District of Columbia
Office of Planning

MEMORANDUM

TO: **District of Columbia Zoning Commission**

FROM: JLS for Eric Shaw, Director

DATE: February 26, 2015 6 dh

SUBJECT: ZC 04-33G Inclusionary Zoning Amendments Technical Appendices

This report provides the Office of Planning's (OP) technical appendices to supplement the Executive Summary filed with the Zoning Commission on February 25, in advance of public hearings to be held on March 3, 2016. It provides the Zoning Commission: greater context and discussion on the District's affordable housing strategy and IZ roll within the strategy, OP's review IZ bonus density, comprehensive plan, the economic impact assessment and specific questions made by the Commission.

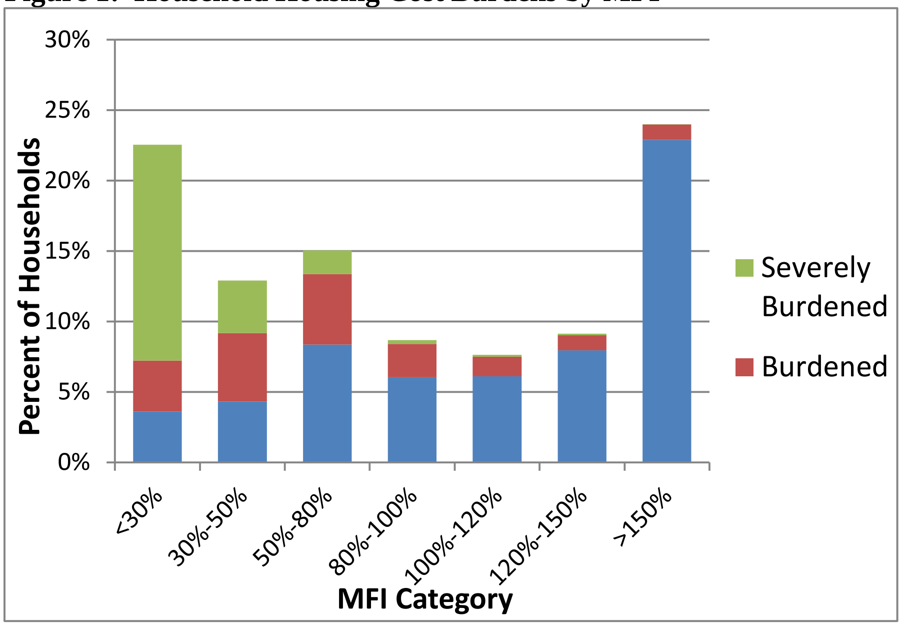
LIST OF TECHNICAL APPENDICES

I. CONTINUUM OF AFFORDABLE HOUSING NEED AND IZ

IZ is one of the District's many affordable housing programs and its application in the District of Columbia should be viewed in that context. There is a continuum of housing need in the District from very low-income special needs households, to young families on a pathway to the middle class, to seniors on a fixed income.

Figure 1 below demonstrates how the need for affordable housing increases as household incomes decline and a greater percentage of households become burdened (paying more than 30% of their income for housing) or severely burdened (paying more than 50% of income for housing) by housing costs. The chart demonstrates that housing cost problems noticeably increase starting with households earning less than 80 percent of the MFI. While the chart does not break it out, 39 percent of households earning between 60 percent and 80 percent of the MFI are either burdened or severely burdened by housing costs. The need for affordable housing is smaller at 80 percent of MFI, but still exists. OP estimates that almost 5,300 rental and 4,300 owning households earning between 60 and 80 percent of the MFI are burdened or severely burdened by housing costs in the District of Columbia.

Figure 1: Household Housing Cost Burdens by MFI

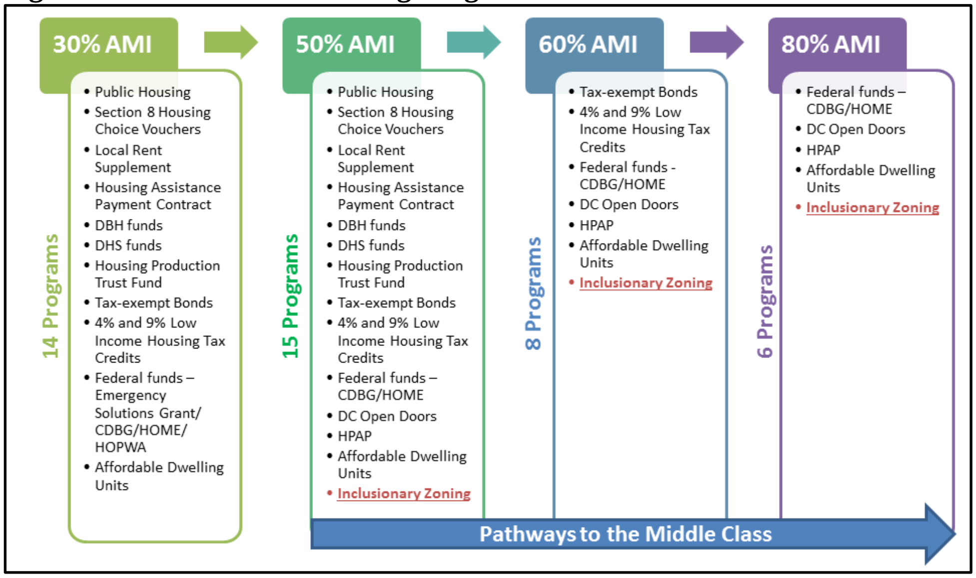


Source: US Census 2009-2013 PUMS, DC Office of Planning.

In response to the need for affordable housing, the District uses federal subsidy programs in combination with a variety of local affordable housing tools to address the need. It is important to view IZ's role within this context. For instance, by providing affordability for moderate-income households, IZ reduces the rent pressures on unsubsidized affordable housing in the District.

Figure 2 below illustrates where IZ falls along the continuum of tools. The District has many tools to assist very low-income households where the need is the greatest, but has fewer tools available to households at 80 percent of MFI. In fact, IZ and District land dispositions are the only tools that targets 80 percent of MFI rental households as most of CDBG dollars end up serving lower incomes.

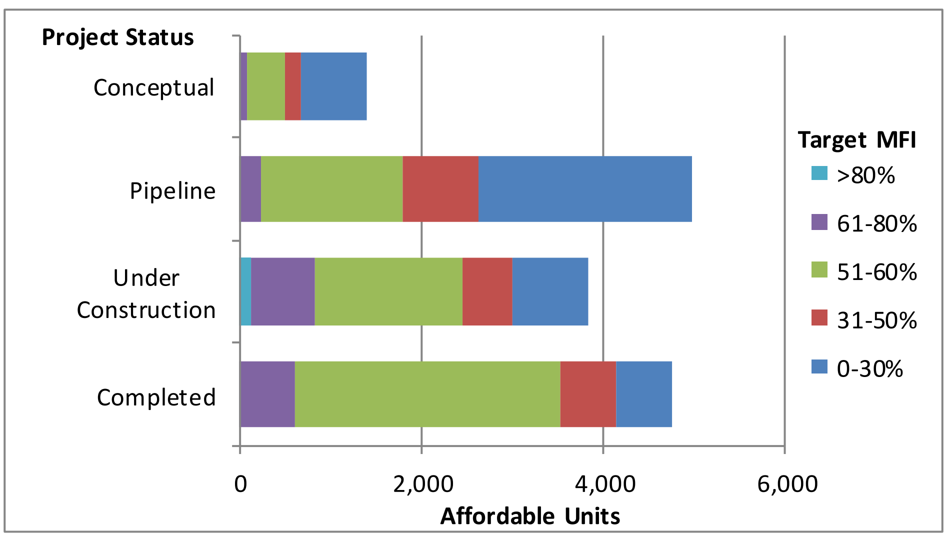
Figure 2: Continuum of Housing Programs



Source: DHCD.

The District's Comprehensive Housing Strategy Task Force report *Bridges to Opportunity* set a goal of 10,000 new and preserved affordable units by 2020. Over the past four fiscal years, the District has almost doubled its annual commitment of local funds to affordable housing, going from $114 million in FY 2013 to over $220 million in FY 2016 for major housing programs like the Housing Authority, the DC Housing Finance Agency and the Housing Production Trust Fund (HPTF). The District's Affordable Housing Tracker now lists 272 projects totaling over 15,000 units of either preserved or new affordable units in various stages of development across all of these tools. Affordable units from the IZ program will add approximately 23 percent to this total. However, only 11 percent of the units in the District's pipeline are for households earning between 60 percent and 80 percent of the MFI; the same income bracket where the vast majority of IZ units are being produced. Figure 3 below shows the distribution of these units by target MFI and development status. Units targeted for households earning between 60 percent and 80 percent of the MFI are shown in purple.

Figure 3: Affordable Units by Project Status and MFI



Source: DHCD

IZ therefore plays a very important role in the District's continuum of affordable housing need and tools by providing affordable units for households that are not otherwise served by other programs.

A. Inclusionary Zoning Program Basics

Inclusionary Zoning is a land-use tool used in over 500 jurisdictions across the country to integrate affordable housing units in otherwise market rate housing developments. IZ production of affordable units is therefore highly dependent on the location, type, size, and tenure of the market rate developments.

IZ is best used to provide modest levels of long-term affordable housing in high cost neighborhoods with strong housing demand where it would be prohibitively expensive to subsidize. IZ's goal is to help further vibrant neighborhoods of diverse household incomes. IZ is typically not a tool used to serve very low incomes.

IZ programs generally consist of five core components that can be adjusted to improve affordability, mitigate impact on land values, and improve efficiency. These are:

- A Minimum Percent of Units Required;
- Target Household Incomes;
- Establishing Housing Costs;
- Compensating Bonus Density; and
- Adminstrative Processes.

In addition, IZ programs have other elements including development standards, off-site flexiblity, and in some cities payments-in-lieu. Figure 4 below summarizes some of these components from a sample of cities from across the country and nearby jurisdictions.

Figure 4. Sample of IZ Programs

	AMI Targets			
Jurisdiction	Rental	Ownership	Percent of Units	Bonus Density
District of Columbia	50%-80%	50%-80%	8%-12.5%	20%
Chicago	60%	100%	10%	20%-30%
San Francisco	55%	90%	12%	by Plan Review
Montgomery County	65%	70%	12.5% to 15%	22%
Fairfax County	50%-65%	70%	5%-12.5%	20%

Source: Lincoln Institute for Land Policy, DC Office of Planning.

The District's IZ program design stems from Title 11 Zoning Regulations with program implementation enabled by the Inclusionary Zoning Implementation Act of 2006 and Chapter 22 Inclusionary Zoning Implementation in Title 10 Housing. Basic elements of the District's program include:

- Applicability to new construction of ten or more units and to existing buildings where an expansion of ten or more units represents a 50 percent increase in gross floor area;
- A minimum requirement of 8 percent to as much as 12.5 percent of units be affordable;
- Eligibility for households that earn equal to or less than 50 percent (Low-Income) and/or 80 percent (Moderate-Income) of the MFI depending on zone and type of construction;
- A requirements that the affordability be for the life of the project;

- A bonus density of 20 percent to permit more market rate units; and
- Housing costs are established by a purchase price / rent schedule based on 30 percent of the income limit for the household assumed to be occupying a unit type.

1. Applicable and Exempt Zones

IZ application by zone was initially established based on several criteria including:

- Theoretical ability to achieve bonus density within a given zone;
- Consistency of changes to the building envelope and bonus density with the Comprehensive Plan or historic character of a neighborhood;
- Not in conflict with federal interest; and
- Development capacity for sufficient growth.

2. Income Targets

The District's IZ program currently targets households earning equal to or less than 50 percent of the MFI, and/or households earning between 50 and 80 percent of the MFI (see map in Figure 13 on page 18). These requirements vary by zone. Figure 5 below shows how these income limits vary by household size and the types of employment fitting that income. For instance, a Fire and EMS Dispatcher earns approximately $61,152 per year.

Figure 5: IZ Income Limits and Sample Households

Family Size	Less than 50% MFI Income Limit	Less than 50% MFI Sample Job/ Household	Less than 80% MFI Income Limit	Less than 80% MFI Sample Job/ Household
1	$ 38,220	Security Guard	$61,152	Fire & EMS Dispatcher
2	$ 43,680	Kindergarten Teacher w / 1 child	$69,888	Healthcare Social Worker w / 1 child
3	$ 49,140	Secretary Admin Asst w / 2 children	$78,624	Registered Nurse w / 2 children
4	$ 54,600	Bank Teller & Personal Care Aide w / 2 children	$87,360	Shipping Clerk & Rehab Counselor w / 2 Children
5	$ 60,060	Delivery Truck Driver & Hostess w / 3 children	$96,096	Payroll Clerk & Pharmacy Aide w / 3 Children

Source: HUD, Bureau of Labor Statistics, DC Office of Planning

OP learned from housing counseling agencies that small moderate income households are not typical clients and often do not turn to government programs for assistance with affordable rental housing, yet based on Figure 1, many of them pay more than 30 percent of their income on housing. DHCD is committed to developing marketing and outreach strategies to inform similar households that housing assistance is available through the IZ program.

3. Setting Housing Costs

DHCD sets IZ unit housing cost through a Maximum Rent and Purchase Price Schedule published annually (see Section VII.F). The starting point of the schedule is total housing costs are set equal to 30 percent of the income limit for the household assumed to occupy the unit. Households who are therefore below the income limit must spend more than 30 percent of their income on the IZ unit. Steps used in establish IZ sales prices act to create a range of households who can afford the unit. However, there are no currently used similar steps for establishing the maximum IZ rents to create a range of households who can afford them.

IZ Ownership Pricing

Figure 6 below demonstrates the steps taken to establish the maximum sale price of an IZ 1-bedroom condominium. The household assumed to be living in the unit can afford $1,638 per month. An estimated condominium fee is deducted as is the property taxes for the unit. What remains is $1,152 for the principal and interest on a mortgage loan. DHCD uses a higher interest rate then currently available because changes in interest rates over time could threaten the affordability of the unit. Similarly, a review of IZ estimated and actual condominium fees found that IZ estimated fees are on average $154 or 84 percent higher than the actual condominium fees. Only one project had condominium fees slightly higher than the IZ estimated fees. This difference both helps expand the range of households who can afford the IZ price, but also serves as a buffer in case fees rise. A 2013 study conducted by Manna Inc found that condominium fees rose on average $181 or 74 percent the first five to six years after a project is completed.

A higher estimated condominium fee then the actual fees for that unit and an interest rate higher than currently available depress the purchase price and expand the range of households who can afford the unit. The table also shows the minimum income needed to afford the units when the average condominium fee of $228 and the current interest rate of 3.77 percent is used. In addition, IZ households also qualify for the District's Home Purchase Assistance Program (HPAP). The result is a range of households who can afford the unit down to an income of $51,963.

Figure 6: Maximum Sales Price Process and Affordability Test

Sample 1-Bedroom Condo @ 80% MFI		Target	Minimum
Income	1.5 people	$ 65,520	$ 51,963
Monthly Income		$ 5,460	$ 4,330
Max Housing Cost	30% of Income	$ 1,638	$ 1,299
Condo Fee	$0.61 x 625sf	$ 381	$ 228
Taxes	.0085 of $219,100*	$ 105	$ 105
Mortgage Payment		$ 1,152	$966
Maximum Loan	30-Year at 5.27%	$ 208,175	
Down Payment	5%	$ 10,925	
Sales Price		$ 219,100	

*Less homestead deduction of $71,400
Minimum 3.77% interest rate and average condo fee

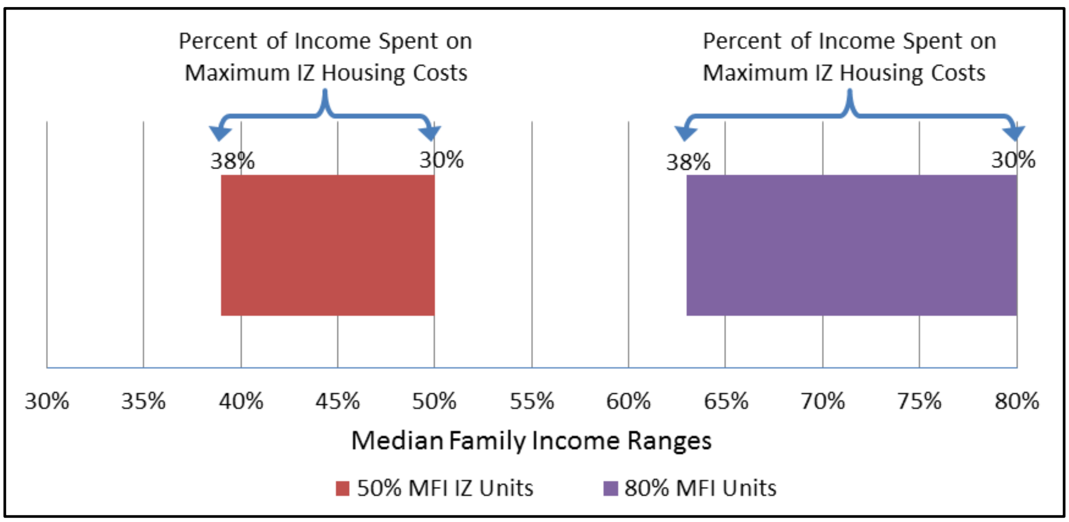
IZ Rental Pricing

Using 30 percent of the income limit is an industry standard for many affordable rental-housing programs including the Low-Income Housing Tax Credit (LIHTC) program and the District's Housing Production Trust Fund (HPTF). The only adjustment made is for estimated utilities that occupants have to pay out of pocket. Neither of these programs limit what percent of their income households must pay to afford the affordable unit. Only public housing caps what an actual household pays in housing costs to 30 percent of their income. Even Housing Choice Vouchers will only pay up to the Fair Market Rents (FMR) established by HUD, voucher holders must pay more than 30 percent of their income if their rent exceeds the FMR.

Working group members during the review process stated that many LIHTC credit projects in Central Washington and north through the Mid-City Area achieve rents right at 30 percent of the income limits, indicating that in many neighborhoods households just below 60 percent of MFI are willing to pay more than 30 percent of their income on housing. However, this may not be necessarily true in all neighborhoods of the District. A few stakeholders have said previously that this willingness to pay more than 30 percent of income changes has households approach 80 percent of the MFI. In fact, two thirds of surveyed IZ households who turned down IZ units set aside at the 80 percent MFI level responded that the units were too expensive.

Under the administrative regulations, DHCD does not refer any household to an IZ unit where the rent exceeds 38 percent of their income. Figure 7 illustrates the range of household incomes by MFI that can be referred for a given IZ unit. The figure illustrates that a household earning 63 percent of MFI can qualify for an IZ unit if they are willing to spend 38 percent of their income on the rent and utilities for the unit. Similarly, a household earning 39 percent of MFI can qualify for a 50 percent MFI unit.

Figure 7. Depth of IZ Affordability: Housing Costs at 30 Percent of Income Limit



Source: DHCD

DHCD has decided to hold the IZ rents constant over the next several fiscal years while the MFI rises in order to:

- Reduce the number of IZ households that will be housing cost burdened by the IZ rents;
- Broaden the range of households who be able to afford the IZ rents; and
- Improve the marketability of the IZ units overall to help decrease the length of time it takes to lease units; and
- Mitigate the impact on developers compared to an actual reduction in rents.

OP estimates that over the next several years, this very important action will expand the range of households who can qualify for the IZ rents, while mitigating the impact on developers compared to an actual reduction in rents. Figure 8 below illustrates how IZ costs will change from 30 percent of the income limit down to an eventual goal of 27 percent of the income limit.

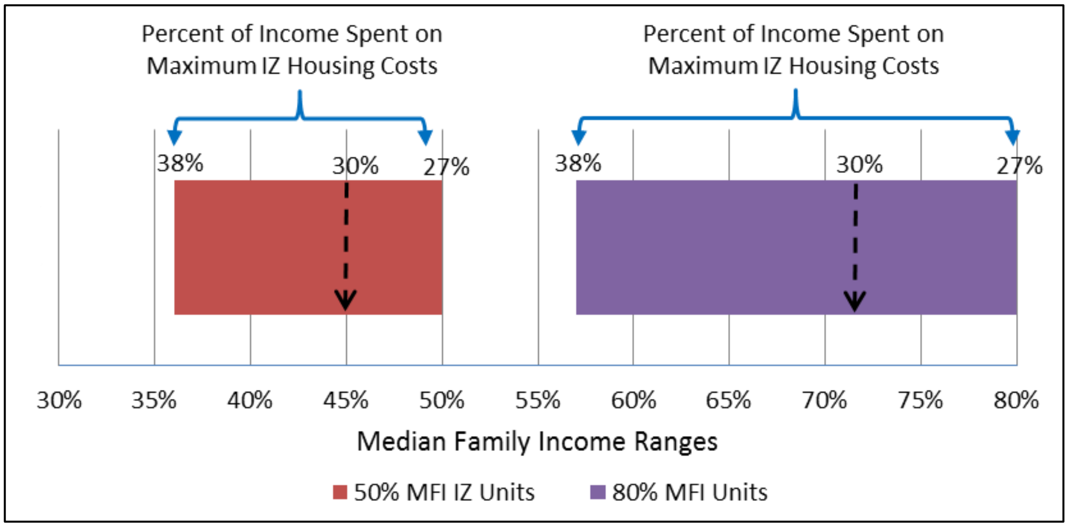
Figure 8: Forecast of the MFI and Changes in IZ Affordability

Year	MFI Forecast	80% MFI Studio Rent	Percent of Income	Affordable to MFI
2015	$ 109,200	$ 1,529	30.0%	80.0%
2016	$ 111,200	$ 1,529	29.5%	78.6%
2017	$ 113,300	$ 1,529	28.9%	77.1%
2018	$ 115,400	$ 1,529	28.4%	75.7%
2019	$ 117,600	$ 1,529	27.9%	74.3%

Source: DC Office of Planning

Figure 9 below illustrates the impact on the range of households IZ will serve. For example, the reduction in rents overtime relative to the rise in the MFI, will enable a greater number of households to live in IZ units without being burdened by housing costs and enable households down to 36 percent of MFI to qualify for a 50 percent unit and a households at 57 percent MFI to qualify for a 80 percent MFI unit.

Figure 9: Depth of IZ Affordability: Housing Costs at 27 Percent of Income Limit



Source: DHCD, Office of Planning

This will have an impact on development discussed in Section IV.B.3., but the approach and IZ rules will minimize the impact. Publishing this approach will allow developers to build that into their expectations as they test projects for financial feasibility. The administrative rules will address how existing IZ projects will be treated.

4. Bonus Density

In 2006, the Zoning Commission decided that if the bonus density was theoretically unavailable then IZ should not apply. OP conducted two analyses in order to test the bonus density was achievable. First, OP conducted a test of the permitted building envelope by zone (See Appendix Building Envelope Analysis). Second, OP reviewed 109 projects filing IZ applications, of which unsubsidized matter of right projects are summarized in Figure 11.

The building envelope analysis (see Section VII.B.) had two goals including estimating the degree of design flexibility within the envelope and identifying which zones had trouble theoretically achieving the bonus density. The analysis found that design flexibility1 generally declined from the combined IZ changes to FAR, height and lot occupancy, with the exception of three zones; the C-2-A, W-1, and the W-2. In these zones, IZ actually improved design flexibility. The analysis also found that in two zones the maximum FAR, including IZ bonus density, is not fully achievable under current height and lot occupancy permission. OP's set down report included proposed corrections to the C-2-C to provide access to the full bonus density permitted by IZ. The envelope analysis also determined that, even with the height and envelope changes proposed by the Applicant, the 22 percent bonus density was not fully achievable.

OP found that approximately 85 percent of IZ developments received an average bonus density close to the 20 percent provided by the program. Figure 10 below summarizes an analysis of 54 market rate projects that were matter of right development. The 15 percent of the projects that did not receive bonus density were typically well below their matter of right density due an inability to use significant portions of the site, or a business decision to not use steel and concrete construction in order to achieve the full height permitted by the zone. In some cases, historic structures limited the developer's ability to use the bonus density. In all cases, the inability to achieve the bonus density did not seem to impede the developments from happening.

Figure 10: Summary of Percent Bonus Density Achieved

	Unsubsidized MofR		Unsubsidized MofR w/BD		Unsubsidized MofR w/out BD	
Zone	Count	Average BD	Count	Average BD		Average BD
C1	3	26%	3	26%	-	NA
C2A	20	15%	17	21%	3	-20%
C2B	6	23%	6	23%	-	NA
C2C	2	-22%	1	14%	1	-57%
C3A	9	18%	9	18%	-	NA
C3C	1	-24%	-	NA	1	-24%
CR	3	13%	2	20%	1	0%
R5A	1	-32%	-	NA	1	-32%
R5B	5	28%	5	28%	-	NA
R5C	1	20%	1	20%	-	NA
R5D	3	-14%	2	20%	1	-82%
SP1	-	NA	-	NA	-	NA
SP2	-	NA	-	NA	-	NA
Totals	54		46		8	
	100%		85%		15%	

Source: DC Office of Planning

A similar review of BZA cases determined that 68 percent of projects received the full 20 percent bonus density or more when and overlay permitted. A similar pattern emerged with those projects that did not achieve bonus density. Conditions included undevelopable portions of the site, surplus development rights on sites with small adjacent structures, or historic structures limiting the mass of the addition. Most variances in these cases include parking when the bonus units required a shift to structured parking, and variances to loading, and roof structures. A minority of cases included variances that would permit greater FAR like courtyards, height, or lot occupancy.

[1] OP defines this as the ability to achieve FAR limits without having to build to the full extent of the permitted height and lot occupancy.

5. IZ PRODUCTION

Figure 11: Total IZ Production

Status	Projects	IZ Units
Completed	37	338
Occupied		236
In Marketing		102
In Construction	33	242
Planned	39	320
Sub-Total	**109**	**900**
Pre-IZ Application	160	3,300
Total	**269**	**4,200**

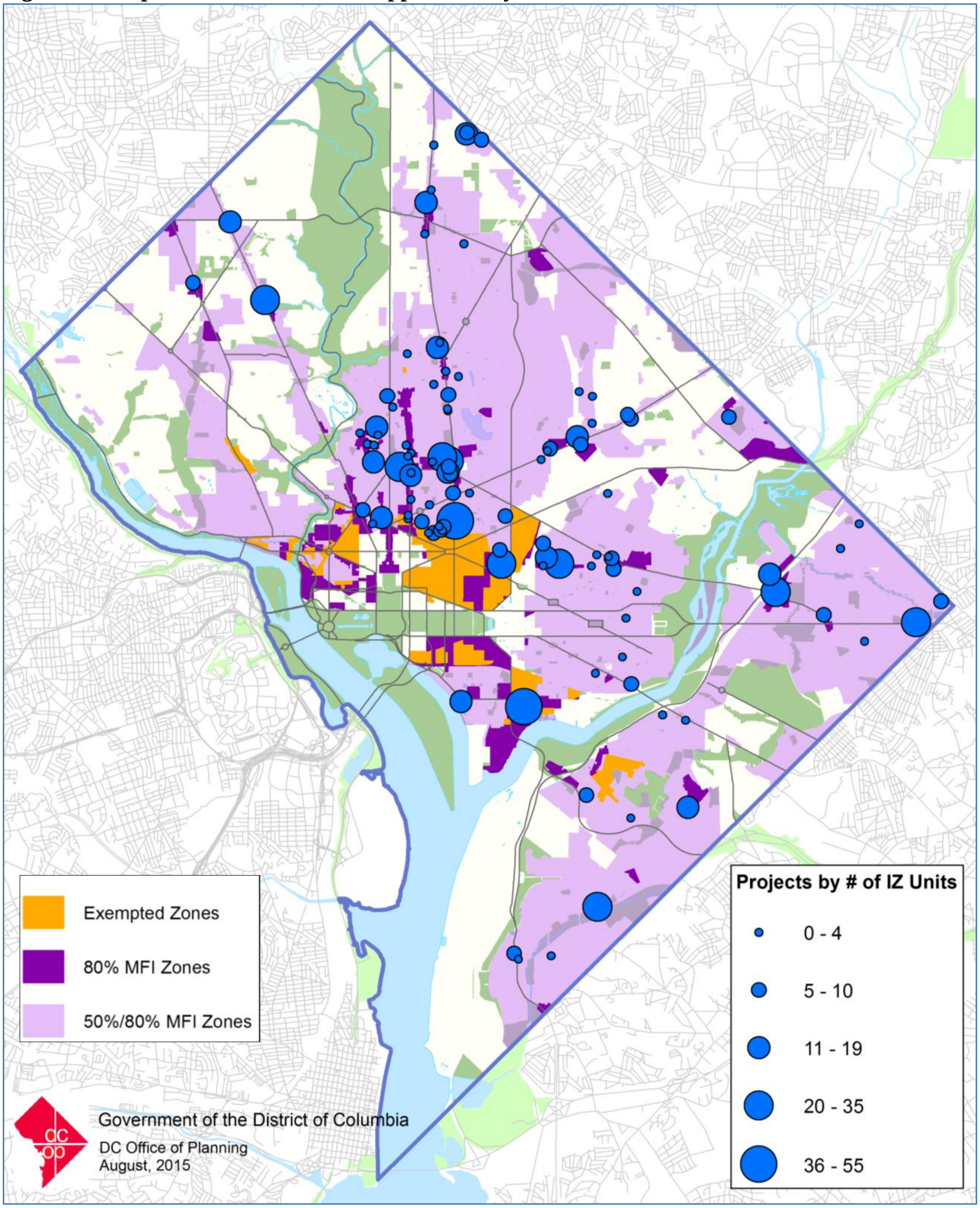
After a slow start due to the aftereffects of the financial collapse of 2007, IZ production accelerated to where Fiscal Year 2015 saw over 29 projects and 212 affordable IZ units file IZ applications for a total of 109 projects and 900 units since the program's inception.[2] Of these, 37 projects have delivered with 236 units occupied and another 102 still in marketing. Thirty-three projects are under construction with 242 units and 39 projects that have yet start construction will add another 320 units. OP tracks another 3,300 IZ units in various stages of development that have yet to file their IZ applications. This brings the total number of potential IZ units over the next several years to over 4,200 units. This is more than Montgomery County's portfolio after over 30 years due to the number units where affordability controls has expired.

Approximately 78 percent of units are set aside for households at 80 percent MFI and 22 percent are for households at 50 percent MFI. Rental units represent 81 percent of IZ units while ownership units represent 19 percent. The vast majority (80 percent) of units are small studios and one-bedrooms with two-bedroom units representing only 20 percent.

Projects are scattered across the city with the main concentration in Central Washington where there is the greatest private sector market rate activity (see Figure 12 on page 11). The map also shows zones in light purple, which must split the affordable units between households at 50 percent and 80 percent of the MFI. Areas in dark purple are required to set aside units only at 80 percent MFI. Orange areas are exempt from IZ requirements.

[2] These numbers include 26 subsidized projects with 254 IZ units managed directly by the developer and not by DHCD staff, but that are required by IZ to remain affordable after subsidies expire. OP uses this number because the bonus density offered by the IZ program permits subsidized affordable projects to create more affordable units on the same property than previously possible.

Figure 12: Map of IZ Production and Application by Zone



As stated earlier in Section III.C., IZ production is dependent on the location, type, size, and tenure of the market rate developments. Therefore, IZ production reflects current development patterns.

B. IZ ADMINSTRATION

1. Process

The District divides IZ program management between DCRA and DHCD. The DC Zoning Administrator reviews and approves projects filing their Certificates of Inclusionary Zoning Compliance (CIZC) as part of the building permit process, ensures the proper covenants are recorded by completion and inspects the units as a normal part of the Certificate of Occupancy (CofO) process. DHCD's responsibilities include publishing an annual Maximum Rent and Purchase Price Schedule, receiving the Notice of Availability (NOA) indicating the units are ready for marketing, guiding the households through the process, and ongoing monitoring, stewardship and enforcement. DHCD requires qualified households entering into the lottery to follow the deadlines below to stay in the process:

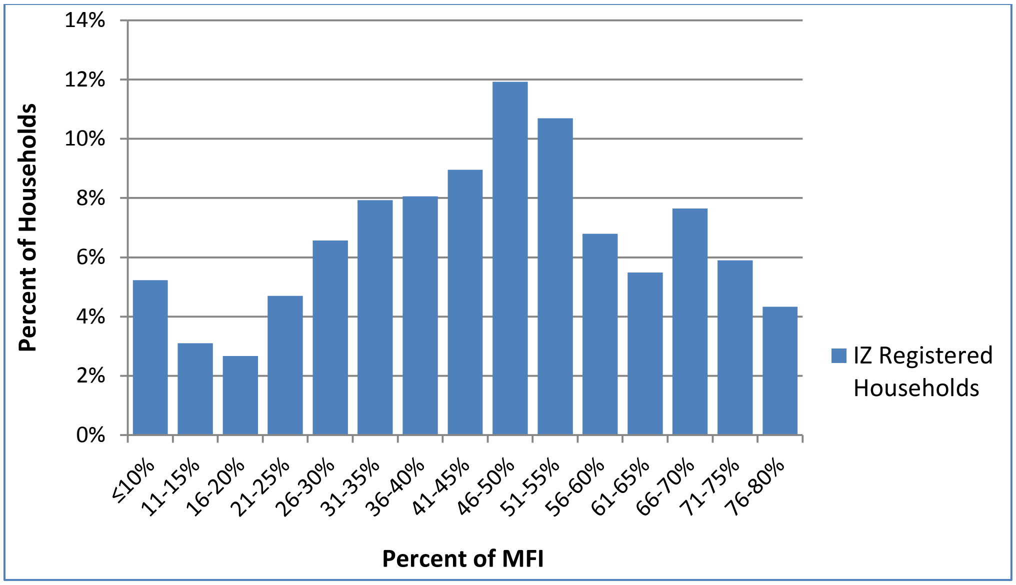
- Within 17 days households confirm interest in property
- Within 45 days households must submit required documents
- Within 60 days households must sign lease agreement or for-sale contract.

Over the past year, DHCD has made significant strides to reduce the length of time it takes to match units coming on line with potential occupants. DHCD has reduced the median time from lottery to lease/sale closing from over 200 days to a median of 102 days for rental and 139 days for for-sale IZ units. This dramatic improvement over the past year eliminates one of the concerns discussed in section III.A. of this report. The single biggest administrative change that caused this improvement was requiring households to express interest in the lottery for a particular project. Prior to 2014, DHCD was randomly selected households that fit the profile of the available units regardless if they were interested in a project's location or amenities. DHCD has a goal of reducing processing time from lottery to occupancy of 60-90 days.

2. Metrics and Demographics

Research included a review of registrant applications and a survey of households to better understand the demand for IZ units. Figure 13 below shows the distribution of households by income on the lottery registry. The median household is in the 46 to 50 percent of MFI range and the simplest majority of households is found between 31 percent of and 60 percent of the MFI.

Figure 13: Distribution of Registered Households by MFI

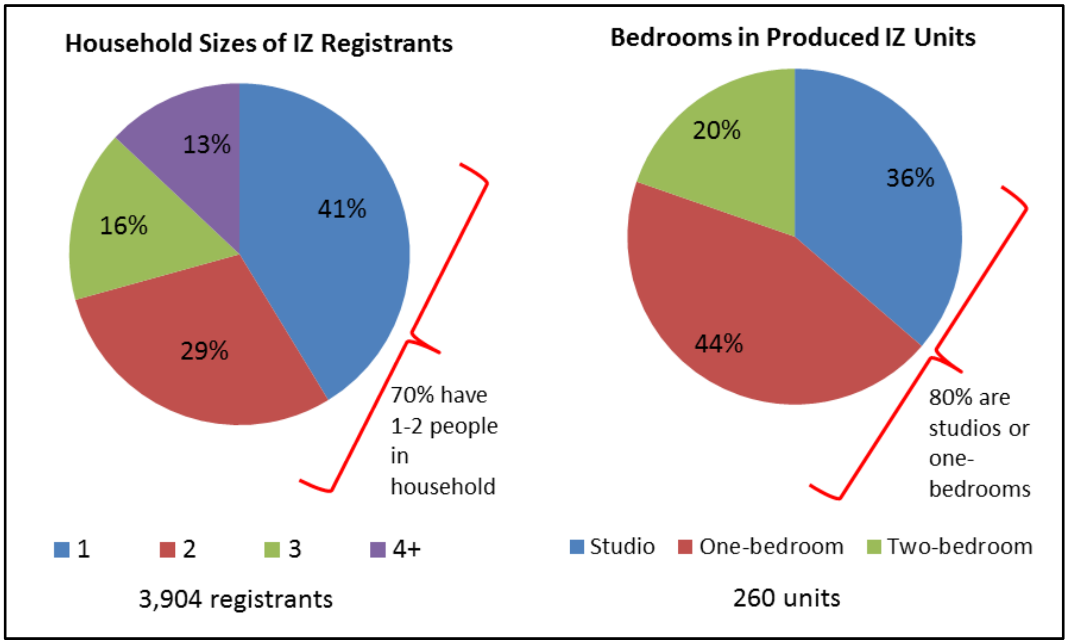


Source: DHCD

It appears from this data that, since 78 percent of IZ units are targeted for households at 80 percent MFI, but only 18% percent of registered households can afford those units, there is a mismatch between demand and IZ production. However, comments from organizations contracted to do IZ outreach and education suggest that the problem may not be one of demand but of marketing. The profile of households on the registry do not represent the need, but only a sample of people who seek help finding affordable housing. DHCD is committed to developing marketing strategies to inform households at the higher income ranges that housing assistance is available through the IZ program.

In other ways the IZ program is closer to matching the demand for affordable housing represented by households on the registry. Figure 14 below compares the size of households to the type of units that have been delivered. 70 percent of IZ registrants are one and two person households and 80 percent of IZ units are studio and one-bedroom units; the remaining 20 percent of units are two-bedrooms. Just recently IZ delivered its first four bedroom unit, but there are a few row house projects that are expected to deliver more over the next year.

Figure 14: Distribution of IZ Registrants by Households and IZ Units by Size



Source: DHCD

3. Proposed Administrative Regulations and Process Changes

DHCD continues to improve the administration and stewardship of IZ units. As mentioned, there are several steps in various stages of implementation. DHCD has already implemented steps such as asking registrants to express interest in a particular project prior to holding a lottery or requiring registrants to receive both IZ program education and also Home Buyer Education.

New administrative regulations are ready to be published, but are on hold due to the potential for further necessary changes should the zoning regulations change significantly. For example, proposed administrative rule changes:

- Enable developers, should they choose, to forego the lottery process upon submission and approval of a marketing plan; and
- Require registrants interested in purchasing to receive a pre-qualification letter from a lender prior to referral to a property to ensure credit worthy homebuyers are referred to the developer.

DHCD continues to work with lenders who are willing to participate with the program. There are now five lenders listed on the IZ program website that are willing and ready to finance the purchase of IZ homes. Prior to 2014, there were no participating IZ lenders, which meant lenders had to review and approve the covenants for each individual loan application separately.

Finally, DHCD is researching and implementing ways to improve marketing and outreach of the program to the households it targets. In fact, in the past year the size of the pool nearly doubled in size to 3,900 households. A larger pool of registrants, particularly at the higher income range, will enhance the lottery and speed the occupancy process.

C. PROPOSED ALTERNATIVES

Per the request of the Zoning Commission, Figure 15 below provides a summary comparison of the Applicant's and OP's proposed shifts in the percent of IZ units required, target incomes and bonus density.

Figure 15: Side by Side Comparison of Applicant and OP Proposed Amendments

	Current IZ	Applicant's Proposal	OP's 1A Proposal (Revised)	OP's 1B Alternate
Income Targets	50% and/or 80% MFI[1] depending on zone, regardless of tenure	Targets 50% MFI for Rental; 70% MFI for ownership	Adds C-3-A, C-2-B, SP-1 & W-2 to zones required to do both 50% and 80% of the MFI	Targets 60% MFI for Rental; 80% MFI for ownership
IZ Percent of Project	Greater of 8%-10% of residential square footage or 50%-75% of the bonus density achieved*	Increases requirement to 12% of a residential square footage for all projects.	Reduce requirement to 8% of residential use; eliminate 50% of bonus density requirement	No proposed changes
Bonus Density & Building Envelope	20% Bonus density plus many changes to height and lot occupancy	Increases bonus density annd significant increases to height and lot occupancy	No additional density, some proposed changes to height	No additional density, some proposed changes to height
Setting Housing Costs	30% of income limit for unit; ownership adjustments for interest rates and condo fees; utilities for rental	25% of income limit for unit	Adjust rents to 27% of housing costs	30% of income limit for unit; ownership adjustments for interest rates and condo fees; utilities for rental
Comments	DCBIA believes bonus density not sufficiently available	Applicant seeks greater affordability and expands to Downtown. Significant negative impacts to land values	Preferred by DCBIA, but with adjusted income targets 50/50 split betwenn 65% & 80% MFI	Preferred by applicant. DC BIA very concerned about impact to rental without additional incentives

* Varies by zone and construction type; 75% of maximum bonus density equals 12.5% of the residential square footage.

1. Applicant's Proposal – Adjusts Rents and Targets Household Incomes by Tenure of the IZ Development:

The Applicant's petition proposed four major shifts to the IZ program. First, it shifted income targets of IZ rental development to 50 percent of MFI and IZ ownership developments to 70 percent MFI. Second, it increased the percent of required IZ square feet to 12 percent of the total gross residential area of the project. Third, it increased height for many zones and removed lot occupancy restrictions for IZ developments. The proposal also shifts housing costs to 25 percent of the income limit. Finally, the applicant's proposal applies IZ to areas of Central Washington that are currently exempt from inclusionary requirements. This proposal combines targeting lower income households and reducing the rents to those households with additional bonus density and changes to height and lot occupancy to access that additional density. The shift to target ownership units to 70 percent of the MFI is in conflict with the Act.

2. OP Options 1A and 1B

In response to the applicant's petition potential impact on development and concerns over consistency with the Comprehensive Plan, OP began to identify potential alternatives and conducted research to refine them. OP reviewed national best practices to see how other cities target their IZ programs (see Figure 4) and completed a housing burden analysis to determine how housing costs in the District affected households across the income spectrum. OP looked at changes in the building code, which permitted greater height and density without the expense of steel and concrete construction. The research resulted in two options discussed below

Option 1A (OP's Recommended Option) – Adjust Rents and Expand Zones Required to Split Household MFI Targets to 50 percent & 80 percent MFI and Eliminate IZ Requirement tied to Bonus Density:

This option is combined with changes to the rent schedule to reduce housing cost burdens and expand the range of households who can afford the units. It adds five zones (C-2-B, C-2-B-1, C-3-A, SP-1, and W-2 see map on page VII.D) that must split their affordability requirement between both 50 percent and 80 percent MFI households. The goal was to test if the changes to the building code that permit greater height and density without converting to steel and concrete construction and the savings that enables could be leveraged to achieve deeper affordability.

In addition to what was proposed at set down, OP recommends reducing the required percentage of square feet by eliminating the requirement connected to the percent of bonus density achieved. This is due to the economic impact of the change to residential projects, which is discussed in Section IV.B. This option will decrease the total number of IZ units produced in these zones. In a project that is entirely residential the loss is minimal, but in a project with a significant amount of non-residential uses it the total reduction in IZ square footage becomes greater.

Figure 16 demonstrates the impact of this change in production to a project on a 20,000 square foot lot in the C-2-B zone with 84,000 square feet of gross floor area. As stated in a project with no retail the IZ requirement would only decrease from 7,000 to 6,720 square feet. However, a project with 16,000 square feet of retail would see its IZ requirement decrease from 7,000 square feet to 5,440 square feet. The change would produce approximately 3 units for households at 50 percent of the MFI.

Figure 16. Impact of Affordability of Option 1A

	Base IZ	Option 1A (Rev)
Lot Area	20,000	
FAR (Base/IZ)	3.5/4.2	
Base SqFt	70,000	
Bonus SqFt	14,000	
Total SqFt	84,000	
Retail SqFt	16,000	
Residential SqFt	68,000	
IZ Requirement		
8% of Res SqFt	5,440	5,440
50% of Bonus	7,000	-
50% MFI	-	2,720
80% MFI	7,000	2,720

OP estimates based on historical production that this change would shift the distribution of future IZ units to 36 percent for households at 50 percent of MFI and 64 percent of units for households at 80 percent MFI.

Option 1B – Target Household Incomes by Tenure of the IZ Development: Rental at 60 percent MFI and Ownership at 80 percent MFI:

This option aligns the target households more closely to the affordability gaps in the District's supply by varying them based on the tenure of the building. OP based this option on the analysis of census data that estimated the gap in supply and demand becomes significant at 60 percent of MFI for rental and 80 percent MFI for ownership. Other IZ programs across the country apply similar targets to their IZ programs.

This option does not increase the total number of units, and conversations with affordable housing developers suggested there is less of a need to reduce the rents to create a band of households who can both meet income qualifications and afford the units. However, without this additional adjustment many households would still be housing cost burdened by IZ units.

Note: The nature of 1B's shift to rental targets to 60 percent MFI requires an amendment to the Inclusionary Zoning Implementation Act of 2006 because the act specifically identifies households at both 50 percent and 80 percent of MFI. Therefore this option cannot be implemented without the Council amending the law.

II. COMPREHENSIVE PLAN ANALYSIS

The Applicant proposed a ten (10) foot height increase for all IZ-applicable matter-of-right zone districts. In order to determine if such an increase in height is possible and still be considered "not inconsistent" with the Comprehensive Plan, OP compared the corresponding Comprehensive Plan Future Land Use Map (FLUM) designations with height regulations for the matter-of-right zone districts where IZ is applicable. Specifically, OP compared the policy guidance with the zone district regulations where the CR, C-1, C-2-A, C-2-B, C-3-A, W-1, W-2, W-3, SP-1, SP-2 districts occur. The policy guidance of the FLUM of each location of the zone is important as it reflects certain local, neighborhood sensitivities for height, density and massing at a more fine-grain level, where, overtime, the public has made known its preferences for development.

Each of the applicable zone districts listed above were found to have between five and 17 different FLUM designations that range from "High" to "Medium" to "Moderate" to "Low" levels of intensity of commercial or residential development. Each FLUM designation generally corresponds to a certain height ranges.

The C-2-A and C-2-B zone districts, which occur frequently in the commercial corridors of the District, illustrate OP's findings for every district studied. In most locations, the C-2-A and C-2-B districts abut established residential neighborhoods and as a result, frequently include a "Moderate" or "Low" FLUM designations. This typically guides matter of right development to heights of no greater than 65 feet (the C-2-B zone could also achieve 90 feet through a Planned Unit Development) or 50 feet (up to 65 feet through a Planned Unit Development), respectively. The C-2-A District permits a matter of right matter of right height of 50' with IZ bonus and C-2-B permits a matter of right matter of right height of 70' with IZ bonus. The addition of 10' or an additional story to these districts result in ultimate buildings heights of 60' or 80' respectively as a matter of right. Buildings of such heights would be inconsistent with the FLUM designations. This circumstance of inconsistency whereby greater height than planned occurs with at least three (3) FLUM designations for each of the zone districts studied.

Conversely, in almost all zones studied, there are certain locations with "High" or "Medium" FLUM designations where it would appear an additional 10' or (1) one story may be acceptable and fit within the FLUM designations. However, a very fine-grained study would be required to determine exactly where an additional 10' or one-story of height may be acceptable to the surrounding neighborhood.

In conclusion, certain locations of certain zone districts may be able to accommodate an additional 10' of height and others may not. OP can conclusively state that in each of the studied districts, there will be at least three (3) or more locations where an additional 10’ of height or one-story would be inconsistent with the FLUM designation for future development. As such, OP is unable to support a broad-brush additional height of 10’ to the zone districts the Applicant has proposed, as a more fine-grain approach is required to accommodate neighborhood sensitivities.

III. ECONOMIC IMPACT ANALYSIS

To estimate the potential impacts of changes to IZ on residential development OP developed a residual land value model and worked with a number of developers including those who are part of the Applicant’s petition, architects and other development professionals to finalize inputs to the model and test its behavior. The goal was to approximate a prototypical project in the District that would be financially feasible in one or more neighborhoods. OP’s analysis and level of detail is very similar a model developed by the Cornerstone Partnership that can be found at their website www.affordableownership.org. This section provides a summary of OP’s analysis.

A. <u>OP Options 1A and 1B</u>

Figure 17 below is a summary of the impacts to land values of OP’s proposed Options 1A and 1B. In an attempt to understand the relative importance of the impact to individual zones, the zones are ranked in order of their potential future development capacity. As example, OP estimates that there is approximately 24.7 million square feet of net new development available in the C-2-A zone district.

The analysis supports both OP’s original 2006 analysis and statements made by developers that IZ’s current design favors rental developments and that IZ bonus density increased land values in zones that were only required to set aside units at 80% of the MFI (ex. 16.9% increase for rental in the C-3-A) . While the magnitude of that increase was unexpected, the goal was to err on the side of helping residential projects in commercial mixed-use zones where they must compete for land with office and hotel uses. In 2006, with residential development having just started in DC, the fear was that IZ affordability requirements could reduce a residential developer’s ability to offer a competitive price for land. A negative impact could have potentially resulted in a reduction of new residential units in favor of office construction.

Figure 17: Summary Impact Analysis by Zone Ranked by Total Development Capacity

Rank	Zone	Square Feet Development Capacity	Percent of Capacity	Current IZ on 2009 Pre-IZ Land Values Rental	Current IZ on 2009 Pre-IZ Land Values Ownership	OP 1A on Current Land Values Rental	OP 1A on Current Land Values Ownership	OP 1B on Current Land Values Rental	OP 1B on Current Land Values Ownership
1	C-2-A	24,705,367	18%	-0.4%	-4.9%	-4.6%	0.0%	-4.0%	4.9%
2	CR	24,360,707	18%	18.9%	4.1%	-3.2%	-4.1%	-1.9%	0.0%
3	C-3-A	23,210,803	17%	16.9%	7.5%	2.4%	-2.5%	3.1%	0.0%
4	R-5-A	13,296,429	10%	-5.4%	-7.7%	-6.8%	0.0%	-5.2%	7.2%
5	R-5-D	9,464,705	7%	-0.1%	-4.2%	-5.4%	0.0%	-4.2%	4.8%
6	C-2-B	7,998,179	6%	15.1%	7.6%	-8.5%	-2.6%	-7.9%	0.0%
7	R-5-B	7,303,141	5%	-1.2%	-5.2%	-5.0%	0.0%	-3.8%	5.2%
8	C-3-C	6,886,802	5%	13.7%	0.4%	-4.2%	-4.2%	-3.0%	0.0%
9	C-2-C	3,807,195	3%	-3.9%	0.4%	1.1%	-1.2%	2.2%	0.0%
10	W-3	3,609,595	3%	18.9%	4.1%	-3.2%	-4.1%	-1.9%	0.0%
	Sub-Total	124,642,923	92%						

Source: DC Office of Planning.

Red outline reflects zones that are proposed to change; other zones are presented for evaluation purposes.

Figure 17 shows how OP's proposed Options 1A and 1B affect land values across different zones. Option 1A measures the total impacts of a combination of reducing the rents down to 27 percent of the income limit to expand the range of households who could afford the IZ units and requiring zones to split their requirement between 50 percent and 80 percent of the MFI. Option 1A only amends four zones (C-2-B(1), C-3-A, SP-1 & W-2) and only two of those had development capacity in the top ten. The other zones (CR, C-3-C, C-2-C and W-3) in the table are presented for evaluation purposes. Option 1A has a negative impact to land values[3] of rental projects ranging from negative 3.2 percent (W-3) to as much as a negative 8.5 percent (C-2-B). Ownership projects were only affected in zones where requirements shifted from just 80 percent MFI to split between 50 percent and 80 percent MFI.

Option 1B measures splitting the requirements by tenure of the building; 60 percent of the MFI for rental and 80 percent of the MFI for ownership projects. 1B did not include reducing the rents as well, but keeps them at 30 percent of the income limits. The table shows that 1B had similar impacts to rental development as 1A, but had positive impacts for ownership projects where the requirement shifted from being split between 50 percent and 80 percent MFI to solely at 80 percent.

The major difference between the two proposals is that 1B happens all at once and has disparate impacts between rental and ownership projects. 1A the impacts between tenure are comparable and changes to the rent schedule can be implemented over time.

B. Changes to the Maximum Purchase Price / Rent Schedule

The broadest and most significant impact of Option 1A comes from changes to the housing cost assumptions used to establish IZ rents. In Figure 17 the only impacts due to changes in zoning are in the C-2-B and C-3-A (CR, C-3-C, C-2-C and W-3 for evaluation only). The impact to all the other zones in the table is due to the changes in the schedule. Due to the broad and significant level of impact, changes to the price schedule need to be implemented over time. DHCD is proposing to hold IZ rents constant as the MFI changes over the several years. Figure 17 presents the impact with the assumption that they all happen at once. Figure 18 below focuses more narrowly on OP's Option 1A's impact on rental

[3] Positive impacts to land values for rental development stem from the inclusion of the parking reductions approved as part of the Zoning Regulations Review (ZRR) process and the correction made to the C-2-C to add 10 feet in height.

development to better understand how individual modifications affect residential development and tests the impact of a gradual change in the rent schedule.

From left to right it shows the cumulative impacts of ZRR changes in parking, requiring deeper affordability in the C-3-A and C-2-B zones, removing the requirement tied to bonus density and finally the subsequent impacts of holding rents constant over the next several years as the MFI rises highlighted in red. For example, the C-3-A saw a reduction in the parking requirement that enabled the tested project of 100 units to go from two levels of parking to one. This potentially increases the land values by 12.5 percent. The amendment to require projects in the C-3-A to split IZ units between 50 percent and 80 percent reduces the savings from ZRR parking reductions to 5.4 percent. Removing the IZ requirement based on bonus density helps cumulative benefits to land values back up to 7.2 percent. Finally, holding IZ rents constant will impact development as well. In Figure 17 above, the table's numbers reflect the impact if all the changes happened all at one time. Figure 18 illustrates how changes to the rent schedule might be felt over time as the MFI rises and IZ housing costs drop from 29 percent to 28 percent of income. Due to all the other factors that change over time, such as construction costs, rents, cap rate etc; actual land values may not change.

Figure 18. Option 1A (Revised) Impact on Land Values of Rental Development

Zone	ZRR Parking Change	Split Units 50/80	Remove Percent of Bonus	29% of Income	28% of Income
C-2-A	0.0%	NA	NA	-1.5%	-3.1%
CR*	14.4%	NA	NA	12.2%	10.1%
C-3-A*	12.5%	5.4%	7.2%	6.1%	5.1%
R-5-A	0.0%	NA	NA	-2.3%	-4.5%
R-5-D	0.0%	NA	NA	-1.8%	-3.6%
C-2-B	0.0%	-5.9%	-4.5%	-5.4%	-6.2%
R-5-B	0.0%	NA	NA	-1.7%	-3.3%
C-3-C*	13.7%	NA	NA	11.5%	9.2%
C-2-C*[2]	17.9%	NA	NA	15.8%	13.7%
W-3*	14.4%	NA	NA	12.2%	10.1%

* ZRR Parking reductions triggering signifcant cost savings

[2] Includes proposed correcting amendment to add 10 feet in height.

OP recommends against applying the savings from ZRR parking reductions toward deeper IZ affordability. The model assumes the savings from the parking reduction is fully captured by land values. In actuality some of the value will increase the developer's return, but some of the value will be captured by lower rents as previously marginal sites become economically feasible and increase the overall supply of housing. ZRR's parking reductions were an important step toward achieving broader affordability across the District.

C. <u>Applicants Petition</u>

The applicant's proposal combined reducing maximum rents two 25 percent of the income limit and targeting 50 percent of the MFI for rental and 70 percent of the MFI for ownership. This had a correspondingly even larger negative impact on land values than either of OP's proposals shown in Figure 18. In some cases the impact was even more significant because to access the bonus density, the additional height provided by the applicant's proposal required a change in construction methods from stick frame to steel and concrete construction. The combined impacts of targeting lower income households, reduced rents to those households, along with more expensive construction resulted in impacts to land values that reached negative 83.5 percent in the C-2-B zone. Even the C-2-A zone, which had one of the more moderate impacts, still saw a reduction of land values of negative 6.6 percent.

D. Economic Impact Model

OP chose a residual land value method to test the impacts of proposed amendments because of the technique's ability to evaluate the relative impacts of the proposed changes to both rental and ownership developments. In 2006 OP evaluated the impacts of IZ by measuring changes to a developer's return, however since rental and ownership investors require different rates of return it was not possible to measure the relative impacts. There were several major assumptions including:

- Economic reason to maximize development rights including height and bonus density
- IZ and market units have the same construction costs
- Marginal construction costs stay the same until increase in stories trigger use of steel and concrete
- IZ units are distributed across the lower half of floors
- IZ units are permitted to be smaller than market units

The model tries to approximate a financially feasible prototypical project that would occur in one or more of the District's neighborhoods where there is already significant development interest. The analysis was built off inputs from the current Maximum Purchase Price / Rent Schedule, published reports from Delta Associates, CBRE and others, industry standards, zoning requirements, and individual and group discussion with industry professionals including those representing the Applicant. The table below summarizes the analysis for a 100-unit rental project in the C-2-A zone district.

The summary shows that the current form of IZ has a modest negative impacts of negative 0.4 percent on land values from an otherwise market rate project. It also shows the impact of moving the rents to 27 percent of the income limit.

Figure 20. Sample of IZ Economic Analysis of Option 1A Rental

C2A Rental Scenario						
		Base Market Rate Project				
	Factor	Per NSF	Per Unit	Project	Base IZ	Scenario IZ
Monthly Rent		$ 3.33	$ 2,101	$ 210,077	$ 241,831	$ 239,626
Parking Revenue	$ 200	$ 0.21	$ 130	$ 13,000	$ 13,000	$ 13,000
Annual Income		$ 42.41	$ 26,769	$ 2,676,926	$ 3,057,974	$ 3,031,506
Vacancy/Economic Loss	5%	$ 2.12	$ 1,338	$ 133,846	$ 152,899	$ 151,575
Operating Expenses	33%	$ 13.99	$ 8,834	$ 883,386	$ 1,060,063	$ 1,060,063
RE Taxes (Included in OE)		$ 4.70	$ 2,970	$ 296,998	$ 330,160	$ 325,661
Net Operating Income		$ 26.29	$ 16,597	$ 1,659,694	$ 1,845,012	$ 1,819,868
Cap Rate	4.75%					
Estimated Value		$ 553.52	$ 349,409	$ 34,940,932	$ 38,842,363	$ 38,313,015
Hard Costs	$ 158	$ 192.68	$ 121,631	$ 12,163,110	$ 14,595,732	$ 14,595,732
Parking	0.50	$ 36.68	$ 23,156	$ 2,315,625	$ 2,315,625	$ 2,315,625
Soft Costs	23%	$ 52.75	$ 33,301	$ 3,330,109	$ 3,889,612	$ 3,889,612
Contingency	5%	$ 11.47	$ 7,239	$ 723,937	$ 845,568	$ 845,568
Land Costs		$ 143.05	$ 90,302	$ 9,030,224	$ 8,994,095	$ 8,576,522
Hurdle Rate/Minimum Return	26.8%	$ 116.88	$ 73,779	$ 7,377,927	$ 8,201,731	$ 8,089,957
Total Costs		$ 553.52	$ 349,409	$ 34,940,932	$ 38,842,363	$ 38,313,015
Return		26.8%	26.8%	26.8%	26.8%	26.8%
Impact to Land (Market to IZ)					-0.4%	-5.0%
Impact to land (IZ Current to IZ Scenarios)						-4.6%
Notes:						
Base IZ = 75% of Bonus @ 65% AMI @ 30% of Income with 20% Bonus Density and 0' Height Bonus						
Scenario = 75% of Bonus @ 65% AMI @ 27% of Income with 20% Bonus Density and 0' Height Bonus						

A similar analysis completed for condominium developments. The table below illustrates how Option 1B, which shifted the targets for condominium developments from both 50 percent and 80 percent MFI to only 80 percent MFI. The table shows how the current IZ program had negative 4.9 percent impact on land values over a market rate project by reducing land from $10.2 million to $9.7 million. Option 1B shift to target a higher average income helped the project's land value 4.9 percent from $9.7 million to $10.2 million.

Figure 21. Sample of IZ Economic Analysis of Option 1B Condominium

C2A Condominium Scenario						
		Base Market Rate Project				
	Factor	Per NSF	Per Unit	Project	Base IZ	Scenario IZ
Unit Sales Revenue		$ 612	$ 601,741	$ 40,918,411	$ 45,079,112	$ 45,734,094
Parking Revenue	$ 30,000	$ 31	$ 30,441	$ 2,070,000	$ 2,070,000	$ 2,070,000
Total Revenue		$ 643	$ 632,183	$ 42,988,411	$ 47,149,112	$ 47,804,094
Cost of Sale	5%	$ 32	$ 31,609	$ 2,149,421	$ 2,357,456	$ 2,390,205
Warranty per Unit	$ 2,500	$ 3	$ 2,500	$ 170,000	$ 170,000	$ 170,000
Net Revenue		$ 609	$ 598,073	$ 40,668,990	$ 44,621,657	$ 45,243,889
Hard Costs	$ 168	$ 205	$ 201,293	$ 13,687,902	$ 16,425,483	$ 16,425,483
Parking	0.50	$ 37	$ 36,149	$ 2,458,125	$ 2,458,125	$ 2,458,125
Soft Costs	23%	$ 56	$ 54,612	$ 3,713,586	$ 4,343,230	$ 4,343,230
Contingency	5%	$ 12	$ 11,872	$ 807,301	$ 944,180	$ 944,180
Land Costs		$ 153	$ 150,469	$ 10,231,877	$ 9,730,864	$ 10,203,613
Hurdle Rate/Minimum Return	31.6%	$ 146	$ 143,679	$ 9,770,198	$ 10,719,775	$ 10,869,258
Total Costs		$ 609	$ 598,073	$ 40,668,990	$ 44,621,657	$ 45,243,889
Return		31.6%	31.6%	31.6%	31.6%	31.6%
Impact to Land (Market to IZ)					-4.9%	-0.3%
Impact to land (IZ Current to IZ Scenarios)						4.9%
Notes:						
Base IZ = 75% of Bonus @ 65% AMI priced @ 30% of Income with 20% Bonus Density and 0' Height Bonus						
IZ Scenario = 75% of Bonus @ 80% AMI @ 30% of Income with 20% Bonus Density and 0' Height Bonus						
Land Cost in Gross Square Feet				$ 126	$ 100	$ 104

The tables below illustrate sample impacts of the Applicant's proposal on rental and condominium projects and demonstrate the deeper affordability's impact on development. Land values for a rental project in the C-2-A were negative 22.4 percent, whereas the condominium scenario saw a benefit of 4.1 percent. This was relatively minor compared to projects in the C-2-B which saw declines in land value of 83.5 percent for rental projects and 62.6 percent for condominiums because the additional height required to access the density triggered a change to more expensive steel and concrete.

Figure 22.Sample of IZ Economic Analysis of Applicant's Petition Rental

Applicant Scenario

C2A Rental

		Base Market Rate Project				
	Factor	Per NSF	Per Unit	Project	Base IZ	Applicant IZ
Monthly Rent		$ 3.29	$ 2,077	$ 207,724	$ 238,719	$ 234,416
Parking Revenue	$ 200	$ 0.21	$ 130	$ 13,000	$ 13,000	$ 13,000
Annual Income		$ 41.96	$ 26,487	$ 2,648,684	$ 3,020,632	$ 2,968,991
Vacancy/Economic Loss	5%	$ 2.10	$ 1,324	$ 132,434	$ 151,032	$ 148,450
Operating Expenses	35%	$ 14.69	$ 9,270	$ 927,039	$ 1,112,447	$ 1,130,988
RE Taxes (Included in OE)		$ 4.51	$ 2,844	$ 284,385	$ 314,438	$ 302,341
Net Operating Income		$ 25.18	$ 15,892	$ 1,589,210	$ 1,757,154	$ 1,689,553
Cap Rate	4.75%					
Estimated Value		$ 530.01	$ 334,571	$ 33,457,057	$ 36,992,709	$ 35,569,541
Hard Costs	$ 158	$ 192.68	$ 121,631	$ 12,163,110	$ 14,595,732	$ 14,838,994
Parking	0.50	$ 36.68	$ 23,156	$ 2,315,625	$ 2,315,625	$ 2,315,625
Soft Costs	23%	$ 52.75	$ 33,301	$ 3,330,109	$ 3,889,612	$ 3,945,562
Contingency	5%	$ 11.47	$ 7,239	$ 723,937	$ 845,568	$ 857,731
Land Costs		$ 124.51	$ 78,597	$ 7,859,676	$ 7,535,004	$ 6,100,968
Hurdle Rate/Minimum Return	26.8%	$ 111.91	$ 70,646	$ 7,064,601	$ 7,811,169	$ 7,510,661
Total Costs		$ 530.01	$ 334,571	$ 33,457,057	$ 36,992,709	$ 35,569,541
Return		26.8%	26.8%	26.8%	26.8%	26.8%
Impact to Land					-4.1%	-22.4%

Notes:
Base IZ = 75% of Bonus @ 65% AMI @ 30% of Income with 20% Bonus Density
Scenario = 75% of Bonus @ 50% AMI @ 25% of Income with 22% Bonus Density and 10' Height Bonus
Scenario TC Not Applicable

Figure 23. Sample of IZ Economic Analysis of Applicant's Petition Condominium

C2A Condominium Scenario						
		Base Market Rate Project				
	Factor	Per NSF	Per Unit	Project	Base IZ	Scenario IZ
Unit Sales Revenue		$ 612	$ 601,741	$ 40,918,411	$ 45,079,112	$ 46,113,921
Parking Revenue	$ 30,000	$ 31	$ 30,441	$ 2,070,000	$ 2,070,000	$ 2,070,000
Total Revenue		$ 643	$ 632,183	$ 42,988,411	$ 47,149,112	$ 48,183,921
Cost of Sale	5%	$ 32	$ 31,609	$ 2,149,421	$ 2,357,456	$ 2,409,196
Warranty per Unit	$ 2,500	$ 3	$ 2,500	$ 170,000	$ 170,000	$ 170,000
Net Revenue		$ 609	$ 598,073	$ 40,668,990	$ 44,621,657	$ 45,604,725
Hard Costs	$ 168	$ 205	$ 201,293	$ 13,687,902	$ 16,425,483	$ 16,699,241
Parking	0.50	$ 37	$ 36,149	$ 2,458,125	$ 2,458,125	$ 2,458,125
Soft Costs	23%	$ 56	$ 54,612	$ 3,713,586	$ 4,343,230	$ 4,406,194
Contingency	5%	$ 12	$ 11,872	$ 807,301	$ 944,180	$ 957,868
Land Costs		$ 153	$ 150,469	$ 10,231,877	$ 9,730,864	$ 10,127,352
Hurdle Rate/Minimum Return	31.6%	$ 146	$ 143,679	$ 9,770,198	$ 10,719,775	$ 10,955,944
Total Costs		$ 609	$ 598,073	$ 40,668,990	$ 44,621,657	$ 45,604,725
Return		31.6%	31.6%	31.6%	31.6%	31.6%
Impact to Land (Market to IZ)					-4.9%	-1.0%
Impact to land (IZ Current to IZ Scenarios)						4.1%
Notes:						
Base IZ = 75% of Bonus @ 65% AMI priced @ 30% of Income with 20% Bonus Density and 0' Height Bonus						
IZ Scenario = 75% of Bonus @ 70% AMI @ 30% of Income with 22% Bonus Density and 10' Height Bonus						
Land Cost in Gross Square Feet				$ 126	$ 100	$ 102

Construction costs varied by the type of construction, the tenure of the project and number of below grade floors required to meet the minimum zoning requirements for parking. Condominium projects were assumed to be more expensive to represent higher end finishes then a rental project at the same location. When height and bonus density triggered a seventh floor, construction costs shifted from Non-Type 1 construction (stick) to Type 1 Construction (steel and concrete). OP applied view premiums of one percent per floor and three percent to one side of the building. IZ units were assumed to be on the lower half of floors and on the side without a view premium.

Figure 24. Construction Costs

Summary of Hard Cost per Square Foot				
	Rental	Condo	Row House	
Type I (Steel and Concrete)	$ 205	$ 215		
Non-Type I (Stick)	$ 158	$ 168	$ 150	
Parking Level	Per SqFt	SqFt/Space	$/Space/Level	Avg$/Space
Surface	$ 12	375	$ 4,500	$ 4,500
1	$ 75	475	$ 35,625	$ 35,625
2	$ 113	450	$ 50,625	$ 43,125
3	$ 169	425	$ 71,719	$ 52,656
4	$ 253	400	$ 101,250	$ 64,805

OP tested the sensitivity of the output (changes to land value) to a variety of changes to the inputs and found that the results were relatively consistent.

OP researched inputs by reviewing current economic literature and working with a variety development professionals to review the inputs. For instance, a five percent contingency on project hard costs is a standard assumption for new construction, whereas a rehab project might expect to have a 10 percent or higher contingency.

The project hurdle rate was established using current estimates of debt and equity ratios and annual rates of return for the rental scenario seen in Figure 25. This resulted in an annual rate of return for the project of 6.5 percent. This annual rate of return for the project is paid over an investment period of 4.2 years, which included 15 months of predevelopment, 6 months of below grade construction; 18 months of above grade construction and 11 months for the units to lease up and sale the building. The annual rate of return of 6.5 percent over the 4.2 years from acquisition through construction, lease up and sale resulted in a total required rate of return of 26.8 percent.

Figure 25. IZ Rental Project Hurdle Rate

Financial Inputs	Base Returns Percent	Annual Return	Weighted Average
Equity Percent/Return	30%	11.0%	3.3%
Tax Credit Equity	0%	0%	
Debt Percent/Return	70%	4.5%	3.2%
Annual Hurdle Rate	100%		6.5%
Investment Period (years)			4.2
Total Return (Weighted Average)			26.8%

IV. ZONING COMMISSION QUESTIONS

This section responds to the Zoning Commission's question that have not been addressed elsewhere in the report. Based on the transcript of the July 13, 2015 meeting the Commission had the following questions:

- ***Which zoning districts are excluded from IZ?***

Figure 26 below provides a summary of the zone districts exempt from IZ and rationale for the exemption. For instance, in the very low-density single-family dwelling districts (R-1), duplexes (a typical form to achieve bonus density in IZ programs) is generally considered inconsistent with the Comprehensive Plan's designation for detached housing, and OP estimated there was little opportunity for development of 10 or more units in these zones.

Figure 26: Zones and Overlays Exempted from IZ Requirements

ZONE	REASON(S) FOR EXCLUSION FROM IZ
R-1-A and R-1-B	Rare development type with low yield
R-5-E	No bonus Density can be utilized within allowable bulk/placement
DD (Downtown Development Overlay)	No bonus Density can be utilized within allowable bulk/placement
SFCD (Southeast Federal Center Overlay)	No bonus Density can be utilized within allowable bulk/placement
TDR Receiving Areas • Downtown East • New Downtown • North Capitol • Southwest • Capitol South	No bonus Density can be utilized within allowable bulk/placement
W-2 w/in Georgetown Historic District	Historic Character limits building form
R-3 w/in Anacostia Historic District	Historic Character limits building form
C-2-A w/in Naval Observatory Precinct District	Federal Interest
Eighth Street Overlay	Federal Interest

There is a lot of residential development in the Downtown Development District (DD) overlay and the corresponding receiving zones for Transferrable Development Rights (TDR), but these are areas where housing must directly compete on a square foot to square foot basis with commercial uses. Housing requirements and incentives were established as part of earlier planning efforts for a "Living Downtown" in the early 1990s. The development envelopes within the DD and TDR receiving areas were maximized in 2001 to accommodate the housing requirements and incentives, thus there is no additional capacity to offer as bonus density through the IZ regulations. Reducing project revenues with IZ affordability requirements could reduce residential land values and may steer some projects to office. This becomes an even greater risk as the office market recovers strength.

The new D zone districts provide for a voluntary form of IZ through the credit system. In essence, projects receive bonus credits, which are substitutes for bonus density. The credits can be sold to non-residential uses to exceed the non-residential Floor Area Ratio (FAR) maximums. For these reasons, OP is not recommending any changes to the zones that are currently exempt from IZ.

- ***Provide a side-by-side analysis of the Applicant's request and OP's recommendations with an explanation of why they deviate.***

	Current IZ	Applicant's Proposal	OP's 1A Proposal (Revised)	OP's 1B Alternate
Income Targets	50% and/or 80% MFI[1] depending on zone, regardless of tenure	Targets 50% MFI for Rental; 70% MFI for ownership	Adds C-3-A, C-2-B, SP-1 & W-2 to zones required to do both 50% and 80% of the MFI	Targets 60% MFI for Rental; 80% MFI for ownership
IZ Percent of Project	Greater of 8%-10% of residential square footage or 50%-75% of the bonus density achieved*	Increases requirement to 12% of a residential square footage for all projects.	Reduce requirement to 8% of residential use; eliminate 50% of bonus density requirement	No proposed changes
Bonus Density & Building Envelope	20% Bonus density plus many changes to height and lot occupancy	Increases bonus density annd significant increases to height and lot occupancy	No additional density, some proposed changes to height	No additional density, some proposed changes to height
Setting Housing Costs	30% of income limit for unit; ownership adjustments for interest rates and condo fees; utilities for rental	25% of income limit for unit	Adjust rents to 27% of housing costs	30% of income limit for unit; ownership adjustments for interest rates and condo fees; utilities for rental
Comments	DCBIA believes bonus density not sufficiently available	Applicant seeks greater affordability and expands to Downtown. Significant negative impacts to land values	Preferred by DCBIA, but with adjusted income targets 50/50 split betwenn 65% & 80% MFI	Preferred by applicant. DC BIA very concerned about impact to rental without additional incentives

* Varies by zone and construction type; 75% of maximum bonus density equals 12.5% of the residential square footage.

A full discuss of the comparison is provided in Section V.

What is the impact of OP's 1B (rental at 60 percent MFI) on the Low-Income Housing Tax Credit (LIHTC) program? Will we find eligible families at that level?

The federal LIHTC program requires a minimum affordability of 20 percent of units at 50 percent of the MFI, but it permits projects to target households at 60 percent MFI when at least 40 percent of the units are set aside as affordable. Option 1B's shift to target rental projects to this income range should reduce regulatory conflicts between IZ and LIHTC. The housing burden analysis provided in Table 7 of OP's set down report, and Figure 1 in Section III.B. of this report and comments from affordable housing developers indicate there is no shortage of demand at 60 percent of the MFI. Option 1B should have little to no impact on LIHTC projects.

Provide further explanation of the amendment to §2603.11 (fewer units at a lower MFI) and how private lenders/finance agencies and HPAP might interact.

The purpose of §2603.11 is to avoid marketing problems created when the maximum IZ price is close to or even higher than the existing market rate units in the surrounding neighborhood. In these neighborhoods, IZ applicants would likely prefer a unit without the IZ price controls, thereby making it difficult to sell the IZ units. While discussions with private lenders/finance agencies did not focus on this amendment, OP and DHCD do not expect the industry to treat these units any differently from the 50 percent or 80 percent MFI units.

Should "Mayor's designee" be added to §2603.5 for Mayor's right to purchase IZ units?

§2603.5 grants the Mayor the right to purchase IZ units, §422 of the Home Rule Act permits the Mayor to delegate his functions. Per OAG, it is unnecessary to add "designee" to the regulations.

Please elaborate on the use of "price controls" under Recommendation #4 on page 5.

The Zoning Commission's requirement that IZ units remain affordable for the life of the project necessitates limiting the pace of an IZ unit's appreciation to approximately the same pace of change in the MFI. This keeps the IZ ownership unit affordable to subsequent purchasers in the same target income range. For instance, the District's IZ program would permit:

- A 50 percent of MFI unit, initially purchased in 2013 for 116,600, to be sold for up to $121,656 in 2015; or
- An 80 percent MFI one-bedroom IZ unit, initially purchased in 2013 for $220,100, to be sold for up to $229,643 in 2015.

This way IZ purchasers receive some amount of appreciation while the unit stays affordable for subsequent purchasers.

Condominium fees that rise significantly have the potential to threaten either the IZ unit owner's ability to afford the unit themselves; or to receive the appreciation permitted by the program; or the affordability to subsequent purchaser's or both. OP's proposed amendment to create § 2606.3 would create a release valve to protect against rising condominium fees. It would permit, for example either the 80 percent of MFI unit:

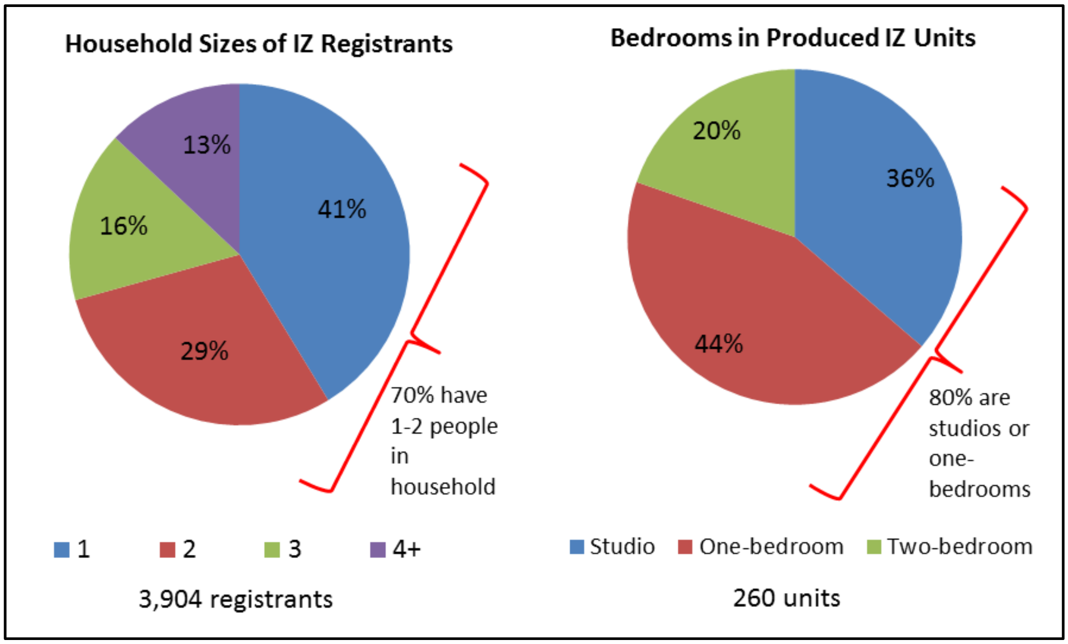
- To be sold at the control price of $229,493 but to someone who earns up to 100 percent of the MFI who can afford the increase condominium fees. In this case the control prices would remain for the life of the project, but subsequent purchasers could earn up to 100 percent of the MFI; or
- The unit could be sold at a market rate price and the difference in the proceeds between the control price and the market price would be deposited to the HPTF.

Provide more information about the geographic distribution of the IZ units.

IZ production is subject to where developers are attracted to build market rate units, so the vast majority of the IZ units produced are in Wards 1 and 6 in and around Central Washington. Market rate development is shifting eastward across the city in neighborhoods where there is a supply of vacant and underutilized land. IZ is producing units west of the park, but production there is limited due to the availability of developable sites. IZ does apply to all new construction of 10 or more units[4], so subsidized units east of the river and in other parts of the District must provide affordable units after their subsidies expire.

Provide more information about the size of IZ units.

[4] Except for those zones specifically exempted such as the R-5-E or the Downtown Development District (DD).



Source: DHCD

IZ units are permitted to be and are trending smaller than the market rate units with the same number of bedrooms. However, due to the proportionality rule of § 2605.2, IZ is producing a slightly greater proportion of 2-bedroom units than market rate two-bedrooms. The result is that across all units, IZ units average 721 net square feet compared to 712 net square feet for the market rate units.

How is IZ helping the District meet the new Fair Housing rules on geographic distribution of affordable units?

Most of IZ production is in high cost areas of the city where there is little production of affordable units through new construction. Therefore, IZ is helping the District meet the recent court interpretation of Fair Housing laws that essentially requires affordable housing must be geographically dispersed in high-income neighborhoods as well.

The condominium fees in the report seem low, please provide more clarity and where you are getting your information.

Figure 20. IZ Size Assumptions & Condo I

Unit Type	Sq.Ft.	Fee/Month
Studio	500	$ 305
1 Bedroom	625	$ 381
2 Bedroom	925	$ 564
3 Bedroom	1,050	$ 641

DHCD currently uses $0.61 per square foot, and estimated unit sizes summarized in Figure 20 to the right, to estimate IZ unit condominium fees. The cost per square foot comes from a study conducted by Manna Inc. of condominium projects that were completed for two years and more. The study's goal was to see how condominium fees rise once the condominium association has time to review their budget and establish fees necessary to create sufficient reserves. The study found that condominium fees rise on average 74% or $181 in the first five years after completion. Since the study was completed, DHCD has raised condominium fees with the rate of inflation. The size assumption is the average size of units by unit type per data from the Office of Tax and Revenue (OTR).

DHCD conducted a review of estimated and actual IZ condominium fees and found on average the IZ estimate was 84 percent ($154) higher than the actual condominium fees paid by IZ households. Only one IZ development had condominium fees higher than the IZ estimate. IZ administrative regulations permit DHCD to lower the maximum IZ unit price if condominium fees are 10 percent more than the IZ estimate. OP and DHCD concluded that the difference between estimated and actual combined with the right to lower the initial maximum sales price provides enough margin for error to protect the affordability of IZ units from rising condominium fees.

Provide more information the on the Delta Associates data used in the set down specifically the relevance to conditions in DC versus the rest of the region.

Delta Associates publishes a quarterly report on rental buildings across the region, but all data used by OP is specific to the District. Delta surveys 19,067 units in DC as part of its most recent report. Delta defines Class A buildings as those built since 1991 with clubhouses and other amenities. "Club house" is a generic term for non-residential amenities within a project. In DC, this would mean lounges with kitchen facilities, gyms, business offices, theatres, and other amenities. For instance, 77 H Street with 22 IZ units, also has two lounges with bar and kitchen facilities, a gym and a roof deck. Because of their larger size, demand and other factors, new rental IZ developments in the District are typically offering more amenities then new condominium IZ developments. Only one condominium IZ development has similar amenities on par with several IZ rental developments.

Please clarify the statement from page p.14, of OP's set down report "Rents for developments using LIHTC or other programs do not exceed the 30% of their income limits, but frequently developers of these affordable housing projects also adjust the rents to market conditions to ensure occupancy and/or receive additional subsidies to fill gaps if rents are estimated to be significantly lower."

OP was pointing out the most other affordable housing programs permit a developer to charge up to 30 percent of the subsidy's income limit, which means some households will have to pay more than 30 percent of their income to afford the unit. Developers only offer rents less than 30 percent of the subsidy's income limit either because the market conditions of the location dictate it, or because they have a mission of serving even lower incomes than the minimums required by the tax credit subsidy. Either condition often requires the developers to seek additional grants and other subsidies in order to make the project financially feasible.

Can down payment assistance help potential IZ purchasers, and is education and credit counseling offered?

All IZ lottery registrants go through a two-hour IZ training to understand the program, their rights, and responsibilities. In addition, those registrants wishing to purchase IZ units are required to go through the same homebuyer education and counseling required of households receiving funds through the Home Purchase Assistance Program (HPAP).

Please provide more information on OP's economic impact analysis including inputs like contingency of 5% and how the hurdle rate was established.

Section IV.B and VII.C. provides a summary and complete explanation of the economic impact analysis used to understand the impacts on residential development of the proposed amendments to IZ. OP researched inputs by reviewing current economic literature and working with a variety of development professionals to review the inputs. For instance, a five percent contingency on project hard costs is a standard assumption for new construction, whereas a rehab project might expect to have a 10 percent or higher contingency.

The project hurdle rate was established using current estimates of debt and equity ratios and annual rates of return for the rental scenario seen in Figure 21. This resulted in an annual rate of return for the project of 6.5 percent. This annual rate of return for the project is paid over an investment period of 4.2 years, which included 15 months of predevelopment, 6 months of below grade construction; 18 months of above grade construction and 11 months for the units to lease up and sale the building. The annual rate of return of 6.5 percent over the 4.2 years from acquisition through construction, lease up and sale resulted in a total required rate of return of 26.8 percent.

Financial Inputs	Base Returns Percent	Annual Return	Weighted Average
Equity Percent/Return	30%	11.0%	3.3%
Tax Credit Equity	0%	0%	
Debt Percent/Return	70%	4.5%	3.2%
Annual Hurdle Rate	100%		6.5%
Investment Period (years)			4.2
Total Return (Weighted Average)			26.8%

V. OTHER INFORMATION

A. Building Envelope Analysis

	Current Matter of Right					Current IZ Modifications					Applicant's Proposal				
Zoning District	FAR	Height	Lot Occupancy[1]	Potential FAR[2]	Envelope Flexibility	FAR +20%	Height	Lot Occupancy[1]	Potential FAR[2]	Envelope Flexibility	FAR +22%	Height	Lot Occupancy[3]	Potential FAR[2]	Envelope Flexibility
CR	6.0	90	75%	6.00	0%	7.20	100	80%	7.20	0%	7.320	110	80%	8.00	9.29%
C-2-A	2.5	50	60%	2.40	-4%	3.00	50	75%	3.00	0%	3.050	60	80%	4.00	31.15%
C-2-B	3.5	65	80%	4.80	37%	4.20	70	80%	4.80	14%	4.270	80	80%	5.60	31.15%
C-2-C	6.0	90	80%	6.40	7%	7.20	**100**	80%	7.20	0%	7.320	100	80%	7.20	-1.64%
C-3-A	4.0	65	75%	4.50	13%	4.80	65	80%	4.80	0%	4.880	75	80%	5.60	14.75%
C-3-B[3]	5.0	70	100%	6.00	20%	6.00	70	80%	4.80	-20%	6.100	70	80%	4.80	-21.31%
C-3-C[3]	6.5	90	100%	8.00	23%	7.80	90	80%	6.40	-18%	7.930	90	80%	6.40	-19.29%
R-5-A	0.9	40	40%	1.20	33%	1.08	40	40%	1.20	11%	1.098	40	40%	1.20	9.29%
R-5-B	1.8	50	60%	2.40	33%	2.16	50	60%	2.40	11%	2.196	50	60%	2.40	9.29%
R-5-C	3.0	60	75%	3.75	25%	3.60	60	75%	3.75	4%	3.660	60	75%	3.75	2.46%
R-5-D	3.5	90	75%	6.00	71%	4.20	90	75%	6.00	43%	4.270	90	75%	6.00	40.52%
W-1	2.5	40	80%	2.40	-4%	3.00	50	80%	3.20	7%	3.050	60	80%	4.00	31.15%
W-2	4.0	60	75%	3.75	-6%	4.80	80	75%	5.25	9%	4.880	90	80%	6.40	31.15%
W-3	6.0	90	75%	6.00	0%	7.20	100	80%	7.20	0%	7.320	110	80%	8.00	9.29%
SP-1	4.0	65	80%	4.80	20%	4.80	70	80%	4.80	0%	4.880	80	80%	5.60	14.75%
SP-2	6.0	90	80%	6.40	7%	7.20	**100**	80%	7.20	0%	7.320	100	80%	8.10	10.66%

Source: DC Office of Planning

[1] Assumes all floors including commercial ground floors if applicable use lot occupancy limits.

[2] Potential FAR is the number of stories within the height limit, multiplied by the lot occupancy. The stories were estimated using a 15' first floor and 10' floors thereafter.

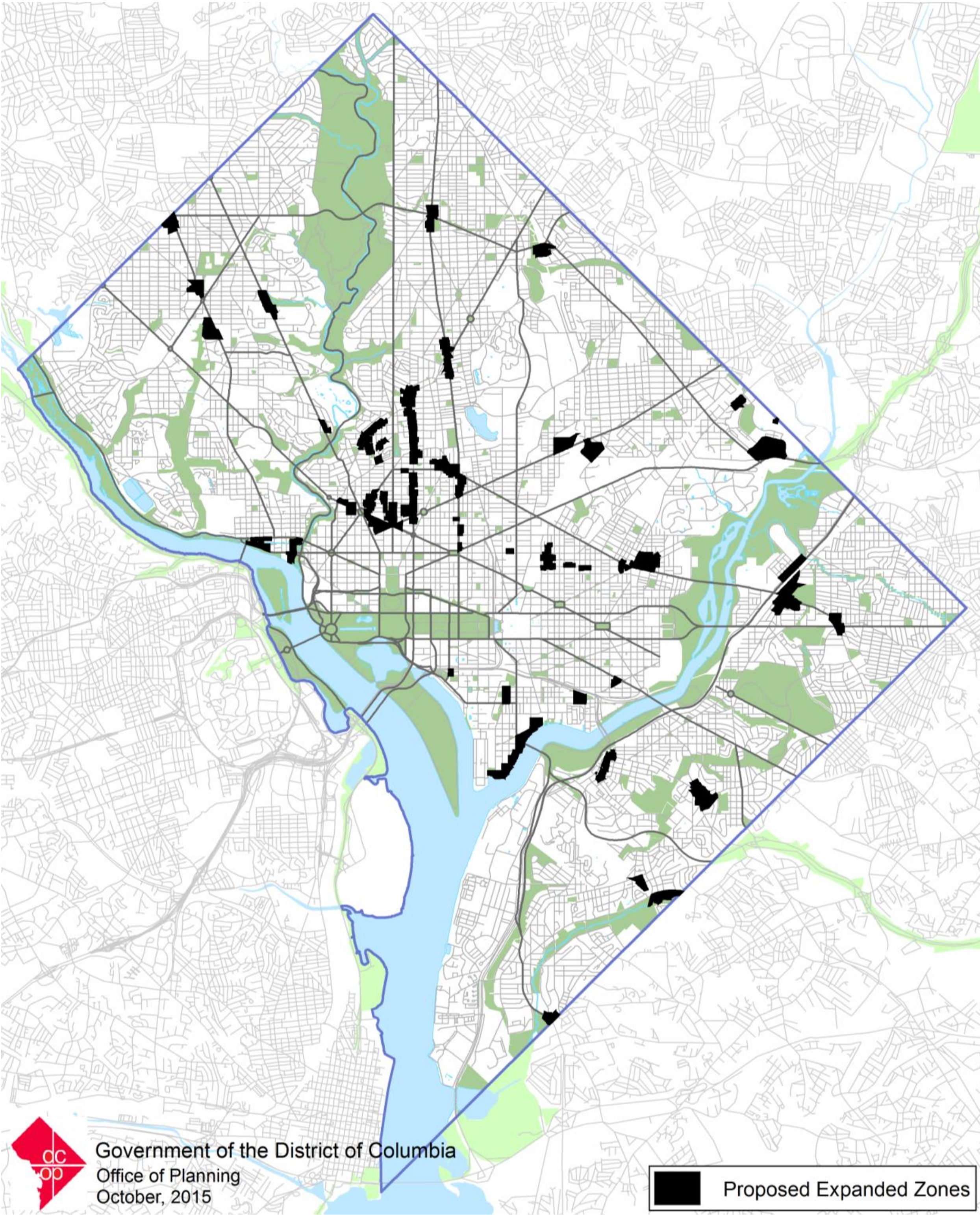
[3] Certain zones have, and the Applicant proposed lot occupany of 100%. OP used a maximum of 80% lot occupancy due to light and air.

Envelope Flexibility = (Potential FAR - FAR)/FAR

Bolded cells included amendments proposed by OP

Underlined cells are amendments proppposed by the Applicant

B. Map of Option 1A Expanded Zones



C. Working Group Participants

Representatives from the following organizations participated in the working group meetings:

Income Targets and Housing Costs

CNHED
Housing Counseling Agency
City First
WC Smith
Dept. of Housing and Community Development
Dante Partners
Leslie Steen
Manna, Inc
UrbanPace
10SquareTeam
Saul Ewing
Coalition for Smarter Growth
DC Fiscal Policy Institute

Bonus Density and Economic Impact Analysis

Concordia
EYA
Bozzuto
WC Smith
Dept. of Housing and Community Development
Dante Partners
JBG
Community Three Partners
10SquareTeam
Somerset Development
Saul Ewing
Coalition for Smarter Growth
Hines Development
DC Fiscal Policy Institute