Summary Workshop Report

Adapting Inclusionary Zoning to a Changing Housing Market

A practitioner’s workshop for the Washington, D.C. region

Co-sponsored by Metropolitan Washington Council of Governments, Coalition for Smarter Growth, and Northern Virginia Affordable Housing Alliance

October 15, 8:30 am – 1:30 pm

Metropolitan Washington Council of Governments

777 North Capitol Street, NE • Suite 300 • Washington, DC 20002

The event was opened by Paul Desjardin, Director of Department of Community Planning and Services, Metropolitan Washington Council of Governments, followed by welcoming remarks by the Hon. Roger Berliner, President, Montgomery County Council.

**A national view on Inclusionary Zoning**

**Jeffrey Lubell**, Executive Director, Center for Housing Policy

Jeff spoke of how inclusionary zoning has shown substantial durability despite the downturn in the economy. IZ depends on new production, and in the last five years new housing production dropped precipitously due to the recession related to the housing market. Even though the economy remains weak, especially in other parts of the country, only five of 400 IZ programs were rolled back. Housing prices that dipped during the recession but still tend to be higher than what is affordable to a large share of households. Supply remains inadequate, further pressuring housing prices.

Despite market downturns, the policy has continued to deliver results. In the Washington, DC region, the strong production from Montgomery County’s Moderately Price Dwelling Unit Program has produced over 700 units since 2008. The benefit of the income integration of on-site IZ units has been demonstrated. A recent study documented the educational achievement of low income children who outperformed their peers by attending schools in low poverty schools. This can be attributed in large measure to the distribution of MPDUs in more affluent neighborhoods in Montgomery County.

To remain effective, policies have changed and evolved to respond to a dynamic market. Fairfax County has changed over time, adopting provisions for high rise construction as the county considered the transition from a wholly suburban county to one that is more urban, and looked to older areas to be redeveloped at higher densities.

The growing preference among senior and single person households for housing near transit and close-in neighborhoods is reducing auto trips, but supply isn’t keeping up. Supply is struggling to meet demand for housing in these kinds of neighborhoods. Housing price increases could force moderate and lower income households to move farther away and potentially increase sprawl. To accommodate demand near transit, a winning coalition of environmentalists, affordable housing advocates, smart growth activists should work to overcome the barriers to increased supply and create an affordable housing strategy. We need to overcome the barriers to density restrictions, zoning, and environmental regulations. While all these provisions have justification, taken together, they are undermining housing affordability. We need to take advantage of our transit station and close-in neighborhoods and build affordability in the DNA of our location-efficient places. Land prices are already high in urban, close-in locations and around transit stations. We need to plan around station areas and look for solutions such as shared structured parking. Tysons is an example of increased density and a plan to incorporate affordable housing.

In California, IZ recently suffered a major setback. A California court ruled that IZ is unlawful rent control on rental housing. Should local governments downzone all properties in order to force IZ in? Or can we make development more predictable, and allow more density and less parking through approaches such as form-based codes.

**Our region’s housing market**

**Lisa Sturtevant**, PhD, Deputy Director, Center for Regional Analysis, Associate Research Professor, School of Public Policy, George Mason University

 The Washington regional economy has been recovering but uncertainty about future federal expenditures could weaken the outlook. The gap between household income and home prices, however is stark. From 1970 – 2010, median household income grew by 46%, compared to 144% for median home value and 69% for gross rent. About half of all renters pay more than 30% of their income in rent. Despite the decline in home prices following the recession, homes have recovered most of their value since the peak. The District of Columbia has reached the highest level of recovery with 90% of the peak and $600,000 peak median home price, followed by Arlington at 88% and $630,000.

While the region has experienced strong job growth, population and housing have not kept up. Between 1970 and 2010, job growth was 150%, while population growth was 74% and housing units increased by 116%. Lagging population growth means that we are importing workers from outside the region, generating long distance commuting.

Summary outlook for the Region’s Housing Market:

* Regional housing market has been recovering; sales activity and prices may soften in the near-term.
* Rents may not grow as fast and vacancy rates may increase in the near-term.
* Job growth over the next five years will put upward pressure on home prices, particularly in areas close to transportation/transit and employment centers.
* There is a need for more multi-family housing and smaller, more affordable owner and renter homes in the region.
* A lack of a sufficient supply of housing contributes to worsening traffic and quality of life and threatens our region’s economic vitality.

**Market & policy issues in IZ implementation**

Moderator: David Bowers, VP & Market Leader, Enterprise Community Partners

**John Payne**, Fairfax County Deputy Director, Department of Housing and Community Development

Fairfax County’s John Payne discussed the Affordable Dwelling Unit Program (ADU), which was enacted decades ago but faced legal challenges that delayed its implementation. He expressed concern that what jurisdictions are often challenged with is exclusionary zoning that prevents sufficient production of housing. Citing a recent positive experience, he noted that through the Tysons Corner redevelopment planning model, an extensive community process helped residents buy into the idea that a complete community means housing affordable at different incomes.

The ADU program begin producing units in the early 1990s and has generated 2300 units to date, 1300 are for sale, 1000 are rentals. The term of affordability has fluctuated from 50 years to 15 years to 30 years. Upon expiration, the subsidy is recaptured. Some of the 15 year units are about to expire. The ADU law has been amended 4 or 5 times. The ADU program gives a 20 percent density bonus in exchange for a 12.5% affordable unit set aside. Income targeting is 70% AMI for ownership, and 65% and 50% AMI for rental. For higher cost multi-unit buildings with elevators and structured parking, the ADU set aside is 6.5% with a 10% density bonus. The ADU ordinance does not cover high rise construction.

In the case of Tysons where density is unlimited within ¼ mile of the Metro stations, a total of 20% workforce housing is required, affordable to households earning 80-120% AMI. There is also an option to develop units off-site. **Michelle Krocker**, Executive Director of the Northern Virginia Affordable Housing Alliance clarified that off-site compliance outside the ¼ mile radius of a Metro station but inside the Tysons 1700 acre boundary is intended to create an incentive to develop housing at deeper levels of affordability – at 50 and 60% AMI - where costs are lower as opposed to 80-120% AMI which will be most of what is built in the higher density zones near Metro stations.

During the recession, the county experienced less production of units and fewer turnovers. Foreclosures had an impact on affordability of market units as people moved into foreclosed properties rather than ADUs, which come with restrictions for resale.

Condo fees are a challenge to affordability as they might start low but then go up over time. Also, 1-2 bedroom multi-unit projects on a podium appear to be the current market trend, and this product isn’t serving families.

The Redevelopment and Housing Authority can buy units and offer them as affordable rental housing for lower income households.

**Chris Anderson**, Montgomery County Program Manager for the Moderately Priced Dwelling Unit (MPDU) program

Chris began managing the county’s MPDU program in 2005. Policy issues related to the program first adopted in 1974 constantly come up. The county’s approach to administering the program with adaptability and flexibility has sustained its success. The program started with a five year affordability term, after which the unit was sold to the market with no recapture provision. The time period has been modified several times and is now 30 years for ownership and 99 years for rental. The 12.5% set aside for MPDUs does not provide a density bonus but does allow for flexibility in development standards. The incentive bonus allows for a 22% increase in density in exchange for up to 15% MPDUs. MPDUs are priced based on construction costs. This is a challenge in high rise infill locations. The growth in condo fees is also a major challenge to affordability. Some jurisdictions, such as D.C., have rolled the condo fee into the base price. Montgomery County chose not to do this.

Montgomery also created a mandatory workforce housing program to serve up to 120% AMI households but changed it to a voluntary program. The top price point in the workforce housing policy is close to market rate. Montgomery allows the Housing Opportunities Commission (the county’s Housing Authority) and non-profits to purchase units for sale or rent to lower income residents.

**Gilles Stucker**, Housing Resource Administrator, D.C. Department of Housing and Community Development

D.C.’s IZ program has three parts – zoning regulations, statue, and administrative regulations. The IZ zoning regulations were finalized in 2006, the IZ Act in 2007, and the administrative regulations in 2009. The Inclusionary Units are mandated whether or not the density bonus is fully realized. The IZ Program is brand new, and no Inclusionary Units have been sold or rented yet. The District has also been producing affordable housing through the Zoning Commission (e.g. Planned Units Developments), as part of the dispositions (sale or lease) of public land, and through the D.C. Council (collectively “ADUs”). ADUs produced between 2004-2006 in Columbia Heights were sold at low prices and are selling now at a profit. Market rate sellers in comparable units have taken losses when they resold their units.

Inclusionary Units and ADUs are priced considering condo fees. The District is trying to find a solution to increases in condo fees, which affects the affordability of housing. The District has other affordable housing laws and policies that help retain affordable housing such as rent control and condo conversion controls.

Question: How can we get more 3-4 bedroom IZ units to serve families?

Answer from **Lisa Sturtevant**: Single person households are generating the largest demand. I don’t see a huge demand for large multi-bed room units in multi-family developments.

Question: Didn’t Montgomery County allow IZ units to be sold to anyone after a certain period if they were unsold? D.C. has had 2 IZ units on the market for more than 9 months.

Answer from **Chris Anderson**: Yes, Montgomery allows units to be sold to buyers of higher incomes if they stay on the market too long but with the same restrictions and requirements.

Answer from **Gilles Stucker**: We believe that the conflict with FHA rules was a key obstacle to selling the units. We are working on actions to resolve this problem. The Zoning Commission recently took emergency action to relieve the 2 units of the provision in conflict with FHA rules and is working on longer term solutions.

**Homeownership program challenges with financial institutions**

**Anne Geggie**, Director of Programs and Impact Evaluation, NCB Capital Impact (moderator & panelist)

**Vickie Gaul**, Associate County Attorney, Montgomery County

**Dave Wilkinson**, Executive Director, City First Enterprises

**Deborah Watson**, VP*,* Affordable Housing and Strategic Partnerships, Bank of America Home Loans

Two key issues for homeownership programs, including IZ is that the Federal Housing Finance Agency (FHA) does not allow affordability restrictions to survive foreclosure and does not allow jurisdictions to require notice of default. Many local program covenants retain the affordability terms post-foreclosure. This has caused local affordable housing programs across the country to experience such a constriction in potential mortgage lenders for their programs that few loans are being made with this provision in place. There is a structural problem between the demand from programs and homebuyers and the supply of loans from lenders. Solutions include creating consistency amongst programs (for legal documents, for example).

And specifically for IZ, there is an important need for stewardship, to provide support for homeowners and as asset management from the jurisdiction.

**Dave Wilkinson**, CityFirst Enterprises/ CityFirst Homes

[City First Enterprises](http://www.cfenterprises.org), a nonprofit community development organization, was awarded funding by the District government to establish a workforce housing land trust known as CityFirst Homes. The program allows for permanent affordability, wealth-building, collaboration with the private sector and homebuyer support. Homebuyer support includes education classes, assistance in attaining a mortgage and post purchase support. In the second year of operation, CityFirst Homes has sold 40 permanently affordable homes and has 120 in the pipeline. Through this kind of pre and post purchase support and stewardship, CityFirst Homes addresses a number of the challenges facing affordable homeownership programs.

Given that lenders reject deed restrictions surviving foreclosure (because of the Fannie and FHA rules prohibiting this), CityFirst Homes addresses the issue by working to avoid foreclosure through substantial technical support to lenders and buyers, and careful stewardship of the homes. Foreclosure rates among Housing Trusts with stewardship programs are close to zero compared to 22% and 14% for programs with no stewardship. Stewarded housing has a far lower foreclosure rate than the US market. Secondly, a short sale reserve fund could be used to buyback any homes that go into foreclosure.

CityFirst Homes also tracks payments of owners to help owners before they fall far behind in payments. CityFirst Homes also uses a small stewardship fee (~$19/month) as a way to track payments. If the owner fails to pay this fee, this might be an indicator that the owner is late on the main payment.

Dave noted that D.C. has decided to amend its zoning regulations governing covenants to conform to FHA requirements.

**Vickie Gaul**, Associate County Attorney, Montgomery County

The County’s issues with FHA were not solely related to the foreclosure issue – the county covered this issue with HUD staff, but the more important issues were resale and enforcement provisions.  The most difficult hurdle for the county with respect to HUD was allowing the county to continue to enforce its MPDU restrictions, including but not limited to, requiring that a violating owner (one who, for example, illegal rents their MPDU) to sell the unit to the county, a non-profit or an income eligible purchaser.

Until 2010, the county had never had an issue with MPDU purchasers obtaining FHA-backed mortgages.  However, in 2010, a condo attorney representing a condo board raised some concerns.  The condo building was applying for FHA- backed mortgages for the condo’s units and the application required a draconian certification from the board requiring it to certify that the governance of all of the condo’s units, including the MPDUs, was in compliance with FHA requirements.  When the attorney was not satisfied with the county’s response to his concerns, he raised them with HUD.  The issues concerned whether the county’s MPDU law was in violation of HUD/FHA requirements in the areas of appropriate resale formulas, including valuing improvements made to MPDUs (203.41(d)(1)(i)), appreciation in value (203.41(d)(1)(ii)) and appropriate remedies for the county when homeowners breached the MPDU Covenants and/or MPDU law – specifically, whether the MPDU laws remedies were impermissible restrictions on conveyance (203.41(d)).  These issues were resolved in the county’s favor by HUD sending the county a letter confirming that the MPDU program meets HUD/FHA requirements.

At the same time that Vickie was working on behalf of the county to address the Condominium board issue, she was also working with NCB Capital Impact, the National Community Land Trust (CLT) Network and Fairfax County on reviewing/updating HUD’s FHA Mortgagee Letter of January 1994.  In revising the mortgagee letter, the parties attempted to bring it up to date with the manner in which affordable housing units are now created, sold and governed.  The proposed draft attempted to be broad enough to cover both CLT concerns and those of local governments while still being specific enough to appease HUD.  The proposed mortgagee letter was submitted to HUD, but nothing has happened.

The county has first right of refusal for units. This can be done but must be done very carefully. The county’s MPDU covenants do not survive foreclosure. If these are the provisions for your IZ covenants, you will have problems with FHA. The county could, if it chose to, either purchase an MPDU at a foreclosure sale and/or negotiate a deal with the foreclosing lender for the purchase of the MPDU and use the county’s Housing Initiative Fund to purchase the unit.

**Deborah Watson**, Bank of America

Bank of America approves IZ programs as a whole rather than as individual mortgages. All programs need to follow GSE, HUD and Bank of America guidelines. Bank of America accepts loans that conform to Freddie Mac’s standards which are more conservative than Fannie Mae’s. Fannie allows survival of affordability terms in the case of foreclosure, Freddie does not. The Bank keeps a database of approved programs, with over 400 programs.

Bank of America has been requested to, but cannot accommodate, giving notifications of default to a third party like an IZ program. Other banks might do it but don’t have the capacity due to the large volume of loans.

**Mike Scheurer**, Virginia Housing Development Authority, pointed out that financing for multifamily rental housing faces many of the same barriers that homeownership programs do.

Closing remarks by **Michael Kelly**, Director of Department of Housing and Community Development, District of Columbia

Mr. Kelly thanked the participants for their focus on affordable housing issues on behalf of the DC Mayor Vincent Gray. He discussed how affordable housing is recognized as an important factor in access to employment and education, and that the role of the government can be to level the playing field so that everyone has greater access to resources. The District of Columbia has implemented a number of polices and efforts to create mixed income, mixed use and mixed tenure housing opportunities and neighborhoods and used government resources to provide the resources to provide access to the resources to create the places. The District has convened a Comprehensive Housing Strategy Task Force to look not just at supply but also as helping residents have access to better job opportunities and increase their incomes so that their housing choices greatly increase.

Inclusionary zoning is a strategy that helps create income integrated neighborhoods and the District has nearly 1,000 units in the pipeline. This kind of tool recognizes that fighting sprawl can be done through higher density development. IZ needs to be a clear policy and not change arbitrarily.

IZ is wrestling with how to build wealth through equity while also maintaining long term affordability to serve low and moderate income families over time. One size does not fit all for policies to be effective and sustainable. There is not just one answer for both Tenleytown and Anacostia.

**Summarizing highlights of workshop:**

1. IZ is durable to many changes in the market.
2. IZ programs are periodically adjusted to respond to needs and changing market conditions.
3. For ownership units, condo fees, capital improvements, and shared appreciation are all areas that have been challenging and need further work.
4. FHA rules have recently hampered lending for both homeownership and rental building financing. CityFirst Homes and Montgomery County have worked within FHA constraints to continue to achieve the goals of the program. More work needs to be done on clarifying FHA rules and creating effective alternative approaches to FHA constraints. Local programs are waiting for a response from FHA on key provisions.
5. Mortgage lenders can work smoothly with IZ programs if they can review and understand the program and ensure covenants conform to Freddie Mac and Fannie Mae standards.
6. Pricing and income targeting can be a challenge when programs target too close to market rates and lose their advantage of offering something the market doesn’t provide. Further work needs to be done on this, along with analyzing how construction costs and bonus density affect programs.

**Follow up discussion topics:**

Based on discussion at the workshop and feedback from the evaluations, participants identified and ranked these topics for follow up discussion:

1. IZ unit pricing/construction costs/income targeting
2. Financing challenges for multi-unit rental buildings
3. Condo/HOA fees
4. Public and decision-maker education on general IZ benefits & policies
5. Rental program administration & stewardship
6. FHA/financing issues in for sale IZ units
7. Homeownership program administration and stewardship
8. Alternative compliance to on-site IZ units (off-site, fees in lieu, etc)

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