where they follow conventional design, such fees are likely to be seen as meeting the California courts' "reasonable relationship" standard.

In *City of San Jose*, the court quickly dismissed the challengers' contention that the presence of an in-lieu fee option meant that the ordinance as a whole should be reviewed under a heightened standard appropriate for measures designed to mitigate impact. The court noted that no developer was required to pay the in-lieu fee and that a developer could always opt to satisfy the ordinance by providing on-site affordable housing units (61 Cal. 4th at 476).

There is every reason to believe that courts will continue to uphold the basic right of local governments to promote the welfare of their residents by ensuring the availability of housing that is affordable to lower-income households.

Variations Among State Laws

It is no coincidence that inclusionary housing programs are heavily concentrated in a few states. California, New Jersey, and Massachusetts all have (or had) state laws that strongly encourage or even require local inclusionary housing policies. Adopting inclusionary policies in other states often requires significant research into any special state constitutional provisions or statutes that might limit local authority.

In California, Colorado, and Wisconsin, state courts have interpreted laws relating to rent control to bar localities from using inclusionary housing measures to regulate rents, but not the price of ownership units. Local jurisdictions in all these states have, despite these legal limitations, successfully implemented at least one of the inclusionary housing strategies discussed in this report.

The National Association of Home Builders produced a summary of state laws that either support or impede local inclusionary housing ordinances. They found that 13 states (Connecticut, Florida, Illinois, Louisiana, Maryland, Massachusetts, Minnesota, Nevada, New Hampshire, New Jersey, Rhode Island, Vermont, and Virginia) have statutes that either explicitly or implicitly authorize local inclusionary policies. Two states (Texas and Oregon) have explicit prohibitions against inclusionary housing. In many of the remaining states, key state policy concerns shape the design of local inclusionary policies (Hollister, McKeen, and McGrath 2007).

In some cases, changes or clarifications to state law can help promote local adoption of inclusionary housing policies. Florida housing advocates managed a decade-long campaign that resulted in the passage of more than a dozen inclusionary ordinances. This campaign succeeded in large part due to a sustained legislative effort to pass two laws: one to ensure that price and rent control provisions in mandatory inclusionary programs were legal under state law, and one to support the creation of local community land trusts to manage inclusionary and other housing units (Ross 2014).

Conclusion

It is important for jurisdictions adopting inclusionary housing programs to pay close attention to the evolving case law on this issue. But there is every reason to believe that courts will continue to uphold the basic right of local governments to promote the welfare of their residents by ensuring the availability of housing that is affordable to lower-income households.

CHAPTER 7

Planning for Successful Implementation

Affordable homes at Mueller Austin are interspersed throughout various neighborhoods built by different developers. *Credit: Catellus Development*

The success of an inclusionary housing ordinance rests on the jurisdiction's ability to appropriately staff and fund ongoing program administration. Staff must have specialized skills to engage successfully with developers of complex real estate projects. Once inclusionary units are completed, monitoring and stewardship of rental units and especially homeownership units require dedicated staffing on an ongoing basis to ensure that units remain affordable and that the program is meeting its stated goals. The cost of this staffing is small relative to the value of the affordable housing being managed, but jurisdictions have to plan for this ongoing expense.

Case Study: Denver, Colorado

The case of Denver, Colorado, illustrates how staffing differences in two types of inclusionary housing programs made a big difference in preventing foreclosures.

In 2012, the city's 10-year-old inclusionary housing ordinance (IHO) faced an unprecedented challenge. Staff reported to the city council that the IHO had created 1,155 affordable homeownership units, but that 185 of those homes had been lost to foreclosures (Denver Office of Economic Development 2012). This news created enormous political pressure to reform or even repeal the program. Some were tempted to conclude that inclusionary housing could not work in Denver.

At the same time that Denver was developing a citywide inclusionary program in the early 2000s, the commission overseeing the reuse of Denver's Lowry Air Force Base established its own inclusionary housing policy. Developers at Lowry were required to make roughly 900 homes affordable to lower-income families (Webster 2005). Over the same period of time that 185 of the city's inclusionary units went into foreclosure, there were zero foreclosures at Lowry. What caused this difference?

Lowry had created a community land trust (CLT) to monitor and manage its affordable homes. While the city had a single staff person managing more than 1,000 affordable units, Lowry's CLT had two to three people working closely with only 186 homeowners. The CLT pushed for more affordable prices, prevented buyers from taking out adjustable-rate mortgages, and stepped in when homeowners got into trouble (Harrington 2013). In 2013, Denver established emergency measures that helped avoid further foreclosures. In 2014, the city council passed a comprehensive redesign of the program that included provisions to increase the staffing for administration and to outsource some capacities.

Roles for Program Staff and Contractors

Successful implementation of an inclusionary housing program requires staff with specialized skills necessary to coordinate and oversee complex real estate developments, screen buyers and tenants, and then monitor units over time. Table 2 summarizes some of the functions that staff or contractors typically perform.

SUPPORTING THE PRODUCTION OF AFFORDABLE UNITS

No matter how detailed and well-conceived an inclusionary housing ordinance is, some situations will call for human judgment to implement the program fairly and act in the best interest of the community. It is not sufficient to simply publish rules and expect developers to implement them successfully. City staff, or staff of some partner agency, must help developers interpret and apply the inclusionary policies. In many communities, staff has some discretion to waive certain requirements, approve alternatives, or bring additional resources such as fee waivers or housing funds to the table for projects to achieve high levels of public benefit.

However, achieving flexibility is no simple task. Staff has to work closely with developers to evaluate the impact of inclusionary requirements on a project's financial performance and to develop alternative proposals that benefit the developer and the community. This requires some level of technical skill, and cities sometimes struggle to find staff with the necessary experience. Occasionally, cities turn to outside consultants or other partners to perform these tasks.

Mammoth Lakes, California, is a ski resort town with very high housing costs. The town adopted affordable housing mitigation regulations that require developers of new housing, hotels, resorts, or commercial real

Table 2

Key Functions to Be Performed by Staff or Contractors

1 | Supporting the Production of Affordable Units

- Communicating program requirements to developers and property managers
- Reviewing development proposals for compliance with rules
- Negotiating certain requirements to maximize production (in some communities)
- Ensuring that affordable units meet appropriate design and location standards
- Ensuring timely payment of fees (if any)
- Planning and implementing reinvestment of fee revenue to produce affordable units

2 | Monitoring and Stewarding Rental Units

- Setting affordable rents
- Working with property managers to ensure fair marketing of units
- Monitoring eligibility screening for new tenants
- Recertifying annual incomes of tenants
- Enforcing requirements (as necessary)

3 | Monitoring and Stewarding Homeownership Units

- Setting initial prices at an affordable level
- Marketing homes to eligible buyers
- Ensuring that potential buyers receive homebuyer education
- Verifying that applicants understand program requirements and resale restrictions
- Screening applicants against eligibility requirements
- Working with lenders to ensure access to appropriate financing
- Monitoring homes for owner occupancy over time
- Managing resales to future income-eligible buyers at formula price
- Enforcing program requirements when necessary

estate to develop new affordable housing units as part of these projects. However, town leaders recognized that the community lacked the capacity to manage detailed negotiations with developers. They turned to a local nonprofit, Mammoth Lakes Housing (MLH), for assistance. The town contracts with MLH to provide a number of services, such as monitoring their entire portfolio of resale-restricted housing, collecting data on housing needs, working with private developers to ensure compliance with the housing mitigation ordinance, and assisting the town to address its housing goals (Hennarty 2013).

MONITORING AND STEWARDING RENTAL UNITS

The majority of inclusionary programs rely heavily on property management companies to ensure ongoing compliance of inclusionary rental units, but many administrators report significant challenges resulting from this approach (Hickey, Sturtevant, and Thaden 2014).

Programs frequently expect managers of rental properties with inclusionary units to market available

units, screen applicants for program eligibility, document and annually recertify tenant incomes, and take action to address noncompliance. Many cities provide ongoing training for property managers to help them understand the rules they are charged with enforcing, and most undertake some level of monitoring to ensure that managers are applying the rules appropriately and equitably. However, problems are still common.

Programs must plan ahead to cover administrative costs adequately in both high-growth and low-growth periods.

Most property management companies have no experience with affordable housing programs, and it can be challenging to rely on them to enforce potentially complex public agency rules. As a result, a growing number of programs are centralizing some of these responsibilities, often in-house. Hickey, Sturtevant, and Thaden (2014) describe how the City of San Mateo, California, centralized waiting lists and screening due to the high turnover of property managers. Now the city manages a single applicant pool and sends prescreened tenants to property managers to fill vacancies.

MONITORING AND STEWARDING HOMEOWNERSHIP UNITS

Ensuring long-term affordability for homeownership units is more challenging than it is for rentals and requires attention to a wider range of issues. Cornerstone Partnership and the National Community Land Trust Network led a yearlong process that engaged dozens of practitioners and several national homeownership organizations to create a set of "Stewardship Standards" to preserve long-term affordability. The standards include more than 41 independent program elements and policies that participants believed were essential for successfully preserving long-term affordability as well as resources such as sample documents and templates to facilitate the adoption of best practices (Cornerstone Partnership 2014a).

Ownership units require more active involvement, and property management companies do not offer the needed expertise for these activities. As a result, most cities with portfolios of inclusionary homeownership units have significant staffing dedicated to managing and monitoring those units.

NeighborWorks America and NCB Capital Impact reviewed the staffing levels among a wide range of affordable homeownership programs with long-term restrictions, including many inclusionary housing programs. They found that staffing levels varied significantly, with small programs managing fewer than 100 units per employee and some larger programs overseeing 500 or more units per employee. Their report said, "It seems prudent to plan on staffing at the level of one full-time staff person (or equivalent) focused exclusively on post-purchase monitoring and resale administration for every 150 to 300 affordable homeownership units" (Jacobus 2007b).

Many cities have turned to third-party administrators to assist with the tasks of monitoring and enforcing deed restrictions on homeownership units. These third-party partners are most often nonprofit organizations, but a number of private firms provide administrative services to dozens of local jurisdictions in New Jersey. One type of partnership showing particular promise is when jurisdictions work with community land trusts (CLTs) to implement inclusionary programs. For example, Community Home Trust, a CLT in Chapel Hill, North Carolina, plays a key role in the administration of the city's inclusionary housing program.

Funding Administrative Costs

Programs must plan ahead to cover administrative costs adequately in both high-growth and low-growth periods. PolicyLink documented the many sources

The Arbor Rose development in San Mateo, California, offers seven affordable town houses with either one or two bedrooms. *Credit: Sandy Council*

that inclusionary housing programs rely on to fund ongoing administration (Jacobus 2007a). The most common sources were local government general funds and federal housing block grant funds. However, many communities use a portion of inclusionary housing fee revenue to pay for program administration. A number of communities have developed fee structures that grow over time as administrative demands grow. A few charge tenants or homebuyers application fees, and a growing number charge significant fees when inclusionary homeowners resell or refinance their homes. In cases where the inclusionary program staff manages significant aspects of the resale, fees as high as 3 percent of the resale price may be appropriate.

Community land trusts typically charge homeowners a monthly ground lease fee to help defray administration costs, and a small number of cities including Chicago have included similar administration fees in deed covenants. Salinas, California, charges owners of inclusionary rental units an annual monitoring fee as well.

Measuring Impact

Too often, a lack of external compliance requirements results in literally no system for tracking outcomes of inclusionary housing programs. Schwartz and her colleagues at the RAND Corporation evaluated whether inclusionary programs were achieving significant economic inclusion. She reported that "no jurisdiction had all the information we requested, and . . . no jurisdiction regularly tracked demographic information and sales prices or rents across successive occupants of units" (Schwartz et al. 2012).

While it is not uncommon for academic researchers to conclude that more data is necessary to answer important questions, the question that Schwartz was

HomeKeeper Tracking System

Recognizing the need for better outcome tracking, Cornerstone Partnership brought together practitioners from multiple communities to develop a data system called HomeKeeper, which several inclusionary programs are using to monitor program outcomes. The City of Cambridge, Massachusetts, recently adopted HomeKeeper, and housing manager Anna Dolmatch reported that "it has eliminated multiple spreadsheets, and we no longer have to search through paper files for information" (Eng 2014, p. 1).

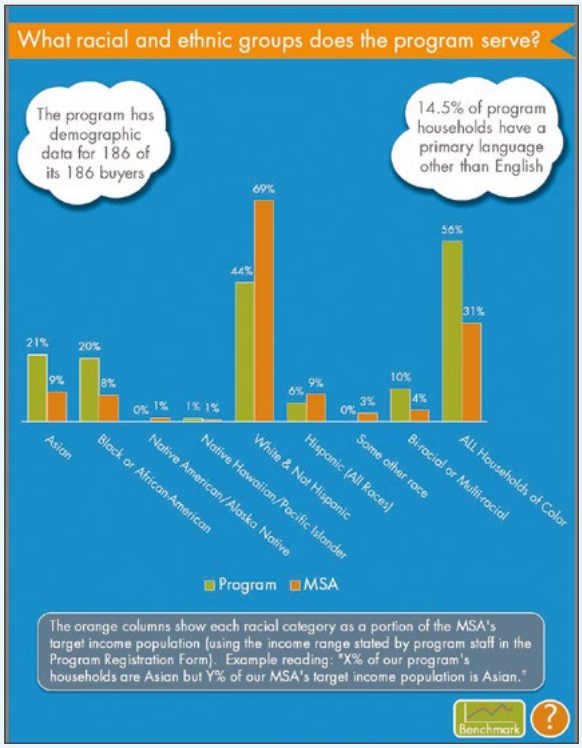
HomeKeeper captures demographic and income data from households at the time they are applying, enables management of waiting lists and lotteries, and automates screening for eligibility. Once units are occupied, HomeKeeper helps staff monitor ongoing activities. For homeownership units, HomeKeeper tracks all the financial data related to the sale and financing of a home, helps staff manage resales, and ensures ongoing affordability. As a by-product of automating these administrative systems, HomeKeeper captures the key data necessary to understand a program's impact.

HomeKeeper users receive an annual "Social Impact Report" that summarizes program performance and includes an overview of the type and location of units produced and the demographic and income characteristics of residents. The report also shows trends over time, such as how resident income compares with program income limits, the ongoing affordability of units, the difference between below-market-rate prices and market prices, the amount of equity earned by home buyers, and their annualized rate of return. Because more than 60 programs participate in the HomeKeeper project, these reports can not only present each program's outcomes, but they can also benchmark those outcomes against the performance of a national peer group (Cornerstone Partnership 2014b).

Figure 10 presents an example of the kind of information available from a HomeKeeper report. The chart compares the racial demographics of a program's buyers to a pool of income-eligible households in the local area. This particular program is reaching African American and Asian families but underserving Hispanic households. Without this benchmarking data, these trends would be hard to track.

Figure 10

Sample Metrics from a HomeKeeper Social Impact Report



Source: Cornerstone Partnership

The Sand River Cohousing development in Santa Fe, New Mexico, provides homes at below-market rates for senior citizens. *Credit: Angela Werneke*

researching was the very issue that most likely motivated the creation of many of these programs. In fact, the data she needed was exactly the same kind of data that the staff routinely provide for federally funded housing projects.

Some communities have begun to require annual reporting on program activities. Sacramento County, California, for example, includes inclusionary reporting as part of a broader biennial report. It must include the number of units produced, the amount of land dedicated and purchased, the amount of funds collected, and the levels of affordability among the units created.

These annual reports are not as common as they should be, but those that exist do not seem to address policy makers' need for analysis of program performance. One exception is Monterey County, California, where the inclusionary zoning policy requires both an annual report and a more in-depth five-year report. The annual report is a brief summary of the program's accomplishments over the previous years. The five-year report includes the number of units produced and households served, the amount of in-lieu fees collected and how those fees are used, and recommendations for policy revisions. This report is presented for public comment. Ultimately, all inclusionary housing programs—both individually and collectively—would benefit from significantly improving and standardizing data collection and performance metrics.

Conclusion

Inclusionary housing programs cannot be successful unless they are well run and adequately staffed, and they must secure sufficient funding for ongoing administrative costs. Communities also need to be able to track program data in order to evaluate outcomes and make needed changes over time.

CHAPTER 8

Conclusions and Recommendations

The Pacifica Cohousing Community maintains seven energy-efficient, permanently affordable units on its eight-acre property in Carrboro, North Carolina. *Credit: Community Home Trust*

The evidence summarized in this report strongly supports the idea that local inclusionary housing policies can fairly and effectively tie production of affordable housing to the construction of new market-rate real estate development.

Inclusionary housing offers a way to expand and preserve a supply of housing that is affordable to lower-income people. The responsibility for affordable housing is increasingly being devolved to states and localities as federal resources become scarce, and inclusionary housing programs offer an effective way for private-public partnerships to address this ongoing need.

Growing communities can implement inclusionary policies to generate significant amounts of affordable housing without negatively affecting market-rate development. Ultimately, inclusionary programs can impose meaningful costs on developers, but when they are coupled with incentives, the net impact on development is typically modest, neutral, or even occasionally positive. The affordable housing requirements that can be supported without overburdening development, however, differ from one community to another. Hence, effective policy design and program implementation are crucial for successful results.

Most importantly, inclusionary housing offers one of the only effective strategies for overcoming economic segregation and building sustainable mixed-income communities. The evidence suggests that economic integration is an important way to combat the negative effects of generational poverty. It also suggests that residents across all income levels benefit from (1) reducing sprawl (and the associated costs for taxpayers); (2) living in more sustainable cities; and (3) experiencing cultural, racial, and economic diversity.

While building-by-building integration is not always necessary, traditional publicly subsidized affordable housing programs have struggled and largely failed to achieve neighborhood-level economic integration. Ultimately, tying provisions of affordable housing directly to market-rate development removes the biggest obstacle to creating inclusive communities: access to desirable land for development.

What Can Local Governments Do to Maximize the Impact of Inclusionary Housing?

Research supports the premise that inclusionary housing programs must be designed with care. In order to maximize the impact of inclusionary programs, local sponsoring agencies should:

BUILD PUBLIC SUPPORT

1. Build consensus around the need for greater investment in affordable housing and the desirability of a housing strategy that emphasizes mixed-income communities.

2. Engage community stakeholders, including real estate developers, in the process of designing an inclusionary program.

3. Share program results with the public on a regular basis to build ongoing support.

USE DATA TO INFORM PROGRAM DESIGN

4. Conduct an economic feasibility study prior to implementation to ensure that proposed performance requirements or fees can be reasonably absorbed by development profits and land values.

5. For programs that rely on linkage or impact fees, conduct a nexus study prior to implementation to ensure that required fees are roughly proportional to the impact of new development on the need for affordable housing.

6. Track program activity to enable policy makers to understand the program's impact and make incremental improvements.

ESTABLISH FAIR, REASONABLE EXPECTATIONS FOR DEVELOPERS

7. Provide flexibility to developers to improve the rate of production.

8. Ensure that alternatives to on-site production are economically comparable.

9. Require developers to provide increased public benefits when they build off-site units.

10. Regularly adjust incentives and requirements to ensure that the number and types of units produced align more closely with local housing needs.

ENSURE PROGRAM QUALITY

11. Pay close attention to the geographic location of units to ensure economic integration.

12. Develop design standards to ensure that the affordable units are of appropriate size and quality.

13. Plan and budget for stewardship and monitoring to protect long-term affordability.

What Can States Do to Support Local Inclusionary Housing Policies?

State legislative leadership has been essential to the growth of inclusionary housing. New Jersey effectively mandates local inclusionary housing policies, and Massachusetts and California have developed statewide policy frameworks that grant real powers to overcome exclusionary zoning policies and encourage local cities and towns to adopt inclusionary housing ordinances.

States that want to encourage but not require local inclusionary housing policies could adopt legislation that makes the legality of local inclusionary housing explicit. Just as important, states can establish clear statewide planning frameworks that (1) explicitly allow local governments to implement inclusionary housing policies, just as they have the authority to regulate other land uses; (2) prohibit local exclusionary housing practices; and (3) require local communities to proactively plan for and build affordable housing.

Affordable housing puts minds and hearts at ease. *Credit: John Baker Photography*

Without specifically mandating the strategy each community will use, policies like these create an expectation that each community will manage its growth in a way that ensures that some portion of new housing is affordable to lower-income residents.

In most cities, the need for affordable housing has never been more urgent. For many jurisdictions across the country, now is the time to consider adopting robust inclusionary housing policies that build affordable housing stock and create inclusive communities.

What Can the Federal Government Do to Support Inclusionary Housing Policies?

Inclusionary housing is not and should not be a central part of the federal government's affordable housing strategy. Local inclusionary housing programs are not a substitute for a robust federal role in the production and preservation of affordable housing. In order to make a dent in the national housing problem, federal investment in public housing, block grant programs like HOME Investment Partnerships Program and Community Development Block Grants (CDBG), and the Low Income Housing Tax Credit program must continue and expand. Local inclusionary programs can offer a way to supplement and leverage the impact of that federal investment, particularly in areas that are experiencing growth.

The federal government could take the following steps to encourage and support local inclusionary housing:

1. Remove barriers for accessing FHA-insured mortgages and the secondary mortgage market for buyers of inclusionary homes.

2. Provide incentives or preferences for the allocation of federal transportation funding to communities that develop affordable housing in concert with new transit infrastructure.

3. Educate state and local housing agencies on why inclusionary housing can be an effective tool for their comprehensive affordable housing strategies.

4. Develop a platform for tracking and monitoring the location of affordable units created through local policies (including but not limited to inclusionary policies) and combining that information with public data on the locations of federally subsidized housing to enable comparison of the performance of various programs.

5. Allow local jurisdictions to use HOME and CDBG funds to support stewardship of affordable units with long-term affordability controls.

In most cities, the need for affordable housing has never been more urgent. For many jurisdictions across the country, now is the time to consider adopting robust inclusionary housing policies that build affordable housing stock and create inclusive communities.

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Cornerstone Partnership (Cornerstone) promotes strong, inclusive communities where all people can afford a decent place to live and thrive. Cornerstone is a national peer network for homeownership and inclusionary housing programs that preserve long-term affordability and community stability. Cornerstone provides expertise on policy and practice, offers technical assistance, tools, and resources to help its members build capacity and strengthen impact, and builds connections that help programs learn from each other and share what works. Cornerstone's work supports practitioners, advocates, elected officials, consultants, and other housing professionals dedicated to helping individuals and families access equity and opportunity.

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The Network is a national nonprofit membership organization of community land trusts (CLT) and other organizations that promote strategic community development and permanently affordable housing to benefit lower income families throughout the United States. The Network supports our members by:

1. Raising public awareness of CLTs and permanently affordable housing,
2. Providing training, conferences, technical assistance, and capacity building resources for nonprofits and government organizations,
3. Researching best practices, innovations, and outcomes of membership organizations,
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Inclusionary Housing

Creating and Maintaining Equitable Communities

Roughly 500 communities in the United States have developed inclusionary housing policies, which require developers of new market-rate real estate to provide some units that are affordable to low- and moderate-income residents. For cities struggling to maintain economic integration, inclusionary housing is one of the most promising strategies available to ensure that the benefits of development are shared widely. However, policies must be designed with care to suit local conditions and guarantee that requirements do not overburden development. Through a review of the literature and case studies, this report details how local governments are realizing the potential of inclusionary housing by building public support, using data to inform program design, establishing reasonable expectations for developers, and ensuring long-term program quality.

Inclusionary housing is likely to play a more significant role in our national housing strategy in the coming decade. Faced with declining federal and state resources for affordable housing and growing populations, communities need to take full advantage of every potential tool. The evidence summarized here suggests that inclusionary housing programs produce a modest yet steady supply of new affordable housing resources. Because programs generally preserve long-term affordability, the pool of local inclusionary units can grow steadily into a significant share of an area's housing stock.

As importantly, the data suggests that inclusionary housing is one of the few proven strategies for locating affordable housing in asset-rich neighborhoods where residents are likely to benefit from access to quality schools, public services, and better jobs. Increasingly, communities across the country are investing in the creation of new transit-oriented urban neighborhoods, and inclusionary housing policies are one of the only ways to ensure that these places develop in an equitable manner. Ultimately, equitable development benefits not only lower-income households; integrated, inclusive, and diverse communities enhance the lives and outcomes of all residents.

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