Additional Petitioner Testimony on
Zoning Case No. 04-33G

To the District of Columbia Zoning Commission

Anthony Hood, Chairman
District of Columbia Zoning Commission
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On behalf of the DC Campaign for Inclusionary Zoning

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ZONING COMMISSION
District of Columbia
CASE NO.04-33G
EXHIBIT NO.239

Thank you for the opportunity to offer additional testimony on Case 04-33G.

This case is of great consequence to many DC residents struggling to stay afloat in our housing market. We appreciate your desire to carefully consider how inclusionary zoning (IZ) can help lower-income households without significant negative impacts on housing development.

I. Summary

We encourage the Zoning Commission to base its decision on the strong, impartial standard of Office of Planning's (OP) model, which was developed by all stakeholders including real estate developers and the DC Building Industry Association (DCBIA), and represents a best practice in evaluating inclusionary zoning policy. The Petitioner changed its support to Option 1B from our original proposal, because we were concerned by analysis from the OP model showing too significant of an economic impact. Instead, we support Option 1B because all the evidence indicates it will not adversely impact rental development in DC, which shows sustained strength and resiliency. Estimates of Option 1B's impacts are well within the range of cost fluctuations developers normally anticipate and price in to every project. There is far from enough affordable housing production planned for renters at 60 percent median family income (MFI), and thousands will remain severely burdened by rental costs even after the District's pipeline is fully built out. Inclusionary zoning can help fill this gap. Option 1B will help thousands of struggling DC residents – administrative assistants, mail clerks, maintenance workers, and school bus drivers[1] – who experience severe housing affordability problems. By contrast, Option 1A largely leaves an ineffective policy in place and squanders a great opportunity, by continuing to produce 80 percent MFI rentals which are readily available on the private market. For these reasons we continue to urge the Zoning Commission to adopt Option 1B.

II. Economic Impact

It is not surprising that when business groups are asked directly how proposed regulations might affect them, they say those regulations will be harmful. Yet time and again, those predictions do not come to pass. In 2005, the DC Building Industry Association (DCBIA) predicted that then-proposed inclusionary zoning would significantly damage the market. That did not happen, and instead, residential construction has hit a 25-year high.[2] Additional testimony from DCBIA is unlikely to offer the Zoning Commission the objective and robust evidence it seeks.

An impartial, representative picture of potential impact on development is already available: a model developed by the Office of Planning (OP), which was built on market data and developed with stakeholder input – including input from real estate developers and DCBIA members. The use of such models is a best practice for evaluating inclusionary zoning policies: national and

[1] Selection from top 10 most common occupations in the District of Columbia with median income between $39,600 and $52,100, which is between 40 and 60 percent MFI for a family of two. State Occupational Employment and Wage Estimates, US Bureau of Labor Statistics.

[2] New Private Housing Units Authorized by Building Permits, District of Columbia, US Census Bureau, via Federal Reserve Bank of St. Louis.

jurisdictional housing experts have developed models closely resembling OP's and have recommended their use.[3]

The model was carefully designed, built by consensus, and makes a strong case for Option 1B. The Petitioner supports Option 1B because of our attention to sound economic analysis and sensitivity to the need to moderate economic impact. We changed our position to Option 1B rather than our original, more ambitious proposal, because the OP model showed that Option 1B had a more reasonable impact. DCBIA has shown confidence in the model as well, using it as the basis of their supplemental testimony last month.[4]

Evidence from this model shows that Option 1B is unlikely to significantly impact residential development in the city, and is no more likely to do so than the proposal supported by DCBIA, Option 1A. This is visible in Figure 17 in Office of Planning's recommendation report, reproduced below. The land value impact of Option 1A ranges from 1.1 percent to -8.5 percent. Option 1B ranges from 3.1 percent to -7.9 percent. The Petitioner has proposed modifying the set aside in Option 1B so that no zone experiences a decrease in land value exceeding -5 percent, in keeping with an approach that responsibly stretches the market. We have asked that the set-aside in C2B be modified to 7 percent of residential floor area in C2B; and to the greater of 8 percent residential floor area or 10 percent residential floor area in R5A.

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

		Square Feet Development	Percent of	Current IZ on 2009 Pre-IZ Land Values		OP 1A on Current Land Values		OP 1B on Current Land Values	
Rank	Zone	Capacity	Capacity	Rental	Ownership	Rental	Ownership	Rental	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.

In a practical sense, a negative land value impact is the predicted amount of cost savings a developer must achieve to maintain the same rate of return on the project. The model estimates how much land prices – the source of this savings – will adjust. Even in the C2B, the zone with the largest impact under Option 1B, a typical 120-unit project must achieve a cost savings of less a half million dollars to achieve the same rate or return as with no change to IZ. That amounts to less than half of the contingency priced into such a project.[5]

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[3] See Cornerstone Partnership's Inclusionary Calculator and the Housing Development Dashboard by the Terner Center for Housing Innovation at the University of California at Berkeley.

[4] Exhibit 228, Additional Information Provided by DCBIA.

[5] The Office of Planning model assumes a typical 5 percent contingency.

To provide greater context for these figures, we present the following example of a 120-unit, $40.5 million development including land valued at $11.2 million. (**Table 1**). Under Option 1B with the Petitioner's proposed modification, to achieve the same return on investment, cost savings of only $470,000 would have to be achieved. Using OP's land valuation model, this is a -4.2 percent impact to land value. This is not a significant amount to be resolved, especially at an early stage of development. Savings could be achieved in any number of ways – debt and equity structuring, construction costs, interest rates, or land costs. A $470,000 difference in land costs is unlikely to be significant enough to jeopardize a $40 million project. We note that the contingency priced into such a project would cover the $470,000 gap more than twice over.

Table 1.

Example of a Rental Development in C2B		
	Development Value (millions)	Land Value (millions)
Market Without IZ	$34.7	$9.69
With Current IZ	$40.5	$11.15
With Option 1B*	$39.9	$10.68
Impact to Land Value		$(0.47) -4.2%

* With Petitioner's suggested modification of set-aside to 7% grfa.
Source: Calculations with Office of Planning residual land value impact model.

Given that the objective evidence shows that Option 1B has equivalent impacts as Option 1A in terms of impacts to land value, and that the magnitude of this impact is so small, there is no reason to believe that Option 1A is economically preferable to Option 1B. Office of Planning has raised the issue that targeting a lower income level for rental, and a higher income for ownership, will discourage rental development.[6] Yet for several reasons, this is unlikely. Demand, prices, and planned investment in DC's rental market are all strong. Rents for newly constructed apartments have grown 4 percent over the past year – twice as fast as the past 5 years. Vacancy rates are down, despite significant increases in supply, and are projected to decrease even further in the next few years. And there is a significant volume of new investment in DC's rental market – over 11,000 new rental units are expected to deliver over the next 3 years.[7] All this indicates an opportunity to make a policy change at a time when the market is most able to absorb it.

III. Pipeline

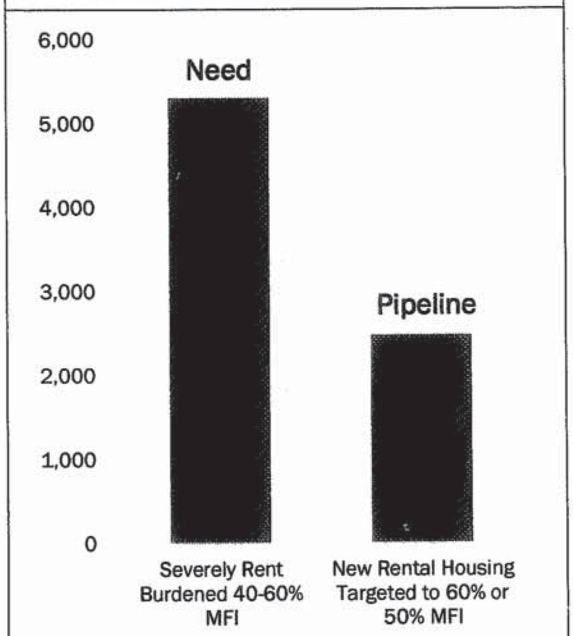
While Option 1B would have an equivalent economic impact as Option 1A, unlike Option 1A, Option 1B would produce the type of affordable rental housing that is truly needed, while Option 1A would not.

[6] Exhibit 119, Office of Planning Recommendations Summary, Feb. 2016, pg. 7.
[7] All figures in the latter half of this paragraph are from Delta Associates, Class A Apartment Market Overview, 2016.

The affordable housing pipeline is simply insufficient to meet the need for rental housing among 60% MFI households. We looked very closely at each project in the city's pipeline, and came to a very different conclusion than Office of Planning, which has argued that enough affordable housing production is currently planned for 60% MFI renters. Looking specifically at the number of planned new rental housing units for 60% MFI households, it is clear that there remains a significant need for affordable homes for such households, which IZ can help to fill. In fact, there are twice as many 60% MFI households in need as there are units in the pipeline for them. (**Figure 1**).

Figure 1.

60% MFI Rental Housing: Comparison of Need and Planned Production



Source: DCFPI analysis of 2013-2014 American Community Survey and affordable housing pipeline.

We examined project-level public records on every DCHD projects under construction or in underwriting, and every DMPED project with an approved development plan.[8] These data lead us to conclude that the figures cited in OP's reports do not provide the best picture of how many 60% MFI renters will be assisted by planned production. OP's figures appear to include existing units that will be rehabilitated and preserved, and homeownership projects – activities which while important, will not decrease the number of renters needing of affordable housing. It also appears that projects that have already been completed are included in the figures, as well as projects still in the early planning stages where the quantity of affordable housing units is uncertain.

The project-level data indicate that only 58 percent of the affordable housing pipeline is new

[8] DHCD Development Finance Division Pipeline Report: Underwriting and Construction pipelines.
DMPED Real Estate Project Pipeline: Filtered to projects with status Under Construction, Pre-Development, or In Negotiation. Additional information on DMPED projects was obtained from legislative records of the DC Council; publicly available land leases, development agreements, and land disposition agreements between DMPED and developers; news reports; and DMPED press releases and website.
Full documentation of our estimates of the affordable housing pipeline is available at the Zoning Commission's request.

rental housing. Approximately 35 percent of units in the affordable housing pipeline are existing units that will be preserved. A substantial number of the new units that will be constructed are homeownership projects, which again will not decrease the amount of need for affordable rental housing. In total, there are only 2,400 new affordable rental units in the pipeline targeted to 60% MFI households – far fewer than the figures that have appeared in the record.

Looking at the data on planned new rental housing for 60% MFI households, it is clear that there remains a significant need for affordable homes for such households, which IZ can help to fill. Thousands of families at the 60% MFI level will remain unserved and severely burdened by rental costs when the actual amount of planned new affordable rental housing is completed. There are more than twice as many 60% MFI renter households in need as there are units in the pipeline for them.[9] (This is even making the unlikely assumption that need will not increase during the years until the pipeline is built out.) Option 1B is needed to create more affordable rental units for families at 60% MFI to help bridge the significant gap between need and the pipeline.

IV. Affordability Needs

Finally, Option 1B is preferable to Option 1A because Option 1A would continue to produce 80% MFI units that are not needed because the market largely already meets that need.

The vast majority of renters at 80% MFI are accommodated by existing private market housing and do not experience severe housing cost burdens. Furthermore, the Urban Institute has forecasted a surplus of rental housing affordable at 80% MFI within the next few years as new construction relives pressure on the market.[10]

A simple search on the online housing search platform Zillow makes clear that rentals priced affordability to 60% MFI households barely exist in the private market, yet a multitude of housing options exist at 80% MFI – even in some of DC's highest-cost neighborhoods in Wards 3 and 6. (**Figure 2**). By contrast, only a few apartments are available at 60% MFI, and they are concentrated in Wards 7 and 8.

This lack of options means that one in four families at 60% MFI pay the majority of income for rent.[11] Reflecting this tremendous need, three-fourths of households waiting for inclusionary zoning units are at or below 60% MFI.[12]

The goals of expanding access to high-opportunity neighborhoods, increasing the supply of affordable homes for lower-income familes, and mitigating displacement in DC are simply not served by contiuing to target IZ rental units to 80% MFI, an income group that overwhelmingly does not need them – especially when a clear need at 60% MFI exists.

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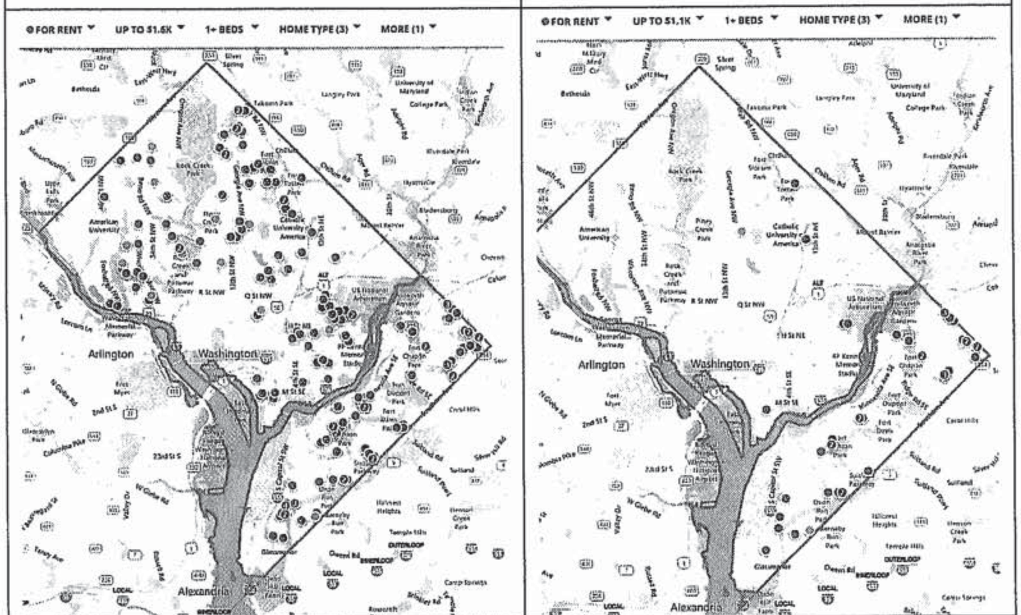
[9] Ratio of severely rent burdened households 40-60% MFI to number of new rental units in the pipeline affordable at 60% or 50% MFI. DCFPI analysis of 2013-2014 American Community Survey and affordable housing pipeline.
[10] Urban Institute, Affordable Housing Needs Assessment for the District of Columbia, Phase II, 2015.
[11] DCFPI analysis of 2013-2014 American Community Survey.
[12] Exhibit 119, Office of Planning Recommendations Summary, Feb. 2016, pg. 13.

In sum, robust, impartial evidence shows Option 1B will not adversley impact rental develpoment in the city, and will provide affordable housing to District residents truly in need. We urge the Zoning Commission to adopt Option 1B.

Figure 2.

Rental Units Available Today

80% MFI Up to $1,600 / 1-bdrm	60% MFI Up to $1,100 / 1-bdrm



Source: Zillow, Jul. 13, 2016. Left; Right.