

Testimony of Charles K. Barber
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Zoning Commission Case # 04-33, Inclusionary Zoning

Monday, July 25, 2005

I Introduction

- A. DCBIA comprises over 400 real estate related businesses in the District of Columbia, including developers, architects, engineers and attorneys that are directly involved in housing development in the City
- B **DCBIA strongly supports affordable housing.** Many of our members – both non-profit and for profit groups – are directly engaged in the production of affordable housing and have produced thousands of affordable homes in the District of Columbia over the past many years
- C. DCBIA and a number of its members have cooperated with DC Council Chair Linda Cropp during the past several weeks and participated in numerous discussions initiated by her and coordinated by the Office of Planning. Our members were generous with their time and shared significant amounts of information about the business aspects of housing production with all parties to these discussions, including several representatives of the Campaign for Inclusionary Zoning for the District of Columbia

Notwithstanding these discussions, DCBIA has substantial concerns about the means selected for increasing affordable housing in the District of Columbia, i.e., the mandatory inclusionary zoning proposals before the Commission today, including the recommendations of the Office of Planning. During the hearing, you will hear directly from several residential developers who will address specific concerns with the MIZ proposals. Following is a more general view of DCBIA as a whole.

II. The Commission Should Exercise Extreme Caution in Adopting any Type of Mandatory Inclusionary Program

- A Mandatory inclusionary zoning has been adopted by less than 5% of the approximately 8,400 state and local jurisdictions. DCBIA has reviewed the policies from several other cities and jurisdictions, including Montgomery County, Boston, Denver, San Francisco, San Diego and Sacramento. Attached to my testimony is a summary of this review. On the basis of this review, there are substantial questions of whether mandatory inclusionary zoning is an efficient and effective mechanism for increasing affordable housing. At best, the gains in affordable housing that these programs have produced are modest – and far more difficult to achieve in dense urban environments

ZONING COMMISSION
District of Columbia
CASE NO. 04-33
EXHIBIT NO. 55
ZONING COMMISSION
District of Columbia
CASE NO. 04-33
EXHIBIT NO. 55

- B. Mandatory inclusionary zoning applies a blanket mandate that inevitably leads to a regulatory regime that is costly, complex and uncertain in outcome. While some individual developers may be able to make these models work in today's market, it is by no means clear how these models will impact the industry as a whole, and whether these models will become obsolete as the housing market undergoes its inevitable changes.
- C. The economic premise of mandatory inclusionary zoning places the costs – and the risks – of affordable housing on the housing developer. In theory, additional density is available to compensate the developer, which is intended as a hedge against substantial loss rather than a real incentive. As a practical matter, striking a balance among all of the inter-related variables of the program could substantially increase the economic risk the developer faces, and ultimately act as a disincentive to the development of housing – both market-rate and affordable.
- D. In recognition of the difficulty of devising a “one size fits all” approach – even with the Office of Planning's nod towards distinctions in building size and construction types – we have advocated an incentive-based approach that would allow each developer the flexibility needed to determine how inclusionary zoning might work on each project. Properly structured, an incentive-based program would have a better chance of increasing affordable housing without negatively impacting the competitiveness of the District's housing market.
- E. Housing developers do have choices on where to develop. The District's housing market is in competition with “hot” sites in suburban jurisdictions, including Silver Spring and Rockville in Maryland, as well as Clarendon and Ballston in Virginia, to name a few. To the extent a mandatory inclusionary zoning policy significantly limits the returns developers can obtain in the District, developers will increasingly “volunteer” to develop housing elsewhere.
- F. Finally, given the modest gains in affordable housing even the proponents of a mandatory program project, DCBIA and other groups have urged the District to take a step back and to examine more effective ways to increase affordable housing. We have urged a comprehensive, multi-faceted program that recognizes the need for predictable, broad-based funding, restructuring existing programs and providing for a range of incentives to both preserve existing affordable housing and create new housing. Increasing affordable housing is an important goal, and, if we are serious, we must go beyond the meager results likely to be achieved – with substantial cost and complexity – by a mandatory inclusionary zoning program.

III If a Mandatory Inclusionary Zoning Program is Adopted, DCBIA Urges the Commission to Take a Hard Look at a Variety of Specific Issues.

There are many “moving parts” to a mandatory inclusionary zoning proposal, only a few of which have been highlighted by either the Campaign for Inclusionary Zoning or the Office of Planning. While many of the housing developers who will subsequently testify will address some of these issues, the following is a list of some of the more significant:

- A. Application to substantial rehabilitation** DCBIA believes that any program be restricted to new construction, and not cover substantial rehabilitation, where the results can only be counterproductive to the preservation of older properties.
- B Amount of affordable housing** OP’s requirement of the greater of 75% of the bonus density or 10% of the matter of right density for lower density buildings is too stringent. Similarly, the 50% requirement of bonus density or 8% of matter of right for larger buildings is also cutting the requirement too close. These numbers exemplify the problem of the “one size fits all” approach, because they may work in some circumstances but not others, and at some times but not others. DCBIA recommends that any program consider ratios less likely to threaten the current revival of residential development in the District.
- C Length of affordability.** Various proposals have been made for how long affordable units should remain under price controls. In for sale units, DCBIA recommends that there be incentives for affordable owners to feel and act like “owners” by being able to share in the upside of the increase in equity in such units. This can be accomplished, for example, by a 10-year affordability requirement with a gradual increase over time in the percent of the equity the affordable owner could retain.
- D Responsibility for renting the units or selecting owners** Proposals have been made for giving the government a substantial role in renting the affordable units, or acting as “middle man” in selecting tenants or owners. DCBIA believes that the government’s role in administering any program should be carefully circumscribed so that housing developers and managers are given flexibility in renting or selling to “qualified” affordable residents.
- E. Time frame for setting affordability requirements.** The price for affordable condominium projects should be set at the time of filing for excavation and sheeting and shoring permits, using an agreed upon mortgage rate setting mechanism at that time. This will allow the housing developer to better manage the pricing risk on affordable units and will reduce the amount of subsidy required because of the lower risk.
- F. Waivers and flexibility** Since a blanket program will invariably create a hardship on certain developers because of the vagaries of specific projects, there needs to be an efficient method for addressing waivers. Any prolonged process

will act as a further disincentive to undertake a housing project. OP's recommendations for allowing certain waivers to be awarded through an administrative process should be broadened to act not as sanctions but as opportunities to build more affordable housing.

- G. **Effective date.** There should be considerable thought as to the effective date of any new program. At any given time, plans for housing development are in various stages of preparation and are frequently accompanied by substantial investments based on an assumed regulatory playing field. Changing that playing field should only be done with appropriate lead times.
- H. **Required legislative amendments.** There are a host of legislative changes that will have to be addressed in conjunction with any mandatory inclusionary zoning program, including issues of the legality of different condominium fee structures in the same project, the taxing of buildings to reflect the price controls on affordable units, and the applicability of a new program on already existing programs to increase affordable housing. While these issues are beyond the purview of the Zoning Commission, there must be a process that allows for their consideration before the implementation of any mandatory inclusionary zoning program.
- I. **Specific Exclusion of the Downtown Development District (DDD).** Given that there is no bonus density to provide as an incentive in the DDD, and the inclusion of the DDD is in the advocates proposal, it would be helpful to the housing developers in the area to know that DDD is not being included at this time but rather next winter or spring when mapping of mandatory inclusionary zoning areas is likely to take place.
- J. **Specific Exclusion of areas zoned C-3-C that already have incentives in place to maximize density.** Recently, for the first time in many, many years, residential projects are competing with office projects for vacant land, particularly in the area north of Union Station along First Street, NE, now known as the NOMA Corridor. This area is a Transferable Development Rights (TDR) receiving area. TDRs allow a developer to increase the density of their projects. Thus, for projects using TDRs, there is no bonus density to provide affordable housing. In addition, any disincentive to build housing (a 1 to 1 ratio on bonus density is a disincentive to most housing developers) will hurt the supply of affordable housing by decreasing the supply of new market-rate housing. In addition, a square foot of residential space provides more to the DC general fund than a square foot of office space (assuming, of course, that 70% of the office workers do not live in the District).
- K. **Specific Exclusion of the conversion of commercial buildings to residential buildings.** For the same reasons as given in J above, that is, (1) an increase in market-rate housing will take pressure off the conversion of existing affordable housing to market-rate housing, and (11) a square foot of residential space provides

more to the DC general fund than a square foot of office space (assuming that 70% of the office workers do not live in the District)

In conclusion, there are a host of inter-related complex issues that need to be addressed in connection with any mandatory inclusionary zoning policy in order to ensure that the housing industry as a whole is not adversely impacted by imposing a fixed mandate for the creation of what will be a relatively small amount of affordable housing.

Attachment

CAUTIONARY OBSERVATIONS ON MANDATORY INCLUSIONARY ZONING

**Prepared by the District of Columbia Building Industry Association
and Submitted to the Zoning Commission on Monday, July 25, 2005,
at Hearing on Case No. 04-33 – Text Amendments to Require the
Provision of Affordable Housing – Inclusionary Zoning**

In evaluating mandatory inclusionary zoning (MIZ) as a public policy option for the District, it is important to distinguish concept from practice. As a concept, MIZ is portrayed by its advocates as simply the reverse of exclusionary zoning – a straightforward, cost-free way to zone a degree of affordability into residential development and, along the way, to integrate communities economically. But in practice, the attempt to apply a blanket mandate of controls over housing developments of different characteristics in changeable markets inevitably leads to a regulatory regime that is costly, complex and uncertain in outcome. That may explain why over more than three decades so few jurisdictions have adopted MIZ and why the results achieved to date have been so modest. With some 8,400 state and local political jurisdictions in the nation (The Economist, 7/2/05), the existence of only 350 to 400 IZ programs of some type does not suggest a public policy of demonstrated success.

Is MIZ effective?

It is useful to take a closer look at those results achieved, which advocates cite as compelling evidence of the efficacy of MIZ. Montgomery County's Moderately Priced Dwelling Unit (MPDU) zoning ordinance, for example, is often pointed to as the nation's model MIZ program. Over thirty years, some 11,000 MPDUs have been produced for an average of about 350 units per year – an amount the Urban Land Institute has described as averaging "about 8% of the county's total annual housing permits, and annual production is dropping every year."

The production of affordable housing in Montgomery County, in fact, has slowed in recent years, as the initial larger-scale residential developments up-county have approached build-out. Density bonuses as builder compensation for subsidy costs are less effective in more mature, already dense communities, where new development is typically in the form of more costly, high-rise construction. It is no surprise, then, that the bulk of the county's MPDU units was built in Germantown and Gaithersburg, and not in Bethesda. What is clear is that the economics of MIZ work best in land-rich communities experiencing a surge of new stick-built housing. As the staff of the Montgomery County Council reported: "Implementation of the MPDU program in non-suburban settings gives rise to economic and land use challenges." In response to those challenges, the county has now turned to the use of county-owned land for the production of affordable housing as part of subsidized mixed-income developments.

Still, the proponents have taken heart in the adoption of MIZ by five cities – Boston, Denver, San Francisco, San Diego and Sacramento. All are cities that have experienced strong housing markets and rapid escalations in housing prices, which have generated powerful political pressures “to do something” about affordability for low and moderate income households.

But what actually has been done? A recent report, “Large Cities and Inclusionary Zoning” (November, 2003), by Business and Professional People for the Public Interest (BPP), an MIZ advocate, surveyed the not very impressive results: in Boston, 200 affordable units since 2000, in Denver, 804 units “planned;” in San Francisco, 128 units, 1992-2000, and 90 since 2002, in San Diego, 1,200 units since 1992 (in an earlier program restricted to an outlying area undergoing new development); in Sacramento, 465 since 2000. Sacramento, whose MIZ program includes density bonuses of 25%, expedited processing, fee waivers and priority application for other available subsidy funding, leads the pack with average annual production of about 150.

It seems the practical economics of residential in-fill development in urban areas offer only limited adaptability to MIZ regimes. In testimony before the DC Council, for example, the Office of Planning estimated that adoption of the CMIZ proposal now before the Zoning Commission would have resulted in the production of only 780 affordable units in the District over the past five years. The benefits of MIZ are apparently a lot easier to promise than to deliver.

Is MIZ efficient?

Much of the academic literature on MIZ grapples with the question of costs – what are they and who pays them, when a \$750,000 market-rate home is sold as an affordable set aside at, say, \$250,000. A recent study by the Reason Public Policy Institute (RPPI), a California think-tank, identifies that difference in price as an “opportunity cost” imposed on the builder, landowner and market-rate buyer in some variable combination depending on site-specific factors. Essentially, RPPI regards MIZ as an attempt at price controls with the resulting market distortions that classic supply and demand economics predict.

Proponents of MIZ, on the other hand, look not at opportunity costs but at the costs of development and assert that subsidy costs to the builder can be off-set by density bonuses or other development incentives. As a theory, this would appear to make some sense. As a practical matter, however, striking a balance among all the inter-related variables of MIZ that will work as a fixed formula across all new residential development makes much less sense.

Less theoretical and more practical is the common sense reality that any builder will seek to recover the costs of mandated subsidies. If the builder can not foresee that recovery, the development does not get built. If the builder can, it does – either because the incentives (density bonuses) are adequate, or because the land-

owner and/or the market-rate buyer will absorb the subsidy cost. Unsurprisingly, then, many builders look upon MIZ as just another tax on residential development resulting in higher home prices and lower production rates

The issue of subsidy costs and incentive off-sets is being played out now in New York City, where MIZ has been proposed for the re-development of an area along the Brooklyn waterfront. The city's Departments of Planning and Housing Preservation have come out against the MIZ proposal and instead have recommended a more flexible voluntary program of "inclusionary housing." In support of their position, the Citizens' Housing Planning Council wrote to the New York State Assembly (1/4/05): "First and foremost, we fear that if the requirements of a mandatory program are not calibrated precisely, they will adversely affect the feasibility of developing many sites and will actually reduce overall housing production. Even if the requirements, when adopted, perfectly anticipate the financial needs and tolerances of housing developers, ever changing market and financial conditions would quickly render them outdated. The relative permanence of zoning regulations compared to market movements dictate that inclusionary housing provisions should be optional, so that they are used when market conditions are favorable and do no harm when conditions are less hospitable to new housing development."

The Center for Rethinking Development at the Manhattan Institute (August, 2004) summed up the issue more succinctly. "Making inclusionary zoning mandatory would be a huge mistake."

In promising a supply of affordable housing without public costs, MIZ advocates often neglect to mention the obvious costs of program administration and enforcement. Most observers readily agree that the execution of MIZ programs is inherently demanding and, as the Urban Land Institute put it, "requires the attention of dedicated, inventive public servants." MIZ also entails the direct and in-direct costs of compliance borne by the home builder as another regulatory requirement in an already lengthy building permit process.

Also often overlooked are the costs of MIZ to the jurisdiction, when affordability price controls on new development lower potential assessed land and property values with a consequent reduction in tax revenues. Another community cost applies when high-cost housing is not occupied by households (and tax payers) earning enough to afford high-cost market rates. This is essentially a tax base issue that impacts the MIZ goal of economically integrating high housing cost neighborhoods.

Two points for careful consideration.

An evenhanded reading of the MIZ proposals now before the Zoning Commission suggests that they are guided by two basic principles – first, that builders should

not profit from the production of affordable housing; second, that inclusiveness is as important a goal as is affordability

On the first point, the proposed builder density bonuses are not structured as actual incentives to stimulate affordable housing production. Instead, the apparent intent is to offer just enough of a cost off-set to avert a slow down in current market-rate development. Presumably, market-rate demand and prices can be relied on to “make the project work.”

The current housing (condo) boom in the District may proceed for some time, but it is unlikely to extend indefinitely. Accordingly, any MIZ ordinance adopted by the District should recognize that housing markets are cyclical, that interest rates and construction costs are volatile, that residential investment dollars are mobile and, therefore, that the cost recovery potential of any density bonus is a function of changing market conditions. At some point, the project may no longer work.

Interestingly, the Office of Planning cites a study by the Furman Center for Real Estate and Urban Planning at New York University as “the most comprehensive economic analysis on inclusionary zoning.” From that most comprehensive study: “These results suggest that if the City (New York) considers adopting a mandatory IZ program, it should proceed with caution. Because feasibility varies by neighborhood, programs should only be implemented on a neighborhood-by-neighborhood basis, with affordability requirements attuned to local market conditions. Programs should be implemented only if they are determined to be financially feasible both at present and under likely future market conditions.”

But a mis-match between affordability requirements and market conditions is not the only stumbling block to IZ effectiveness. New York City’s current voluntary IZ program distributes its density bonus of 20% in a seemingly generous ratio of four market-rate square feet to one affordable. The incentive potential of that distribution, however, is blunted by other restrictive IZ provisions adopted largely to support inclusiveness objectives. The result is that only 603 affordable units have been produced since 1987. The Executive Director of the Metropolitan Council on Jewish Poverty has been quoted in comments on a high-visibility IZ project: “Instead of forcing the developer to acquire a very expensive parcel of land on 61st Street (Manhattan) that same project could be built in Brooklyn or Queens producing four to five times the number of units. If the goal is to create affordable housing, why build on the most expensive land in the city?”

That question, of course, raises the broader question – are affordability and inclusiveness entirely compatible goals. Observers have noted that the goals, in fact, do become contradictory, when the aggressive pursuit of one trades off at the expense of the other. Just as restrictive on-site production mandates promote inclusiveness at the expense of affordability, so broader off-site and in-lieu payment options trade off inclusiveness to extend affordability benefits to more residents. The point: both goals are commendable and both have costs.

A concluding note.

The need to increase the production and preservation of affordable housing for District residents is beyond dispute. In our judgment, however, adoption of the MIZ proposals now before the Zoning Commission would be ill-advised and counterproductive in meeting that need.

Contrary to the assertions of advocates, the experience of other jurisdictions demonstrates that MIZ has not proved to be a consistently effective public policy for the meaningful production of affordable housing. Further, the costs, complexities and market disincentives inherent in such zoning would threaten the continued revival of residential development in the District.

Without the flexibility of a voluntary program to mitigate changing market conditions and without adequate incentives for its challenging application in urban areas, IZ will result in only negligible production of affordable housing – at more than negligible costs to market-rate development with attendant negative impacts on District revenue.

Instead of directly addressing affordable housing needs as a community-wide responsibility, MIZ attempts to offload that responsibility on the housing market – relying on the economically dubious notion that high-cost, market-rate housing can be used effectively to supply the demand for low-cost, subsidized housing. What is needed instead is a more comprehensive District housing policy that recognizes the community responsibility with increased public funding, more efficient administration of existing programs and the more aggressive use of city-owned land for subsidized housing development.