Attached are:

- A letter dated May 27, 2009 from Howard Handler, Government Affairs Director of North Shore - Barrington Association of Realtors (NSBAR)
- A brochure from NSBAR/Illinois Association of Realtors
- Articles against inclusionary zoning

nsbar.org The Gateway to Education, Information and Technology

May 27, 2009

Jeff Ryckaert
VILLAGE OF DEERFIELD

RE: Affordable Housing

Jeff:

Thank you for giving me ample time to speak with you today. Per our conversation, enclosed, please find information that I believe you and the Plan Commission will find very helpful in reviewing various affordable housing policies. I have most, if not all, of these documents electronically as well.

If the Commission decides to move forward on an affordable housing plan, I hope our Association will be used as a resource in its development.

However, in the meantime, we strongly urge the Commission to focus on broader policies that do no not price more people out of Deerfield – unlike mandatory inclusionary zoning and teardown taxes. We would be very pleased, and believe it is essential, for the Village to consider regulatory reform as a component of its eventual plan.

Our Association has joined HUD's National Call to Action for Regulatory Reform – we encourage Deerfield to join us and hundreds of other municipalities across America in signing on as a supporter of HUD's Call to Action.

Please contact me if I can be of further assistance.

Sincerely,

Howard Handler

Howard Handler
Government Affairs Director

enclosures

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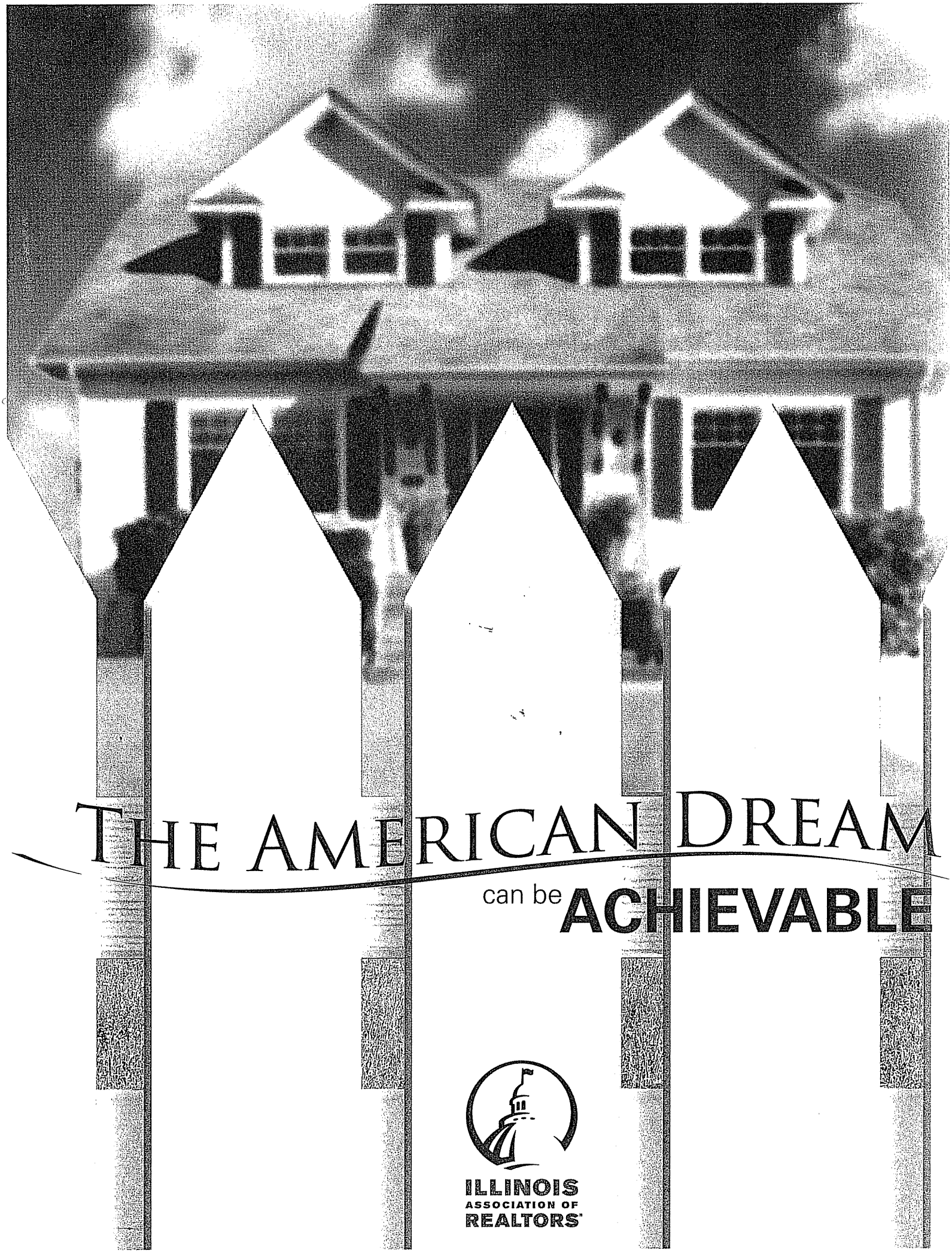
THE AMERICAN DREAM
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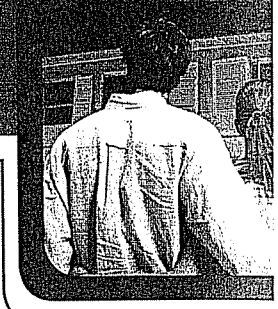
Welcome HOME



A lack of affordable housing is a pervasive problem in many Illinois communities. Finding creative ways to increase affordable housing can be a challenge. This Tool Kit is designed to provide basic strategies to jumpstart or breathe new life into a housing program in your community, and provide a 'welcome home' to deserving families.

Illinois' Largest Housing Challenge: Affordability

In many Illinois communities, the high costs of homes make it difficult for police officers, firefighters, teachers, nurses and other essential workers to reside in the communities they work in. The higher costs of homes force working families to live far from jobs and limit the workers' abilities to participate in both community and family life after their workdays end.

As home costs go up, the promise of a safe, decent home also becomes unattainable to many who form the foundation of our communities. Employers, in turn, lose the ability to attract and retain the workers necessary to grow their business. This can cause local economies to falter. As stated in the State of Illinois' Comprehensive Affordable Housing Plan of 2006*, "An adequate supply of affordable housing is a key factor that companies consider when locating or expanding their business, and thus affordable housing gives Illinois a competitive advantage in attracting investment."

Local Government Can Play an Important Role in Housing Affordability

For the most part, housing policies have been the domain of the federal and state governments. However, addressing the insufficient supply of affordable housing is a challenge that municipal governments should take on in order to build stronger communities.

The purpose of this Tool Kit is to identify strategies that local leaders can implement to help working families afford homes in the communities they support.

* *To learn more about the Housing Affordability and Appeal Act, visit www.ihda.org*

Housing challenges and solutions can vary significantly from place to place. What works in one locality may not work in another. Each community needs to develop housing strategies tailored to fit its specific needs.

The Illinois Association of REALTORS® along with your local Association of REALTORS® hope that you find this Tool Kit helpful in developing those strategies.

How Do Communities Develop Effective Affordable Housing Programs?

Here are a few STRATEGIES that have been successful in municipalities throughout the country and in Illinois.

1. **Creating a Homebuyer Assistance Program**
2. **Evaluating Existing Barriers to Home Ownership and Development**
3. **Finding Revenue Sources for Housing Programs**
4. **Developing Incentives for the Production of New Affordable Homes**

STRATEGY ONE

CREATING A HOMEBUYER ASSISTANCE PROGRAM

Several municipalities in Illinois have created their own homebuyer assistance programs that serve the needs of low and moderate income families through the resources of the State, local lenders, and the municipality.

Since 2001, over 50 municipalities have collaborated with Illinois Housing Development Authority (IHDA), in designing and offering homeownership opportunities to their residents.

Home rule municipalities may "cede" all or a portion of their tax-exempt private activity bond cap to IHDA for the creation of a customized program for their community. The program can help first-time homebuyers purchase a home and enjoy all the benefits that homeownership brings. It can be tailored to address any specific population or concern for the community such as offering:

- **Below market rate mortgages**
- **Closing cost and down payment assistance**
- **Discounted Private Mortgage Insurance/Mortgage Payment Protection Plans**
- **I-Loan Certificates that provide credit to federal income taxes that can be taken by the borrower as an increase on the paycheck or as a tax return**

For information from IHDA on this partnership, contact Roger Morsch, Director of Business and Product Development at 312/836-5230 or to learn more about the Authority, visit www.ihda.org. Municipalities can also access other state and federal subsidy programs to help assist homebuyers.

See www.ihda.org, and click on "Home Ownership Programs" for more information on how municipalities can apply for HOME Investment Partnership Programs.

Working in Partnership with Other Municipalities

The ASSIST Program, which is offered in several municipalities in Illinois, is a good example of how municipalities can work together to create a housing assistance program in their individual towns. With this program, several municipalities pooled their private activity bond volume and offered direct assistance to homebuyers. The ASSIST program offers a gift of 4.25 percent of the amount borrowed combined with a 30-year mortgage. To qualify, buyers need an income that is at 100% of the area median income or less.

IHDA-administered programs can be combined with other private (e.g. Federal Home Loan Bank) or governmental (e.g. County Development Agencies) funding sources to expand the eligibility/assistance or add additional features to the program.

STRATEGY TWO

EVALUATING EXISTING BARRIERS TO HOME OWNERSHIP AND DEVELOPMENT

Often times, municipal leaders have tools available to them that they are unaware of that can facilitate an increase in housing opportunities. These "tools" are in fact the review, reevaluation, and possible repeal of regulatory policies that affect various types of housing development. Onerous zoning and other land use policies that may be well intentioned can inhibit opportunities for housing for many people.

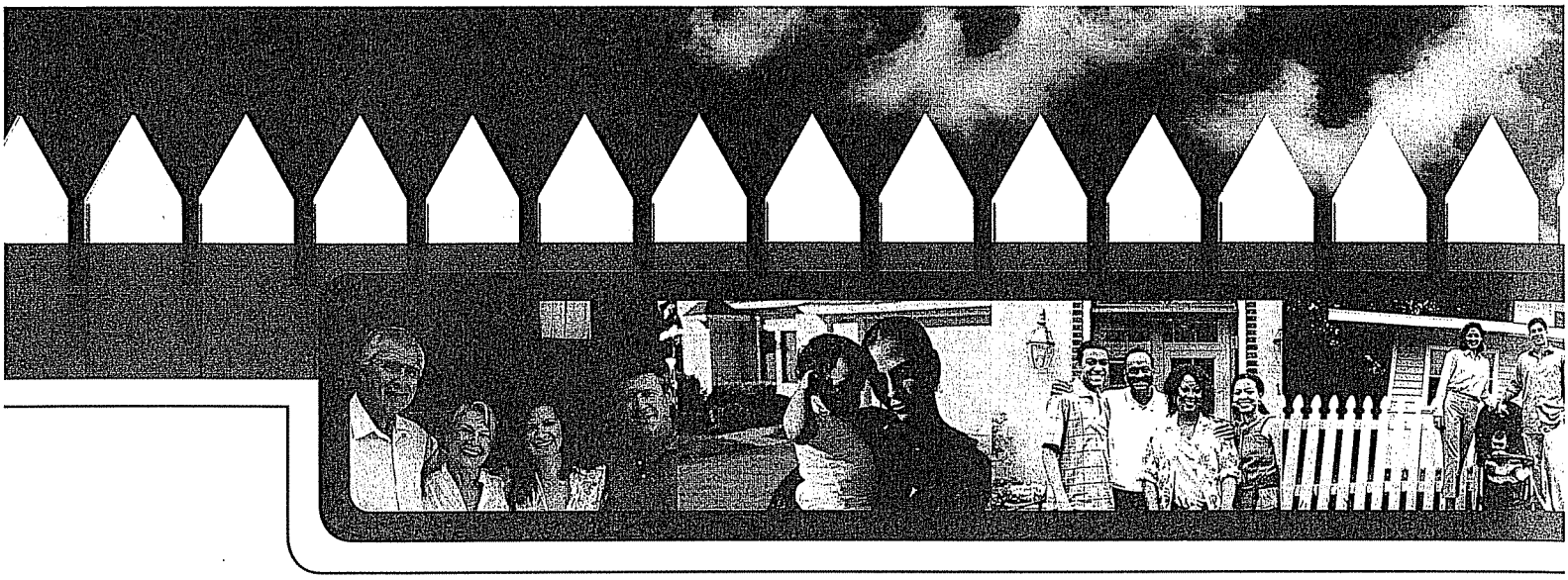
Zoning Policy

Zoning is a regulatory tool that provides a municipality with great power over land use. These policies can severely limit or greatly expand what an owner can do with their property. Unfortunately, many municipalities have zoning codes that are outdated and inflexible that can lead to a diminished housing supply. Curtailing the ability for housing providers to respond to today's needs has a natural result of higher housing costs. According to a recent study by the Brookings Institution, "The weight of the evidence suggests that places with stricter land use regulations differ systematically from those where they are less strict. The evidence is clearest...about housing prices, which are higher in strictly regulated places."[1]

District Limitations

The concept of separating property types through districts was borne about from incompatible land-uses such as factories and housing being built next to each other and it was considered unhealthy. While there is logic to preventing housing next to an industrial site that uses poisonous chemicals it makes little sense to not allow for a duplex to be built next to a single-family. Residential district regulations that could cause this example could be stringent lot size requirements, minimum square footage requirements, or specific residential use

[1]Pendall R., Puentes, R., Martin, J. *From Traditional to Reformed: A Review of the Land Use Regulations in 50 Largest Metropolitan Areas*, Research Brief, August 2006, The Brookings Institution, Washington, D.C.



requirements to name a few. Regulations such as these provide little option for creative owners or property developers to provide housing for those who make low to moderate income. We recommend adopting flexible zoning requirements that allow for mixed-use development and for a diverse housing stock.

Zoning Changes

Rezonings that have taken place over time that have created "non-conforming" properties is an additional barrier that you may not have considered. In an effort to reduce overcrowding or resolve parking issues some municipalities have "downzoned" individual lots or districts. While this approach on the surface seems to make sense the municipality is actually diminishing the housing supply for those that can least afford it. For example a property may have been legally converted from a single-family property to a two-unit, however if it is subsequently downzoned and now is classified as non-conforming and cannot be rebuilt if there is major property damage, often times you are displacing a family that cannot afford another option. Downzoning also has been used to bring the zoning classification down to what the current use is. In this instance you don't have a non-conforming property, however you have removed opportunities for future use when the property becomes a redevelopment opportunity. Beyond the parameters to ensure true health and safety for residents and business owners, zoning should not put unnecessary limitations on land use.

Prohibited Uses

Some municipalities have outright prohibitions on residential uses such as manufactured housing and accessory dwelling units for example. Manufactured housing has been stigmatized by its history of being substandard, however building technology has come a long way on some of these units. In a publication prepared by the Center of Housing Policy, "Many of the higher-end manufactured homes are indistinguishable from manually-framed homes, yet cost thousands of dollars less to construct."[2] Some examples of limitations created by disallowing accessory unit living arrangements are inhibiting lower cost opportunities for extended family members, or limiting the ability for the property owner to collect extra income to pay his own mortgage. We recommend that zoning policies be reviewed to make sure these options are available to property owners and developers.

Additional Requirements

Unreasonable design and landscape requirements also can severely impact the bottom line on housing development. While minimum standards to ensure quality of life for the resident and their neighbors make sense, a municipality must also consider that some requirements can have a significant impact on property prices. Examples could be requiring a brick and masonry façade rather than a vinyl material, or requiring sod instead of grass seed. The desire for every home to include higher end materials and amenities that do not increase product utility can limit the ability for many area workers from living in your community.

■ Land Development

Approval Process

While it is important for a proposal to be properly vetted and reviewed, municipalities should take a close look at what steps in the approval process can be expedited or eliminated. In a typical municipality in Illinois, the process to get a proposed development approved is comprised of many steps, typically taking several months of meetings and reviews. All the while, the property owner is paying professionals such as attorneys, engineers, architects and other consultants to assist them in getting through the process, which in turn, affects the final sale price of the home to be purchased.

Density and Open Space Requirements

Low density and open space requirements for new development should only be approved after careful analysis of its housing impact. While large lots created by low density requirements meet certain quality of life goals they also decrease the number of units available and are expensive to maintain. In regards to open space, requiring large tracts of land to remain undeveloped result in diminished opportunity to provide housing. We understand that open vistas and beautiful views have value, however those benefits have to be balanced with the need for more attainable housing in your community.

Development Fees

Every fee that a unit of government adds onto the development of a home has substantial impact on the cost of housing within the community. While the mantra that "growth has to pay for itself" is valid, it is not uncommon for impact fees to be arbitrarily assessed and potentially quite regressive. The Center for Housing Policy states in its publication "...working families may be forced to bear more than their fair share of these costs."[3]

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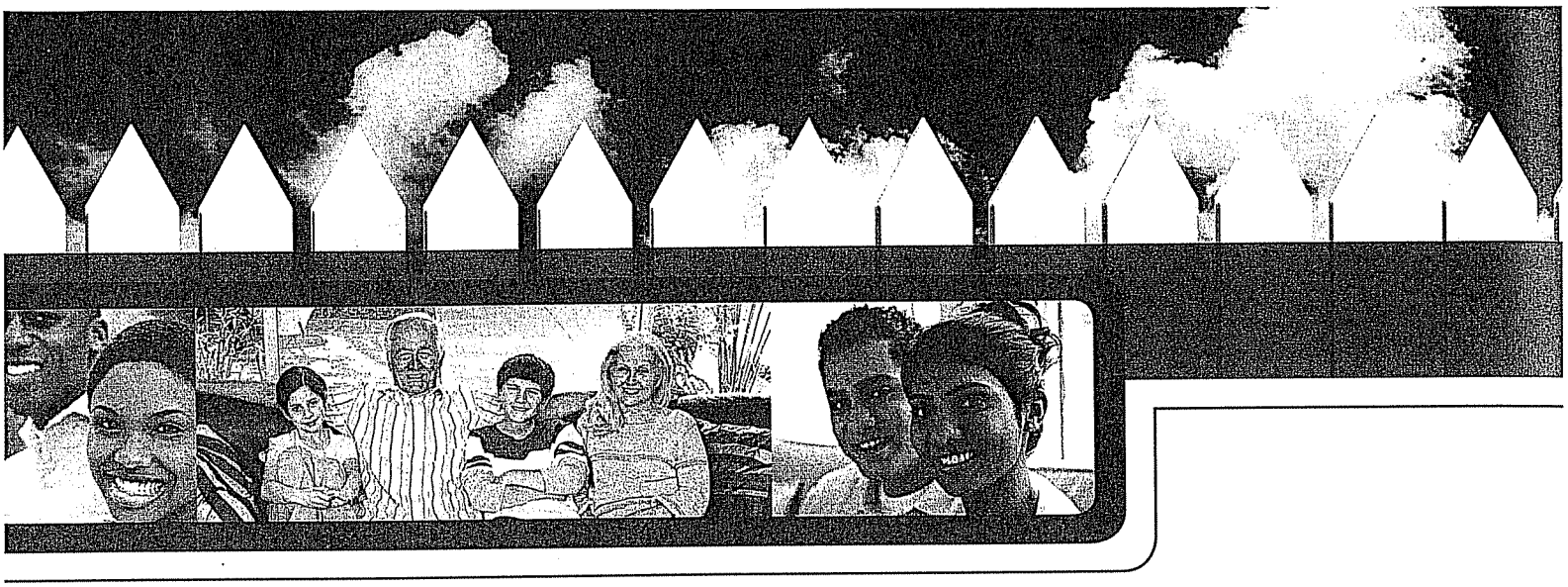
[2] Lubell, J., Increasing the Availability of Affordable Homes, A Handbook of High-Impact State and Local Solutions, Homes for Working Families and the Center for Housing Policy, 2006, Washington, D.C., p. 12. [3] Lubell, J., *Increasing the Availability of Affordable Homes*, A Handbook of High-Impact State and Local Solutions, Homes for Working Families and the Center for Housing Policy, 2006, Washington, D.C., p. 14.



Impact fees in some municipalities can be more than $35,000.[4] This included with high land costs can prohibit a person from purchasing a property before a brick is even put on the ground! In addition, other development fees can be quite limiting as well, water tap-on fees, permitting fees, development review fees are all examples of fees that should be reanalyzed to reveal the negative impact on many potential residents.

As a final suggestion we recommend that you subscribe to the U.S. Department of Housing and Urban Development's (HUD) Regulatory Barriers listserv. This can be found at http://www.huduser.org/rbc/network.html. This will provide you with information on what other areas are doing to reform their local requirements to encourage more affordable housing development. You also might consider participating in HUD's National Call to Action that can be found at http://www.huduser.org/rbc/nca/index.html. Since its inception in January 2007, this initiative is a way for units of government to work together to increase housing opportunities through regulatory reform strategies.

STRATEGY THREE

FINDING REVENUE SOURCES FOR HOUSING PROGRAMS

Resources for Housing Programs

There are a variety of state and federal resources that can be accessed and used in conjunction with local resources to create a housing program. Some municipalities in Illinois use their Community Development Block Grant (CDBG) budget for homebuyer assistance programs. Subject to certain criteria, the U.S. Department of Housing and Urban Development (HUD) provides access to financial resources to municipalities committed to providing housing options to those with incomes that won't allow them access to the community.

Visit the HUD website at www.hud.gov to research whether your city or village may gain access to either Community Development Block Grant (CDBG) funds or HOME Investment Partnership (HOME) funds to increase affordable housing options within your community.

Using Your Own Bonding Authority

If you are a home rule municipality, you may be eligible to use your own bonding authority for either housing rehabilitation programs or down payment assistance programs. We recommend that you check with your finance department or bond specialist to see if this is an option for you. As an example, the Village of Oak Park has leveraged its bonding authority in tandem with IHDA to create a first time homebuyer program through participating lenders.

Employer Assisted Housing

As you review your annual budgets you might consider an allocation for down payment assistance to employees of your municipality. We advise you to check with your finance and legal departments to assess the feasibility of such a program.

Additionally, working with local employers to encourage them to develop similar programs can go a long way to provide those who work in the community the ability to live there as well. As an added benefit, when working through a non-profit housing agency in your area, an employee can be eligible for a tax credit and/or matching grants in Illinois. We suggest you refer them to IHDA for further information. Their website information is listed on the back of this publication.

Housing Trust Fund

A municipality can also dedicate a portion of expected property tax revenue growth toward a housing trust fund. Housing trust funds are flexible vehicles for financing housing programs supported by dedicated sources. Because of their flexibility, housing trust funds can be invaluable tools that complement more restrictive funding sources.

The Rental Housing Support Program (RHSP)

The State of Illinois will be starting a new program in the spring of 2008, called the Rental Housing Support Program. The State will be providing funding for monthly rent subsidies for units that house low-income families and individuals. Tenants pay a portion of the rent directly to the landlord and a program administrator pays the remainder of the rent directly to the landlord. This program can be promoted to landlords in your municipality. Contact the Illinois Housing Development Authority (IHDA) to find the program administrator in your area.

[4] *Meeting Minutes*, City of Marengo, July 10, 2006, cityofmarengo.com/pdfs/ccmeetings/ccmin071006.pdf.

STRATEGY FOUR

DEVELOPING INCENTIVES FOR THE PRODUCTION OF NEW AFFORDABLE HOMES

Public policy at the municipal level should increase its focus on the best way to spur production of residential units that are affordable to middle and lower income persons and families. While this can be done in a variety of ways we recommend an incentive-based approach that includes density bonuses, fee waivers, companion funding policies, creative use of TIF, and expeditious permit and review policies. Some municipalities have entertained mandatory approaches like a "set-aside", however a community can run the risk of driving away residential development if certain margins are not achieved and the project is no longer feasible. In the long run, this translates into the diminished growth of the municipal tax base.

Municipal leaders should work with the development community on the best ways to incentive-ize new affordable homes.

There are several incentive-based approaches to developing newly constructed affordable homes that should be explored.

Density Bonuses

A municipality can allow the developer to develop a greater number of market rate units than would be permitted by right as a way to compensate for the reduced rate of return on the affordable units. In return for the greater density, the developer agrees to provide some number of affordable units. The developer's general rule of thumb is that one additional market rate unit is needed for every affordable unit that is provided.

Waiver of Fees

Any fees that are tied to the development process should be considered for waiver on the affordable units. Permit fees, tap-on fees, local impact fees, etc. should all be considered. In other words, if a developer agrees to provide three new affordable units in a new development, the fees related to the three affordable units should be waived.

Assistance to Builders in Exchange for Affordable Homes

Municipalities can encourage developers to set aside a certain number of units as affordable by providing special assistance which could include the following:

- **Relaxation of specific requirements regarding such things as height restrictions, setbacks, parking, provisions, floor area requirements.**
- **The municipality can perform the marketing of the affordable units as well as the qualification of prospective buyers.**
- **Discounted City Land. If the City acquires land that is donated or sold at a lower price, that land can be sold to a developer at a discounted price in exchange for the construction of affordable units.**

TIF Districts and Enterprise Zones

A municipality may create a Tax Increment Finance (TIF) district that can be a mix of commercial and residential uses. The municipality could require a set-aside of a specific number of affordable residential units for new development within the TIF. Enterprise zones are another tool that should be explored as a way to revitalize a neighborhood or incentive-ize the creation of new affordable housing.

Expedited Permitting and Review Policies

As mentioned in Strategy Two, many municipalities have time-consuming processes for obtaining building permits, zoning variances and other approvals. By adopting expedited permitting and review processes for developments that have affordable units, the cost of producing the affordable units is reduced and thereby serves as an incentive.

Goals and Measurements: Are the Incentives Working?

When an Affordable Housing Program is being created, it is very important to incorporate goals and identifiable measurements which will help indicate whether the policy that's been adopted is working and is effective.

The incentives-based approach can work. As an example, a soon-to-be completed condominium project in north Arlington Heights (called Timber Court), twenty-one new, affordable condos will be available for purchase.

Read more about how this was accomplished without strict mandates but with a collaborative effort between the Village and the developer: www.metroplanning.org/homegrown/hd_TimberCourt.pdf.

As you contemplate the challenges of creating mutually beneficial affordable housing program, it is our hope that you call on us for our experience and willingness to be part of the solution

Additional Web Resources

Illinois Housing Development Authority
http://www.ihda.org/

Affordable Housing – Design
http://www.designadvisor.org/

Manufactured Housing
http://www.manufacturedhousing.org/default.asp

Modular Homes
http://homebuying.about.com/cs/modulareducation/a/modularhomes.htm

Modular Homes – NAR
http://www.realtor.org/libweb.nsf/pages/fg321

US Department of Energy
http://www.eere.energy.gov/state_energy_program/grants_by_state.cfm/state=IL

Department of Commerce and Economic Opportunity
http://www.commerce.state.il.us/dceo/Bureaus/Energy_Recycling/Energy/Energy+Efficiency/housing_energy_program.htm

Heartland Alliance
http://www.heartlandalliance.org/maip/research.html#Affordablehousing

Partnership for Homeownership – Housing Initiative
http://pfho.org/HousingInitiatives03/housinginitiatives03.htm

Home from Work – Employer Assisted Housing Program – NAR
http://www.realtor.org/housopp.nsf/pages/homefromwork06?opendocument

Housing Opportunity Development Corporation
www.hodc.org

Assets Illinois Program
http://www.dhs.state.il.us/page.aspx?item=30821

The Center for Housing Policy has a publication entitled "A Handbook of High Impact State and Local Solutions"
www.nhc.org

ILLINOIS ASSOCIATION OF REALTORS®

Policy Summary No. 318

Housing Supply and Affordability: Do Affordable Housing Mandates Work?

By Benjamin Powell, Ph.D and Edward Stringham, Ph.D

Project Director: Adrian T. Moore, Ph.D

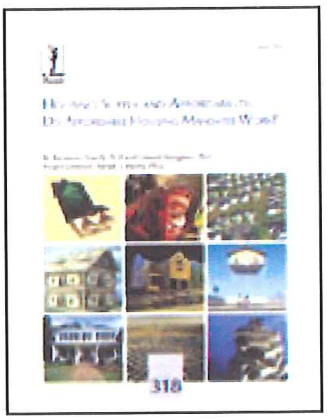
While most of America is enjoying a housing boom and more people than ever can afford to buy a home, in some areas the story is not so happy. From New York to Silicon Valley, and from Milwaukee to Las Vegas, many urban areas nationwide face a housing affordability crisis. In these communities new housing production has chronically failed to meet housing needs, causing housing prices to escalate.

In most of those communities there is great pressure on state and local governments to "do something" about the housing affordability crisis. One of the most popular responses has been "inclusionary zoning" ordinances that mandate developers sell a certain percentage of the homes they build at below-market prices to make them affordable for people with lower incomes.

The number of cities with affordable housing mandates has grown rapidly. A report published in the mid-90s estimated that about 10 percent of cities over 100,000 population had inclusionary zoning requirements, and many advocacy groups predict the trend will accelerate in the next five years. New Jersey and California were early leaders in the adoption of inclusionary zoning, spreading to hundreds of communities in both states. In California, between 1990 and 2003, the number of communities with inclusionary zoning more than tripled—from 29 to 107 communities—meaning about 20 percent of California communities now have inclusionary zoning.

The way inclusionary zoning tries to tackle the affordable housing problem is by mandating that developers sell a certain percentage of new homes at a cut rate. Affordable housing advocacy groups push inclusionary zoning as the best way to address affordable housing needs. "Inclu-

This is a summary of *Housing Supply and Affordability: Do Affordable Housing Mandates Work?* by Benjamin Powell, Ph.D and Edward Stringham, Ph.D, April 2004, www.rppi.org/ps318.pdf



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sionary zoning may be the only effective available tool left for local governments to meet the housing needs of hard working residents," says the chairman of the National Housing Conference, a coalition of such groups.

But Economics 101 tells us that price controls like those imposed by inclusionary zoning will likely lead to less housing, not more, and may well reduce the amount of affordable housing available in the communities that need it the most. As developers have often pointed out, if they are required to sell some houses a prices below market rates, they will have to make up the difference by raising the prices of the other homes in the development. And if that does not work, they can simply shift development to other communities where there are not inclusionary zoning mandates. Either way you get higher prices or less housing.

So which is true? Is inclusionary zoning virtually a silver bullet to solve affordable housing problems, or is it a sure-fire way to decrease the supply of housing and drive up prices even further? Or, as policymakers should be asking:

1. Does inclusionary zoning lead to more affordable housing?
2. What effects does inclusionary zoning have on the housing market?
3. What are the fiscal effects of inclusionary zoning?

As a recent report observed, "These debates, though fierce, remain largely theoretical due to the lack of empirical research." Without knowing the economic and other real world consequences of inclusionary zoning, policymakers have difficulty assessing the merits or faults of the policy.

We set out to answer those questions and provide the first thorough empirical analysis of the effects of inclusionary zoning. To do so we use data from the San Francisco Bay Area in California, which consistently ranks as one of the least affordable housing markets in the nation, and which has been very aggressive in adopting inclusionary zoning in more than 50 communities so far and going back as far as 1973. These communities have various sizes and densities with different income levels and demographics, so they provide a good sample to tell us how inclusionary zoning is probably working nationwide.

DOES INCLUSIONARY ZONING LEAD TO MORE AFFORDABLE HOUSING?

The real acid test for inclusionary zoning is whether or not it leads to more units of affordable housing being built and sold in the community. But we found that after passing an inclusionary zoning ordinance, the average city produced fewer than 15 affordable units per year.

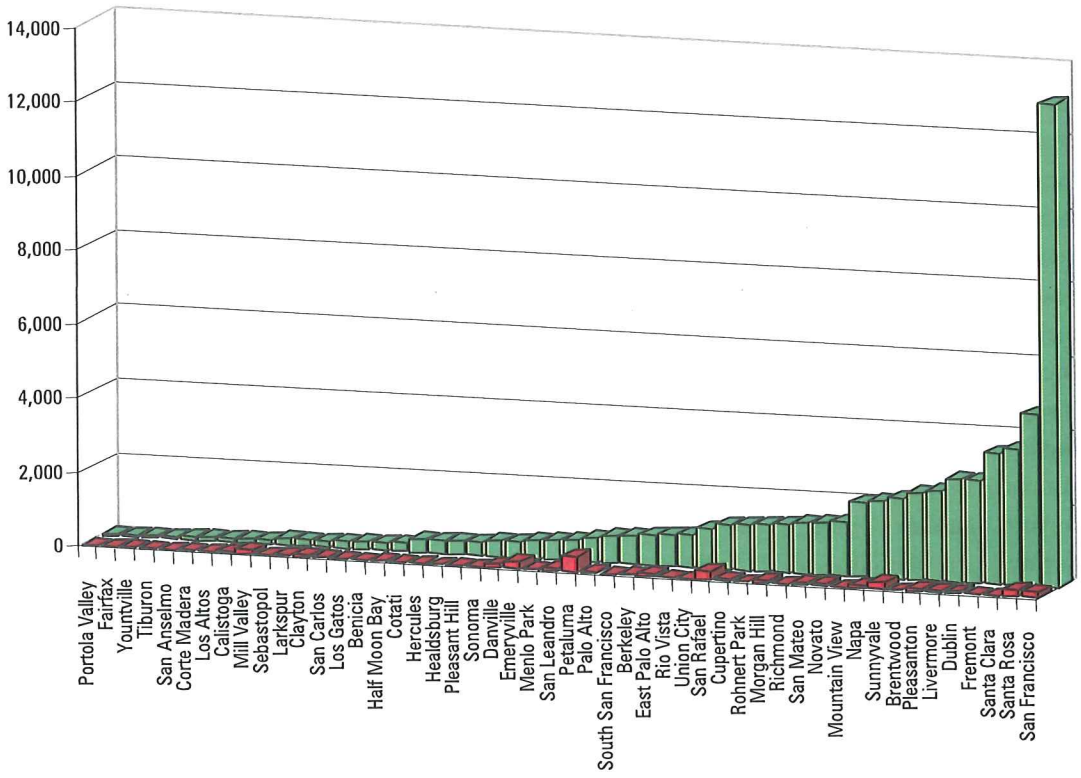
Bay Area cities started adopting inclusionary zoning in 1973, and were among the very first areas to begin experimenting with this policy tool. And with all those years to work on getting it right, inclusionary zoning still has resulted in few affordable units. To date, the 50 Bay Area cities with inclusionary zoning report they have produced fewer than 7,000 affordable units. The average since 1973 is only 228 units per year.

Contrast this with the Association of Bay Area Governments estimate that the region needs 24,217 affordable housing units per year. At current rates, inclusionary zoning will only produce 4 percent of the region's estimated affordable housing need (See Figure 1). This means inclusionary zoning will require 100 years to meet the current five-year housing need.

The reason inclusionary zoning has failed to create more affordable housing is that price controls don't get to the root of the affordable housing problem. In fact, by causing fewer homes to be built they actually make things worse. The real cause of affordable housing shortages is a shortage

Figure 1: Housing Needs Versus Expected Units Produced under Inclusionary Zoning

- "Affordable" units produced through inclusionary zoning. (Calculated for 5.5 years by multiplying average units per year produced under inclusionary zoning times 5.5.)
- Five year housing needs according to the Association of Bay Area Governments "Regional Housing Needs Determination".



of overall housing caused by government restrictions on supply. The Bay Area is a good example, since from 1990 through 2000, the region added nearly 550,000 jobs but only about 200,000 new homes. The California Department of Finance recommends 1.5 new jobs per new home; the Bay Area produced only 55 percent of the suggested amount of housing.

Supply has not kept up with demand due to artificial restrictions. One recent study found that 90 percent of the difference between physical construction costs and the market price of new homes can be attributed to land use regulation.

The solution is to allow more construction. When the supply of homes increases, existing homeowners often upgrade to the newly constructed homes. This frees up their prior homes for other families with lower income. Inclusionary zoning restricts this upgrade process by slowing or eliminating new construction. With fewer new homes available, middle- and upper-income families bid up the price of the existing stock of homes, thus making housing less affordable for everyone.

WHAT EFFECTS DOES INCLUSIONARY ZONING HAVE ON THE HOUSING MARKET?

Who bears the costs of inclusionary zoning? Restricting prices below market increases demand and decreases

supply. When units must be sold for a loss, someone must pay for that difference. It turns out that, no surprise, landowners and market-rate buyers will ultimately pay the cost of the mandated affordable units. Unfortunately, this tax on new housing makes housing less affordable for everyone but the lucky few. Inclusionary zoning only exacerbates the affordability problem by increasing market prices and further discouraging supply.

We estimate that inclusionary zoning causes the price of new homes in the median city to increase by $22,000 to $44,000. In high market-rate cities such as Cupertino, Los Altos, Palo Alto, Portola Valley, and Tiburon we estimate that inclusionary zoning adds more than $100,000 to the price of each new home.

But developers have another option besides eating the cost of mandated affordable units or trying in a large regional market to sell the rest of the units at jacked-up prices: they can go elsewhere to build.

And they do. Inclusionary zoning drives away builders, makes landowners supply less land for residential use, and leads to less housing for homebuyers—the very problem it was instituted to address. In the 45 Bay Area cities where data is available, we find that new housing production drastically decreases the year after cities adopt inclusionary zoning. The average city produced 214 units the year before inclusionary zoning but only 147 units the year after. Thus, new construction decreases by 31 percent the year following the adoption of inclusionary zoning. (See Figure 2)

In the 33 cities with data for seven years prior and seven years following inclusionary zoning, 10,662 fewer homes were produced during the seven years after the adoption of inclusionary zoning. By artificially lowering the value of homes in those 33 cities, $6.5 billion worth of housing was essentially destroyed.

But the loss in "the homes that could have been" is even greater than that. Recall that over the past 30 years inclusionary zoning in the Bay Area has only led to a reported 6,836 affordable units, which amounts to 228 per year. Taking an optimistic approach, if we look at the 45 inclusionary cities that produce the yearly average of 14.7 affordable units, we might expect as many as 663 units per year in the region. For the 45-city sample, however, the data indicates that inclusionary zoning may be decreasing the production of housing by upwards of 2,982 units per year (See Figure 3). That is a net loss in the region of over 2,300 homes each year.

This is crucial because most entry into the housing market by lower-income families is by buying older homes freed up when middle-income families move into new homes. Reducing the overall production of housing both drives up prices and means that the people crowded out of the housing market are the lower–income, would-be homeowners.

WHAT ARE THE FISCAL EFFECTS OF INCLUSIONARY ZONING?

Inclusionary zoning has two major effects on local economies. First, the costs in the housing market drain wealth out of the local economy. Second, inclusionary zoning leads to losses in state and local government revenue.

Inclusionary zoning imposes large burdens on the housing market. For example, if a home could be sold for

Figure 2: Average Housing Production the Year Prior and the Year Following the Adoption of Inclusionary Zoning

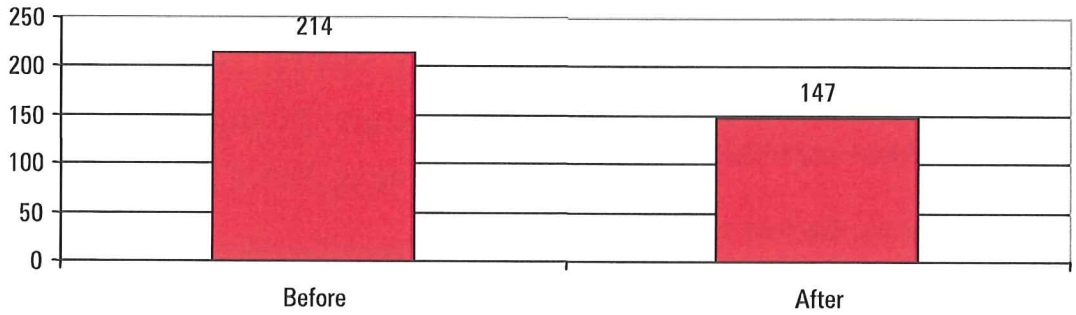
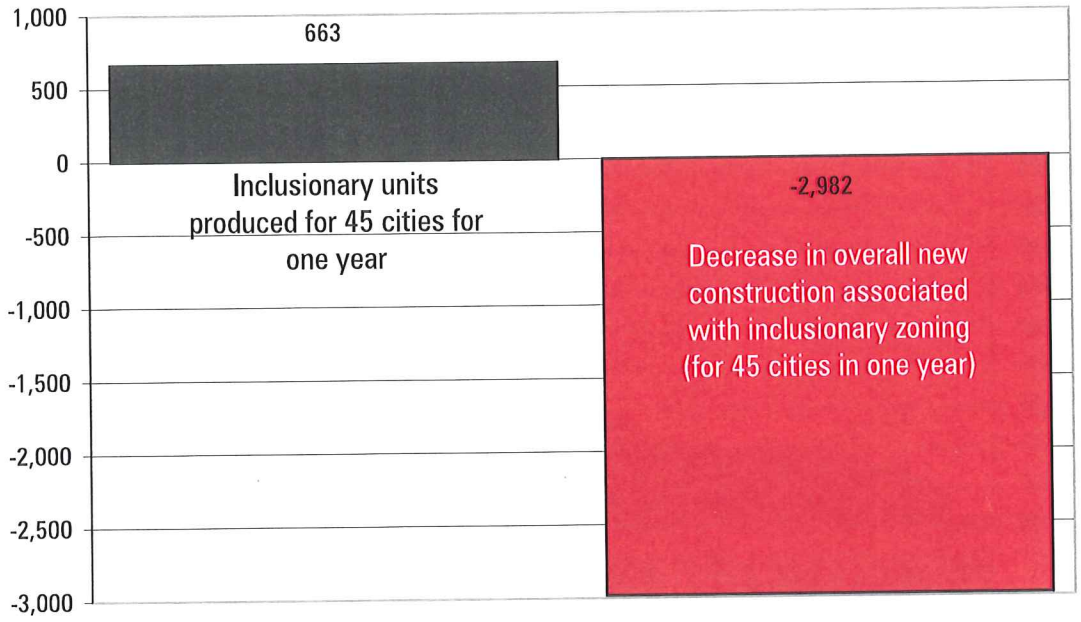


Figure 3: Comparing the Increase in "Affordable" Units to the Overall Decrease in New Construction Associated with Inclusionary Zoning



$500,000 but must be sold for $200,000, the revenue from the sale is $300,000 less. In half the Bay Area jurisdictions this cost associated with selling each inclusionary unit exceeds $346,000. In one-fourth of the jurisdictions the cost is greater than $500,000 per unit, and the cost of inclusionary zoning in the average jurisdiction is $45 million, bringing the total cost for all inclusionary units in the Bay Area to date to $2.2 billion (See Figure 4).

And yet, inclusionary zoning ordinances are often sold to policymakers as the proverbial free lunch, with proponents claiming, "A vast inclusionary program need not spend a public dime." They argue that even if market-rate buyers and landowners end up paying the price of the subsidy, at least local governments need not spend revenue to create affordable housing. "From a local agency standpoint, inclusionary zoning provides affordable housing at *no public cost*" (emphasis added).

The story, however, is not that simple. The advocates fail to take into account that inclusionary zoning leads to direct losses in state and local government revenue.

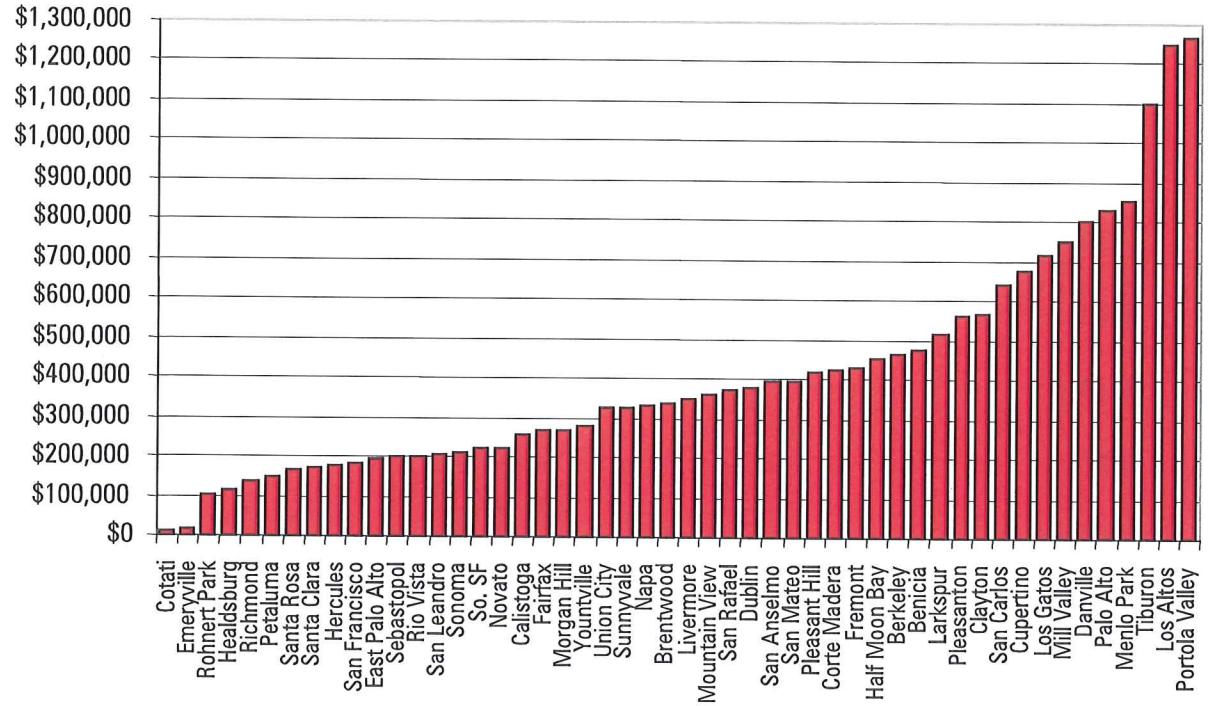
Price controls on new development artificially lower assessed values, and so taxes on those homes are collected based on a value below the true market value, costing state and local governments tax revenue each year. But price-controlled homes cost state and local government the same as market-priced homes to service. How ironic that these cities that impose this loss on themselves, when housing already does not typically generate sufficient tax revenue to pay for the services cities provide.

Because inclusionary zoning restricts resale values for a number of years, the loss in annual tax revenue can become substantial. The total present value of lost state and local government revenue due to Bay Area inclusionary zoning ordinances is upwards of $553 million.

Besides leading to lost revenue, inclusionary zoning also imposes direct costs on local governments. Cities have to enforce price-control requirements in new developments and have to police the resale of price-controlled units as long as they exist to make sure they are not resold at market prices. Running and monitoring the program in Palo Alto costs $40,000 to $60,000 in annual administrative costs alone for 253 units over the past 30 years.

In addition, inclusionary zoning creates other administrative costs because the price-controlled units are far more difficult to sell than market-rate homes. One of the biggest challenges for builders of price-controlled units is qualifying buyers. Some builders estimate that the administrative cost of selling price-controlled homes is about double what

Figure 4: Average Cost Associated with Selling Each Price-controlled Unit



is spent on market-rate homes. One builder describes the costs of qualifying buyers for a current development in Novato:

> *For the 40 buyers we have to date, we have processed over 270 applicants. The conversion ratio is so low that we are hiring additional staff to process the workload. The city also required us to have a custom software program developed to manage the list of applicants. The procedure is so complex that the software costs over $400,000 to develop. This cost is for only 352 homes.*

The process also takes time. The same builder says that at the Meadow Park development in Novato, "The process, as mandated by the city, is so cumbersome that we have only been able to sell 40 homes in six months. We started with over 2,600 prequalified buyers and have only been able to process 270 potential buyers netting 40 sales in six months. We literally can build the homes faster than we can process sales." Both the direct administrative costs and the financing cost of carrying unsold inventory while searching for qualified buyers are additional administrative burdens created by inclusionary zoning ordinances.

CONCLUSION

Inclusionary zoning has failed to produce a significant number of affordable homes due to the incentives created by the price controls. Even the few inclusionary zoning units produced have cost builders, homeowners, and governments greatly. By restricting the supply of new homes and driving up the price of both newly constructed market-rate homes and the existing stock of homes, inclusionary zoning makes housing less affordable

Inclusionary zoning ordinances will continue to make housing less affordable by restricting the supply of new homes. If more affordable housing is the goal, governments should pursue policies that encourage the production of new housing. Ending the price controls of inclusionary zoning would be a good start. ■

Smart Growth, Smart Choices Series

The Builder's Perspective on Inclusionary Zoning

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Land Development Services

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Table of Contents

What is Inclusionary Zoning?

Inclusionary zoning is a local government requirement for home builders and developers to construct a certain percentage of units in every new market-rate development that will be at a determined "affordable" level for people identified as having low or moderate incomes. This determination is made by "qualifying" persons to participate in a program by verifying their household income as being, typically, 80% of the area's median household income.

Community officials typically will enact inclusionary zoning with several "stated" goals in mind, including establishing a larger housing stock, creating more affordable homeownership opportunities and integrating instead of concentrating affordable units throughout a jurisdiction. Another possible, but less direct, reason could be to give the appearance to constituents of "doing something" about affordable housing, particularly in communities that have experienced rapid and dramatic rises in housing values and a correlating rapid decrease in availability of reasonably priced, decent housing.

The typical components of an inclusionary zoning ordinance include; voluntary versus a mandatory implementation; an income qualification level (typically set at 80% or less of area median income); project size threshold, providing for an exemption for smaller developments; Pricing criteria that establish the sales/rental prices of the units; re-sale controls that limit re-sale prices or rents for a period of 5 to as much as 30 years to keep units part of the affordable housing stock; additional incentives that promote ownership over rental.

History of Inclusionary Zoning

The first inclusionary zoning ordinance was passed by Fairfax County, Virginia in 1971, but was ruled invalid due to the fact that Virginia is a "Dillon" rule state, and such policies cannot be legislated at the local level without state legislative authorization.[1] In 1974, nearby Montgomery County, Maryland, passed a similar ordinance, the one difference being that a density bonus was provided to compensate the home builder for loss of income with additional housing units. The program was re-instated in 1990, following a model similar to that of neighboring Montgomery County. MD

Throughout the 1970s and 1980s, California was the primary location where the adoption of inclusionary zoning ordinances took place. The combination of rising home prices and a strong affordable housing and social justice advocacy movement in the state lent itself towards municipalities adopting these types of ordinances. Also, this period coincided with high inflation and interest rates, so there was additional pressure for governments to take action to provide for affordable housing in this region. Despite the national recession, inclusionary zoning did not expand much beyond California, and the Washington, D.C. area through the 1990's with the exception of perhaps the Boston and Denver areas

Current Trends

The record low interest rates, starting in 2001, combined with a widening of financing options have led to for record homeownership levels, but the squeeze on supply has led to a rapid escalation in housing prices. Many local governments, alarmed by the rapid increase in housing costs in their communities have felt pressure from advocacy groups, as well as business groups concerned about economic development recruiting, to "take action" to address the affordable housing issue in their community. Metropolitan areas in such places as Seattle, Minneapolis, Chicago, and Miami began to look into inclusionary zoning examples from California and Washington, DC as a possible solution to their affordable housing crises; as well as in smaller cities such as Madison, WI, Ann Arbor, MI, Burlington, VT, and Santa Fe, NM.

Existing Inclusionary Zoning Ordinances

The best track record for these programs exists primarily in the San Francisco, Los Angeles, Washington, D.C., Boston and Denver metropolitan regions. This paper briefly examines the history of programs in these areas.

San Francisco Area:

Based on the number of jobs created by the expanding Bay Area economy, approximately 24,217 "affordable" housing units per year are needed to house workers who have been added to the economy. In 30 years, the 27 participating municipalities in the Bay Area managed to create 6,840 affordable units through inclusionary zoning requirements, or roughly 28% of the *annual* affordable housing need.[2]

At the same time, due to inclusionary zoning requirements, the San Francisco Bay area lost a total of $2.2 billion in home value equity (lost home value equity equals the market value price less the below market value price set by government) that could have been taxed by local government for the social good or created additional wealth among the residents of San Francisco Bay. When divided amongst the 6,840 units of housing produced, the "tax" on the area economy to create each affordable unit is $321,637.42.[3]

Los Angeles Area:

Based on the number of jobs created by the expanding Los Angeles area economy, approximately 12,460 "affordable" housing units per year are needed to house workers who have been added to the economy. The sum total of "affordable" housing units created in 27 years is 6,379, or roughly 51% of the *annual* affordable housing need.[4]

At the same time, due to inclusionary zoning requirements, Los Angeles and Orange Counties lost a total of $3.8 billion is home value equity that may have been taxed by local government for the social good or created additional wealth among residents of these two counties. When divided among the 6,379 units of housing produced, the "tax" on the area economy to create each affordable unit is approximately $596,546.[5]

Additionally, similar studies of the effect of inclusionary zoning on the overall supply of housing in the Los Angeles area show a chilling effect on the amount of housing constructed. Studies show that within the 13 municipalities which adopted inclusionary zoning ordinances, 17, 296 fewer homes were constructed in the seven years following enactment of inclusionary zoning than in the seven years prior.[6]

Washington, DC

The program with the longest running track record in the country is in Montgomery County, MD, near Washington, DC. Approximately 10,781 affordable housing units have been created since the program's inception, through what is described officially as the "Moderately Priced Dwelling Unit" program.[7] The program historically exempted projects of 50 units and has required that 12.5% to 15% of all housing units in non-exempted developments be provided at "below market rate".[8] Additionally, unlike the San Francisco Bay Area or the Los Angeles area, Montgomery County was (relatively) sparsely populated and overwhelmingly "single-family" when the ordinance was passed. This allowed for the County to begin building multi-family "townhouse" communities in a somewhat planned fashion without overwhelming the existing infrastructure of the community. This also allowed for the County to provide density bonuses of up to 22 percent beyond what would have been built if the program had not been enacted. This may have helped to dampen the effect of lost housing value and reduced supply that was witnessed in more densely populated California.

However, the inclusionary zoning experience has not been without its flaws in Montgomery County. As the county has become more urbanized and has reached "build out" there are fewer and fewer large parcels of land on which to develop large residential development. Many area builders are now building residential projects on smaller infill lots and many are under the 50 unit size required for inclusionary zoning standards. The result has been a "bell curve" (seen in Figure 1 as the line labeled "Series 2") of housing production, with large number of affordable units produces within the 1970s and 1980s, and significant fall off in the 1990 and 2000s. While approximately 800 MPD units a year were being produced in the 1970s and 1980, today approximately 200 MPD units a year is more typical.[9]

Additionally, the higher density townhouse complexes built during the 1970s and 1980s are beginning to show signs of age. Therefore, these communities have fallen into danger of becoming stigmatized as "warehouses" for the less prosperous.

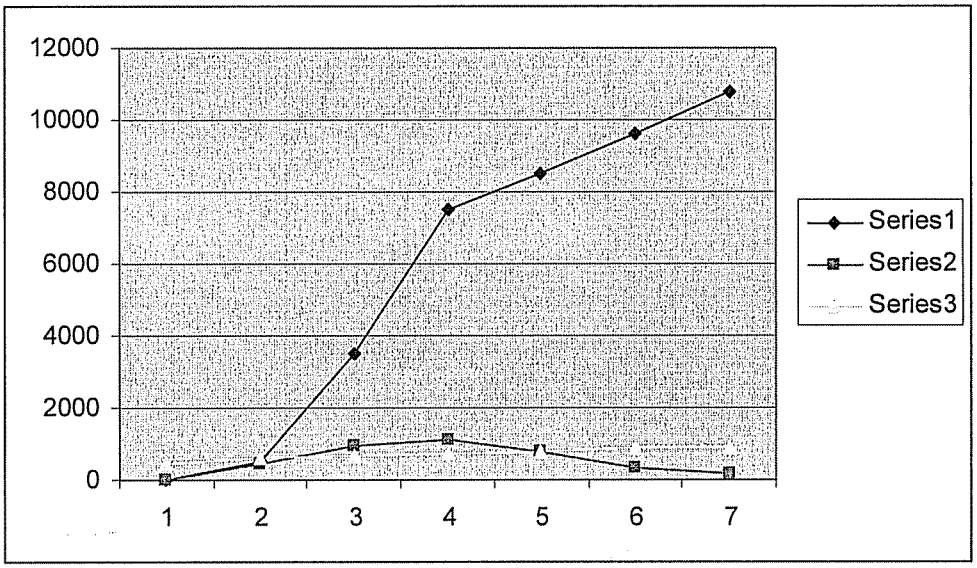


Figure 1: Montgomery County, MD MPDU Program

Series 1 = Population (in 1,000s) from 1 (1970) to 7 (2000)
Series 2 = Affordable Unit Produced per Year (in 100s) from 1970 to 2000
Series 3 = Total number of Affordable Units

Figure 1 Data Based on US Census Data and data from Montgomery County, MD Department of Housing and Community Affairs

Another restriction on the addition of MPDUs in Montgomery County is the growing demand for multi-story condominium development. This has created a challenge for the county administrators, as it is more expensive to build per unit for multi-story structures (generally 3 floors or more).[10] That makes the County's job compensating the developer that much harder, and any compensation that the County is unable to make would be achieved, most likely, through an increase in the market rate housing price.

Boston, MA

Both the cities of Cambridge and Brookline, MA, directly adjacent to the city of Boston, have passed inclusionary zoning ordinances in the late 1980s, in reaction to the area's first home value jump that started after the region's early 1980s high tech boom. Housing values in the region leveled off dramatically during the late 1980s and early 1990s recession, which hit the region especially hard. However, a second employment boom in the late 1990s and early 2000s led to another wave of dramatically escalating home values in the region. Within the Town of Brookline for instance, the median home value in 2004 rose to just over $1,000,000 dollars.[11]

The City of Brookline began their program in 1987 and in the ensuing 18 years, the program has created just 89 affordable units[12], concurrently, the median house value for the City of Brookline rose from $393,094 in 1990 to $550,000 in 2000[13], a 28% increase in price. This increase reflects the rising housing values throughout the Boston area.

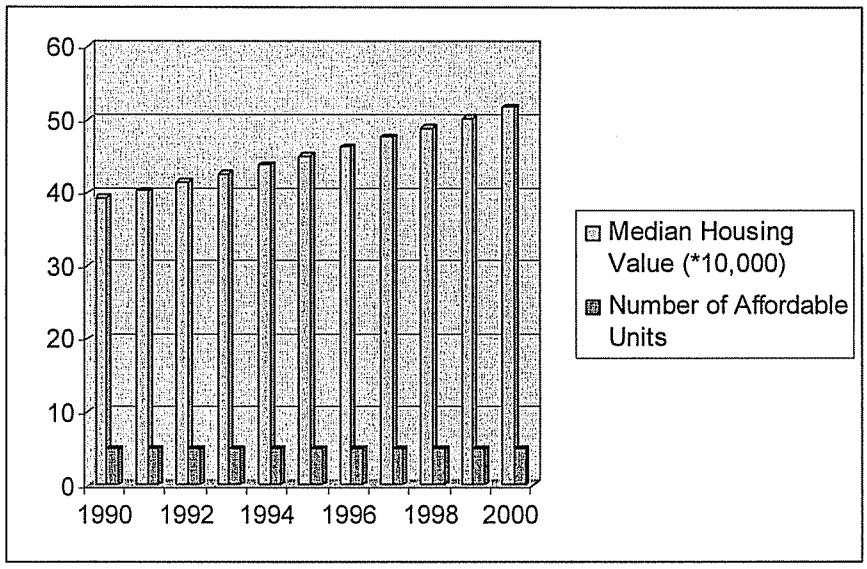


Figure 2: Town of Brookline, MA: Affordable Housing Units Produced (average) vs. Median Housing Value 1990 -2000

Denver, CO

The passage of inclusionary zoning ordinances in the Denver region is a relatively newer phenomenon compared to California and the northeast. However, a number of cities within the region passed inclusionary zoning ordinances during the late 1980s and 1990s in response to rapid growth and rapidly increasing home prices in the area. The City of Denver itself passed an inclusionary zoning policy in 2002 and has created over 670 affordable units in the past three years.[14] Much of the ability to be able to provide a comparably (to other Colorado cities) large number of "affordable units" in a short period of time has to do with the development boom within the city associated with the airport relocation from Stapleton to the Denver International site. This relocation allowed for the redevelopment of thousands of acres at the old airport site, as well as new development on recently annexed land near the far, outlying new airport location. This is a situation rather unique to Denver. Most inner cities have little land left for development of thousands of new units so it should not be assumed that this relatively large number of "affordable units" could be produced in other large central cities.

Generally speaking, the development of inclusionary housing policies has done little to slow the steep increase in housing costs. Surprisingly, relatively small Boulder, CO is the most expensive Metropolitan Statistical Area in the country not located within the San Francisco Bay Area or New York Metropolitan areas.[15] Boulder was one of the first communities to adopt an inclusionary zoning policy in the Denver region, in 1983. Other jurisdictions that have adopted inclusionary zoning policies include Longmont and Fort Collins.

Inclusionary Zoning and the Competitive Housing Market

Inclusionary Zoning as a Price Control

"The Problem was that since French bakers were denied the ability to make cheap bread at a profit, and forced to sell expensive bread at a loss, they did the only rational thing possible: They made very little bread at all. [This precipitated that infamous response by Queen Marie Antoinette to the concern that the people have no bread] That's how bread riots developed and maybe even the French Revolution itself. – Jonah Godberg, Economist.[15]

A dramatic example, but the results may be the same, perhaps not revolution, but quite possibly an even greater shortage in housing in a time when a growing population is feeding the demand. Due to the basic economic tenant of supply and demand, the result of this scenario would be even *more* expensive housing.

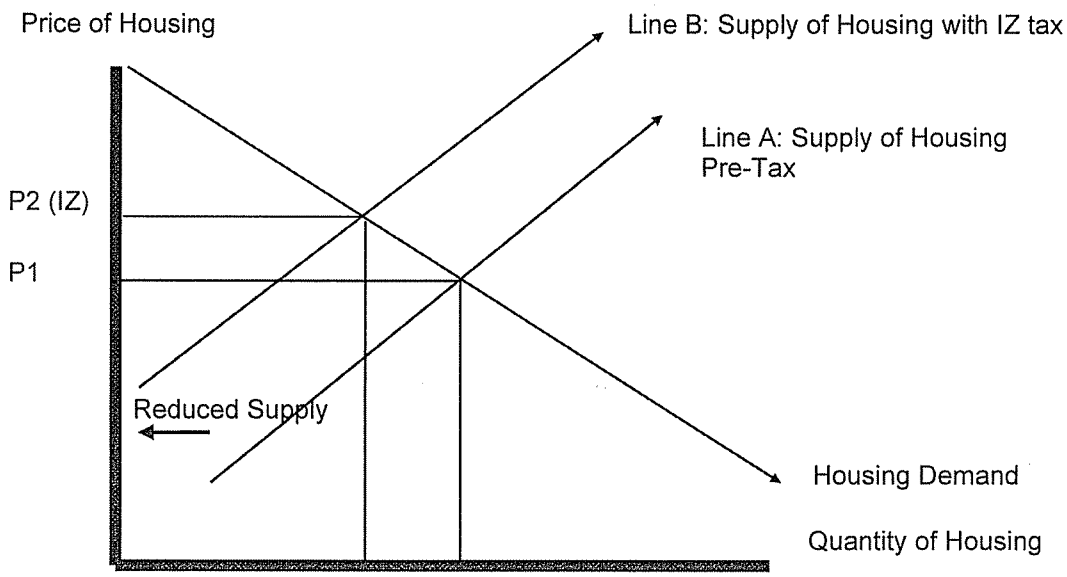
Inclusionary zoning policies are a form of *price control.* Price controls can be defined as "economic policies used to fight inflation. (The name arises because this involves control over incomes.) Many or most macroeconomists oppose the use of these controls since they interfere with the price mechanism, encouraging inefficiency: they lead to shortages and declines in the quality of goods on the market, while requiring large government bureaucracies for their enforcement... ...They work best for those sectors of the economy dominated by monopolies or oligopolies with a significant sector of workers organized in labor unions."[16]

As a form of price control, inclusionary zoning policies will affect the housing market in significant ways. The four main areas in which the market is most affected (and will correct itself against an intrusive regulation) are supply, demand, filtering and leakage which will be discussed below.[17]

Supply and Demand

Figure 3 is a rather simple macroeconomic diagram that demonstrates the markets response to price controls being placed on a commodity, in this instance the commodity is housing. The market will set the price of housing at a point where supply and demand are met, as demonstrated in Line A. However, when a price control such as inclusionary zoning is placed on a market, two things immediately happen - there is a reduced supply of housing, and the price for producing each unit of housing is increased, as demonstrated in Line B. On a macroeconomic scale, the end result will be the overall increase of housing costs in a community as time and quantity of housing moves forward, after the adoption of inclusionary zoning policies.

Figure 3: Inclusionary Zoning as a "Tax" on the Housing Market



Graphic Courtesy of Edward Stringham, Phd. and Benjamin Powell, Phd., of San Jose State University

Filtering

Filtering and leakage are market phenomena related directly to a region's housing market, most specifically the political and geographical make-up of a region.

Filtering is the process by which market prices are contorted from jurisdictions implementing inclusionary zoning into areas not implementing inclusionary zoning, similar to a ripple effect. Filtering in the housing market occurs when artificial price controls are placed on the commodity being produced. The theory is that, because inclusionary zoning policies tend to drive up housing costs in jurisdictions which implement inclusionary zoning, those middle income buyers who no longer can buy in the inclusionary zoning jurisdiction must now compete with other buyers in nearby jurisdictions within the region.[18] More competition causes higher housing prices, *even in jurisdictions which do not implement inclusionary zoning requirements.*

Leakage

Leakage theory entails any time a control, tax or subsidy is placed on a commodity, and there is a "displacement" of the commodity which would have occurred with no government intervention. In the case of housing, even in high priced housing markets, affordable units are produced even with no government intervention such as price controls. The leakage phenomenon occurs because of market "inefficiencies" that are generated through the cost (in terms of time and money) of administering a program (such as inclusionary zoning) and also because such programs increase competition in the affordable housing market, hence weakening the profitability of providing such additional units and thereby reducing their supply.[19] These "lost units" through the

leakage phenomenon are never counted by inclusionary zoning advocates when tallying the number of affordable units created by such a program, thus making the program appear more productive than it really tends to be.

Incentives and Cost Offsets – Do They Really Exist?

When considering the constitutionality of any government policy, government cannot "take" a citizen's property without just compensation. Although the issue of "just compensation" is often contentious (particularly when dealing with eminent domain condemnation of property), at a bare minimum, government must compensate a private citizen at a 1 to 1 ratio of determined value.[20] Therefore, a key to allowing for the continued implementation of the inclusionary zoning programs is to demonstrate that developers are being justly compensated for the requirement to provide below market rate housing prices. The most popular "cost offset" is to allow developers to build at higher densities than in an existing zoning district will allow in order to provide additional units. The increased profit on the additional number of units, the theory goes, compensates for any losses incurred by the requirement to provide below market rate housing.

Creating this benefit through density bonuses can be extremely problematic, however. The first major problem with this benefit is Not In My Back Yard citizen sentiment towards higher density housing, which can result in a loss of dwelling units through the political process prior to approval. Local news sections of newspapers around the country are filled with stories of public hearings of livid citizens against any development nearby that is not one unit higher in density than their own properties.[21] The loss of dwelling units means that the supposed "offsets" are reduced or never achieved and the builder often must transfer the loss to the cost of the market rate houses. A second problem is that construction costs generally tend to increase as density increases. The Montgomery County example cited earlier in this paper is a good example. Therefore, as the "benefit" is increased, it becomes less profitable in general to build. Finally, local planning ordinances and comprehensive plans are filled with market contradictions to providing lower-cost housing. For example, conservation and open space requirements, excessive buffering and setbacks all eliminate land that could be used to construct housing. In this type of regulatory environment, the ability to provide true "cost offsets" to builders is already an uphill battle to begin with.

The Town of Brookline, MA offered developers the option of density bonuses, reduced parking requirements or $5,000 in cash (which would theoretically of the three have the least value) as a cost offset for their mandatory inclusionary zoning housing units. For all 89 units produced in the history of the program, the builder selected the $5,000 cash.[22]

The Socio-Economic Benefits of Inclusionary Zoning

In December 2004, a state Home Builders Association ran a series of focus group meetings organized by an independent third party consultant. In the focus group sessions, average residents selected at random, with no prior knowledge about what the focus group discussion was to be, were asked to discuss inclusionary zoning policies in approximately 2 hour sessions. The process was facilitated by questions from a

moderator. Not surprisingly, most of the residents in these sessions typically agreed that the goal of integrating lower income families into higher income areas was an admirable policy and they had no theoretical problem with government implementing such policies.[23] However, there was major concern voiced by residents that families of lower income may not be able to maintain their property at the same standard as their higher income earning neighbors, thus causing long-term problems in communities which have Inclusionary Zoning.[24]

The discrepancy between theory and reality, instinctively raised, by average residents, highlights some underlying problems with the concept that programs such as inclusionary zoning are a "quick-fix" to poverty and socio-economic segregation. Issues such as long term maintenance of property, and resale caps and equity caps, which do not allow for the full benefit of homeownership, are seldom discussed when talking about the socio-economic benefits of Inclusionary Zoning. Many inclusionary zoning programs require a 50% to 100% equity gain on re-sale of property be returned to the program.[25] In many respects, such requirements almost reduce homeowners to renter status in terms of benefits.

Another concern raised by inclusionary zoning policies regarding socio-economic benefits is who these programs truly serve. Most programs begin to qualify residents at 80% of median family income. However, communities that typically implement inclusionary zoning policies have extraordinarily high income levels. Consider Palo Alto, CA, which has a median family income of $117, 574.[26] At 80% of that level, families earning $94,059 a year can qualify for the program, hardly considered "low income" by any standard. The same rings true in other affluent communities with inclusionary zoning policies, including Boulder, CO and Montgomery County, MD, where 80% of median family income are $56,205 and $57,241 respectively.[27]

Considering the Negative Consequences of Inclusionary Zoning

Considering all the negative consequences and inclusionary zoning policies, government should be extremely wary of imposing such a control on the housing market within their jurisdiction. The intent of this paper is to indicate that when all the facts and trends are examined, inclusionary zoning policies do more harm than good to the affordable housing market and should therefore be avoided.

Singling out a market with price controls

The definition for price control, presented in the first page of this paper indicates that, inclusionary zoning would have mostly a detrimental effect on the large and diverse housing industry. From an economic standpoint, an extremely diversified industry (in terms of production and number of builder companies) such as home construction is one of the most inappropriate industries to impose price controls upon.

The Number of "Affordable Units" Produced Woefully Inadequate

As demonstrated in every metropolitan area that has implemented inclusionary zoning policies, including Boston, San Francisco, Los Angeles and Washington, DC, the number of "affordable" housing units produced by inclusionary zoning in multiple decades is only a fraction of affordable units needed each year. However, the negative consequences of such policies on housing markets appear to be amplified negatively given the small number of units produces. Local official must consider this basic "cost-benefit" analysis before implementing these kinds of requirements.

Loss of Taxable Land Value

As was documented in both the Los Angeles and San Francisco area, the amount of lost taxable land value due to inclusionary zoning requirements for below market rate housing can quickly add up to *billions* of dollars in large metropolitan areas. This, in turn, can equal millions of lost tax dollars that could be spent on other affordable housing programs such as down-payment assistance, and low interest loan programs.

Reducing Supply Raises Costs

This is indisputable "Economics 101". Any regulatory policy that decreases the ability to construct market rate housing will have the immediate effect of raising the cost of housing in that community. Therefore, community leaders must always be skeptical of introducing any additional regulations as an approach to produce more affordable housing in their community.

Regulatory Bureaucracy Raises Costs

Much as regulatory policies reduce supply and raise costs, so does the administration of a newly initiated program. The costs to a municipality for additional staff equipment and facilities to administer such programs must come in the form of additional taxation. Such taxation is typically borne by homeowners through the property tax, thus raising the overall cost of housing. Additional time during the regulatory review process also equates to additional cost to homebuilders which must be passed on to the homebuyer.

Leakage and Filtering Raises Costs

Inclusionary zoning advocates, in general, fail to address the higher housing prices created by increased competition (leakage) and increased scarcity (filtering) that accompany such policies within a metropolitan area. This not only leads to increased housing costs but also "lost" affordable units. These lost affordable units must be compared against any gain in affordable housing units by such programs to come to a "true net" number of affordable housing units.

Insufficient Cost Offsets Raises Housing Costs

There are far too many variables out of the control of governments that enact inclusionary zoning ordinances, which can undermine the ability of government to truly offset the cost to a builder for providing an affordable housing unit. That cost must then be passed on to the homebuyer in the form of higher market rate housing costs.

Dubious Results of Socio-Economic Integration and Success

The complexity of social and economic integration is, unfortunately, underestimated by those advocates who perceive inclusionary zoning policies as a "panacea" for this societal problem. Generally, those who do perceive these programs in that light highly underestimate issues such as long term maintenance costs, equity return caps, homeowner association and condominium fees as creating further burden on residents of inclusionary zoning housing units.

Limits on True Benefits of Homeownership

Inclusionary zoning advocates discuss these kinds of programs as disposing the benefits of homeownership to those who may otherwise not be able to acquire such. However, most of the programs have requirements that render participants little more benefits than if they were renting, with considerably more financial obligations. Typical inclusionary zoning programs impose resale price controls on inclusionary zoning units for 15 and even up to 30 years, required equity "pay-back" in to program, ranging from 50% to 100%, coupled with no financial assistance for major maintenance such as re-roofing or re-siding a home, landscaping and maintenance, homeowner association fees and condominium fees. This combination virtually eliminates the ability of an inclusionary zoning unit owner to build equity and could actually be crippling to participants, who may be better off in a rental situation where many of these needs are taken care of as part of their rental payment.

Considering Alternatives to Providing Affordable Housing

A helpful alternative to mandatory inclusionary zoning is to provide for more constructive solutions to provide for a greater number of affordable units, particularly in areas where housing affordability has become a serious concern.

Stop targeting the housing market with price controls

The history of price controls is one of unmitigated failure. Governments have attempted to impose price controls on specific goods for 40 centuries, starting with Ancient Rome's "Law of the Maximus"; the events leading to the French Revolution; through to Nationalist China and South Vietnam's draconian price control enforcement which led to popular discontent and ultimate collapse of those governments; the failed attempts at price controls in the United States in the 1970s, which only led to food and oil shortages, even higher inflation and a national recession; and most recently the collapse of the Soviet Union and communist Eastern Europe in the early 1990s.[28]

A fundamental question also needs to be asked to inclusionary zoning advocates and the municipal governments that enforce them. Why do they perceive housing as a "basic need" market commodity that is somehow different than food, clothing and automobiles (mobility)? Most local governments would agree it would be ridiculous to require Wal-Mart to provide a set aside for clothing at below market rate as a condition for a building permit, or for Ford to set aside below market rate Mustangs in order to build an auto dealership. Shouldn't the same hold true for the housing market? Builders do have impacts on schools, roads and other public infrastructure, and typically contribute financially to their expansion. However, how does the construction of housing create a need for additional affordable housing? If anything, new housing construction lessens demand for affordable housing by increasing supply. Price controls are a failed economic band-aid that are not sustainable in the long run.[29] Housing advocates and governments need to develop sustainable comprehensive strategies in order to develop an adequate stock of affordable housing.

Jurisdictions need to honestly balance housing priorities with other goals

Local jurisdictions bemoan the rise in the cost of housing in their jurisdictions and look to enact new policies such as inclusionary zoning to address the problem when they should be focusing on broader housing strategies. Some local jurisdictions already have housing policies in place designed to address the issue of providing diverse and equitable housing choices. Several states, including Florida, Georgia, Rhode Island, Washington, and Oregon require all local jurisdictions to develop a "housing element" as part of a required comprehensive plan.[30] Unfortunately, many jurisdictions day-to-day planning activities tend to focus on politically favored decision-making such as transportation, land use, and environmental goals, while housing often lags behind. Often, polices such as environmental conservation are promoted at the expense of housing, as reducing available land for development increases the cost of housing.

It is not impossible to conceive that communities could do more to promote affordable housing just by implementing the policies they have on the books, rather than introduce additional regulation into the marketplace.

Increase the supply of housing in markets with high demand

Economics 101 dictates that if demand increases and supply cannot match the demand, that product will increase in price. This may be one of the prime reasons why housing values escalate dramatically in high growth areas. The difficulty lies in the fact that in high growth areas, it is difficult for the voting public to perceive there *is not enough growth* to avoid an affordable housing problem. The only way to resolve the disconnect between economic reality and political perception is strong political leadership. Locally elected officials must be vigilant in their awareness that many of their decisions routinely have a direct and indirect effect on the cost of housing, and they should not give in to misperceptions by those blindly promoting the mantra "Not In My Backyard."

Regulatory barriers to constructing housing

Related to the NIMBY effect on local decision-making, local officials serious about addressing affordable housing must make real and significant changes to their land development approval process. Residential development reviews can often take several years from submittal to approval. Often, long delays occur because of continuations of public hearings and complex and overlapping requirements to address "citizen concern" This process alone can often drag on for many months or even years. Many state's statutes require only one public hearing prior to zoning changes. Cities can be serious about addressing regulatory reform by strictly reducing the number of public hearings that can occur for such approvals, among other time saving approaches that can reduce the amount of time which developers cannot make use of their land.

There are a host of regulatory reforms that communities can take to both increase the number of houses constructed as well as reduce the cost of constructing housing developments. The NAHB Smart Codes check list includes rather simple steps which jurisdictions can take to reform their regulatory process for land development, including – allowing for innovation and flexibility in site planning and design, reducing infrastructure requirements for such things as roads sidewalks and drainage (so called gold plated infrastructure syndrome), allowing for a mix of housing types without requiring variances, implement a "buildable lot inventory" so government has a better understanding how to provide for a sufficient amount of land for housing development, as well as a myriad of administrative reforms that can reduce costly delays in the development review process.

Public-Private Partnerships

There is a nearly endless combination of public and private partnerships available for the construction of affordable housing. From federal dollars within the HUD, to Fannie Mae and Freddie Mac programs, to money from the operating budgets of local jurisdictions, to local foundations, there are billions of dollars available for the construction of affordable housing. Public funding is crucial to help leverage dollars from the private financing market. This financing can occur in the form of grants, tax-credits, low interest loans and vouchers. Locally elected officials must be serious about the hard work involved in promoting affordable housing. Every local official has the ability to nurture these partnerships, it just takes leadership and serious commitment.

Implement a broadly funded housing trust-fund at the local and state level to assist qualified homebuyers with down-payment assistance and other housing costs.

Some states have established "Housing Trust Funds", which can be used to help supplement federal and local dollars and help leverage additional private investment for the construction of affordable housing. Often these housing trust funds are funded by transactional taxes, such as deed transfer tax, bed tax on hotels, and document stamp taxes. Many states, including California, Minnesota and Florida have initiated such

funds. However, continually maintaining the funds at a level to sufficiently address the needs of workforce and affordable housing takes political commitment over time.

Communities must demonstrate a true political leadership, innovation and commitment to a broad based program of housing opportunities.

An excellent example of this political leadership and commitment can be found through the Baltimore City, Maryland's "Live Baltimore Home Center" (www.livebaltimore.com) housing development program.[31] While Baltimore's specific issues focus mainly on redevelopment for new housing, it is an excellent example of public expenditures on promotion and organization to boost housing opportunities for all segments of society. It is also an example of how a community has embraced innovation and information technology, such as promoting the program through an attractive and user-friendly web-page, instead of embracing economic policies which have failed for centuries. This is an 21st Century example that could be adopted by any community no matter what there specific housing goals and needs are. Baltimore City does not have an inclusionary zoning requirement, yet has begun construction on or completed 12,590 units of attractive, affordable and moderately priced housing units *in just three years,* a figure more than nearby Montgomery County managed to create in 35 years through its MPDU program.[32] Approximately 70% of the units in Baltimore are being constructed by market-rate, private developers.[33] Through innovation and clear political leadership, the city is rapidly becoming an oasis of attractive, affordable and moderately priced housing in a region notorious for its astronomical housing costs. The city government has managed to accomplish this not by requiring additional regulatory and financial burdens, but providing financial and regulatory incentives to home builders, and have been remarkably successful.[34]

Conclusion

The primary purpose of this paper is to highlight a "cost-benefit" analysis of the inclusionary zoning policy. It is hoped that the evidence from this paper indicates that the benefits of these programs are minimal, considering the scope of the problem of housing affordability. The costs, on the other hand raise grave concerns about potential negative consequences on housing supply and cost, which clearly outweigh any minimal benefit achieved through these programs.

Creating decent, affordable housing and homeownership for the entire socio-economic spectrum of society is a noble one, one that government shares with the home building industry. However, additional regulations, difficult to mitigate cost burdens and proven economic policy failures are not the answer. Clear political leadership and a true commitment to affordable housing are needed, as well as a comprehensive approach to the problem of unaffordable housing, not politically expedient and unproductive band-aids. This includes developing broad based funding mechanisms in which all of society contributes to the provision of affordable housing units, and embracing innovation which requires "thinking outside the box". It also includes a realistic understanding that a growing country will need to develop land and many more houses for future generations.

The time is now to beginning planning the homes for those future generations and to ensure they are affordable to all who seek them.

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ISSUES ASSOCIATED WITH THE IMPOSITION OF INCLUSIONARY ZONING IN THE PORTLAND METROPOLITAN AREA

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December 1, 1997

ISSUES ASSOCIATED WITH THE IMPOSITION OF INCLUSIONARY ZONING IN PORTLAND OREGON

EXECUTIVE SUMMARY

The impacts of inclusionary zoning regulations should be fully understood before a community determines the appropriateness of implementing such fees. This study was commissioned to present a formal discussion of the major issues surrounding inclusionary zoning as it relates to the Oregon portion of the Portland metropolitan area.

Inclusionary zoning is a requirement mandating that a particular number or percentage of "affordable" housing units be built in order to be granted development approval. The variation being evaluated in the Portland area would apply to residential developments greater than 10 units, and require a developer to deliver 20% of his units at a price considered affordable for a households earning 80% of the region's median income.

The following is a summary of the key conclusions of our analysis:

Key Conclusions

- Inclusionary zoning requirements function as a tax on new development. This "tax", or the cost of providing the below-market housing units, is passed on to the consumer and the landowner. Over the long run, developers will not bear the cost of this tax. Dr. Arthur O'Sullivan, with Oregon State University's Department of Economics, summarizes the impacts of inclusionary zoning.

  > *"Who pays for inclusionary zoning? The requirement of subsidized housing has the same effect as a development tax." "The developer makes zero economic profit with or without inclusionary zoning, so the implicit tax is passed on to consumers (housing price increases) and landowners (the price of vacant land decreases). In other words, housing consumers and landowners pay for inclusionary zoning"*[1]

- Through taxing the production of new housing units, the economic impact of inclusionary zoning would be a reduction in housing production. This would be expected to place inflationary pressure on the entire spectrum of market-rate housing in the region.

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[1] OSullivan, Arthur (1996). Urban Economics, 3rd Edition. Chicago, IL: Irwin Publishers, p294

- The primary intent of inclusionary zoning is typically to increase the inventory of affordable housing in the metropolitan area. The more likely scenario is a reduction in overall housing opportunities for low income residents. In the Portland metropolitan area, the anticipated economic impacts of inclusionary zoning would be as follows:

  A Reduction in Housing Supply.
  Rising Market Rents
  A Diversion of Housing Demand

- While attention has focused on subsidized housing programs, general market trends have had a much more substantial impact on the inventory of housing units affordable to low income households. Over the last two years, we estimate that the stock of homes in the metropolitan area priced at $125,000 and below was reduced by 80,000 units. In the rental apartment market, a 10% rise in rent levels reduced the number of units available for under $500 per month by almost 20,000 units.

- The anticipated inflationary impacts of inclusionary zoning are likely to more than compensate for any units gained, and actually decrease the stock of housing affordable to the targeted income groups. If inclusionary zoning was implemented, and future development activity was consistent with recent trends, roughly 1,032 single family and 565 multi-family "affordable" housing units would be mandated per year. The 565 unit annual gain in multi-family units attributable to the program would be offset by an overall loss in units available at these rent levels in the region by a mere 0.28% increase in rent levels.

- Inclusionary zoning represents a highly inequitable tax. The metropolitan area's affordable housing problems reflect a regional problem, and have been at least partly attributable to regional policy decisions. Shifting the burden of affordable housing provision to new residential development has no equitable basis.

- The most likely impacts of inclusionary zoning will be largely regressive. One of the largest equity concerns is that implementation of inclusionary zoning may transfer wealth from new residents and apartment dwellers to existing homeowners and income property owners. The upward pressure anticipated on housing prices and rents would favor existing homeowners and owners of rental apartment projects, while negatively impacting renter households.

- The following is a summary list of the anticipated winners and losers if mandatory inclusionary zoning is implemented in the Portland metropolitan area:

Winners	Losers
20% of Low-Income Households in Subsidized Stock Income Property Owners/Investors Existing Home Owners (Retirement) Non-Profit Housing Providers?	80% of Low-Income Households in Market Rate Stock Other Renters Home Buyers Landowners Developers?

- As an unintended consequence, the majority of low-income households would be harmed by the imposition of mandatory inclusionary zoning in the area. Inclusionary zoning is effective only if viewed through the limited criteria of creating subsidized housing units. When viewed in the broader context of the overall housing market, mandatory inclusionary zoning would be expected to reduce the stock of housing available to low income households substantially.

TABLE OF CONTENTS

I. Introduction

The impacts of inclusionary zoning regulations should be fully understood before a community determines the appropriateness of implementing such fees. This study was commissioned to present a formal discussion of the major issues surrounding inclusionary zoning as it relates to the Oregon portion of the Portland metropolitan area.

Inclusionary zoning is a requirement mandating that a particular number or percentage of "affordable" housing units be built in order to be granted development approval. Common variations include a buy-out option, in which a developer puts money into a trust for development of affordable housing rather than build units, and tradable development rights, in which a developer contracts with a public or private agency to have affordable units constructed off-site. The variation being evaluated in the Portland area would apply to residential developments greater than 10 units, and require a developer to deliver 20% of his units at a price considered affordable for a households earning 80% of the region's median income.

The stated intent of inclusionary zoning is to increase the inventory of affordable housing in the metropolitan area.

II. Economic Characteristics of Inclusionary Zoning

Inclusionary zoning requirements function as a tax on new development. By mandated that a component of a residential development be set aside at a reduced price point, inclusionary zoning changes the financial characteristics of real estate developments and the development process. Inclusionary zoning reduces the saleable value of the development upon completion, which would lower the return to the developer without adjustments in the price paid for land and/or the price charged for the remaining product.

When evaluating the anticipated impact of inclusionary zoning regulations, one of the key variables to be considered is the degree to which cost shifting occurs. While the inclusionary zoning requirements are placed on a developer, the cost associated with the requirements can be transferred to the buyer of the remaining residential units through a higher purchase price, absorbed by the developer through a lower profit margin, or deducted from the value of the land. The degree to which cost shifting occurs determines the actual incidence of the charge, or who pays the costs associated with providing the affordable housing units.

Our analysis will evaluate anticipated impacts associated with inclusionary zoning by applying economic principals to the development process. The development process serves as the medium through which market demand (growth in households and employment by type) is translated into development products or types. The development process represents a rational, and therefore

largely predictable, response to what we refer to in this document as the development environment. The development environment includes a large number of participants, including:

- Developers (individuals, corporations, non-profits, etc.);
- Land owners (individuals, corporations, etc.);
- Lenders (banks, insurance companies, pension funds, etc.);
- Equity contributors (insurance companies, pension funds, etc.);
- The "market" (households and potential lessees); and
- Governmental agencies (local, regional, state, etc.).

Developers serve as the primary drivers of the development process, typically initiating development projects. The developer makes a living through managing risk, evaluating the probable financial return on a project in light of assumed risk. Developers cannot be expected to initiate a development in which the risk to return ratio is not compelling. Both lenders and equity contributors will also evaluate any development opportunity proposed by a developer using similar criteria. The "market" is the customer or end-user in the development process, and will largely dictate to the developer what is desirable and what they are willing to pay for the end product (either through purchase price or lease rate). Governmental agencies typically define the legal and bureaucratic process under which property is developed, and can influence the marketplace by incentives and/or restrictions.

The interaction of participants outlined above produces several definable characteristics of the development environment. These include: the expected rates of return required for developers and equity contributors for alternative degrees of risk assumed; the interest rate, fees and equity required by the lender; the selling price or lease rate that the market is willing to pay for alternative products; fees and exactions required by governmental agencies; and the types of development allowed by governmental agencies.

If inclusionary zoning is instituted, the short-term and long-term effects are expected to vary considerably. In the short term, developers are expected to bear a large share of the cost, passing whatever proportion they can on to the consumer. If the land has already been purchased, the developer will not have the option to pass some of the cost to the landowner. The likely impact would be a reduction in profit margin for the developer, or a loss if the charges were high enough.

Assuming a competitive market, the developer would be expected to maintain a stable profit margin over the long term. The developer's profit margin reflects what he considers to be an adequate return in light of the risk he assumes initiating the development. In order to maintain an adequate return, the developer will need to shift the cost of the charge to the buyer and/or the landowner. The direction and magnitude of this shift is a key variable in assessing the impact of inclusionary zoning.

The incidence of the fees depends on how much of the charge is passed on to the consumer or back to the landowner. In a normally functioning market, economic theory would predict that the cost of providing the affordable housing units would largely be shifted back to lower land prices. Everything else equal, developers would not be willing to pay as much for land if they also has a

mandate to provide affordable housing units. If landowners have alternative uses for land, such as farming, then somewhat less land may become available for development; but if all land in a jurisdiction is likely to be developed, capitalization into land prices is a likely outcome. Shifting costs to the market is problematic, as the project must compete with a larger market that was not subject to the inclusionary zoning mandate.

While shifting costs to the landowner would be the most likely outcome in a normally functioning market, the Portland metropolitan area's land market is currently constrained, allowing landowners a stronger negotiating position. As a result, it will be difficult for developers to negotiate a lower land value that would allow them to offset the impact of the inclusionary zoning requirements. Dr. Arthur O'Sullivan, with Oregon State University's Department of Economics, summarizes the impacts of inclusionary zoning.

> *"Who pays for inclusionary zoning? The requirement of subsidized housing has the same effect as a development tax." "The developer makes zero economic profit with or without inclusionary zoning, so the implicit tax is passed on to consumers (housing price increases) and landowners (the price of vacant land decreases). In other words, housing consumers and landowners pay for inclusionary zoning"*[2]

In the Portland metropolitan area, the anticipated economic impacts of inclusionary zoning would be as follows:

- Reduction in Housing Supply- *By increasing the cost of new development, the amount of housing supplied by the market would be expected to decrease.*
- Rising Market Rents- *The increased cost of new development, in conjunction with a reduction in new supply, will place inflationary pressure on residential rents and home prices.*
- Housing Demand Diverted- *Higher housing and development costs within the Metro boundary would increase the attractiveness of communities on the periphery, such as Newberg, Woodburn, and Clark County. These communities would be expected to capture a greater share of regional growth, increasing commuting distances and vehicle miles traveled.*

III. Residential Market Impacts

Implementing an inclusionary zoning mandate on new residential development would be expected to impact the price and quantity of housing units sold in the market. This section introduces many of the probable impacts on affordability in the residential markets.

Recent Trends

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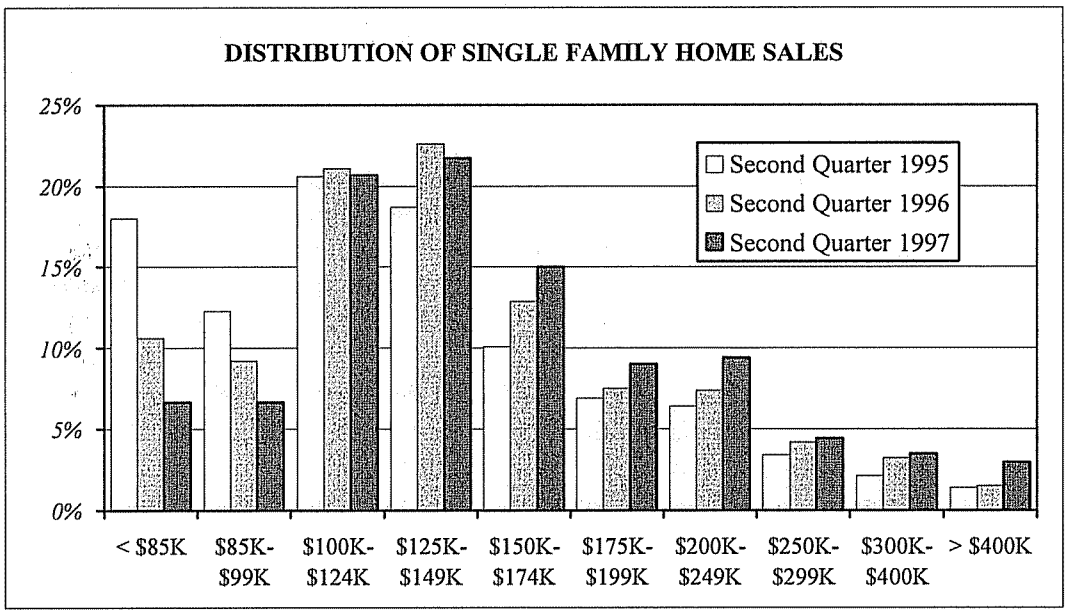
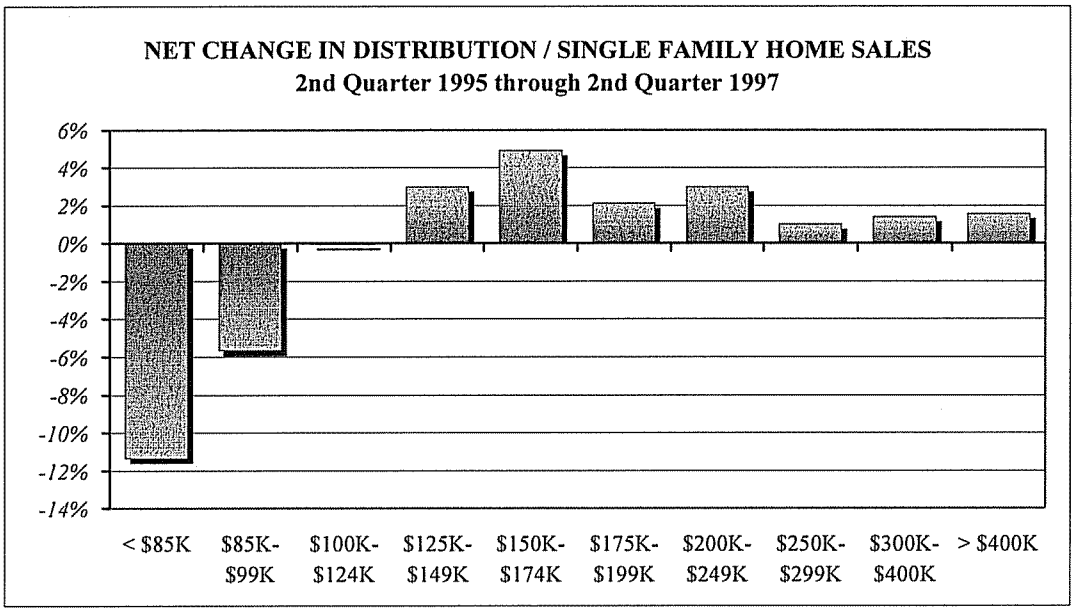
2 OSullivan, Arthur (1996). Urban Economics, 3rd Edition. Chicago, IL: Irwin Publishers, p294

Recent market trends are indicative of a shift in the distribution of home sales. The following chart illustrates this trend, in which the low-end of the market declines dramatically while the remaining price segments reflect a less pronounced rate of escalation. This home price escalation pattern is consistent with what we would expect in a land-constrained situation, which places price pressure on existing housing stock, which historically serves as the region's primary source of affordable housing.





The percentage of homes priced under $125,000 in the area dropped from 52% of the market to 35% of the market during this period. When applied to the region's stock of single family homes, this translates into a reduction of 80,000 units in that price range over the last two years. Rising

home prices are directly correlated with rising rent levels. A 10% rise in effective rental rates would reduce the number of rental apartments available in the region under $500 per month by almost 20,000 units. The region does not have the means to address impacts of this magnitude with affordable housing programs.

Over the last six and a half years, which represented an unusually brisk pace of development, residential permits in the Oregon portion of the Portland metropolitan area averaged 6,450 single family and 3,530 multi-family. Assuming 80% of new residential projects were subject to the inclusionary zoning requirements proposed, and development continued at the recent pace, a total of 1,032 single family and 565 multi-family units would be required to meet the proscribed income requirements. The 565 unit annual gain in multi-family units attributable to the program would be offset by an overall loss in units available at these rent levels in the region by a mere 0.28% increase in rent levels. As a result, the anticipated inflationary impacts of inclusionary zoning are likely to more than compensate for any units gained, and actually decrease the stock of housing affordable to the targeted income groups. In addition, the full spectrum of the housing market will experience higher home prices.

Among the most common market misconceptions is that developers prefer to build to the higher end of the market, as it yields a higher profit margin. Under this scenario, the affordable housing problem reflects an unwillingness of developers to offer relatively low priced homes. This misconception reflects a lack of understanding of the risk/return relationship in real estate development. While the magnitude of profit on a higher-end home may be higher, the rate of return is typically similar. Developers building homes priced over $300,000 also incur significantly higher marketing risk, making their risk-adjusted yield lower. Many homebuilders would prefer to build to the entry-level market, but are forced to produce higher-priced homes by land values. With typical lot prices in the area ranging from $60,000 to $100,000 per lot, homebuilder's are forced out of the relatively low-risk entry-level market.

IV. Equity Issues

Equitable taxation is usually stated as an objective of taxing entities. However, equity is a complex issue that means different things to different people. Two major philosophies exist on equitable taxation: Taxation should be based on the benefit principle or taxation should be based on the ability to pay. Inclusionary zoning cannot be considered equitable under either philosophy.

According to the benefit principle, an equitable tax is based on the quantity of government services used. Individuals who consume large quantities of government services should pay higher taxes since they benefit more from the tax revenue. As outlined previously, residential landowners and housing consumers are likely to pay the cost of providing the mandated affordable housing units. These same parties will not receive any direct benefits from the mandated affordable units.

The ability to pay principle suggests that the tax liability an individual faces should be based on the ability to pay (generally income based). This approach usually includes a redistribution effect

since the primary beneficiaries of the tax revenue are not necessarily paying more tax. There is no basis to believe that the parties expected to pay the cost of inclusionary zoning, housing consumers and landowners, have a unique ability to pay.

The metropolitan area's affordable housing problems reflect a regional problem, and have been at least partly attributable to regional policy decisions. Shifting the burden of affordable housing provision to new residential development has no equitable basis. In fact, the most likely impacts of inclusionary zoning will be largely regressive. One of the largest equity concerns is that implementation of inclusionary zoning may transfer wealth from new residents and apartment dwellers to existing homeowners and income property owners. The upward pressure anticipated on housing prices and rents would favor existing homeowners and owners of rental apartment projects, while negatively impacting renter households.

V. Conclusions

The implementation of inclusionary zoning would substantially impact real estate markets, changing the behavior of producers and consumers, and altering the growth rate of population and employment. This section provides an overview of the primary beneficiaries and losers associated with implementation of inclusionary zoning.

Beneficiaries

- Low-income households utilizing subsidized units, *which typically account for 20% of qualified households.*
- Non-profit housing providers, *who could be expected to benefit from increased funding. The ability of these groups to benefit from inclusionary zoning would hinge upon their ability to deliver housing products at an efficiency level close to that found in the for-profit market.*
- Investors owning residential income properties, *which would benefit from rising rent levels.*
- Existing homeowners, *who would be expected to benefit from escalating home values.*
- Investors owning residential income properties, *which would benefit from rising rent levels.*

Losers

- Low-income households in market rate rental units, *estimated at 80% of qualified households, who would likely see rising rent levels and a decreasing stock of affordable units.*
- All renter households, *who would be expected to face rising rent levels and a decreasing ability to enter the ownership housing market.*

- Home Buyers, *who are expected to see rising home prices in the area.*

- Developers, *while maintaining their margins, are likely to face a lower level of development activity, therefore reducing their local opportunities.*

As outlined in the previous list, the majority of low-income households would be harmed by the imposition of mandatory inclusionary zoning in the area. The apparent contradiction between non-profit housing providers benefiting at the expense of a majority of low-income households is not unusual, with the relationship summarized by Gerard Mildner of Portland State University:

> *"the interests of low-income households and non-profit housing providers are not overlapping. Federal studies have consistently pointed out that housing vouchers and portable certificates are a better way of serving the poor, while non-profit providers are better served by receiving project-based assistance. And while housing subsidies are required for all the providers' new developments, over 80% of low-income renters find housing in the private market. Thus, the advocates represent the select 20% of low-income renters in assisted housing, not the 80% suffering from rising rents."*[3]

Inclusionary zoning is effective only if viewed through the limited criteria of creating subsidized housing units. When viewed in the broader context of the overall housing market, mandatory inclusionary zoning would be expected to reduce the stock of housing available to low income households substantially.

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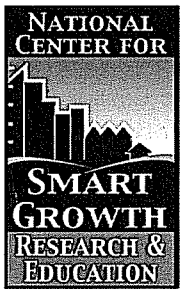

National Center for Smart Growth Research and Education

Housing Market Impacts of Inclusionary Zoning

February 2008

Prepared by the National Center for Smart Growth Research and Education with funding from the National Association of Home Builders.

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Executive Summary

Many communities across the country face affordable housing challenges. An increasing number of communities are considering inclusionary zoning as a response. Inclusionary zoning programs, which require developers to sell a certain percentage of newly developed housing units at below market rates to lower income households, are politically attractive because they are viewed as a way to promote housing affordability without raising taxes or using public funds. Standard economic theory, however, suggests that such programs act like a tax on housing construction. And just like other taxes, the burdens of inclusionary zoning are passed on to housing consumers, housing producers, and landowners. As a result, inclusionary zoning policies could exacerbate the affordable housing problem that they are designed to address.

Although debate over the merits of inclusionary zoning has continued for nearly three decades, there have been no rigorous studies on their effects on housing prices and starts. We offer such an analysis here, estimating the effects of inclusionary zoning policies on single family housing prices, single family and multifamily housing starts, and the size of single family housing units in California over the period from 1988 to 2005. In our analyses, we are able to isolate the impacts of inclusionary zoning programs by carefully controlling for spatial and temporal conditions, such as the neighborhood or school district within which the house is located, and changing market conditions over time.

We find that inclusionary zoning policies had measurable effects on housing markets in jurisdictions that adopt them: the share of multifamily housing increases; the price of single family houses increases; and the size of single family houses decreases. These results are fully consistent with economic theory and demonstrate that inclusionary zoning policies do not come without cost.

Overall, we find that inclusionary zoning programs had significant effects on housing markets in California from 1988 to 2005. Although cities with existing or new programs during the study period did not experience a significant reduction in the rate of single family housing starts, they did experience a marginally significant increase in multifamily housing starts. More specifically, we found that in municipalities with inclusionary housing programs, the share of multifamily housing starts increased seven percent. The reasons for this shift are relatively clear when viewed in the proper context. Housing markets in California expanded rapidly over the 1990s as pent up demand exploded following the 1991 recession. The imposition of inclusionary zoning requirements was not strong enough to slow the overall rate of housing production but did cause a measurable shift from single family to multifamily housing production. We further found that the magnitude of this shift varied with the stringency of the inclusionary requirements.

We also found that housing prices in cities that adopted inclusionary zoning increased about 2-3 percent faster than cities that did not adopt such policies. In addition, we found that housing price effects were greater in higher priced housing markets than in lower priced markets. That is,

housing that sold for less than $187,000 (in 1988 dollars[1]) decreased by only 0.8 percent while housing that sold for more than $187,000 increased by 5.0 percent. These findings suggest that housing producers did not in general respond to inclusionary requirements by slowing the rate of single family housing construction but did pass the increase in production costs on to housing consumers. Further, housing producers were better able to pass on the increase in costs in higher priced housing markets than in lower priced housing markets.

Finally, we found that the size of market rate houses in cities that adopted inclusionary zoning increased more slowly than in cities without such programs. Specifically, we found that housing in cities with inclusionary zoning programs was approximately 48 square feet smaller than in cities without inclusionary programs. Further, most of the reductions in housing size occurred in houses that sold for less than $187,000. These findings suggest that inclusionary zoning programs caused housing producers to increase the price of more expensive homes in markets where residents were less sensitive to price, and to decrease the size of less expensive homes in markets where residents were more sensitive to price.

Introduction

As concerns about affordable housing have grown across the country, local governments have adopted a variety of affordable housing programs in response. An approach that an increasing number of local governments are considering is inclusionary zoning, which requires developers to sell a certain percentage of newly developed housing units at below market rates to lower income households. Although specific details of these programs vary widely, they are politically attractive because they are viewed as a way to promote housing affordability without raising taxes or using public funds.

No program, of course, is cost free. According to standard economic theory, inclusionary zoning acts like a tax on housing construction. And just like other taxes, the burdens of inclusionary zoning are passed on to housing consumers, housing producers, and landowners. More specifically, economic theory suggests that inclusionary zoning requirements act to decrease the supply of housing at every price, raise housing prices, and slow housing construction. As a result, inclusionary zoning policies could exacerbate the affordable housing problem that they are designed to address.

Although debate over the merits of inclusionary zoning has continued for nearly three decades, there have been no rigorous studies on their effects on housing prices and starts. We offer such an analysis here. Specifically, we present an analysis of the effects of inclusionary zoning policies on single family housing prices, single family and multifamily housing starts, and the size of single family housing units in California over the period from 1988 to 2005.

We find that inclusionary zoning policies have measurable effects on housing markets. Specifically, we find that in jurisdictions that adopt inclusionary zoning, the share of multifamily

[1] Using the Office of Federal Housing Enterprise Oversight's house price index for California, this is equivalent to $657,090 in 2007 dollars.

housing increases, the price of single family houses increases, and the size of single family houses decreases. We do not examine the purported benefits of inclusionary zoning, such as whether these policies increase the supply of affordable housing or serve to integrate low and high income residents. Therefore, we cannot ascertain whether inclusionary zoning increases social welfare. We demonstrate, however, that such benefits do not come without measurable costs.

Background

The first inclusionary zoning program was adopted in 1974 by Montgomery County, Maryland. The original Montgomery County ordinance required that 15 percent of new developments with more than 50 housing units be sold at a price affordable to low income households. In return, the county provided developers with a density bonus that allowed them to build at a density up to 20 percent higher than the maximum density allowed by zoning. Since then, inclusionary zoning policies have grown in number and variety across the country. For example, between 1990 and 2003, the number of California communities with inclusionary zoning grew from 29 to 107 (Powell and Stringham 2004). As of 2004, an estimated 350 to 400 local jurisdictions had inclusionary zoning programs, with the vast majority of these programs enacted in California, Massachusetts, and New Jersey (Porter 2004).

The economic effects of inclusionary zoning are similar to those of a tax on housing construction, as show below in Figure 1. As more units must are sold at a discount, the cost of development increases. Developers must raise the price on market rate units to compensate for the cost of discounted units. As a result, the price of market-rate housing rises and the production of such housing declines. This decline in housing production can manifest as both a reduction in housing starts as well as a reduction in housing size.

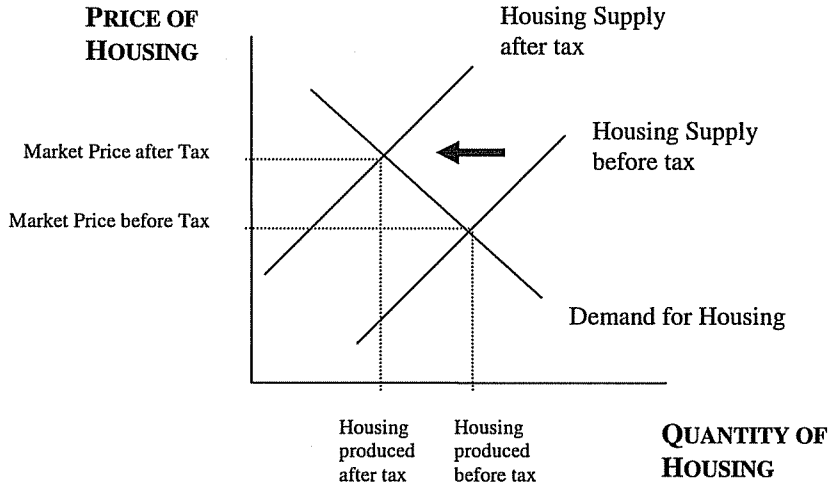

Figure 1: The Economic Effects of Inclusionary Zoning

The features of inclusionary zoning programs vary widely as shown in Table 1. The economic impacts of inclusionary zoning vary based on the different program features. A voluntary program that relies on incentives might not have any economic impacts, while a mandatory program that requires many, deep, and long-term discounts could have significant adverse economic effects.

Size and types of developments subject to inclusionary requirements	Some programs are voluntary, others impose inclusionary requirements only on large single family projects, others impose inclusionary requirements on all types of projects of all sizes.
Percent of units that must be affordable	Some programs require only five percent of new units to be sold at a discount, others require percentages as high as 30 percent.
The depth and duration of price discounts	The depth of price discounts often varies by the target population. For example, many require that units must be made affordable to those at 80 percent of median household incomes, others set different standards. The period of affordability often varies from 10 to 99 years.
The incentives or allowances offered in compensation	Most programs offer some form of incentives or compensation for providing affordable units. Incentives and compensation often include density bonuses, waivers of subdivision requirements, or fee reductions. Some programs permit payments in lieu of inclusionary units.

Table 1: Distinguishing Features of Inclusionary Zoning Programs

Previous research on inclusionary zoning has produced mixed results. While most research has been theoretical and dominated by case studies, some studies have sought to quantify the benefits and potential costs.

An early study by Clapp (1981) describes the potential reaction of developers to inclusionary zoning programs. Tombari (2005) similarly describes the potential adverse effects on housing prices and starts. Powell and Stringham (2004), in their study for the Reason Public Policy Institute, provide quantitative support for the concerns raised by Clapp and Tombari. Specifically, using data from the San Francisco Bay area, they provide evidence to suggest that inclusionary zoning makes market-priced homes more expensive, restricts the supply of new homes, and produces few affordable units.

A considerable volume of case study research, however, comes to quite opposite conclusions. Using data from Los Angeles, Rosen (2002) found no correlation between the adoption of an inclusionary housing policy and housing starts in 28 California cities. Multiple case studies by Calavita (1997, 1998) and his colleagues in California and New Jersey conclude that inclusionary zoning is a viable strategy for increasing the supply of affordable housing and mixing low and high income residents. The National Housing Conference (2002) draws similar conclusions in case studies conducted in Massachusetts.

In a study of the inclusionary zoning programs in the Greater Washington metropolitan area, Brown (2001) concludes that inclusionary zoning programs work best in jurisdictions with large amounts of undeveloped land and less effectively in dense, more mature metropolitan areas. The Non-Profit Housing Association of Northern California (NPH) and the California Coalition for Rural Housing (CCRH) (2003) published the results of a survey on the prevalence and the components of inclusionary housing programs in California. The study found significant variation in both the prevalence and the components of the programs in California, and

concluded that the effects of such programs depend in part on such programmatic details. In the study we present below, we test this proposition using data from the NPH survey.

Scope and Context of the Study

This study examines housing markets in local jurisdictions in California during the period from 1988 to 2005. For a number of reasons, California over this period offers a good setting for examining the impacts of inclusionary zoning. First, the state is large and includes many municipalities with distinct regulatory environments. Second, California is an often studied state with very good data available for housing market analysis. Third, and most importantly, inclusionary zoning programs became increasingly common in California over the study period. Time-series analysis of housing markets in California from 1988 to 2005 includes observations of many cities with existing inclusionary zoning policies, cities without inclusionary zoning policies, and cities that adopted inclusionary zoning policies within the study period. For each individual city in our sample we control for unobserved, time-invariant characteristics that might impact housing starts or the types of houses that are built. By doing so, we are able to isolate the impact of the inclusionary zoning programs, relative to other factors that might be influencing new housing developments; it is the variation in the use of inclusionary zoning across the state and over time that helps to isolate the effects of this policy from other factors.

Although the study setting is well suited for our analysis, any such analysis must be interpreted in the context of prevailing market conditions. As shown in Figures 2 and 3, housing starts in California were strongly influenced by national business cycles over the study period. Housing starts bottomed in the early 1990s as the national economy was in recession but increased fairly consistently as the economy recovered. Housing prices were similarly affected by national business cycles, as shown in Figure 4 for the San Francisco and Sacramento areas, but did not rise until 1996. The average size of a single family house, however, rose slowly but consistently over the study period, as shown in Figure 4.

While these trends primarily reflect national business cycles, housing markets in California have several location-specific characteristics of note. According to Landis et al. (2000), since the 1980s, housing markets in California have not produced housing units commensurate with the rapid growth in demand. The specific reasons for this are numerous, though limitations in the supply of land, capital, and infrastructure are all likely factors. Regulatory constraints probably also played a role. According to Pendall et al. (2006), local governments in California have adopted more growth management instruments than their counterparts in other parts of the country. Thus it is important to note that this study was conducted in markets characterized by strong demand-side pressures and significant and varied supply-side constraints.

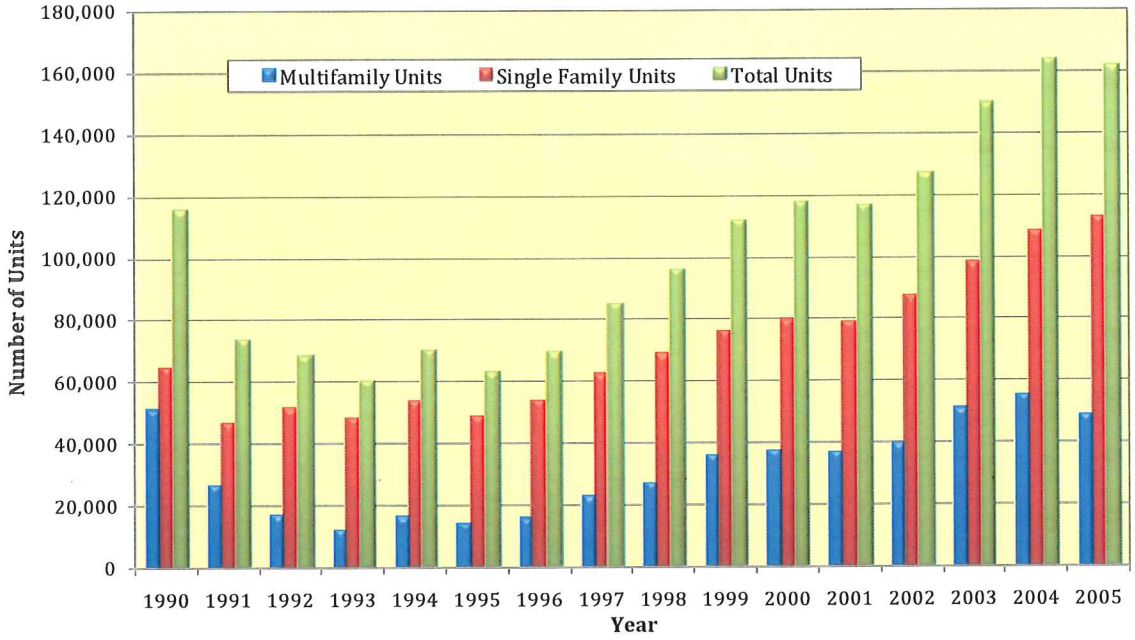

Figure 2: New Housing Construction for All Cities in California

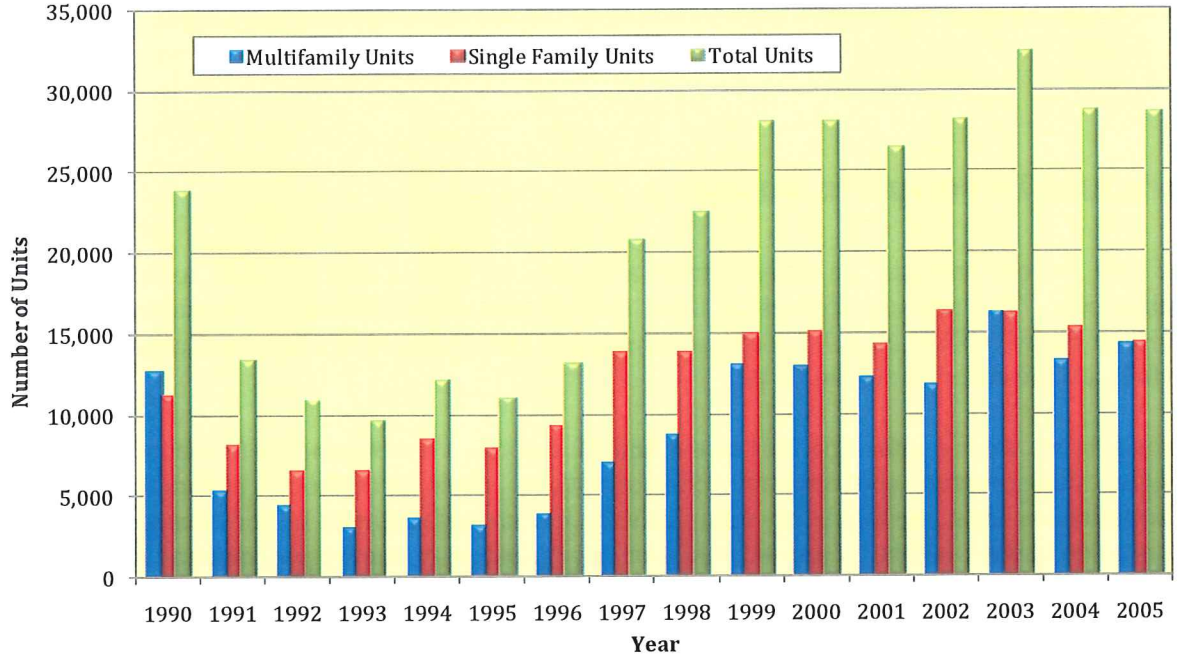

Figure 3: New Housing Construction for Cities in California with Inclusionary Zoning

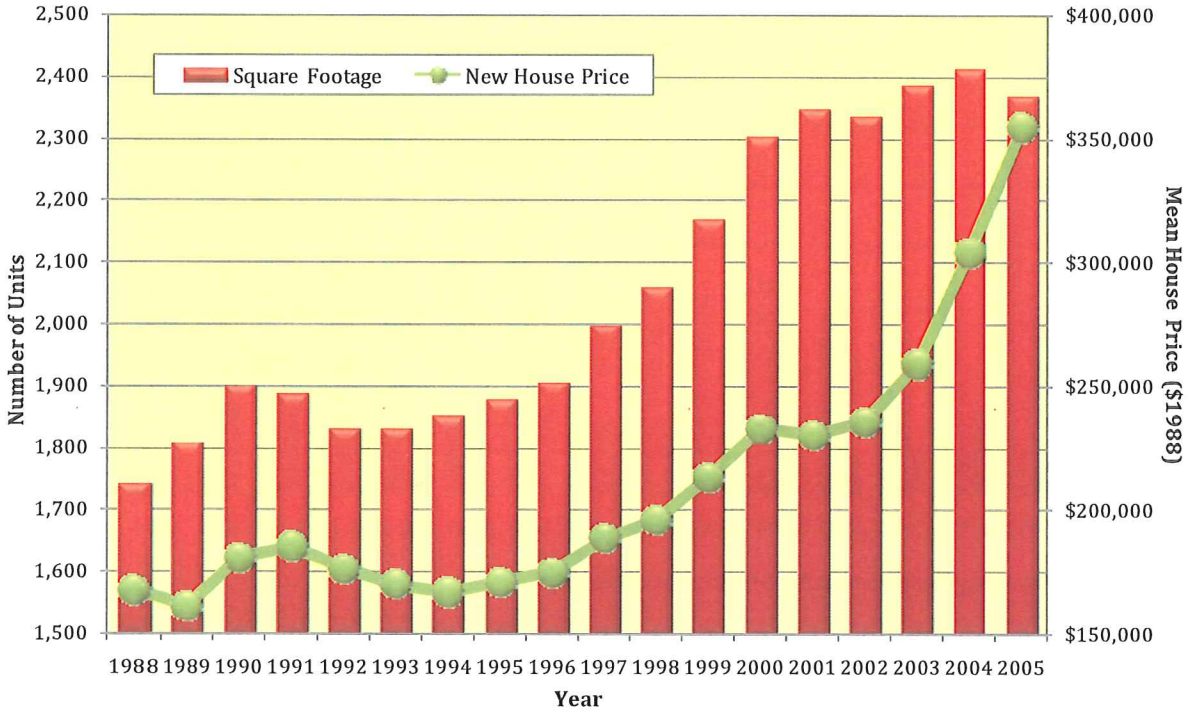

Figure 4: Square Footage and New Housing Price in the San Francisco and Sacramento Metro Areas

Data and Descriptive Statistics

The data for our analysis are derived from a variety of sources and are used to compile two distinct sets. The primary sources of these data include the California Construction Industry Research Board (CIRB), the U.S. Census Bureau, and DataQuick News Service Custom Reports. (Details are presented in Appendix A.)

In the first set we use municipalities as the unit of analysis. We obtained information about the physical, demographic, and economic characteristic of cities throughout California, including information on location, regulatory environment, and natural setting. In addition we collected information about whether the municipality had an inclusionary zoning program and, if so, when the program was first adopted. Data were obtained for the period 1988 to 2005.

This first data set is used to study the impacts of inclusionary zoning on the number and composition (single family vs. multifamily) of housing units built, controlling for other factors.

	Inclusionary Zoning Cities			
Variable	mean	sd	min	max
Off Site Allowances	57%	50%		
In-Lieu Fees	76%	43%		
Land Dedications	25%	43%		
Developer Credit Transfers	13%	34%		
Target Population Very Low Income	41%	49%		
Target Population Low Income	77%	42%		
Target Population Moderate Income	61%	49%		
Period of Affordability (years)	34	12	10	55
Minimum Project Size to Qualify (units)	12	50	0	400
% Units as Part of IZ	12%	6%	0%	30%
Cities (N)	65			
Observations (years of data * N)	1011			

Table 2: Descriptive Statistics

As shown in Table 2, of the 369 municipalities included in our study, 65 had adopted an inclusionary zoning program after 1989 but before the end of the study period. On average, the minimum project size at which a development became subject to inclusionary requirements was 12 housing units and the percent of units that must be made available to low income households was 12 percent. Of the 65 municipalities with inclusionary policies, 57 percent allowed off site allowances, 76 percent allowed in-lieu fees, 25 percent offered land dedication allowances and 13 percent allowed developer credit transfers. The average length of time affordable units must remain affordable is 34 years, although many municipalities have stipulated that the units remain affordable in perpetuity.

As illustrated in Figure 5, cities that adopted inclusionary programs are located throughout the state but are most common in the coastal areas, especially in the San Francisco, Los Angeles, and San Diego metropolitan areas. In general, municipalities that had inclusionary zoning programs, relative to those that did not, had higher incomes, higher housing prices, higher growth rates, more neighbors with similar policies, and were closer to the coast.

In the second set of data, new single family homes sold were the units of analysis. For this set we collected information about newly constructed housing units in the San Francisco and Sacramento metropolitan areas, including physical features of the house, the neighborhood in which the house is located, and the policies of the pertinent governmental jurisdiction—including the features of any applicable inclusionary zoning programs. The second data set we use to estimate the impact of inclusionary zoning on the price and size of new homes sold.

Descriptive statistics of the new homes sold between 1988 and 2005 in the San Francisco and Sacramento Metropolitan area are presented in Table 3. The costs and size changes, mirrored in Figure 4, indicate the recession of the early 1990s, and the upward trend toward larger homes. The mean price of new home sales, even after correcting for inflation, increased steadily after 1995.

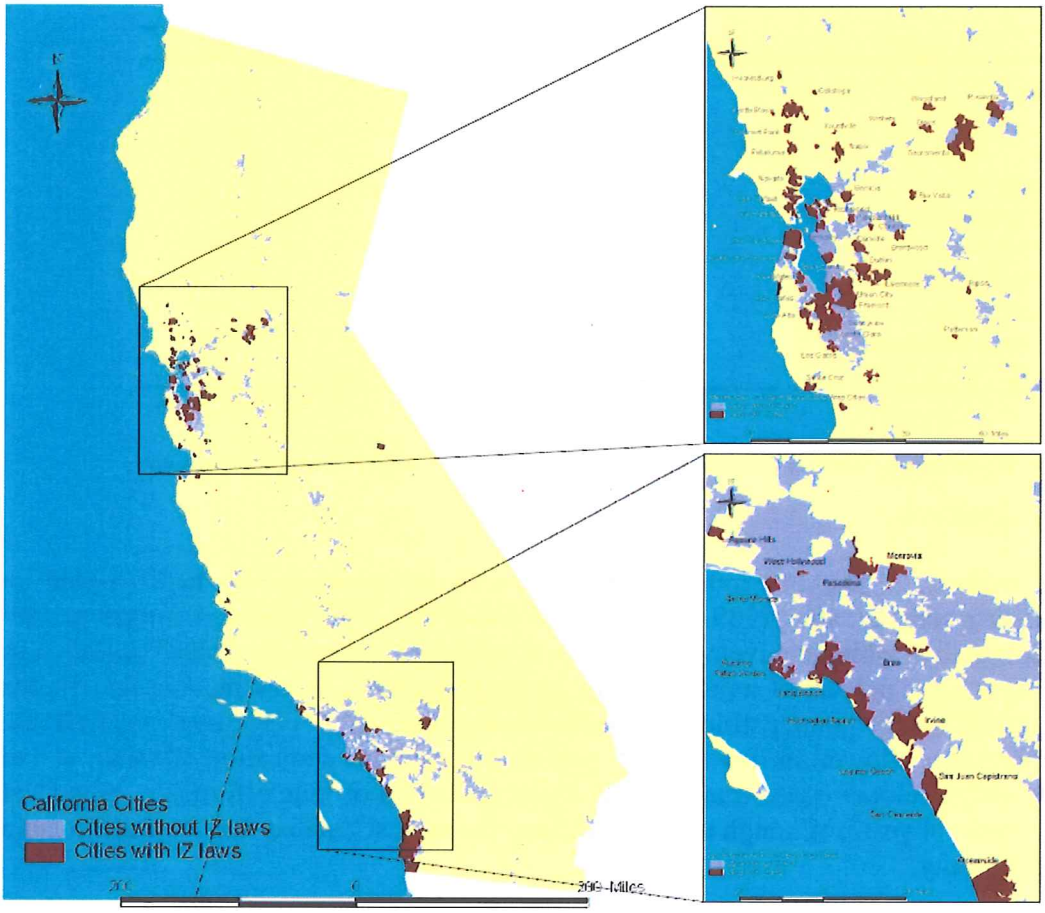

Figure 5: Inclusionary Zoning Programs in California

Year	N	Mean Cost ($1,000s in $1988)	Mean Number of Bathrooms	Mean Number of Bedrooms	Mean Floor Space (1,000 ft^2)
1988	14,580	167.68	2.31	3.07	1.74
1989	21,165	161.31	2.36	3.22	1.81
1990	18,694	180.66	2.42	3.35	1.90
1991	12,526	185.27	2.41	3.28	1.89
1992	11,158	176.67	2.36	3.24	1.83
1993	8,022	170.02	2.38	3.30	1.83
1994	13,189	167.12	2.39	3.35	1.85
1995	11,718	170.87	2.42	3.39	1.88
1996	13,813	175.26	2.43	3.37	1.91
1997	15,482	188.78	2.48	3.47	2.00
1998	15,768	195.86	2.49	3.49	2.06
1999	17,834	213.63	2.55	3.57	2.17
2000	17,977	233.04	2.61	3.62	2.30
2001	18,967	230.40	2.64	3.67	2.35
2002	21,954	235.82	2.60	3.58	2.34
2003	20,773	259.16	2.63	3.58	2.39
2004	21,827	304.15	2.68	3.61	2.41
2005	23,268	354.67	2.67	3.50	2.37
Avg.	16,595	209.46	2.49	3.43	2.06

Table 3: Descriptive Statistics – San Francisco and Sacramento Metro Areas New Home Sales

Methods

To explore the effects of inclusionary zoning, we conducted a multivariate statistical analysis of housing starts, prices and size. Our results are presented in Tables 4 to 7. Tables 4 and 5 present the stock and composition effects of inclusionary zoning on housing starts. Table 6 presents the effects of inclusionary zoning on housing prices. Table 7 presents the results of the analysis on housing size. Each of these analyses includes city-level "fixed" effects to capture market-specific differences between jurisdictions that are assumed constant over time.

In our analysis of housing starts we specify the dependent variable as the percentage change in housing units so that the coefficients can be interpreted as elasticities—that is, the percentage change in starts resulting from a percentage (or unit) change in the dependent variable. As controls, we include city and year fixed effects which allow us to account for any unobserved city-level characteristics (such as proximity to the coast, elevation, or desirable amenities,) as well as characteristics that are uniform across cities, but that vary across time (such as changing market conditions or state-wide recessionary periods)

In our analysis of housing prices, we specify the dependent variable as the logarithm of the sales price, and in our analysis of house size we specify the dependent variable in 1,000 square feet of living space.[2] As in the housing starts models, we control for unobserved spatial and temporal characteristics of the houses that may impact their prices. Specifically, we control for the year and quarter that the home was sold, and we control for the neighborhood and school district within which the house is located. These controls allow us to carefully account for any outside factors that may influence housing prices, thus isolating the impact of the inclusionary zoning programs.

Results

Effects on housing starts. As shown in column 1 of Table 4, we find that inclusionary zoning programs had a small and insignificant effect on total housing starts over the study period. Our analysis suggests that housing starts in municipalities were 0.15 percent greater in municipalities with an inclusionary zoning program compared to those without. This estimate is not statistically significant at the 90 percent confidence level, however.

As shown in column 2, we find that inclusionary zoning programs had a small and statistically insignificant effect on single family housing starts. Our analysis suggests that single family housing starts were 0.19 percent lower in municipalities that had an inclusionary zoning program compared to those that did not. This estimate, however, is also not statistically significant at the 90 percent confidence level.

[2] To capture the potential endogeneity of the inclusionary zoning variable we include a one-year lag of the dependent variable in the regression. While this is not the ideal instrument for treating endogeneity we had no better variables that should be correlated with the inclusionary zoning variable and not with the dependent variable.

Model	(1)	(2)	(3)
Dep Var: ($[HU_{t+1} - HU_t] / HU_t$)(*100)	Total Housing Units	Single Family Housing Units	Multfamily Housing Units
Inclusionary Zoning Program	0.1536	-0.1885	0.3601
	(0.1478)	(0.1918)	(0.2605)
$[HU_t - HU_{t-1}]$	1.03e-05	4.32e-05	3.93e-06
	(2.22e-06)***	(4.00e-06)***	(1.71e-06)**
Observations	5509	5509	5509
City Fixed Effects	YES	YES	YES
Year Controls	YES	YES	YES
R-squared	0.07	0.14	0.01

Robust standard errors in parentheses
* significant at 10%; ** significant at 5%; *** significant at 1%

Table 4: New Housing Stock Change Models

As shown in column 3, we find that inclusionary zoning programs had a small and statistically insignificant positive effect on multifamily housing starts. Our estimate indicates that multifamily housing starts were 0.36 percent higher in municipalities that had an inclusionary zoning program compared to those that did not. Once again, however, this estimate is not statistically significant at the 90 percent confidence level.

Effects on composition of housing starts. As shown in column 1 of Table 5, we estimate that the adoption of inclusionary zoning had a significant effect on the share of single family housing starts. Holding all other variables constant, the share of single family housing starts in municipalities that implemented inclusionary zoning programs was nearly seven percentage points lower than those municipalities that did not implement such a program. This result is very significant—the chances are less than 0.01 percent that there was no effect of inclusionary zoning on this ratio of housing mix.

As shown in columns 2 and 3 of Table 5, respectively, the effect of inclusionary zoning on housing mix varied significantly with the percent of housing units required to be sold to low-income households and with the minimum project size subject to inclusionary zoning requirements. Compared to jurisdictions without inclusionary zoning programs, municipalities with an inclusionary zoning program where the percentage of new homes to be sold at a discount requirement was more severe (greater than 10 percent of a project's units), experienced a 12 percent shift from single family to multifamily housing starts. Similarly, the inclusionary zoning regulation resulted in a 10 percent shift from single family to multifamily housing starts in jurisdictions with an inclusionary zoning program where the threshold that required participation in the inclusionary zoning program was more severe (less than 10 unit projects).

Dependent Variable: % SF Units$_{t+1}$ (*100)	(1)	(2)	(3)
Inclusionary Zoning Program	-6.8868 (1.9365)***		
Inclusionary Zoning Program requiring 10% or less of the units for low-income households		-2.9150 (2.5151)	
Inclusionary Zoning Program requiring more than 10% of the units for low-income households		-12.1033 (2.8076)***	
Inclusionary Zoning Program and a threshold less than 10 units			-9.6961 (2.1297)***
Inclusionary Zoning Program and a threshold of 10 or more units			-0.9995 (3.7497)
% Single Family Units$_t$	0.0671 (0.0173)***	0.0664 (0.01734)***	0.0663 (0.01734)***
Observations	5880	5880	5880
City Fixed Effects	YES	YES	YES
Year Controls	YES	YES	YES
R-squared	0.03	0.03	0.03

Robust standard errors in parentheses
* significant at 10%; ** significant at 5%; *** significant at 1%

Table 5: New Housing Composition Change Models

Dependent Variable: ln(cost) in 1988 dollars	(1)	(2)	(3)
House Price Sample ($1988)	ALL	<= $187,000	> $187,000
Inclusionary Zoning Program	0.022 (0.003)***	-0.008 (0.004)***	0.050 (0.003)***
Observations	298,715	149,253	149,462
Beds, Baths, Baths and Floor Space Included	YES	YES	YES
Census Block Group Boundary Fixed Effects	YES	YES	YES
Year of Sale Controls	YES	YES	YES
Quarter of Sale Controls	YES	YES	YES
School District Boundary Controls	YES	YES	YES
Lot Size Controls	YES	YES	YES
Dummies for Missing Data	YES	YES	YES
R-squared (within)	0.60	0.31	0.58

Robust standard errors in parentheses
* significant at 10%; ** significant at 5%; *** significant at 1%
Note: Sample includes all Bay Area + Sacramento new house sales of homes with less than 12 bedrooms or bathrooms, with less than 30,000 square feet of living space and more than 250 square feet of living space, and that cost more than $20k.

Table 6: The Effect of Inclusionary Zoning on New Housing Values

Effects on prices of new homes sold. Our estimates of the effects of inclusionary zoning programs on housing prices are presented in Table 6. As shown in column 1, we estimate that inclusionary zoning programs raise housing prices by approximately 2.2 percent. Also, as shown in columns 2 and 3, we estimate that the effects on inclusionary zoning are greater in higher

priced housing markets. Specifically, we estimate that inclusionary zoning programs lowered the price of housing that sold for less than $187,000 by about 0.8 percent and increased the price of housing that sold for more than $187,000 by about 5.0 percent.

Effects on the size of new homes sold. Our estimates of the effects of inclusionary zoning on the size of single family housing are presented in Table 7. As shown in column 1, we estimate that the implementation of an inclusionary zoning program lowers the mean housing size by approximately 48 square feet. Further, as shown in columns 2 and 3, the effects of inclusionary zoning on housing size are greater on lower priced homes. Specifically, we estimate that houses that sold for less than $187,000 are approximately 33 square feet smaller in inclusionary zoning jurisdictions while houses that sold for more than $187,000 are larger in inclusionary zoning jurisdictions by a statistically insignificant amount.

Dependent Variable: New House Interior Square Footage (Floor Space) / 1000	(1)	(2)	(3)
House Price Sample ($1988)	ALL	<= $187,000	> $187,000
Inclusionary Zoning Program	-0.048 (0.006)***	-0.033 (0.007)***	0.001 (0.008)
Observations	298,715	149,253	149,462
Beds, Baths and Baths Included	YES	YES	YES
Census Block Group Boundary Fixed Effects	YES	YES	YES
Year of Sale Controls	YES	YES	YES
Quarter of Sale Controls	YES	YES	YES
School District Boundary Controls	YES	YES	YES
Lot Size Controls	YES	YES	YES
Dummies for Missing Data	YES	YES	YES
R-squared (within)	0.53	0.52	0.46

Robust standard errors in parentheses
* significant at 10%; ** significant at 5%; *** significant at 1%

Note: Sample includes all Bay Area + Sacramento new house sales of homes with less than 12 bedrooms or bathrooms, with less than 30,000 square feet of living space and more than 250 square feet of living space, and that cost more than $20,000.

Table 7: The Effect of Inclusionary Zoning on Square Footage of New Houses

Conclusions

Although inclusionary zoning programs have been around for some time, they remain controversial. Proponents argue that such programs are effective tools for increasing the supply of affordable housing and for helping to integrate low and high income residents. Opponents argue that such programs impose cost burdens on developers, increase the price of market rate units and lower the supply of market rate housing. This study provides no new information about the validity of the arguments of the proponents; it does, however, offer new information about the arguments of the opponents.

Overall, we find that inclusionary zoning programs had significant effects on housing markets in California from 1988 to 2005. Although cities with existing or new programs during the study

period did not experience a significant reduction in the rate of single family housing starts, they did experience a statistically insignificant increase (at a 90 percent confidence level) in multifamily housing starts. As a consequence, we found that cities with inclusionary housing programs experienced a significant and relatively large increase in the ratio of multifamily to single family housing production. That is, having an inclusionary housing program increased a city's multifamily housing starts share by seven percent. The reasons for this shift are relatively clear. Housing markets in California cities, persistently constrained by regulatory barriers, expanded rapidly during the 1990s as the national and California economies recovered from the 1991 recession. Inclusionary zoning programs, in cities where they were adopted, placed a small additional burden on single family development and less of a burden on multifamily development. Under the pressure of growing demand, single family starts declined slightly while multifamily starts increased significantly. This caused a significant shift toward multifamily housing development. This shift was greater in cities that required a larger percentage of the new units to be sold at below market rates, and in cities that required inclusionary units in developments with smaller numbers of units. There was no net effect, however, on total housing starts.

We also found that housing prices in cities that adopted inclusionary zoning increased about 2-3 percent faster than cities that did not adopt such policies. In addition, we found that housing price effects were greater in higher priced housing markets than in lower priced markets. That is, housing that sold for less than $187,000 (in 1988 dollars) decreased by only 0.8 percent while housing that sold for more than $187,000 increased by 5.0 percent. These findings suggest that housing producers did not in general respond to inclusionary requirements by slowing the rate of construction of single family housing but did pass the increase in production costs on to housing consumers. Further, housing producers were better able to pass on the increase in costs in higher priced housing markets than in lower priced housing markets.

Finally, we found that the size of market rate houses in cities that adopted inclusionary zoning increased more slowly than in cities without such programs. Specifically, we found that housing in cities with inclusionary zoning programs was approximately 48 square feet smaller than in cities without inclusionary programs. Further, most of the reductions in housing size occurred in houses that sold for less than $187,000. These findings suggest that inclusionary zoning programs caused housing producers to increase the price of more expensive homes in markets where residents were less sensitive to price, and to decrease the size of less expensive homes in markets where residents were more sensitive to price.

Once again, these results must be understood in context. The California housing market expanded rapidly over the 1990s as pent up demand exploded following the 1991 recession. The imposition of inclusionary zoning requirements was not strong enough to slow the overall rate of housing production but did cause a measurable shift from single family to multifamily housing production. The magnitude of this shift varied with the stringency of the inclusionary requirements. The imposition of inclusionary requirements was strong enough, however, to cause a rise in housing prices and a reduction in housing size. Price effects were larger in high priced markets while size effects were larger in low priced markets.

These results are fully consistent with economic theory and demonstrate that inclusionary zoning policies do not come without cost. In robust housing markets, like those of California during the 1990s, inclusionary zoning requirements were not strong enough to slow the rate of housing production, although they did cause housing prices to rise and housing size to fall. In less robust markets, it is more likely that inclusionary requirements have stronger impacts on housing starts than on housing prices and size. Confirmation of such speculation, however, is beyond the scope of this study.

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Appendix A

Our data set has four main components: (1) measures of housing construction in California's cities between 1990 and 2005; (2) city-specific data relating to the physical, demographic and economic characteristics of California's cities; (3) city-specific data relating to the inclusionary zoning regulations that have been implemented in California's cities; and (4), Consumer Price Index data.

1. California Housing Construction Data

1.1 Changes in Housing Stock and Composition

Aggregate house construction data was provided by the California Construction Industry Research Board (CIRB). The data include total new residential building permit counts, by number of units, for all cities in the 58 California Counties from 1990 through 2005. The building classification was provided by the CIRB, in which the new residential building permits were divided into two groups: Single Family Housing, which includes detached, semi-detached, rowhouse and townhouse units; and Multifamily Housing, which includes duplexes, 3-4 unit structures and apartment-type structures with five units or more.[3]

The existing housing stock in each city was collected from the U.S. Census Bureau for the 1990 census year. This estimate includes a measure of the number of single family houses and multifamily houses in each city, in 1990. The intra-annual housing stock totals for the 1991-2005 housing years are calculated by taking the 1990 Census housing stock, and adding the number of homes constructed in the previous year.[4] These estimates were conducted for single family, multifamily, and the total number of housing units.

1.2 New House Construction in the San Francisco and Sacramento Metropolitan Areas

Individual new house sales data was collected from DataQuick News Service Custom Reports. The initial dataset that was received from DataQuick included 415,303 observations, covering all new house sales in the San Francisco and Sacramento Metropolitan Areas for the 1988 through 2005 timeframe. Specifically, the data include new single family and multifamily housing sales

[3] Rowhouses and townhouses are included in single-family when each unit is separated from the adjacent unit by an unbroken ground-to-roof party or fire wall. Condominiums are included in single-family when they are of zero-lot-line or zero-property-line construction; when units are separated by an air space; or, when units are separated by an unbroken ground-to-roof party or fire wall. Multi-family housing also includes condominium units in structures of more than one living unit that do not meet the above single-family housing definition.

[4] Therefore the housing stock in year t is represented by: $HS_{1990+t} = HS_{1990} + \sum_{t=1}^{16} HG_{1989+t}$, where *HS* is the total housing stock in year t, and *HG* is the number of homes built in year t. This process assumes that there is no loss in the existing housing stock, and that the new housing stock is not a replacement of the old stock.

in 11 counties in the San Francisco Area (Alameda, Contra Costa, Marin, Monterey, Napa, San Francisco, San Mateo, Santa Clara, Santa Cruz, Solano, and Sonoma counties) and eight counties in the Sacramento area (Butte, El Dorado, Fresno, Nevada, Placer, Sacramento, San Joaquin, and Stanislaus counties).

Unfortunately, a number of observations in the initial dataset were missing house characteristics data.[5] Of the initial data provided by DataQuick, approximately 298,715 observations were of a quality that they could be used in the hedonic estimation. Of the 298,715 observations, each sale includes the following data: the parcel number of the house; the date of sale (day, month, and year); the price of sale; the city, zip code, and latitude/longitude of the house; the lot size, number of bathrooms, number of bedrooms, and square footage of the house.

2. City-specific Housing Attributes

2.1 Geographic Characteristics of the Data

In the process of creating our dataset, we utilized four different levels of geography from the United States Census: Block Group, Zip Code, City, and County. The Census geographic files were provided in a geographic projection as ArcView Geographic Information System (GIS) Cartographic Boundary Files, and have been normalized to the 2000 geography by Geolytics Inc.

The main unit of measurement in our analysis of the supply of housing is the Consolidated City. A total of 468 cities were reported in the year 2005, four of which do not match with our Census geographies because they were incorporated after the year 2000 (Aliso Viejo, Elk Grove, Goleta and Rancho Cordova).

The ArcView GIS Consolidated City shapefiles were used with a GIS line-shapefile that was constructed to represent the California coast. The shortest distance (in kilometers) from the centroid of each city to the coast was then calculated using ArcView GIS, with a range from a maximum of 312 km (Needles, in San Bernardino County,) to less than a few hundred meters.

2.2 Census Data

The demographic variables in our analysis come from Geolytics' provision of the 1990 U.S. Census Long Form files, and include "Places" data (Cities, Towns, and Incorporated Places that have legally prescribed boundaries, powers, and functions) for the Cities and Towns in California. The data include:

[5] Of the initial 415,303 observations received from DataQuick, 5,679 were missing sales price information, 98,805 were missing bed, bath and square-footage information, and 67,788 were missing latitude and longitude information (note that some of the observations listed above overlap in terms of omitted information). An additional 438 observations with latitude and longitude information were located outside of the San Francisco and Sacramento areas.

1. Total population;
2. Total land area;
3. Ethnicity (percent White, Hispanic, Black, Asian, and Other for each city);
4. Per-capita income;
5. Household income;
6. Total housing units;
7. Percent vacant housing units;
8. Percent owner-occupied housing units;
9. Percent single family detached housing units; and,
10. Median year of construction for all housing units.

The total population and total land area variables were used to construct a population density value for each city. This variable is measured as the total population of the city divided by the total land area of the city in square kilometers.

2.3 School District Boundaries

In California, a student's "home school district," be it elementary or secondary, is assigned by virtue of the residential location. More often than not, a student will attend the nearest school in the district, but this is not uniformly true. Any student can attend any school within the district, as long as there is available space; likewise, a student may petition to attend a school outside of the district, again dependent on available space. For this reason, the 1:1 assignment of school-to-student without information on that assignment was impossible to create.

However, we were able to control for the different school district boundaries. In our model, each house sales observation was spatially matched to its respective elementary and secondary school district. Cartographic boundary files of the school districts, as defined in the year 2000, were collected from the U.S. Census Bureau.

3. Inclusionary Zoning Data

City-level data on inclusionary zoning regulations were taken from the *Survey of Inclusionary Housing Policies* (2003), conducted by the California Coalition for Rural Housing, and the Non-Profit Housing Association of Northern California, during 2002 and early 2003. The survey includes detailed information about how local inclusionary zoning programs are structured.[6] The data collected from the survey include:

1. The year the inclusionary zoning policy was adopted;
2. The minimum project size;
3. The percentage of units required;
4. The targeted income group (very low, low, middle income);

[6] The Inclusionary Housing Policies sample includes 95 cities and 12 counties (not including San Francisco County, which incorporates a single city). These 95 cities represent roughly 20.3% of the total sample of cities in California.

5. Alternatives to construction (off-site allowances, in-lieu fees, land dedication allowance, and developer credit transfers); and,
6. The length of affordability.

Missing information from the survey was collected through personal contact with those cities or counties that did not respond to the survey, or taken from the Reason Public Policy Institute's *Housing Supply and Affordability Survey* (the list of unresponsive cities includes Fairfax, Los Gatos, Port Hueneme, Del Mar, Gonzales, Long Beach, Morro Bay, Vista, Woodland, and Menlo Park).

4. Consumer Price Index Data

Consumer Price Index (CPI) data were used to normalize the house sales price to a base year of 1988. The CPI statistics were provided by the U.S. Department of Labor, Bureau of Labor Statistics. The annual average CPI was calculated for all urban consumers, using all consumable items, for residents of the San Francisco – Oakland – San Jose Metropolitan Statistical Area in California, using a base year of 1988. These data are publicly available from the U.S. Department of Labor's Bureau of Labor Statistics under series IDs (CUURA422SA0) and (CUUSA422SA0).[7]

[7] As a robustness check, different CPI values were used to normalize the house sales price data, including an all-US urban average, a West Coast urban average, and the all-US Housing average (which is only available at the all-US average level of aggregation). The SF-Oakland-SJ CPI is, on average, 1.5 to 3.7% larger than the other CPIs used, with a max difference of +7.1%, and a minimum difference of -2.3%, depending on the year. Our model results are robust to the type of CPI used, but the AIC goodness of fit test prefers the SF-Oakland-SJ CPI for the normalization method.

Kent
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06/03/2009 09:35 AM

To jryckaert@deerfield.il.us
cc
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Subject DuPage Co. scraps "work force" housing proposal

This Daily Herald story was sent to you by Kent (kstreet@deerfield.il.us)

Comments: Background only....

- -
DuPage Co. scraps "work force" housing proposal
- -

By Jake Griffin
Daily Herald Staff
Under fire from residents for being secretive about a plan to encourage developers to build homes for the county's "work force," the proposal was abruptly scrapped Tuesday.

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DuPage Co. scraps "work force" housing proposal

By Jake Griffin | Daily Herald Staff

Published: 6/3/2009 12:01 AM

Under fire from residents for being secretive about a plan to encourage developers to build homes for the county's "work force," the proposal was abruptly scrapped Tuesday.

The proposal essentially would have allowed developers to build houses more densely in certain zoning classifications within the county. Officials said the impact would be minimal. For example, instead of 30 units on a parcel, the policy would allow 36 units, they said.

However, concerns from residents who live near some of those spots prompted county board members to rethink the policy.

The matter has been under study for two years, though, and it was intended to promote homeownership among people who work in DuPage but can't afford to buy here.

Development committee Chairwoman Kyle Gilgis said the proposal will be tabled indefinitely at a special committee meeting next Tuesday, and then it will be sent to the board's intergovernmental committee for any future discussion. However, the intergovernmental committee does not currently have regularly scheduled meetings and Gilgis said there's no timetable for the issue to be addressed. Gilgis said the policy should have the intergovernmental committee's input because its impact doesn't affect only the county's resources.

The development committee was originally scheduled to vote on the policy in two weeks.

While county officials said the "work force housing" policy would simply shorten the process for developers seeking lot-size variances for new homes, many residents believed the proposal would create competing housing stock in an already deflated real estate market.

About 20 residents who attended Tuesday's development committee meeting also complained that county officials didn't notify them of the proposed policy, but Gilgis said the initiative has gone through the county's regional planning commission and the county's zoning board of appeals, which reports directly to the development committee. The DuPage Mayors and Managers Conference is currently mulling it over, too.

That didn't mollify the residents.

"Our opinion is if this is so great, it should have been publicized, but this sounds pretty sneaky, and pardon me for being suspicious of sneaky politics in Illinois these days," said Jim Ruff, who lives in an unincorporated area between West Chicago and Wayne.

There were also many misconceptions about the policy. Many residents complained that the county was making it easier for developers to build apartment complexes for low-income families in single-family neighborhoods.

"Work force housing is intended to build new homes that people who work in DuPage can buy," Gilgis said. "No one's building rental units."

The hope was the policy would create new homes that would reduce wear on county roads and cut commute times for workers. Buyers were to be screened by the DuPage Housing Authority to ensure they

qualified, but there were no requirements that they remain employed in DuPage County if they bought a work force house.