

DRCOG Working Group

Inclusionary Housing

PRESENTED BY

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Economics of Inclusionary Housing

- Why do the economics matter?
- How do affordable requirements impact the project-level economics (the pro forma)?
- How do affordable requirements impact the market overall?
- What tools do communities use to mitigate negative economic impacts?

Why is financial feasibility important?

Inclusionary is a “market-driven” program—it leverages new development to create affordable units that meet the community’s needs.

Without the creation of new market-rate housing, the inclusionary program won’t create any new affordable units.



PROJECT IMPACTS

Development Business Model

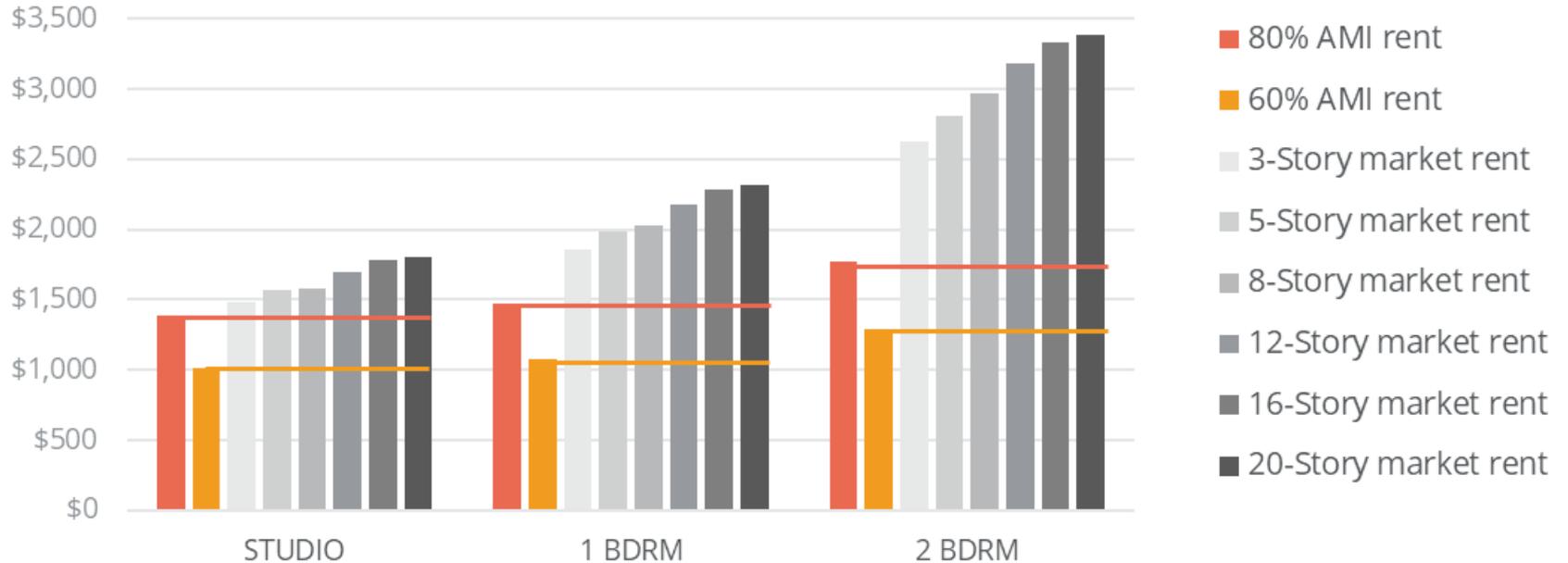
- Developers react to demand but are constrained by building costs and their ability to borrow money to fund the development (usually from investors and bank loans).
- Once the building is complete, the operating revenue (i.e., rents) must cover the operating expenses (property taxes, utilities, maintenance, etc.) and the debt service on the development, as well as pay investors for the initial capital invested.
- If the expected operating income isn't sufficient to do those things, the developer can't secure investors to seed the project, nor can they get a loan to fund the rest of the development cost. In other words—it doesn't get built.



How do affordable requirements impact project feasibility?

- When affordable unit construction is required in rental developments, the income restricted units reduce the potential net operating income;
- However, the per-unit cost of constructing affordable units and operating them is typically the same as market-rate units.
- In a for-sale context, affordable units reduce the expected sale revenue (but cost roughly the same to construct).

The deeper the AMI, the greater the impacts to the operating income.



Feasibility Tradeoffs: Depth (AMI) and Breadth (% of units)

Denver Feasibility Example:

% AMI	Feasible Inclusionary Requirement		Contract Rent for 1-bdrm at specified AMI
	Typical Submarket	High Cost Submarket	
Rental Residential			
50% AMI	5% of units	8% of units	\$886
60% AMI	8% of units	10% of units	\$1,082
70% AMI	10% of units	12% of units	\$1,279
80% AMI	12% of units	15% of units	\$1,476

MARKET IMPACTS

Yes, in these cases:

- 1) The ordinance is structured to **promote unit production**. The fee-in-lieu must be high enough to discourage developers from buying their way out, approximating the cost of building, marketing, and renting/selling an affordable unit
- 2) The community has a **moderate to high volume** of residential development (otherwise it may be more efficient to produce units with public subsidies)
- 3) The IH requirement is **economically feasible**

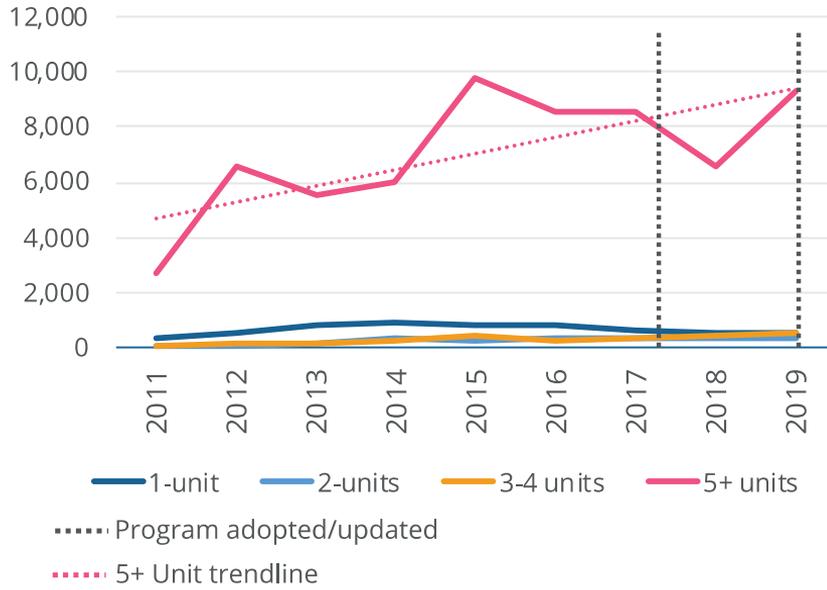
Does IH produce affordable units?

It depends...

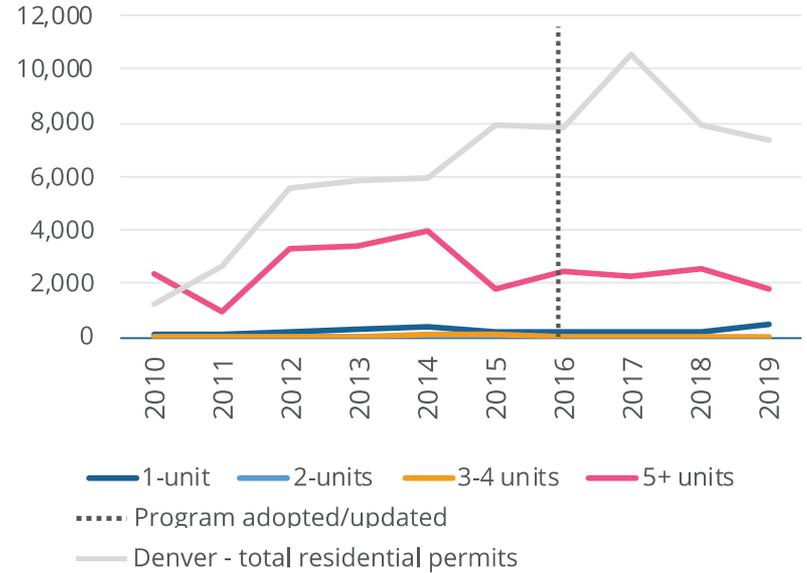
- 1) Housing costs have been increasing rapidly in cities with and **without IH programs**. Why? Low supply, high cost of materials, high cost of labor, investor-driven market
- 2) After implementation of programs, land costs and expected returns will adjust
- 3) Research that indicates IH raises prices puts that impact at $< 3\%$. In other words, **cross subsidies are minor** and typically passed on to households who can afford them (**3% of \$2,000 rent payment = \$60/month increase**)

Does IH increase housing costs?

Seattle



San Jose



Does IH slow housing production?

What do the academics say?

- A 2007 peer reviewed study found “There is no evidence that IZ has constrained supply or increased prices among Bay Area jurisdictions.” However, the same paper showed slight impacts of IZ on housing prices in Boston.
https://furmancenter.org/files/publications/Long_working_paper_08.pdf
- A 2019 paper from Urban Institute summarizes the academic literature and acknowledges that “the evidence on IZ’s effects on the private market is mixed, and a consensus has not been reached on whether these policies restrict development or raise prices... the effects of IZ policies may be particularly sensitive to policy design considerations and market characteristics.” This conclusion highlights the importance of feasibility and policy analysis. The section "Effects of Inclusionary Zoning Laws on Developers" is a good summary.
https://www.urban.org/sites/default/files/publication/99647/inclusionary_zoning._what_does_the_research_tell_us_about_the_effectiveness_of_local_action_2.pdf
- And here’s one that emphasizes program design (showing the financial benefits of program changes in LA):
<https://www.huduser.gov/portal/periodicals/cityscape/vol23num1/ch5.pdf>
- Mercatus Center produced a study earlier this year focusing on the Baltimore-Washington region and found “some evidence that inclusionary zoning increases market-rate house prices but none that it reduces new housing supply. Additionally, the author finds that most *optional* programs that offer developers increased development rights if they choose to provide below-market-rate housing units have been unsuccessful in producing affordable units.” Mercatus Center generally opposes IZ and their research may reflect that bias to some extent; even so, they find the impact of mandatory IZ on housing price increases to be less than 1%. Their finding that optional bonus programs don’t work to create affordable units is generally an argument for mandatory IZ.
<https://www.huduser.gov/portal/periodicals/cityscape/vol23num1/ch6.pdf>
- An easy-to-read summary of evidence from Grounded Solutions (note that grounded solutions is an advocate for IZ):
https://inclusionaryhousing.org/wp-content/uploads/2016/09/Economics-of-Inclusionary-Housing-Policies-Effects-on-Housing-Prices_a.pdf

INCENTIVES & OPTIONS

Mitigating impacts with Off- Sets & Incentives

Options

- *Fee in-lieu – can be set low to incentivize revenue generation or high to incentivize unit production*
- *Land dedication*
- *Offsite unit production*

Incentives

- *Density bonus*
- *Cash subsidy*
- *Parking reduction*
- *Zoning variance*
- *Fee rebates*
- *Expedited review*

MORE RESOURCES

- <https://inclusionaryhousing.org/calculator/>
- <https://www.localhousingolutions.org/housing-policy-library/inclusionary-zoning/>
- <https://apps.urban.org/features/cost-of-affordable-housing/>
- [https://www.urban.org/sites/default/files/publication/99647/inclusionary zoning. what does the research tell us about the effectiveness of local action 2.pdf](https://www.urban.org/sites/default/files/publication/99647/inclusionary_zoning._what_does_the_research_tell_us_about_the_effectiveness_of_local_action_2.pdf)



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