

DEPARTMENT OF PLANNING AND PERMITTING
CITY AND COUNTY OF HONOLULU

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March 12, 2018

The Honorable Kymberly Marcos Pine, Chair
and Members
Committee on Zoning and Housing
Honolulu City Council
530 South King Street, Room 202
Honolulu, Hawaii 96813

CITY COUNCIL
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Dear Chair Pine and Councilmembers:

SUBJECT: Analysis of Affordable Housing Requirements in Hawaii

The Department of Planning and Permitting (DPP) has reviewed the affordable housing requirements imposed by other jurisdictions in Hawaii per your request dated February 7, 2018. The summary below highlights key elements of those policies, along with Honolulu requirements (including the 1999 to 2005 period requested). This is followed by the main takeaways that we used to draft Bill 58 (2017) for an affordable housing requirement (AHR) in the City and County of Honolulu. We found that the other counties have had more comprehensive requirements in place over the past decade, compared to Honolulu's targeted requirement that applies only to properties requesting a zone change. Please see the attached table, Affordable Housing Requirements in Hawaii, for more detailed summaries of current and past policies for each county, based on our research and anecdotal discussions with the respective county.

- **Applicability.** Other counties regulate residential and non-residential uses, including hotel and timeshare units. The Hawaii Community Development Authority (HCDA) bases its requirement solely on lot size. The City and County of Honolulu's current requirement is only for property seeking a change in zoning.
- **Regulated Period.** The other counties' required affordability periods range from five to 20 years for ownership units and 15 to 40 years for rental units. Maui and Kauai Counties require different affordability periods depending on the buyer income groups. Maui County allows a reduction in the number of affordable units if they are to remain affordable in perpetuity. The City and County of Honolulu currently requires ten years.

- **Percentage of Affordable Units.** The other counties' current requirements range from 20 to 30 percent; Maui County's 2006 policy (since revised) required 40 to 50 percent of units to be affordable. The HCDA also specifies a percentage for rental units (15 percent). Hawaii County uses a credit system (equivalent to 20 percent) that requires different amounts for resort and industrial uses. Kauai County requires 30 percent for residential projects (with discounts available) and uses project-by-project analysis for resort uses. The City and County of Honolulu currently requires 30 percent for residential uses requesting a zone change.
- **Income Groups.** Other counties require affordable units to be priced from 80 to 140 percent of area median income (AMI); Maui County's 2006 requirement allowed affordable units to be priced up to 160 percent of AMI. Maui County also specifies rental targets, ranging from 50 to 120 percent of AMI. Each county requires different percentages of the requirement to be assigned to income groups within the range, except HCDA which has an overall 140 percent of AMI requirement.
- **Marketing Periods.** Other counties allow a step up, with the affordable unit allowed to be sold or rented to the next higher income group (at the original affordable price) if it is not sold or rented within a specified marketing period, typically three months. Hawaii County also changes eligibility after specified time periods. Neither HCDA nor the City and County of Honolulu currently have marketing periods specified in their rules, although a few projects—most recently, Hoopili—have negotiated their use as part of the zone change approval process.
- **Alternatives to On-site Development.** These vary by county, such as allowing in-lieu fees, offsite construction within a specified distance or area, land dedication, infrastructure dedication, and using credits. The City and County of Honolulu currently allows in-lieu fees, finished house lots, and credits.
- **Policy Waivers.** Between 1999 and 2005 (referenced in your request), Ordinances 99-51 and 01-33 suspended the City and County of Honolulu's prior affordable housing policy on buyer eligibility and resale restrictions, while keeping in place the required affordable percentages and sales prices. Developers took advantage of this effective moratorium by also selling market rate units as "affordable" and then claiming affordable housing (AH) credits for them since the affordable price was similar to market price. Consequently, over the ensuing years, developers have used these excess ("free") credits to meet affordability requirements instead of actually building affordable units, creating a lost opportunity for new affordable housing. And since the resale restrictions were waived, the units marketed as affordable did not have to remain affordable for any set period.

Based on an analysis of the counties' current and past requirements, one can deduce why most policies have not yet delivered a stable, long-term supply of affordable housing. The requirements proposed in Bill 58 (2017) were carefully designed to be more realistic and feasible for developers than most of these other policies, including the City and County of Honolulu's current policy. The following are the lessons learned from the AHR policies implemented in the State of Hawaii.

Too many affordable units are required. Requiring too many units makes many developments infeasible, which may result in less affordable housing built than a lower requirement that allows more developments (and affordable housing) to actually get built.

- Maui County's former 2006 policy required that 40 to 50 percent of units be affordable. Their current policy requires 20 to 25 percent of the market units to be affordable.
- Kauai County requires 30 percent of units to be affordable (this can be reduced up to 50 percent with incentives such as integration with market units; all single-family units; green principles used; lower AMI range; or 40-year affordability period offered).
- The City and County of Honolulu currently requires 30 percent of units to be affordable.
- **Bill 58 (2017) would require fewer affordable units** than most current or prior policies: ranging from 5 to 20 percent of units (DPP originally proposed 10 to 25 percent of units, but has recommended further reductions to make sure the requirements will work for more projects). The proposed requirements are highest for transit-oriented development (TOD) areas, construction off-site, and for-sale units; and lower outside TOD areas and for rental units.

Income ranges are too high or too low. If income limits are set too low, development is less feasible due to a larger gap between construction costs and what buyers can pay. It can also be more difficult to find qualified, credit-worthy buyers. If income limits are set too close to market price (such as the programs requiring units between 120 and 160 percent of AMI), then the units may be difficult to market when encumbered with resale restrictions (however long the affordability period).

- Maui County's former 2006 policy required affordable units to be sold to households earning between 80 and 160 percent of AMI. Their current policy requires affordable units to be sold to those earning 80 to 140 percent of AMI, but they are reportedly still having issues with finding buyers at the higher AMI levels since they would rather purchase unrestricted market housing. Rental units are required to be rented to those earning 50 to 120 percent of AMI.

- Kauai County requires affordable units to be sold to those earning below 80 to 140 percent of AMI.
- The City and County of Honolulu currently requires affordable units to be sold to those earning below 80 to 140 percent of AMI.
- **Bill 58 eliminates the lowest income range**, requiring affordable units to be sold to those earning below 100 to 120 percent of AMI. This eliminates the requirement to sell units at prices affordable to those making less than 80 percent of AMI, since developers maintain that it is difficult to qualify buyers for purchase who earn below the 90 to 95 percent of AMI income level. It also does not permit sales of affordable units at up to 140 percent of AMI, so that the affordable units are not competing with market-price units.

The required affordability period is not a major obstacle. Despite developer testimony that the 30-year affordability period will keep projects from being financed, or that no one will buy the affordable units, there is no actual evidence (in Hawaii or the rest of the United States) that the affordability period itself has been a primary problem. Per the lessons learned, requiring too many affordable units, and/or requiring them to be sold at close-to-market prices (while still including resale restrictions), appears to be the real problem. Bill 58 was crafted to address these real issues – by requiring fewer units at more marketable prices.

Affordable housing production data is not readily available. In addition to this analysis of current and prior affordable housing programs, we understand that you are interested in the number of housing units produced under these programs. Where available, rough estimates are provided in the attached table Affordable Housing Requirements in Hawaii. The numbers are difficult to accurately obtain and interpret, in connection to affordable housing policies, as there are many factors that delay the time between when a project with affordable housing is approved and actual construction of the affordable units. This situation applies to all counties. In the City and County of Honolulu, for example, projects that were approved decades ago (under a different affordable housing policy) are only now being built due to market factors and the on- and off-site infrastructure needed before construction can begin.

The attached Summary of Affordable Housing Units Approved lists the affordable units approved and/or built in the City and County of Honolulu since January 2010 (with caveats), corresponding to implementation of the current affordable housing policy imposed through unilateral agreements on zone changes. Most counties require some level of reporting on affordable housing production, but generally not in enough detail to track production and long-term supply. Honolulu requires annual reporting on the conveyance and rental of AH units, but not all developers provide enough detail to

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determine if all of the conveyed AH units are maintained as affordable during the restriction period. The reporting requirements under Bill 58 – when coupled with the proposed monitoring system improvements – will enable more accurate and comprehensive data and reports over time.

In summary, all four Hawaii counties are utilizing a range of techniques and priorities to address affordable housing for their particular markets. Some counties have amended their ordinances as conditions have changed and as they figure out what works in the market. Maui County's 2006 policy required too many affordable units, and so did not produce any. Since the number of units required was reduced, affordable units are being built. Kauai County is beginning a technical analysis to develop updated policies.

The proposed AHR in Bill 58 (2017) was based on years of in-depth studies examining our local market conditions, meetings with the development community and housing advocates, and researching best practices. This extensive work will help ensure the successful implementation of an AHR program on Oahu.

Should you have any questions, please contact Harrison Rue of our staff, at 768-8294.

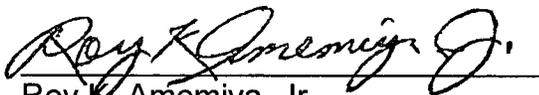
Very truly yours,



Kathy K. Sokugawa
Acting Director

Attachments: Table of Current and Prior Affordable
Housing Requirements in Hawaii
Summary of Affordability Period Analysis
Affordable Housing Units Approved

APPROVED:



Roy K. Amemiya, Jr.
Managing Director

Affordable Housing (AH) Requirements in Hawaii
City and County of Honolulu
Department of Planning and Permitting
March 2018

Jurisdiction	Applicability	Affordable Period	Percentage of affordable units	Income Target by Area Median Income (AMI)	Marketing Periods	Alternative to On-Site Development	Effective Date	Side Notes from Agency
Maui County (current)	<ul style="list-style-type: none"> 10+ of following: <ul style="list-style-type: none"> lots lodging units timeshare units dwelling units (excluding farm labor or second farm dwelling units) conversion of hotel to dwelling units hotel redevelopment expanding lodging or dwelling units by 10+ 	<p>Ownership units:</p> <ul style="list-style-type: none"> 10 years for 80-100% AMI 8 years for 100-120% AMI 5 years for 120-140% AMI <p>Rental units: 30 years</p>	25% of total market units (not total units), or 20% if in perpetuity	<p>Ownership units:</p> <ul style="list-style-type: none"> 30% at 80-100% 50% at 100-120% 20% at 120-140% <p>Rental units:</p> <ul style="list-style-type: none"> 1/3 at 50-80% 1/3 at 80-100% 1/3 at 100-120% 	<ul style="list-style-type: none"> Residents on waitlist first priority, then nonresidents after list exhausted, each by income group. Every 90 days, step up to next income group at original price. Unsold units can be sold at market rate without deed restrictions, but County receives 50% of affordable and market price differential. 	<ul style="list-style-type: none"> Allowed within same community plan area In-lieu fee Land dedication AH credits 	December, 2014	<ul style="list-style-type: none"> Previous AHR had too high % of units required that projects would not pencil. Also at issue, the % of units was tied to sales price, which did not work because it is a moving target--from the time an agreement is executing to time of sale, prices change. The trigger (applicability) was raised on the new AHR to not burden mom-and-pop developments. Changed the 25-year restriction period for ownership units because of worries that it would limit financing options at the time (e.g., higher interest rates), now at 5-10 years. A task force recommended higher numbers than were originally proposed for new AHR. The new AHR drops the 160% AMI maximum income target group to 140% AMI, but there are still issues selling at the higher AMI groups because of similarities with market prices. Developers have instead been selling AH to lower AMI groups. There was reportedly one AH agreement executed under the prior AHR, and 12-13 AH agreements since the current AHR.
Maui County (prior)	<ul style="list-style-type: none"> 5+ of the following: <ul style="list-style-type: none"> dwelling units (excluding farm labor or second farm dwelling units) <ul style="list-style-type: none"> lots combination of dwelling units and lots 3+ of following in hotels: <ul style="list-style-type: none"> lodging dwelling time share Conversion of 1+ hotel unit to dwelling or time share units Hotel redevelopment or renovation increasing # of lodging or dwelling units 	<p>Ownership units:</p> <p>25 years</p> <p>Rental units:</p> <p>in perpetuity</p>	<ul style="list-style-type: none"> 40% if 50%+ of dwelling units and/or lots for sale under \$600,000. 50% if 50%+ of dwelling units and/or lots for sale \$600,000+. 40% if 3+ lodging, dwelling, or time share in hotel; conversion of 1+ hotel unit to dwelling or time share units; hotel redevelopment or renovation increasing # of lodging or dwelling units; or 5+ rentals. 	<p>Ownership units:</p> <ul style="list-style-type: none"> 30% at 80-100% 30% at 100-120% 20% at 120-140% 20% at 140-160% <p>Rental units:</p> <ul style="list-style-type: none"> 1/3 at 50-80% 1/3 at 80-100% 1/3 at 100-120% 	<ul style="list-style-type: none"> Residents on waitlist first priority, then nonresidents after list exhausted, each by income group. Every 90 days, step up to next income group at original price. Unsold units can be sold at market rate without deed restrictions, but County receives 50% of affordable and market price differential. 	<ul style="list-style-type: none"> Allowed within same community plan area In-lieu fee Land dedication Using AH credits 	December, 2006	

Jurisdiction	Applicability	Affordable Period	Percentage of affordable units	Income Target by Area Median Income (AMI)	Marketing Periods	Alternative to On-Site Development	Effective Date	Side Notes from Agency
Hawaii County (current)	<ul style="list-style-type: none"> Zoning 5+ of following: <ul style="list-style-type: none"> residential units lots timeshare units rezoning resort or hotel uses generating 101+ full-time employees industrial enterprises generating 101+ full-time employees 	<p>Ownership units: 10 years</p> <p>Rental units: 20 years</p>	<ul style="list-style-type: none"> 5+ residential units, lots, or time share units: credits equal to 20% resort/hotel uses: 1 credit per 4 jobs industrial uses: 1 credit per 4 jobs 	<p>Ownership or rental units - minimum of required %:</p> <ul style="list-style-type: none"> 20% at 100-120% 30% at 80-100% 40% at less than 80% <p>Finished lots - minimum of required %:</p> <ul style="list-style-type: none"> 20% at up to 100% 20% at up to 80% <p>Ownership units:</p> <ul style="list-style-type: none"> 0.5 credit/unit at 120-140% 1.0 credit/unit at 100-120% 1.5 credit/unit at 80-100% 2.0 credit/unit at less than 80% <p>Rental units:</p> <ul style="list-style-type: none"> 0.5 credit/unit at 100-120% 1.0 credit/unit at 80-100% 1.5 credit/unit at 60-80% 2.0 credit/unit at less than 60% <p>Finished lots:</p> <ul style="list-style-type: none"> 0.5 credit/lot at up to 100% 1.0 credit/lot at up to 80% <p>Land dedication: 1.0 credit/unit, based on for-sale up to 80% or rental up to 60%</p>	<p>Ownership units or lots:</p> <ul style="list-style-type: none"> 0-90 days, only eligible buyers. 91-180 days, can market to qualifying clients of homeownership counselors. 181-210 days, can market to eligible persons who already owned residence. 211+ days, can market to anyone at affordable sales price. <p>Administrator authorized to allow buyers at 20% over AMI group to qualify.</p>	<ul style="list-style-type: none"> Build (for-sale or rent) within 15 miles Land conveyance (50% reduction with infrastructure) Infrastructure conveyance AH credits 	February, 2005	<ul style="list-style-type: none"> In-lieu fee was initially set too low, then too high (currently not used). Needs to be correctly calibrated, similar to option for infrastructure conveyance. Density bonus has been working to offset AHR, but still need available infrastructure to make projects work. Partnerships have been key to successful execution. Have had low turnover of AH units. Using 10-year restriction period. Using up to 140% AMI for entire county due to higher costs on west side. Private market not accomodating below 80% AMI. Current issue with AHR calculation for hotel and industrial uses since it is based on employment, instead of square footage. Buinesses are limiting employment to reduce AHR.
Hawaii County (prior)	<ul style="list-style-type: none"> Zoning for 10+ residential units Resort uses generating 101+ full-time employees Industrial uses generating 101+ full-time employees 	N/A	<ul style="list-style-type: none"> 5+ residential units, lots, or time share units: credits equal to 20% resort/hotel uses: 1 credit per 4 jobs industrial uses: 1 credit per 4 jobs 10+ residential units: 10% resort uses: 25 units per 100 employees industrial uses: based on assessment 	<ul style="list-style-type: none"> Residential and industrial uses: 140% Resort uses: 50-140% 	N/A	<ul style="list-style-type: none"> In-lieu fee Off site (additional requirements if not exclusively AH) Land conveyance Infrastructure conveyance 	January, 1998	

Jurisdiction	Applicability	Affordable Period	Percentage of affordable units	Income Target by Area Median Income (AMI)	Marketing Periods	Alternative to On-Site Development	Effective Date	Side Notes from Agency
Kauai County (current)	<p>10+ of following:</p> <ul style="list-style-type: none"> zoning and state land use under 15 acres (including previous approvals with unsatisfied housing conditions) <p>11+ of following:</p> <ul style="list-style-type: none"> subdivisions dwelling units timeshare units <p>21+ of following:</p> <ul style="list-style-type: none"> hotel rooms 	<p>Ownership units:</p> <ul style="list-style-type: none"> 20 years when income restricted 10 years when not income restricted 0 years when sold at market price <p>Rental units: 40 years</p>	<p>Residential: 30%</p> <p>Resort: based on analysis</p> <p>Incentives (max 50% reduction):</p> <ul style="list-style-type: none"> Reduced 25% if AH integrated with market units Reduced 25% if all single-family detached, no condominium property regime (CPR) Reduced 20% if all single-family attached, no CPR Reduced 0.5-5% if green principals used Each low-income rental unit equals 2 AH units if at 60% AMI, or equals 1.5 AH units if at 80% AMI; and if restricted for 40 years and no county funding/land used 	<p>Residential:</p> <ul style="list-style-type: none"> If 10-25 units, 80-140% (average = 100%) If 26+ units: <ul style="list-style-type: none"> 20% at up to 80% 30% at up to 100% 30% at up to 120% 20% at up to 140% <p>Resort: based on analysis</p>	<p>Ownership units:</p> <ul style="list-style-type: none"> 12 to 0 months before project construction, exclusively for County Mortgage-Ready Home-Buyer List (90-day period). 6 months before project complete, step up to next income group (60-day period). 4 months before project complete, no income restriction (60-day period). 61 days before project complete, no income or ownership restrictions (60-day period). After project complete, units may be sold at market price without AH restrictions. <p>Rental units:</p> <ul style="list-style-type: none"> After 60 days, no income restriction. 	<ul style="list-style-type: none"> Land dedication (within same tax zone or 5 miles) In-lieu fee 	November, 2007	<ul style="list-style-type: none"> AHR was a reactive measure to building boom at the time. No study was completed, so basically using arbitrary numbers and no units have been built. Currently redoing AHR based on best practices. Current issues with all aspects of AHR (i.e., % of affordable units, AMI levels, restriction period). Due to heavy restrictions, developers are coming in with projects under the AHR trigger (applicability). AHR was previously based on a project-by-project basis. Requirements varied, with some 10-20-year restrictions at 20% affordable, or land sales at affordable rates. 140% AMI was used so projects could be built without County funding, but it is too close to market pricing so they had to lower prices to sell.
Hawaii Community Development Authority (HCDA) (current)	<p>Multi-family dwellings on lots over 20,000 sf.</p> <p>If at least 75% of units are for buyers at 100-140% AMI, and no government financial assistance, then exempt.</p>	<p>Ownership units: 5 years</p> <p>Rental units: 15 years</p>	<p>Ownership units: 20%</p> <p>Rental units: 15%</p>	140% (assets not to exceed 135% of income limit)	N/A	<ul style="list-style-type: none"> Elsewhere in Kakaako Mauka area Elsewhere in urban Honolulu (HCDA may impose additional requirements) 	November, 2011	Documented in recent public reports regarding proposed rule changes to AHR.

Jurisdiction	Applicability	Affordable Period	Percentage of affordable units	Income Target by Area Median Income (AMI)	Marketing Periods	Alternative to On-Site Development	Effective Date	Side Notes from Agency
City and County of Honolulu (current)	Zone changes, and 10+ housing units	Ownership units: 10 years (can reset if resold while restricted) Rental units: 10 years	30% Enhancement credits possible if low-income rentals for 11+ years, neighborhood, size of units, specific target groups, and/or transit-oriented development (TOD).	Ownership or rental units: • At least 10% at up to 80% • At least 20% at up to 120% (10% if 10% at up to 80%) • At least 30% at up to 140% (10% if 10% at up to 80% and 10% at up to 120%)	N/A	<ul style="list-style-type: none"> • Conveyance to non-profit. • Rental units restricted 10 years. • In-lieu fee (100 or less units, unless extreme economic circumstance). • Finished house lots. • AH credits (up to 50% of requirement, unless in TOD). 	February, 2010	<ul style="list-style-type: none"> • Issues with credits, especially tied to moratorium years (1999-2005) when developers sold market units as affordable, due to similar pricing, and received credits. Drawdown of these credits has resulted in lost AH following reinstatement of AHR. • Issues with current reporting due to developer information provided. • A few AH agreements have allowed marketing periods. Hoopili allows step up in prices as well, providing an incentive to hold units for higher prices that are not affordable.
City and County of Honolulu (prior)	Zone changes <i>Note: Ord. 99-51 and 01-33 suspended certain AH conditions. All other conditions, including required % and price, remained in effect.</i> <ul style="list-style-type: none"> • For developer sales: <ul style="list-style-type: none"> ▪ Buyer eligibility (can sell to general public), including income limits. ▪ Restrictions on transfer of units, including City's 1st option to buy and shared appreciation. • For owner sales, if lived in unit 3+ years and City had 1st option to buy: <ul style="list-style-type: none"> ▪ Restrictions on transfer of unit pertaining to buyer eligibility. ▪ Transfer of restrictions to new buyer. 	Ownership units: • 8 years if up to 80% AMI • 4 years if 81-120% AMI • 2 years if 121%+ AMI Rental units: 10 years	30% Enhancement credits possible if low-income rentals for 21+ years, and/or size of units.	Ownership or rental units: • At least 10% at up to 80%	N/A	<ul style="list-style-type: none"> • Off site. • Conveyance to City. • Rental units restricted 10 years. • In-lieu fee. • Finished house lots. 	October, 1994 <i>Note: Ord. 99-51 and 01-33 effective August 1999 to August 2005</i>	

Affordable Housing Units Approved

Approved and/or built from January 2010 through June 2016

The development of affordable housing (AH) units is undertaken by various State, City, and private and non-profit developers. The information requested is not readily available in our current database, as the Department of Planning and Permitting (DPP) only monitors projects that have an outstanding AH obligation as part of a zone change or certain 201H projects processed by the DPP or the Hawaii Housing Finance and Development Corporation and approved by the City Council. Not for lack of trying, we have found no tools or mechanisms for the DPP to track AH units approved by the State or projects that do not require discretionary approval from the City. Building permit applications for dwelling units do not distinguish between affordable or market rate units.

As such, we are providing AH data based on projects which received discretionary approval from the City. Between January 2010 and June 2016, nine projects with AH requirements were approved by the City, for a total of 5,754 AH units. These projects are Live Work Play Aiea, Hoopili, Koa Ridge, Central YMCA Condo, Green Homes at Lualualei, Halekauwila Place, Hale Kewalo, Makali'i II at Kapolei, and Meheula Vista. Of the 5,754 units, 466 are at or below 60 percent of Honolulu's Area Median Income (AMI); 1,675 at 80 percent AMI; 3,200 at 120 percent AMI; and 413 units up to 140 percent AMI. All of the AH units are part of and located within the project sites (see Attachment A).

In addition, the DPP has attempted to estimate the number of AH units to be completed by the end of FY 2018 from various sources (including newspaper articles, agency annual reports, developer surveys, and other unverified sources). These include projects which were approved prior to FY 2011, but are still ongoing and projects which do not require discretionary approvals from the City (see Attachment B). These figures have not been verified.

Attachments

Attachment A

UA, 201H, and 206E Projects Approved by the City between January 2010 through June 2016

Project*	Project Type	AH Units**	60% AMI or less	80% AMI	120% AMI	140% AMI	Ord. / Reso.
Hoopili	UA	3,525		1,175	2,350		Ord. 15-13
Koa Ridge	UA	1,050		350	700		Ord. 13-38
Central YMCA/Aloha Condominium	UA	39	39				Ord. 13-34
Live Work Play Aiea	UA	450		150	150	150	Ord. 14-08
Green Homes at Lualualei	201H	25				25	Reso. 10-245, CD1, FD1
Halekauwila Place	206E	203				203	Reso. 10-275, CD1
Hale Kewalo	201H	127	127				Reso. 15-297, CD-1
Makali'i II at Kapolei	201H	35				35	Reso. 11-164, CD1
Meheula Vista	201H	300	300				Reso. 11-197, CD1
	Total	5,754	466	1,675	3,200	413	

* Construction of AH units in some projects may have started, while others have yet to commence building.

** AH units are based on UA condition requiring 30 percent of the project's total number of units to be affordable.

Note: Projects listed above are based on the DPP's current records and may not cover all AH projects approved by State agencies or private and non-profit developers.

1/23/2018

Bill 58 Affordable Housing Requirement Summary of Affordability Period Analysis

March 2, 2018

One of the key concerns developers have expressed about the Bill 58 (2017) affordable housing requirement (AHR) is the proposed 30 year period of affordability. The excerpts below are from prior Department of Planning and Permitting (DPP) reports and letters to City Council, as well as memos from our consultant. They outline our extensive research and analysis about why the longer affordability period is important, and why it will work. Since Councilmembers have expressed concern that much of our research was based on national studies of the hundreds of inclusionary housing programs that have worked well across the country, the DPP recently refreshed our original research on inclusionary programs in all four Hawaii counties (see DPP Letter to Council AHR 3/02/18 and Table of Current and Prior Affordable Housing Programs in Hawaii).

Excerpt from DPP Director's Report on AHR - 5/19/17

Preliminary Research. A staff working group conducted initial research into similar inclusionary programs across the country, as well as applicable examples in Hawaii (see Attachment 2 to the Affordable Housing Strategy, which compares 18 programs). For instance, requiring too high of a percentage can slow or stop development, as Maui learned when they set a 50 percent inclusionary requirement for affordable housing several years ago. However, a carefully planned and calibrated requirement can produce and maintain a growing, stable supply of affordable housing without unduly burdening development. Almost 500 municipalities have similar requirements, including those in "hot" markets with high development costs like Honolulu. Staff research found that, compared with Honolulu's current unilateral agreement (UA) requirements, most programs had the following characteristics:

- **Much longer affordability periods.** Longer periods build and maintain the affordable housing inventory. Denver, San Francisco, Sacramento, and San Diego require that units remain affordable for up to 55 years or more. Some programs require perpetuity (compared to 10 years imposed with UA requirements).
- **Lower Area Median Income (AMI) ranges.** Even in hot housing markets such as San Francisco, Boston, Sacramento, and San Diego, the affordable rental units are dedicated to households with AMIs in the 65 to 80 percent range, while affordable home ownership opportunities target households with AMIs at or below 100 percent (compared to a range of 80 to 140 percent AMI imposed through UA requirements).
- **Lower percentage of units required.** Most programs required from 10 to 20 percent affordable housing (compared to 30 percent imposed through UA requirements).
- **Applied to all building permits** (above a certain size), not just rezoning (like UAs).

The working group spoke with staff and experts from some of these other cities and found that, in effect, their regulations may create fewer units per project but apply to more projects, help more households with greater needs, and maintain affordable units for a much longer term. The working group also followed best practices identified by several recent national studies on inclusionary housing, which recommended the DPP's approach to conduct the nexus analysis and financial analysis.

PERIOD OF AFFORDABILITY

Excerpt from DPP Director's Report on AHR - 5/19/17

Period of Affordability. Maintaining Oahu's affordable housing supply has proven difficult due to the limited periods of affordability under current rules, such as the 10-year restriction period imposed on affordable housing required through UAs. In practice, the restriction period is frequently less. For example, military personnel routinely request hardship exemptions for resale when they are transferred. The AHR will restrict affordable units for at least 30 years in order to build up the portfolio over time. When the unit is resold or otherwise transferred, the 30-year affordability period would start over, keeping the unit affordable for a longer period and not losing it from the affordable inventory (this re-set is not included in Bill 58 CD2). This extended period of affordability is the most critical element of the AHR and is aligned with industry practice in hundreds of localities across the country, although some have chosen to impose 60-years or even permanent restrictions on their affordable units.

Some people have argued that the extended period will limit a homeowners' ability to build equity and move up the housing ladder with a large profit after their period of affordability ends. Nevertheless, the public purpose of the AHR is to help grow and maintain a stable supply of affordable and workforce housing. Fortunately, a carefully crafted policy can create and maintain a significant supply of affordable housing while also providing a fair return on investment to home buyers.

As an example, assuming allowable price appreciation is tied to the Consumer Price Index for All Urban Consumers (CPI-U), say there is an average 1 percent increase per year on overall value (a conservative assumption), then a \$300,000 home could appreciate by \$3,000 the first year, \$3,300 the next, and so forth. With a 10 percent down payment, that \$30,000 investment could appreciate by up to 10 percent per year. Compounded annually, that amount could grow to over \$77,000 in 10 years. Homeowners would also be building equity since payments include paying down the mortgage balance, instead of going towards rent. Although the actual amount would vary depending on the interest rate and term of mortgage, the principal payments could add up to an additional \$40,000 to \$60,000 in equity over 10 years, providing a down payment of \$117,000 to \$137,000 on a seller's future home purchase.

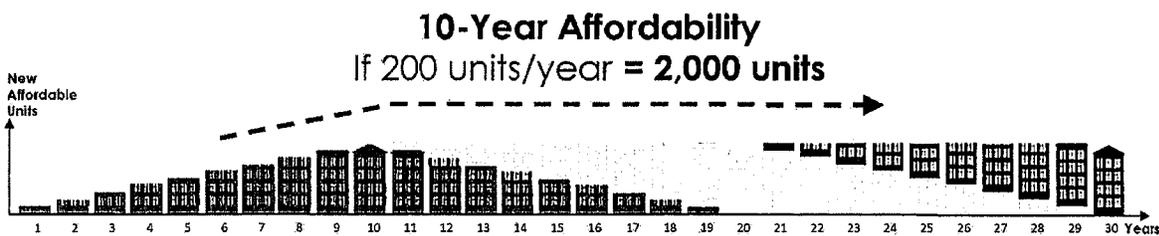
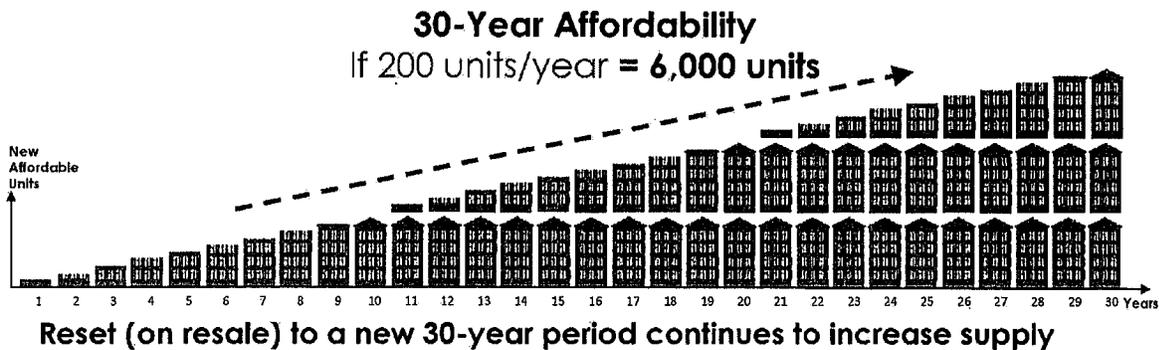
Recent national data has shown that this equity-building works in practice. A 2009 Urban Institute study of seven programs included the City of San Francisco, which has similar affordability issues as Honolulu. For the 10-year period ending in 2010, the typical seller of an affordable home made \$70,000 on resale, for an average rate of return of 11 percent annual compounded interest on the down payment. Grounded Solutions Network uses HomeKeeper national data to track the number of affordable home sellers able to buy market rate homes. Of 80 programs, the national average comes out to 59 percent of affordable housing sellers able to buy market rate homes.

Some developers and bankers have expressed concern that an extended period of affordability will limit their ability to finance projects. They believe the extended period and shared, or limited, equity requirements will restrict the mortgages from being resold on the secondary market, such as through the Federal Housing Administration (FHA), Fannie Mae, and Freddie Mac. This is a common concern, but not a major issue in reality. For most inclusionary programs, buyers were able to obtain financing. According to Rick Jacobus, the FHA, Fannie Mae, and Freddie Mac all finance both shared appreciation and deed restricted units, although

FHA has somewhat stricter requirements.¹ Fannie Mae and Freddie Mac recently announced plans to make financing these homes even easier because Congress has essentially required them to help expand lending to these programs (2008 Housing Economic and Recovery Act legislation). Their new rules actually encourage lenders to finance 30 year+ mortgages.

Excerpt from DPP Letter to Council on AHR - 8/03/17

The DPP offers comments on the importance of requiring the proposed 30-year period of affordability, as opposed to the current 10-year period required under UAs. The public purpose of the AHR is to help grow and maintain a stable supply of affordable and workforce housing over time; the diagram below shows how the AHR will create a much larger, stable supply of affordable units over the next three decades. Over 80 percent of 330 inclusionary housing programs across the country (for which data is available) require 30 years or more; over half of them require 50 years or more (see Rick Jacobus memo dated July 19, 2017). There has been some testimony on Bill 58 (2017) that the longer period of affordability will impact developers' ability to sell the units, as compared to market-rate units. If the cost of a market-rate unit and an affordable unit was the same, that would be a concern, but most programs require an affordable unit to be discounted below the market-rate price. The AHR program is intended to allow first-time buyers, who are unable to qualify for a market-rate unit, to buy a more affordable unit.



Several developers have also expressed concern that the restricted re-sale requirements and extended affordability period will limit the homebuyers' ability to build equity and move up the housing ladder to a market-rate unit. The AHR is carefully calibrated to build up and maintain a long-term stable supply of affordable housing, while allowing first-time homebuyers to build equity and savings for a future market-rate purchase (see pp. 20-21 of the DPP AHR Director's Report). The real comparison is between renting (with no equity building) and the first-time buyer's potential for significant equity and savings.

¹ Fannie Mae guidelines are relatively easy to follow: https://www.fanniemae.com/content/fact_sheet/resale-restrictions.pdf.

Some developers have requested a “fail-safe” option in case they are unable to find a qualified buyer in a reasonable time period; either allowing the sale to a higher-income buyer or changing the required 30-year period of affordability to 10 years. The DPP strongly recommends preserving the longer affordability period, but agrees that allowing a step-up to a higher-income purchaser is a reasonable fail-safe (this is currently permitted under two UA agreements linked to zone changes). This option should include a minimum three-month marketing period to income qualified buyers. If no income-qualified buyer is found, the sale can be made to the next higher-income AMI range, but be sold at the affordable price, and include the long-term resale-restrictions or other standard requirements. This will address developers’ concerns about finding qualified buyers, but still encourage sales to buyers at the lower AMI ranges, since there will be no incentives for developers to wait to sell at a higher price.

Mr. Jacobus’ letter, dated May 5, 2017, addresses finance and development industry concerns about whether the 30-year period of affordability and resale price restrictions would hinder developers’ ability to finance projects due to issues with re-selling the mortgages on the secondary market (he assures us that this will not be a major concern if we are careful in drafting the resale restriction documents). Mr. Jacobus met with industry representatives in June and will continue working with them to ensure the details are correct.

Excerpt from Rick Jacobus Memo on Lending – 5/05/17

You asked me to summarize the current state of the secondary mortgage market with respect to financing products for buyers of homes with long-term or permanent resale price restrictions. Affordable housing restrictions do create special lending needs and the programs need to be designed with appropriate care to ensure that the homes are easily financeable. It is not uncommon for new programs to struggle to support lenders in navigating unfamiliar program rules. However, I have worked with hundreds of local programs implementing these types of restrictions and I am not aware of any location where private lenders have ultimately been unable to finance eligible homebuyers because of the local affordable housing requirements.

Fannie Mae, Freddie Mac and FHA all finance deed restricted units with resale price restrictions. Fannie Mae has the most clearly defined rules. I have attached a short summary of Fannie Mae’s policy but the full details are contained in their Selling Guide section B5-5. In my experience, most communities have been able to find local lenders willing to originate to Fannie Mae’s guidelines. In some cases, a community must make minor changes to their deed restrictions in order to meet the Fannie Mae guidelines. However, these changes generally don’t require any change to important policy objectives or prevent the jurisdiction from ensuring long-term affordability. Fannie Mae, for example will allow restrictions that last any length of time (including permanent restrictions) and has no specific requirement regarding the amount of appreciation that sellers receive.

Freddie Mac does not currently have a formal set of rules that clearly identify the range of resale restrictions that they will accept but they have approved local programs on a case-by-case basis.

FHA’s program is the hardest to work with and many commonly used deed restrictions don’t work for FHA. FHA’s rules, contained in Mortgagee Letter 94-2, require, among other things, that buyers receive at least 50% of any price appreciation and that any restrictions be terminated in the event of foreclosure. A number of cities have negotiated exceptions to the FHA rules so that their buyers can access FHA insured loans while the programs maintain long-term affordability. FHA has developed a draft mortgagee letter to allow more commonly used resale restrictions without requiring an exception but they have not issued it for reasons that are

unclear to me. Most cities have been content to work with Fannie Mae and/or Freddie Mac and not found FHA worth pursuing.

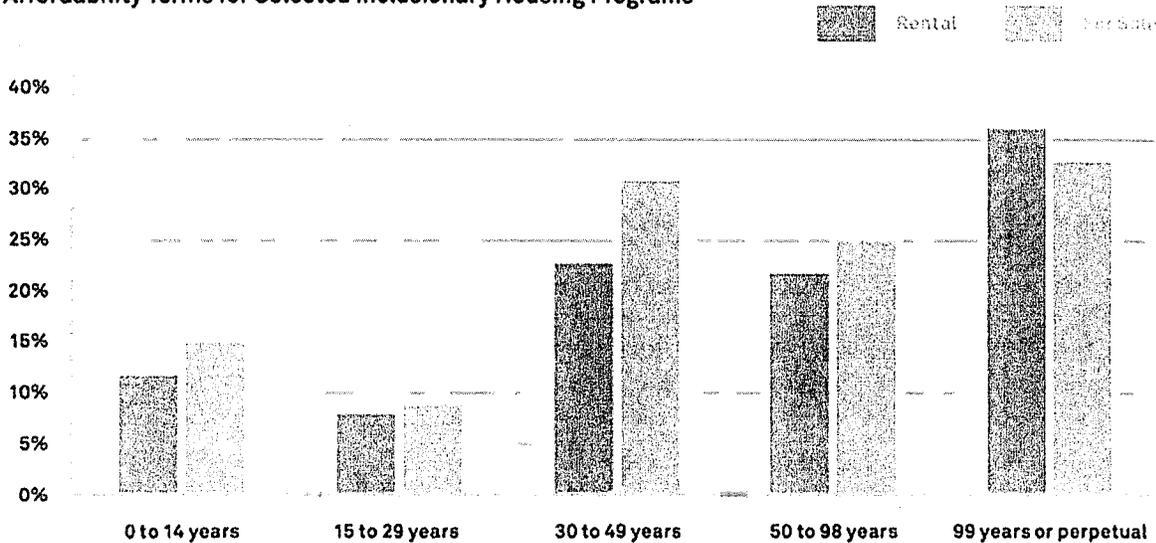
Fannie Mae and Freddie Mac are both likely to announce plans to make financing for price-restricted homes even easier later this year (*note: this was announced and is being implemented*). The 2008 HERA legislation created a 'duty to serve' underserved markets for both Enterprises. The final 'duty to serve' rule adopted by the Federal Housing Finance Agency (FHFA) identifies 'shared equity homeownership' as an underserved market. The Enterprises can receive 'duty to serve' credit for activities that they undertake that improve the availability of financing for buyers of homes with affordability restrictions that last 30 years or longer. Draft Duty-to-serve plans will be released later this month (*note: these have been released*).

Excerpt from Rick Jacobus Memo - 7/19/17

3. How long should affordability restrictions last?

The majority of inclusionary housing programs require affordability restrictions that last 30 years or longer. Less than a quarter of the 330 programs identified in one 2014 study had affordability periods of less than 30 years². While shorter-term restrictions were common in the 1980s, many of the programs that began with 10 or 15-year restrictions have since revised their rules to require longer periods of affordability. The reason for this change seems to be that as housing prices have risen the discount that is necessary to make new units affordable to lower or moderate income buyers has grown so high that policymakers begin to feel that the subsidy level is too high for only one family to receive all of the benefit. Long-term restrictions allow a one-time reduction in price to create a unit that provides an affordable starter home opportunity to one lower-income family after another.

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).

² Hickey, Robert, Lisa Sturtevant, and Emily Thaden. "Achieving Lasting Affordability through Inclusionary Housing," 2014. <http://www.nhc.org/Achieving%20lasting%20Affordability%20through%20Inclusionary%20Housing.pdf>.

Some stakeholders in Honolulu seem to assume that 30-year restrictions are designed with the expectation that homeowners will remain in the units for 30 years. But the best data available suggests that homeowners with long-term price restrictions move with the same frequency and for the same reasons as unrestricted owners³. Regardless of the term of affordability, the majority of buyers move within 10 years.

If restrictions are to last a decade or more, it is important that homeowners have the opportunity to build meaningful wealth *during the term of the restriction* rather than expecting them to wait until restrictions expire. And, in fact, this is what most inclusionary housing programs offer. A study by the Urban Institute found that buyers of inclusionary homes in San Francisco gained an average of more than \$70,000 when they sold after a median length of ownership of only 4.2 years (an 11.3% annual rate of return) in spite of restrictions that ensured that these same homes remained affordable to new income qualified buyers⁴. Because of the long-term price restrictions, San Francisco is able to offer affordable units at resale to hundreds of additional families without any additional subsidy from the city or its developers. The researchers estimated that it would cost the City more than \$25 million annually to provide the same level of affordable housing if inclusionary units were not price restricted.

The key policy question is not whether to allow wealth building, but rather, how best to balance the opportunity to build wealth for the first owner against the affordability of the home to the next buyer. When restrictions expire after a short period, whoever is lucky enough to own the unit on the day the restrictions expire generally earns wealth that far exceeds what market rate owners can earn because they retain the initial subsidy as well as appreciation earned on that subsidy. Most inclusionary housing programs limit this gain to a more modest level in order to ensure that each successive owner has an affordable price and a chance to build meaningful wealth. Many programs attempt to offer owners enough wealth building that they are able to move out and into market rate ownership.

The evidence suggests that this is possible and that most programs are succeeding at this goal. Grounded Solutions Network collects real time data on the performance of price restricted units. Their dataset of more than 4,000 sales shows that more than two thirds of sellers are able to move on to unassisted market rate units when they sell thanks in large part to the wealth building that they experience even with restricted prices⁵.

5. Will long-term price restrictions make it difficult to secure mortgage financing?

Affordable housing restrictions do create special lending needs and the programs need to be designed with appropriate care to ensure that the homes are easily financeable. It is not uncommon for new programs to struggle to support lenders in navigating unfamiliar program rules. However, I have worked with hundreds of local programs implementing these types of restrictions and I am not aware of any location where private lenders have ultimately been unable to finance eligible homebuyers because of the local affordable housing requirements. Fannie Mae, Freddie Mac and FHA all finance deed restricted units with resale price restrictions.

³ Urban Institute, Shared Equity Homeownership Evaluation: Case Study of the San Francisco Citywide Inclusionary Affordable Housing Program, October 2010.

⁴ Urban Institute, 2010.

⁵ Grounded Solutions Network, HomeKeeper Social Impact Report, June 5, 2017.
(<http://myhomekeeper.org/social-impact-dashboard>)

At the meeting you organized with several local developers and lenders on June 29th I was able to talk with them about their concerns related to accessing mortgage financing for units with long-term affordability restrictions. While your local stakeholders had the usual questions about how these programs work, no one raised any issues that suggested to me that buyers in Honolulu would have particular difficulty getting loan approvals due to the proposed price restrictions.

It will be important to include local lenders in the development of the administrative guidelines for the new program in order to minimize the burden placed on local lenders who are attempting to finance these units. Decisions such as how to protect the City's interest when homeowners experience foreclosure can make a big difference to lenders.

Excerpt from DPP Letter to Council on AHR - 2/01/18

Did the Department of Planning and Permitting (DPP) review why prior inclusionary housing efforts on Maui, Kauai, and Oahu have not worked well (or failed)? What's different about Bill 58, and why will it work where others have failed? Hawaii is not like the continent.

Yes, the interdepartmental housing team started in 2013 by looking at most prior inclusionary housing efforts in Hawaii and evaluating why they weren't producing and maintaining enough affordable housing (AH). We found that the biggest issue with most prior programs was that a large percentage of AH units was required, but those units tended to be at or close to (or even above) market prices.

So, even with a relatively low period of affordability, buyers don't want to buy a unit that has restrictions if they can afford a comparable market unit. We then reviewed many other nationwide programs, and other national research, which showed most successful programs require fewer units, but at lower AMI ranges, and for much longer terms. That is why we initially proposed reducing the current percentage of units required from 30 to 20 percent; reducing the top AMI range from 140 to 120 percent; removing the requirement to sell units at 80 percent; and increasing the term from 10 to 30 years (all compared to the current unilateral agreement requirement).

Some developers continue to advocate for allowing them to sell the required affordable units at a relatively high 140 percent AMI, but that is exactly why a program at that level fails – you cannot sell units that are encumbered with resale restrictions and a required affordability period at prices so close to market. It is more effective to require fewer units but make sure they are offered well below market prices.

How can the 30-year period work if many bankers and developers are saying it will be too hard to market or finance? Would reducing the 30-year period to 10 or 20 years (after initial marketing period) help to market them, and be a good 'back-up' fail-safe (on top of just increasing the qualifying AMI of buyers)?

While there is still significant concern that a longer affordability period will make units hard to sell or finance, that concern is misplaced. The key is making sure units are priced well below market, and targeted to buyers who cannot afford or qualify for market units. Selling to people who cannot afford market units actually expands the pool of buyers and could help the whole project sell quicker. The reduced total percentage of affordable units also helps with marketing concerns. There is no evidence that a higher period of affordability is a major impediment to marketing, as compared to a lower price. While local bankers have had some

concerns about whether projects with an extended affordability period will sell, the combination of reducing the required percentage of affordable units, while requiring a minimum price difference, should ensure the units are marketable and projects are feasible.

Excerpt from Rick Jacobus Memo - 1/16/18

Affordability Period

The draft ordinance wisely plans for the risk that affordable homes could sometimes remain unsold for longer periods of time. Relaxing the income limits can help with some common marketing problems and many comparable programs allow this remedy. However the bill also offers to reduce the affordability period, in addition to allowing the higher income limits. This is not a common approach and it seems likely to reduce the impact of the program without solving the most common marketing problems.

Below Market Rate (BMR) homes are almost always in very high demand. New York and San Francisco routinely have thousands of applicants for every available home. However, there are exceptions and it is unfair to require developers to hold units vacant when eligible buyers truly cannot be found.

By a large margin, the most common reason for difficulty selling BMR units is that they were priced and restricted at too *high* an income level. Units that are targeted to lower incomes sell for prices that are more highly discounted below market. It is this large discount that makes it possible to serve buyers who are otherwise priced out of the market. That generally leads to a large pool of interested buyers.

When we increase the income target (say from 100% of Area Median Income to 120% or 140%) we increase the 'affordable' price that these units will sell for. At some point this price approaches the market price. In some cases, we have seen programs impose 'affordable' prices that are above the market price for a comparable unit. When this happens it is not surprising that homes are nearly impossible to sell. This seems to be what happened in Maui where the program required homes affordable to incomes as high as 160% of AMI. The restricted prices of these homes were not far enough below market to reach buyers who were otherwise priced out of the market.

It is important to note that shortening the period of affordability does nothing to solve this most common problem. Buyers who can purchase an unrestricted home can and should choose that option over a restricted home whether the restriction lasts 10 years or 30. A home with restrictions simply can't reasonably be sold at a market price to any buyer.

The most effective way to address this problem is to set the pricing and income targeting initially at a level that results in prices that are comfortably below the market prices in the areas where projects are likely to be built. Some cities address the risk that they might get that initial targeting wrong by requiring developers to always ensure that the BMR units are priced at least 20% below the market value of the unit – though this can significantly increase a developer's cost. Others allow developers who are unable to sell homes after an extended marketing period to instead pay an in-lieu fee. Both approaches avoid creating units that cannot be sold.

Another potential marketing problem relates to financing. There are some situations where no buyers (or very few) in the target income group are able to obtain financing. This is most often a challenge for programs that target buyers earning less than 60% of AMI. In these

cases, allowing developers to sell to higher income buyers at the same price after a good faith effort to find lower income buyers, ensures that homes don't sit empty. The draft CD2 is consistent with national best practice in allowing this kind of relaxation of income limits after a period of marketing. Like the bulk of other similar programs it ensures that the price remains set at the initial level which avoids creating an incentive for developers to fail at the initial marketing in order to later receive a higher sale price.

There is sometimes a concern that the price restrictions themselves will make financing difficult to obtain. I have heard it suggested that reducing the affordability period to only 10 years might reduce this risk but I can't see any reason to believe that this would be the case.

I have personally worked in dozens of communities with these programs; I ran a national network that reached hundreds more, and I am not aware of one community that has been unable to find willing lenders for price restricted homes. All but 7% of Inclusionary housing programs impose restrictions that last 30 years or longer – many as long as 99 years. Both Fannie Mae and Freddie Mac are actively seeking to finance restricted homes. While financing a price restricted home may be more challenging than financing a home with no restrictions, the period of restriction will make no difference in this challenge. And in fact, beginning in 2018, the Federal Duty to Serve Rule gives Fannie Mae and Freddie Mac incentives to finance price restricted affordable homes with restrictions that last 30 years or longer. Homes with 10-year restrictions would not be Duty-to-Serve eligible.