Making Inclusionary Housing More Flexible: Four Ideas for Urban Settings

By Robert Hickey

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INTRODUCTION

Interest in inclusionary housing has accelerated in the past couple years, particularly in cities where rents are rising faster than incomes and the affordability crunch is increasingly impacting the middle class.

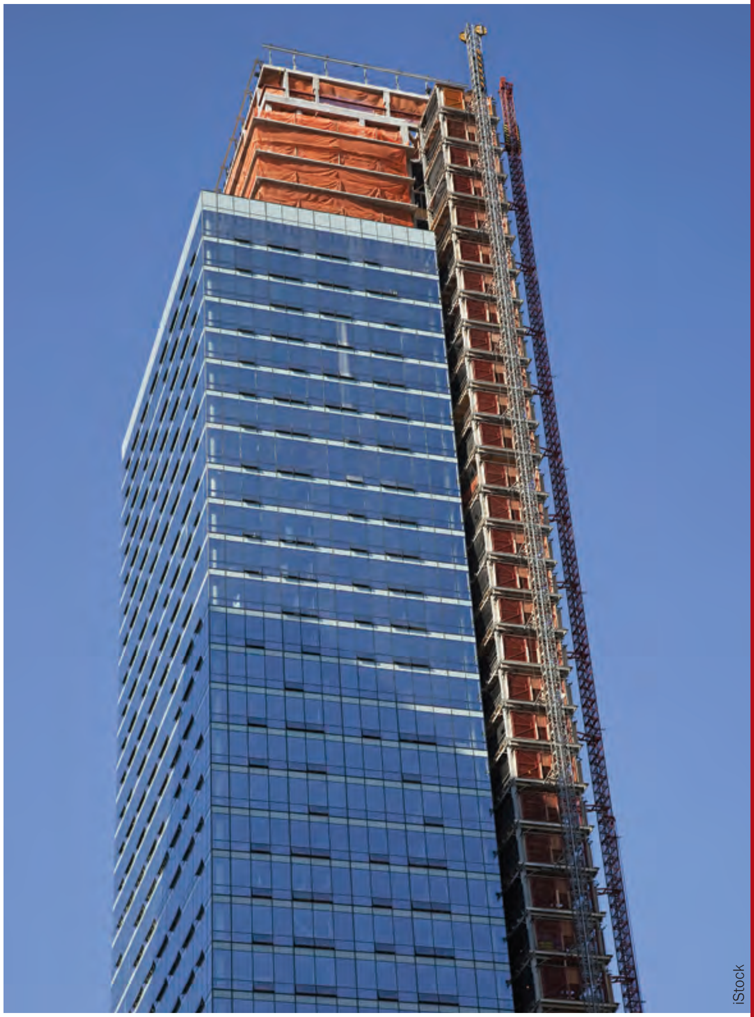
Inclusionary housing policies work through the local land use approvals process to either offer incentives or require developers to make a share of otherwise market-rate housing affordable to low- or moderate-income households.

While some cities such as New York are moving forward with plans to strengthen existing inclusionary housing policies, a new crop of policies is under consideration in areas of the country where inclusionary housing has been historically rare, such as Nashville, Atlanta, Minneapolis and Pittsburgh, Pa.

Various factors are driving this interest:

- High rent burdens are affecting a broad range of residents, including many who earn too much to qualify for federal housing assistance;
- Cities are concerned about their capacity to house and retain a diverse workforce;
- Some communities are raising concerns about the loss of displaced, long-time residents; and
- Localities are looking for better tools for dispersing affordable housing in mixed-income settings and connecting lower-income households to opportunities.

As cities consider new policies, they are searching for the right balance between addressing housing needs and keeping affordability requirements feasible for developers, so the overall housing supply can keep growing.



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Flexible inclusionary housing policies help improve feasibility by offering developers various ways to meet affordability obligations. As every site context is different, particularly in urban settings, variable compliance pathways help developers find the most cost-effective affordability strategy for their particular development situation.

Policy flexibility can be especially valuable in dense, urban settings. The expensive materials required to construct taller buildings and the high land prices in built-up areas can make it difficult to meet affordability requirements within the same building as market-rate housing units. Options to build the affordable units in a separate, lower-cost building, or to pay a fee instead of building the affordable units, can be very helpful economically for the developer.

Such options can also reduce the incentive for developers to try to cut corners on design, which in its worst expression can lead to intra-building segregation and separate entrances for lower income residents — the notorious, if still rare, "poor door" phenomenon.

However, providing alternatives to on-site affordable housing construction does not necessarily further a policy's goal of inclusion and mixed-income communities. Often the most economical option for developers is to build the affordable units in high-poverty neighborhoods where land prices are cheapest, undermining a primary goal of inclusionary housing policies to counteract the concentration of poverty and connect lower-income households to growing neighborhoods favored by the market.

Similarly, jurisdictions that collect fee payments as an alternative to on-site construction can struggle to use these funds to support affordable housing in mixed-income settings, particularly in denser, urban environments where competition for land is intense and development sites are relatively scarce.

With an eye to high-cost cities, where cost-reducing opportunities can be especially valuable, this brief discusses four ways that localities can introduce greater flexibility and improve the workability of their inclusionary housing policies while at the same time promoting mixed-income neighborhoods.

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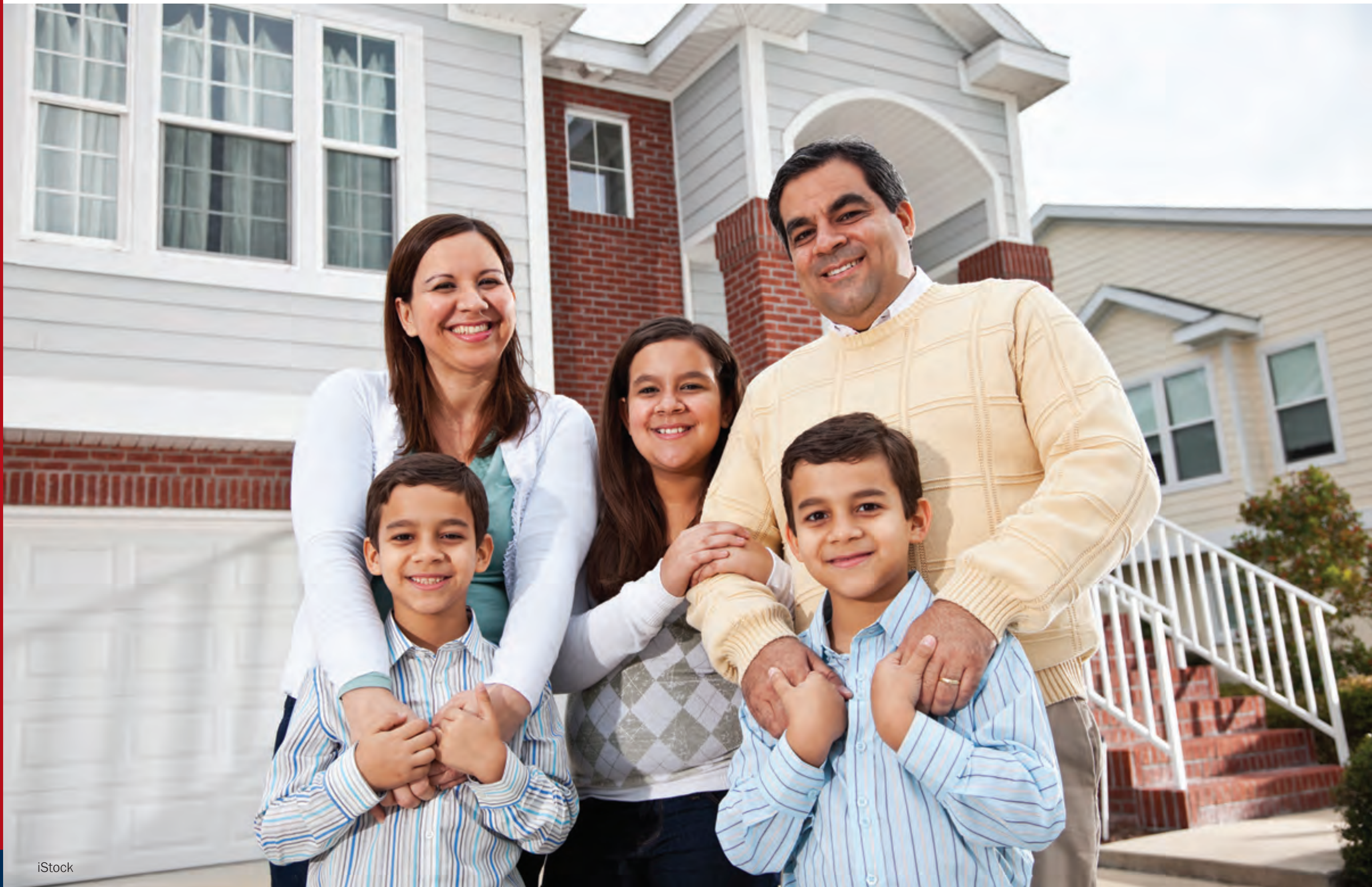

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Four Ideas for Increasing Flexibility without Sacrificing Inclusion

1. Permit Off-Site Development in Multiple Low-Poverty Neighborhoods

While most inclusionary housing policies favor developers meeting their affordability obligations in the same building as the market-rate units, many localities also offer an off-site option. Usually, developers are only allowed to exercise this option if the off-site development will generate a greater number of affordable units, a better mix of bedroom sizes, or deeper affordability, as compared to on-site affordable units.

Many communities seek to achieve inclusion by placing limits on where off-site units can be built. Often, these units are restricted to the same immediate community as the market-rate development — for example, sites within a maximum distance of one mile from the policy-triggering market-rate development. Some jurisdictions permit off-site affordability within the larger geographic territory of the same community planning area (San Diego), community district (New York City) or planning policy area (Montgomery County, Maryland). These districts often comprise multiple contiguous neighborhoods.

There is certain logic to requiring nearby off-site affordability: new market-rate development is a sign of a neighborhood's desirability, and building affordable homes in the same area can help mitigate the impact of market-rate construction on neighborhood affordability.

However, the option to build affordable homes off-site is not always viable for developers because of the limited availability of sites in tightly defined areas. The challenge of finding a separate site for supporting affordable housing in the same community is compounded by the legitimate goal that programs have of ensuring the affordable component coincides with the market-rate development, or takes place no later than a year later.

A more flexible approach to off-site development would be to **broaden the geographic realm of off-site locations to any low-poverty neighborhood with access to core amenities,** such as transit, services, jobs or above-average schools. A jurisdiction could designate various transit districts, employment centers, low-poverty census tracts, or areas of new market activity where off-site development is permitted. Or a locality could use similar criteria to evaluate off-site development proposals on a case-by-case basis, allowing for still greater flexibility through discretionary review.

1400 Mission is a new, 100 percent below-market-rate condominium development in San Francisco that satisfies the off-site inclusionary obligation of a larger market-rate property two miles away.

Bob Hsiang Photography

San Diego

San Diego's Inclusionary Housing Program allows for developers to meet their affordability requirements through on-site affordability, payment of a fee or off-site development. The off-site option is subject to administrative approval from the city's planning director and the CEO of the San Diego Housing Commission. The city's location preference for off-site development is within the same community planning area as the market-rate development. However, these units may also be located outside of the community planning area if the reviewing staff finds that two conditions are met:

1. "The portion of the proposed development outside of the community planning area will assist in meeting the goal of providing economically balanced communities; and

2. The portion of the proposed development outside of the community planning area will assist in meeting the goal of providing transit-oriented development." (San Diego §142.1308.)

2. Offer Options to Preserve or Increase the Affordability of Existing Housing

Several cities have recently adopted or are considering a new alternative to on-site requirements: preserving affordable rental housing that is at risk of being lost to rent spikes in gentrifying neighborhoods. In a similar vein, several localities offer the option to convert existing, market-rate housing to deed-restricted, affordable units. Interest in these two options is coming from compact communities that are land constrained, with dwindling development sites for new affordable housing.

Off-site preservation and buy-down alternatives typically include a requirement that the developer either make a minimum level of investment in rehabilitation, or otherwise ensure that the property is fully repaired, energy efficient and capable of providing decent, safe housing for the duration of its affordability period without the need for substantial additional rehabilitation.

There are various scenarios in which a developer might find it appealing to increase the affordability of existing housing rather than build new affordable units on-site. Developers that already own existing market-rate units in lower-price buildings might see increasing the affordability of these units as more efficient than forgoing higher sales prices or rents in newly constructed properties. There also may be opportunities for developers to provide direct financial assistance to nearby owners of either "naturally occurring" or deed-restricted affordable properties to enable those owners to make major renovations and cover the cost of ongoing maintenance without having to discontinue affordable rents. Often, some form of local assistance is needed to bridge the gap between what it costs to renovate a property and what can be raised through tax credits and private financing. Developer contributions can help fill this gap.

Montgomery County (Md.)

Montgomery County is home to the nation's longest-running inclusionary housing program. The county recently added a compliance option under which developers of high-rise buildings can meet their affordability obligations by converting market-rate homes to deed-restricted affordable homes, subject to administrative approval. While no conversions have yet been completed, a few recently approved developments are utilizing this option.

One example is Hampden Row in downtown Bethesda. Toll Brothers, the developer of a seven-story, 55-unit condominium development, is buying down the affordability of 12 market-rate rentals in a mixed-income property owned by the county's Housing Opportunities Commission. The off-site property is located within the same Bethesda planning policy area, but approximately three miles northwest of Hampden Row.

The onsite obligation for Hampden Row would have been nine affordable condominiums. Toll Brothers will make a payment of $1.434 million to make 12 off-site market-rate rentals affordable to low-income households.

The county agreed to an Alternative Location Agreement with Toll Brothers after finding that the monthly condominium fees of the property would have made the total ownership costs of the below-market-rate homes unaffordable to the program's targeted households, who earn up to 70 percent of area median income (AMI). It was also significant for the county that the developer agreed to provide a greater number of affordable units off-site.

Boulder (Colo.)

The city of Boulder's Inclusionary Housing policy allows developers to pay an in-lieu fee, dedicate land, build new units off-site and, since 2000, rehabilitate and preserve existing market-rate rental or for-sale housing through the use of a deed restriction.

Historically, developers have been averse to exercising this option, but interest is growing, according to city staff, now that land for new construction has become much scarcer. Developers are also expected to show strong interest in this option because the city's in-lieu fee is relatively high, and most developments are not large enough to trigger the need for a sufficient number of inclusionary housing units to make off-site construction and management efficient.

The city presently sets minimum standards for the livability of the rehabilitated units, and is moving to add energy efficiency standards, as well. The city also sets minimum cost-to-value ratios for rehabilitation, similar to ratios used in other housing preservation programs that provide financial assistance to developers for rehabilitation.

In reviewing applications to make existing off-site dwelling units permanently affordable, the city manager weighs such variables as: date of construction, location, initial condition of the unit, level of homeownership association fees and proof by the homeownership association of adequate capital reserves to ensure proper maintenance and level of required rehabilitation.

Off-site preservation, like off-site development generally, does not need to occur in the same community as the market-rate property, but the location must be: consistent with Boulder Valley Comprehensive Plan policies related to the integration of permanently affordable housing throughout the city; suitable for residential use; and supportive of various non-car modes of transportation including walking and biking.

New York City

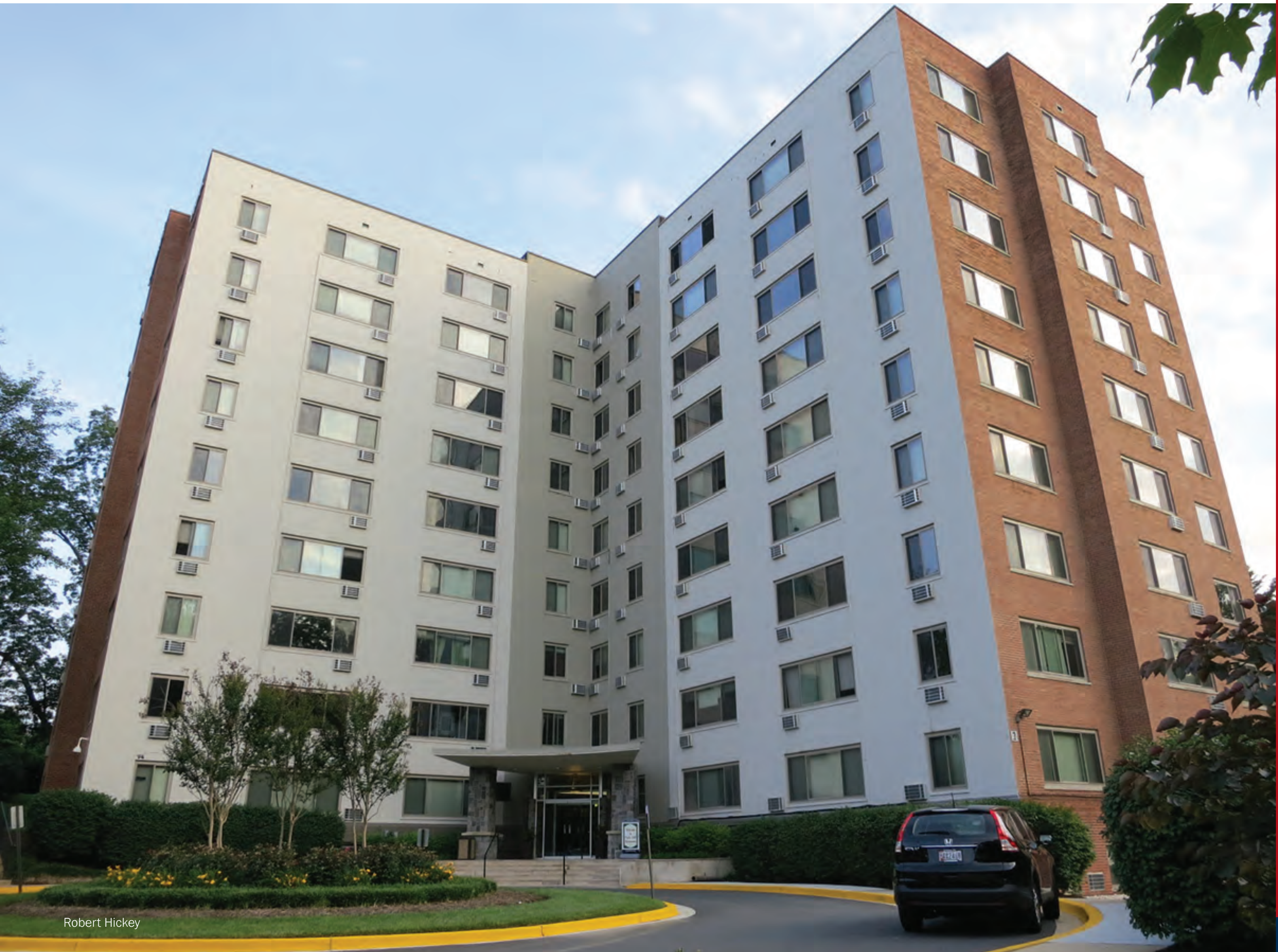
Both of New York City's inclusionary housing programs — the R-10 program and the Designated Areas program — offer an off-site preservation option. Neither has yet enticed developers, but the city has revised its preservation option to make it less onerous and has become more concerned that developers might choose this option exclusively.

Under the original rules of the R-10 program, all existing residents had to income qualify before a building could be deemed eligible for preservation. This presented difficulties, however. In many larger buildings where most residents were income-qualified, one or more residents typically earned too much in any given year, disqualifying the entire building. In addition, existing residents are not obligated to disclose and document their incomes to a prospective investor in the building, and would have needed to do so voluntarily. As a result, virtually no developers used the preservation option.

The city has since changed its rules to allow a building to qualify if the average rents in the building fall below the inclusionary housing target limits. The city also now requires income qualification only for new tenants.

The challenge faced now by city staff is that the preservation option may be too appealing for developers, and the city does not want to stop producing new affordable housing units. The city is presently working to revise its preservation option to encourage a better balance between new affordable housing construction and preservation, potentially by setting stronger, minimum investment requirements and rehabilitation standards.

A condominium developer in Bethesda (Montgomery County, Md.) will satisfy local inclusionary housing obligations by making 12 market-rate rental units affordable in this nearby mixed-income property known as Pooks Hill.



Robert Hickey

3. Restrict Fee-Revenue Spending to Broad, Designated Areas

The option to pay a fee in lieu of providing affordable units on-site provides still greater flexibility, particularly for developers of small projects. To ensure that collected in-lieu fees are invested in ways that lead to economically inclusive neighborhoods, a handful of localities place basic restrictions on where these funds can be spent.

San Diego

The city of San Diego recently restructured its inclusionary housing policy as a fee program applied to market-rate developments of two or more units. Developments are exempt from the fee if they voluntarily provide 10 percent rental or for-sale homes at levels affordable to households earning 65 to 100 percent of AMI. Fee revenues are collected by community planning area. The city's first priority is to spend these funds to support affordable housing in the same community planning area. However, the city has found that there are not always good opportunities to use these funds in a meaningful way in the same neighborhood, particularly since fee revenues are scattered among various planning areas and dispersed in separate pots. Similar to the city's policy of allowing off-site development in various areas of the city, San Diego has begun targeting its fee revenues to any area where other fees are being generated, with an emphasis on the city's transit-oriented development districts, and neighborhoods close to employment centers.

Boston

Boston's Inclusionary Development Policy requires the equivalent of 13 percent affordability for residential developments built with public assistance, located on public land or requesting zoning relief. Developers have the option of building the affordable units within the proposed development, constructing them off-site or paying a "buyout fee."

Buyout fee revenues are deposited in a trust fund that supports affordable housing citywide. A minimum of half of these funds must be spent in neighborhoods where the percentage of affordable housing is less than the citywide average. As of early 2015, the policy had generated $32.3 million in fees, in addition to producing 1,718 affordable units.

True Corner Condominiums is a new, off-site, 22-unit inclusionary housing development in Boulder, located in a rapidly growing area of the city with easy access to shopping, restaurants, good schools and hiking trails. All 22 condos are permanently affordable.

City of Boulder Stock Photos

4. Provide Flexibility on the Incomes Served

In recent years, programs have begun making the affordability requirement itself more flexible, allowing developers to select from a menu of income targets. For instance, a program that normally asks a developer to make 15 percent of total units affordable to households at 80 percent of AMI might also allow the developer to meet their obligation by making a smaller share of apartments affordable to households at 50 percent of AMI, or a greater share affordable at 100 percent of AMI. This option can be useful for not just developers, but also localities that are looking to incentivize deeper affordability, as long as the effect of variable income targeting is not just to weaken the overall affordability requirement.

Santa Monica (Calif.)

Santa Monica's Affordable Housing Production Program (AHPP) is a mandatory inclusionary housing program adopted in 1998. The program employs a variable affordability requirement for rental properties, depending on the income bracket served. If the affordable units are priced for low-income households (earning 80 percent of AMI), 20 percent must be affordable. The affordability percentage drops to 10 percent if units are priced for very low-income households (earning 50 percent of AMI), and to five percent if units are affordable to extremely low-income households (earning 30 percent of AMI). To date, the program has generated approximately 1,000 affordable apartments. Developers frequently choose the option of providing fewer units at a deeper level of affordability.

San Mateo (Calif.)

San Mateo's Below Market Program requires 15 percent affordability at 80 percent of AMI for rental units, and 15 percent affordability at 120 percent of AMI for purchased properties. The requirement drops to 10 percent if rental units are made affordable to very low-income households (earning up to 50 percent of AMI), or if for-sale units are priced for low-income households (80 percent of AMI).

Since the city added this flexibility to its program in 2010, all new rental projects have chosen to use the deeper affordability option. Through this option, four rental projects totaling 517 units have generated 51 very low-income units. No for-sale projects have gone through the planning approvals process since 2010, so it is unclear whether or not this form of flexibility is tenure-dependent.

Conclusion

As inclusionary housing becomes more popular in urban settings with high land costs and high construction costs, workable alternatives to on-site affordability requirements and other forms of policy flexibility will become increasingly important.

This report presents four ideas for improving the flexibility of inclusionary housing and expanding the menu of options available to developers – while still furthering economically diverse communities. These ideas are worth a closer look: not only because they help with the feasibility of affordability requirements for developers, but also because they can produce more affordable homes, particularly since developers are often able to reduce costs and increase efficiencies in off-site, lower-cost locations.

None of the ideas discussed here will be appropriate in every urban setting. For example, jurisdictions with limited new development opportunities may find that allowing off-site development in more neighborhoods is not as useful as allowing developers to preserve or increase the affordability of existing, market-rate housing. Conversely, places with a limited stock of well-located, low-priced housing to preserve may find that other alternatives make more sense.

But most cities can benefit from giving developers more pathways to support mixed-income communities. The tension between inclusion and efficiency will continue to be a challenge in high-cost, urban settings. As more urban jurisdictions take up inclusionary housing, they would be well served by experimenting with new compliance options, such as those described herein, that balance flexibility with inclusion.

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CENTER FOR HOUSING POLICY

Formed in 1931, the nonprofit National Housing Conference is dedicated to helping ensure safe, decent and affordable housing for all in America. As the research division of NHC, the Center for Housing Policy specializes in solutions through research, working to broaden understanding of America's affordable housing challenges and examine the impact of policies and programs developed to address these needs. Through evidence-based advocacy for the continuum of housing, NHC develops ideas, resources and policy solutions to shape an improved housing landscape.

NATIONAL HOUSING CONFERENCE

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BOULDER, COLORADO

Policy Name: Inclusionary Housing
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MONTGOMERY COUNTY, MARYLAND

Policy Name: Moderately Priced Dwelling Unit Program
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NEW YORK CITY

Policy Name: Designated Areas Program and R-10 Program
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SAN DIEGO

Policy Name: Inclusionary Affordable Housing Ordinance
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SAN MATEO, CALIFORNIA

Policy Name: Below Market (Inclusionary) Program
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SANTA MONICA, CALIFORNIA

Policy Name: Affordable Housing Production Program (AHPP)
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