ANOTHER LOOK AT THE PRODUCTION OF IZ UNITS

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We have weighed the advantages and disadvantages – the benefits and costs – of the proposed use of Inclusionary Zoning for the production of affordable units. We conclude that the draft Zoning Regulations re-write does not provide the flexibility needed to fully realize the policy objective of IZ, which is to incentivize and require the production of affordable housing units in diverse settings. The issue has been debated, so we expect that the readers of this memo do not need full explanations of the arguments for IZ. However, we do not think that the arguments that support our position have been adequately presented to the decision-makers.

ARGUMENTS FOR INCLUSIONARY ZONING, BUT..,

- Many of the IZ units are/will be in buildings in parts of the city where low- and moderate-income people cannot usually find apartments.
- Diversity in the location of these low/mod households is inherently good.
- City resources do not have to be spent to create the IZ units.

True – sort of....The question that remains, however, is whether the potential resources that the IZ requirement could generate are best spent in this manner.

An IZ unit in a rental building in a high-cost submarket in DC costs an owner/landlord about $1200 to $1500 per month in rent lost per unit – the difference between the market rent and the discounted rent. At cap rates of 5% or 6% (generous in the current economic climate) reduction in rent means that the owner is able to raise much less capital for his project – about $250,000 per discounted unit. That is a proxy for the resources available to the public that the IZ requirement confers.

So the question becomes – how best can that resource be used? The current law and practice in effect gives it through a lottery to the lucky resident that gets to live in the luxury unit at a greatly discounted rent.

AN ALTERNATIVE

If the IZ rules were to provide an option to allow developers to assign the responsibility to create the IZ unit to other (affordable housing) developers instead of putting the units in their expensive high-rise or mid-rise building, the same number of (or more) affordable units would be produced. Given the option, a rational developer would be willing to assign its units and provide a capital subsidy to the assignee of much of the "lost capital" in his market-rate project. For example, the assignment of, say, 25 units would generate $4 to $5 million of capital for the developer of the affordable units.

Proponents of the new IZ law observe that the city has dedicated so much money to affordable units that more capital of this sort is not needed. We disagree. Although the $100 million committed by the Mayor and Council is generous, it is not sufficient for affordable housing developers to meet the ever-growing need. Tens of thousands of city residents need lower-priced and more suitable housing in all wards of the city.

WHY THE ALTERNATIVE?

A new affordable apartment unit now costs about $300,000 to develop, even in areas that are not near Metro stops and not in the most premium locations. Market-rate buildings of the assigning developers in high-cost areas cost much, much more than $300,000/unit. The most readily available financing for affordable apartments involves the use of tax-exempt bonds issued by DCHFA, equity provided by investors in tax credits, and subordinate (or "soft") debt from DHCD. For a variety of reasons, the bonds and tax credits are plentiful for DC. Their use does not require city money. The subordinate debt is from the District's tax-supported Housing Production Trust Fund. If all the city's $100 million of annual capital subsidy funds were used in the most leveraged way possible, it might produce 1200 units per year, which we believe falls far short of the need. We believe there needs to be much more to facilitate the production of affordable housing.The IZ rules in their present form do not produce large numbers of additional affordable units.

DHCD now directs its funding for these affordable properties at households with incomes below 50% of the area median income (AMI). However, households with incomes in the 50% to 80% of AMI range (about $45,000 to $90,000 per year, depending on household size} also need affordable housing.

We propose that the capital generated from IZ assignments should be used to fill the financing gaps for units that do not qualify for tax credit equity and DHCD debt. For example, an affordable housing developer receiving a capital assignment could develop a building on land near a Metro stop in almost any submarket with half of the units for households at 50% AMI or less and partly for 50% to 60% AMI, which could qualify for tax credits and not use city money, with the balance of the units for 60% to 80% AMI households. This latter group of units would benefit solely from the IZ assignment funds. An assignment of capital based on 25 or so IZ units could support twice that many units in the assignee's building.

So what is more important: finding a way to fund more affordable units or putting a smaller number in very expensive buildings?

The assignee's building, in effect, would be mixed-income.. It would be in a location more attractive and accessible to jobs and services than buildings with the most low-income residents. The building would be permanently affordable, not with some use restrictions that will expire. The building would be green under the city's requirements for buildings using its financing. It would have a substantial number of permanent supportive housing units. It will be managed by property managers accustomed to meeting compliance requirements and serving households that have different needs than most residents of expensive buildings.

The city could choose to offer a developer the option to assign or not. It could adjust the rules to permit only the assignment of the units at 60% of AMI or less. It could differentiate between the types of buildings – allow assignment in 4-story plus buildings, but not in townhouse or garden projects; and/or limit assignments to affordable buildings that are considered TOD.

In addition, there is a potential impact on market-rate project feasibility because of the IZ rules. The "lost" revenue from the in-building IZ units makes projects harder to finance. This may deter housing production overall and result in the city realizing the benefit of real estate taxes more slowly.

The primary point is that the IZ rules create a really valuable asset that could benefit more than just the specific residents who are lucky enough to rent an IZ unit. Assignment of the IZ units – some or all – will help the city reach its affordable housing and related goals.

Please reconsider the terms of the IZ section of the Zoning Regulations to add a provision that permits the option of capital assignments to affordable housing developers in lieu of some or all IZ units being built into the assignor's building.

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