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Inclusionary Zoning Program Design Considerations (with a Program Design Checklist)

General Considerations

- **What is inclusionary zoning?** The term refers to local ordinances or guidelines that require or encourage residential developments to include a certain amount of affordable housing (in the range of 5 to 20 percent). Inclusionary rules are usually triggered by filing a residential site development proposal — typically involving rezoning, subdivision approval or annexation. The housing may be on or off-site. Often, payments may be made to a trust fund in lieu of providing affordable housing. Similar programs affecting non-residential re-zonings are called "linkage" programs and are not discussed here.
- **Who benefits?** The poorest households are obviously most in need of affordable housing. Yet most programs are aimed at assisting families with incomes at 60 percent to 100 percent of median income and in some cases even higher incomes (for the city, county or MSA) — which translates to housing prices that are typically affordable to lower middle class or middle-income households. Developers typically prefer a higher income standard, because it has less adverse economic impact on their projects. Advocates and planners often prefer a lower income standard, on the basis that programs should serve households with the greatest needs. Often, a new inclusionary zoning program represents a political compromise between these two points of view.
- **With what kind of housing?** For philosophical and political reasons, some advocates of inclusionary zoning favor providing owner-occupied housing to the exclusion of rental or "special needs" housing. However, such housing is more expensive to build than rental housing and excludes many households that are unable to become homeowners (because of low incomes or other reasons) or are disinterested in homeownership. Whatever the goals of a program, its designers must decide what forms of housing and pricing should result from the ordinance. Many inclusionary programs require that on-site affordable housing units mirror the make-up of the market-rate housing units. (For example, if a development has 100 percent rental units, all the affordable units should be rental units.)

- **3.For how long?** Some newly created inclusionary zoning programs have made the mistake of creating affordable housing that did not remain affordable for very long. Some home buyers in these programs got windfall profits. Developers often resist long-term controls, and these controls require more regulatory apparatus. But such controls are feasible if desired. The duration of affordability controls typically runs from 10 to 30 years. Controls tend to be stricter in recently-created programs — perhaps following the similar trends in the development of federally-assisted affordable housing.

Appropriate Markets for Inclusionary Programs

Virtually all effective inclusionary programs have occurred in strong housing markets, presumably because developers' and land owners' profit margins were wide enough for them to make economic concessions — namely, discounting rental rates and sale prices. In addition, programs tend to be more successful in communities where the political will exists to support the development of affordable housing and to place strong requirements on market-rate developers.

Mandatory vs. "Voluntary" Requirements

In general, there are two types of voluntary inclusionary zoning programs. First, there are zoning provisions that give developers incentives (such as density bonuses) in exchange for providing a certain percentage of affordable housing units. Second, a few communities have informal or formal policies (such as statements in a General Plan) that encourage developers to include a certain percentage of affordable housing in market-rate developments. At least one study of inclusionary programs in California indicated that mandatory requirements have produced much more affordable housing than voluntary requirements.

Impact on Landowners and Developers

It is an unprovable but reasonable assumption that every inclusionary zoning ordinance has somehow taken into account its economic impact on landowners and developers. This is the likely reason that no ordinance in the country requires a developer to provide 100 percent affordable housing to households with poverty incomes. That would be wholly uneconomic. On the other hand, some programs have succeeded in getting developers to deliver a small percentage of very affordable homes or rental units, while others have succeeded in producing larger percentages of "near market-rate" housing that cost developers very little if any money out of pocket.

An ordinance that is too aggressive with the pricing of the required affordable housing can have the effect of devaluing the land or reducing profits to such an extent that some legal experts might consider it a "taking" under constitutional law. To compensate, some inclusionary zoning ordinances offer a *quid pro quo* in the form of density bonuses or other

incentives.

Most communities enacting such ordinances have sought review and input by citizens, advocates and real estate development professionals. In the best of circumstances, a consensus develops in which everyone sees the greater economic and social good of providing some affordable housing, and also respects developers' needs to make a profit.

Need for Economic Analysis of Proposals

Because of the considerations just mentioned, some communities have determined that it is best to allow developers some flexibility in how they provide affordable housing. For example, few programs would require a developer to build a home on a \$500,000 lot and sell it for \$80,000. As an alternative to making such a drastic economic concession, a developer might be offered the option of building affordable housing off-site, or to make an *in-lieu* payment to an affordable housing trust fund.

Inclusionary programs vary considerably in their flexibility on these points. In general, builders prefer flexibility. On the other hand, more flexible programs put more demands on local government administrators, who are charged with negotiating for the maximum number of affordable units at the lowest costs (within reason). If more flexibility is allowed, expert analysis of each deal is required, either by the local government or an expert third party. The analysis involves issues such as: 1) what is the developer really giving up in economic terms, and 2) if incentives are part of the program, what does the developer get back?

In addition, because no two projects are exactly alike, considerable diligence, foresight and finesse is required to design and implement a successful inclusionary zoning program. For example, how should a program treat two developers who got to the same result by very different routes? Developer A produced his required 20 apartments renting for \$550 a month by using massive federal subsidies and making no financial concessions on his own. But when Developer B was building, the subsidies had run out and she had to absorb \$500,000 in lost profits to create \$600 rents in her 20 affordable apartments. Some inclusionary programs allow developers to use any available subsidies to produce the required affordable housing, and some don't. The best-written ordinances and administrative procedures can anticipate many variables, but cannot eliminate the need for good judgment in dealing with the unique aspects of various projects.

Nexus Argument

From a legal standpoint, an inclusionary zoning ordinance must have a sound rationale. More specifically, some legal experts believe that it is advisable for local governments to produce data and an argument that proves an historical relationship or "nexus" between: 1) the construction of higher-priced housing or commercial properties and 2) the lack of

affordable housing and the social and economic ills that have resulted from that.

This argument is similar to the one used by local governments to require developers to contribute impact fees for roads, fire stations and other off-site infrastructure. With impact fees, the nexus can be proven with traffic projections, population projections, costs and other statistical data.

With an inclusionary zoning program (particularly a mandatory one), conservative legal experts advise that a nexus argument must be made with great care so the ordinance will stand up to potential lawsuits. Where nexus arguments are made, they typically take the form of a report referred to by the inclusionary ordinance. However, other experts assert that nexus studies and nexus arguments are not necessarily required — that in some circumstances, governments have an inherent right to enact “social zoning,” zoning that promotes the health and welfare of the public.

Applicability of Guidelines

These are typical issues:

- What kinds of housing will it apply? Both rental and for-sale housing? How will it treat proposals for low-cost housing?
- To what scale of project will it apply? Most ordinances exclude projects with less than a certain amount of dwelling units or square footage.

Definition of Affordable Housing

Every effective inclusionary program must include a firm definition of what developers must deliver, and to whom. Otherwise, developers will have no standard with which to comply. The results will be called affordable housing, but may not serve the most serious housing needs of the community.

The definition usually follows these logical steps:

- **A statement of the income groups to be served** (such as, below 80 percent of median, below 50 percent, etc.) There may also be a tiered standard, that is, quotas for units at different price levels or at least inducements to “go lower.” One inducement is to require a lower percentage of affordable units if the units are lower priced.
- **Income eligibility standards** are usually adjusted by family size. The easiest standard to use is some percentage of “area median income” as defined, published and periodically updated by the U.S. Dept. of Housing and Urban Development for various [cities, counties and regions](#).

- **Formulas to calculate to maximum prices for housing units**, adjusted by bedroom sizes that relate to the family size and income standards above. Different formulas are used for rental and for-sale housing, usually 30 percent of income for rent and 28 percent of income for mortgage payments on a home. Some formulas for home sales take into account current interest rates.
- **Optionally, some other requirements**. These may include preferences for smaller or larger units, rental vs. for-sale units, special-needs housing etc. Some such requirements might relate back to the findings of a needs study and nexus argument.

Qualifying Individual Households

Every program has some system for the following:

- Verifying and certifying incomes and perhaps other characteristics (such as disabilities) of households that are eligible to live in this "discount" housing
- Indexing over time (e.g. by using updated HUD figures)
- In rental housing (and sometimes for-sale housing) certifying incomes in "turnover" units

Percentage and Types of Affordable Housing Required

Programs typically require developers to make 10 to 20 percent of the units in their projects affordable. The rationale for this percentage could be the estimated "shortfall" of affordable housing in the community, and the estimated amount of new affordable units needed each year. The often unspoken factor is the perception of what developers will accept without rebelling.

As mentioned, a rational system might accept a lower percentage of very low-priced units if this represents an economic concession similar to providing a larger number of moderately-priced units. A program might (based on community needs) also set quotas for various types and sizes of housing (small and large units, rental and for-sale units, types of special-needs housing etc). However, for on-site affordable housing, some programs simply require that the number and types of affordable units mirror the make-up of market-rate units.

Developers, left to their own devices, tend to want to satisfy affordable housing requirements by building small housing units and not the types of housing that meet the most serious community needs. For example, larger affordable apartments for very low-income families are needed in most communities, but many developers don't like to include them because they cost more to build and operate.

Design Standards

It is also essential for programs to have design standards for the affordable units to be delivered. Some programs require that affordable units be identical to market-rate units in square footages and finishes, while other programs simply set minimum square footages and design guidelines for affordable units. Minimum square footages need not necessarily relate to the minimum square footages that are proscribed in most building codes — those are usually minimal indeed.

Nature and Duration of Affordability Controls

Following are some key considerations in this area:

- Rental projects are often required to maintain affordable rents over 10 to 20 years, with an indexing method tied to current income data.
- A program might include incentives for developers to provide housing, land or cash to nonprofit rental or special needs housing developers that pledge to maintain affordability in perpetuity.
- Programs involving for-sale housing might involve one or more of the following control mechanisms: 1) "soft" second mortgages for the difference between appraised value and the delivered price, 2) terms for repayment of such mortgages upon sale or forgiveness over 10 to 20 years, 3) ownership of the underlying land by a land trust, which is a stronger mechanism for sharing equity appreciation, and 4) other related devices such as rights of first refusal.
- To enforce some affordability controls such as shared equity arrangements, it may be necessary for the local government or an agent (such as a nonprofit group) to take title to the affordable units before they are first occupied, so that a valid lien can be established by the entity that will enforce the requirements.
- Where the affordability control involves a cash repayment, funds can be recycled through a trust fund to develop additional affordable housing.
- To construct effective and enforceable affordability controls, it is advisable to use expert legal counsel, advised by affordable housing experts, since few attorneys are familiar with the intricacies of administering long-term affordability controls.

Provision of Affordable Housing On-Site or Off-Site

A program may benefit from giving developers the flexibility of delivering affordable housing on-site or off-site. In some cases off-site housing may be much more desirable, for these reasons:

- If the site subject to rezoning is very expensive land, more affordable housing can be delivered off-site given the economic capacity of the project.
- Some types of housing, such as rental and special needs housing, may require locations near services, on bus lines or near employment. The subject site may not have these desirable attributes.

Payments In-Lieu of Providing Affordable Housing

Many developers may prefer the ease of making an in-lieu payment of cash rather than delivering affordable housing directly. These are the benefits of such an approach:

- "Market-rate" and "high-end" developers may not have the skills and experience to market and operate an affordable housing program, particularly programs involving social services and long-term affordability controls.
- Qualified affordable housing producers are almost always starved for subsidy capital, which is typically the main limitation on their affordable housing production. In some locales (such as rural areas), the lack of subsidy capital has led to a diminished local capacity to produce affordable housing, whether by for-profit or nonprofit entities.
- "Trust fund money," particularly if it is used to write down project costs through "soft" financing, is the most flexible device to deliver the exact kind of affordable housing the community needs. As long as there is land available for affordable housing development, communities that are land-starved might at times want land contributions more than cash. For this and other reasons, the program administrator ought to have the flexibility to require or negotiate for the kinds of contributions that meet current needs.

Payments in-lieu are often made at the time of pulling building permits on specific lots within a land development, so it typically takes two or more years for all the funds to be paid in for a specific development.

Well thought-out programs will include formulas for evaluating the present value of in-lieu funds delivered on various schedules. Needless to say, a dollar today is worth a lot more than a dollar ten years from now.

Formulas for payments in-lieu are difficult to devise. One rational basis is to relate them to the financial concession a developer would have to make to deliver the desired products. For example, assume 10 three-bedroom affordable homes were required of Developer A. The price had to be \$80,000. The cheapest comparable homes in the market cost \$110,000. That amounts to a \$30,000 concession per home, or \$300,000 total, a reasonable in-lieu payment.

For simplicity sake, it may be advisable for a program to use similar logic to establish a schedule of "buy-out amounts" for units of various sizes, that otherwise would have been provided on-site or off-site. These amounts could be indexed over time, for example, by the percentage increase per year in median income.

Regulatory Agreements and Enforcement

Programs that are fair and effective in producing a wide range of affordable housing will generally not have simple rules. Projects are typically subject to regulatory agreements defining very carefully what will be delivered, when and to whom, along with longer-term

affordability controls. Some controls must be passed along to successor developers, rental property owners and homeowners.

Sometimes, a third party might become involved in some aspects of the program. In some communities, nonprofit groups qualify home buyers in for-profit developments that are subject to inclusionary requirements. A nonprofit may also administer trust fund monies and be owner of any "soft" second mortgages involved.

Agreements may set forth financial penalties, but they must be properly constructed so that they are enforceable in court.

Compensating Benefits to Developers

Some inclusionary programs have offered developers such benefits as density bonuses, waiver of impact fees and the like as carrots to go along with the stick of the inclusionary requirements.

Needless to say, such programs are much more popular with landowners and developers. However, in very strong markets, such inducements may not be necessary from a practical standpoint, since profits on land and housing sales are typically much higher than in ordinary markets. From a legal standpoint, local officials may want to offer incentives, to counter possible arguments that their inclusionary requirements are improper "takings." There is no single "right" solution. Each local jurisdiction must make its own determinations on the underlying issues of how to be design a program that best serves the public interest, is ethical, conforms with the U.S. Constitution and state laws, and minimizes the risks of legal challenges.

Desired Results of Guidelines

Inclusionary programs are only as good as their results. So it is wise to design them with careful thought to the desired outcomes. For example:

- What types of affordable housing do we want, at what price ranges? And do we want these prices tiered down to help poorer households, or simply all within one range?
- How much of a financial concession can we expect of landowners and developers, in terms of the percentage of affordable units and "depth" of affordability?
- Do we want the program to build up the capacity and output of nonprofit developers, who will serve clientele not being reached by the free housing market?
- Do we want to create a flexible trust fund? Do we need land for special projects? Or both?
- Perhaps most importantly, do we want to build in the flexibility to respond to evolving needs and market conditions that are not predictable at this time?

This issues paper was written by Peter Werwath of The Enterprise Foundation, under a contract with the City of Santa Fe, New Mexico, 1994, and updated in 2004.

Inclusionary Zoning A Program Design Checklist

1. Will the program be mandatory or "voluntary?"

2. To what class of residential developments will the program apply?
 - Single-family:
 - Multifamily:
 - Mobile home:
 - Threshold number of units:
 - Other characteristics?:

3. What income group(s) will benefit from the affordable housing?
 - Local or MSA median income standard?
 - 100 percent of median:
 - 80 percent of median:
 - 50 percent of median:
 - 30 percent of median:
 - Some of each?:
 - Different percentage to deliver depending upon category? (such as: 5% affordable if <30%; 15% affordable if <100% etc.)

4. How will these income limits be adjusted for family size?

5. How will income limits be updated over time?

6. What formulas and factors will be used to derive affordable rentals and sales prices?
 - Percent of income considered affordable for:
 - Rent:
 - Mortgage payment:
 - Will utilities be included in any calculation?
 - What standard will be used for an interest rate?
 - Will "affordable prices" be calculated and published on a periodic basis or will they be calculated deal-by-deal?

7. What system will be used to qualify and select residents of affordable housing?

8. What types of "affordable housing" may be delivered?

- For-sale homes?
- Rental housing?
- Group homes?
- Shelters?
- Other?

How will these be valued in relationship to each other? (For example, dwelling units vs. beds)

Is there a presumption that certain of these types of housing are more appropriate for certain income groups, and that they should be priced accordingly? (For example, for-sale units for incomes 50-100% of median; rental 30-80% of median; shelters under 30% of median)

Will a unit be considered "complying" if it was made affordable only by outside subsidies (such as subsidies from the city or state)?

On the other hand, will developers be encouraged to incorporate subsidies to make the housing even more affordable than required?

With regard to the last two questions, will for-sale and rental housing be treated differently?

9. How can the city assure a high quality program vs. just dwelling units delivered?

- Review and approval of property management and service plans?
- Require involvement of nonprofits in homebuyer training?
- Encourage joint ventures with qualified nonprofits?

10. Will there be any mechanism for the city to control the bedroom sizes or other basic characteristics of the housing offered? If so, what?

11. What percentage of affordable housing must be delivered?

- Set percentage?
- More if near market prices?
- Less if very low priced?

12. Can the housing be provided off-site?

13. Can the developer make in-lieu contributions?
 - Land?
 - Money?
 - Other in-kind?
 - What is the formula for deriving the value of the "buy-out?"

14. When are affordable units or in-kind contributions to be delivered?
 - Up-front?
 - Staged pro-rata with rest of development?
 - How is the time value of money accounted for?

15. What minimum standards will the city have for an "affordable housing unit?"
 - Square footage:
 - Amenities:

16. What will be the duration of affordability controls on rental housing?
 - Number of years:
 - Will there be a regulatory agreement?
 - How will it be monitored and enforced?

17. What will be the duration and nature of affordability controls on for-sale housing?
 - "Soft" second mortgages?
 - Rights of first refusal?
 - Equity sharing?
 - Land leases/land trusts?
 - If some mechanisms require an intermediary owner, is that OK?

18. Can the city use third parties:
 - In any part of negotiations?
 - To monitor compliance?
 - To hold and administer liens?

19. Will the program administrator be given discretion in any of the following areas?
- To analyze the internal economics of each proposal?
 - To assess and take into account the economic impact on landowner/developers?
 - To analyze the impact of "outside" subsidies?
 - To analyze the "efficiency" of requirements as applied on-site, off-site or in-lieu and to have the discretion to dictate which should be provided?
 - To take into account the desirability of social and economic integration?
 - To analyze the desirability of the site for proposed affordable housing use? (Such as services, transportation, etc.)
 - To have the discretion to dictate the "type" of housing delivered: for-sale, rental, group home, shelter, etc.
 - Ditto for unit sizes?
 - Ditto for percentage of affordable housing units to be delivered in various price classes?

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