Technical Assistance Panel Report on the Inclusionary Zoning in the City of Raleigh

Prepared for the City of Raleigh

Triangle District Council of the Urban Land Institute

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Executive Summary

In the fall of 2012, the City of Raleigh sponsored a ULI Triangle Technical Assistance Panel (TAP) on Inclusionary Zoning in the City of Raleigh. A panel comprised of experts in affordable housing development, market rate single family and multi-family development, zoning law and governmental affordable housing programs was recruited and organized by the District Council's TAP committee, and the TAP exercise took place on November 28th and 29th, 2012.

The Panel's task was to examine the economic and market considerations of such tools to determine whether (1) a non-mandatory inclusionary housing program is feasible and would result in meaningful unit production; and (2) if it were feasible, what magnitude of incentives and/or subsidies would be required. The panel was provided with a detailed briefing book by the City of Raleigh, and supplemented this information with interviews with affordable housing developers, a County housing program expert, affordable housing managers and an advocacy group.

The panel assessed the tools and incentives used to promote affordable housing developments, and roughly calculated the gap between market and affordable housing returns. The major findings of the panel are as follows:

- Affordable housing is costly to produce. In order to produce such housing, developers will be required to absorb these costs or local governments will need to step up—either by providing direct subsidies to developers or by offering rich incentives that are monetized by the developer to cash equivalents.
- Given that mandatory inclusionary zoning (whereby developers bear the brunt of the subsidy) is not an option, the City needs to find a way bridge the gap, with either a broad range of incentives, direct subsidies, or a combination of both.
- The new UDO cannot be designed to provide sufficiently robust incentives to bridge the subsidy gap. Density bonuses are difficult to take advantage of in mixed use zones because increasing density often means increasing construction costs (i.e. moving from surface to structure parking, from wood to non-combustible construction, etc.).
- Existing housing programs such as tax credits and low cost city loans offer powerful subsidies and the City should aggressively seek full utilization of these programs by both profit motivated and nonprofit developers.
- Mixed income housing developments are socially desirable but difficult to deliver because of:
    - Market resistance.
    - Neighborhood opposition.
    - Aversion to such developments by financing entities.
    - Complexity of long term regulatory requirements and obligations.
    - Lack of interest on the part of public sector financing partners (tax credits in particular).
- The cost of improved land is prohibitive and will continue to present challenges as developers move from building on undeveloped land and work more on properties that require costly redevelopment.

Building off of these findings, the panel recommends the following:

- Developers, who meet a minimum threshold of 10 – 15 percent of affordable housing units, must be provided with a number of tools to offset the cost of building that housing including direct financial subsidies, code options, fee rebates and perhaps a change of time horizon for compliance (i.e. return to market rate)
- Local government will need to bring money to the table to make workforce housing happen in many areas of the City, particularly in Downtown locations and TOD locations.
- The City should use tax increment financing to support the production of affordable housing. Special emphasis should be place on supporting mixed income developments in transit corridors and downtown workforce housing.
- The City should commit to undertake and aggressive land banking program in downtown locations, transit corridors, employment centers and opportunity sites in the City that have low levels of affordable housing.

Introduction

THE TAP PROGRAM

The Technical Assistance Panel (TAP) program is a smaller-scale version of the larger technical assistance programs run by ULI-national, adapted for implementation and administration at the District Council Level. Like the national-level programs, the TAP program focuses on mobilizing impartial and expert advice to solve identified problems. Distinguishing features of TAP include:

- A short time frame: panels typically last no more than one or two days.
- A focus on a discrete, well-defined problem
- Modest costs for the applicant, whether cash or in-kind contribution, making the TAP program particularly accessible for smaller governments and non-profits.

CHARGE TO THE PANEL

City of Raleigh policies call for the creation of mixed-income neighborhoods and more affordable and workforce housing. The primary regulatory tool that communities around the US use to obtain these goals—the mandatory inclusionary zoning ordinance—is not enabled in North Carolina. This leaves zoning incentives and direct subsidies as the remaining mechanisms available to encourage affordable and workforce units in privately-developed, market-rate residential and mixed-use developments. The charge for this TAP is to examine the economic and market considerations of such tools to determine whether (1) a non-mandatory inclusionary housing program is feasible and would result in meaningful unit production; and (2) if it were feasible, what magnitude of incentives and/or subsidies would be required.

At the end of the TAP undertaking, the City should have guidance regarding whether such a program could work in this market, and the general magnitude of the bonuses or incentives that would need to be offered in order to be effective in producing affordable units. The City intends to use the TAP recommendations to (1) decide whether a voluntary inclusionary housing program is worth pursuing, and if so, (2) what program parameters should be used as a starting point.

THE PANEL

To answer these questions, the Triangle District Council TAP Committee sought out panelists with expertise in mixed-use and single family development, affordable housing development, development finance, zoning law, and affordable housing government programs.

The TAP process was overseen by the TAP Committee Co-Chairs Jeff Davis, JDavis Architects and Sal Musarra, Kimley-Horn & Associates.

TAP Chair

Gregg Warren, DHIC
Gregg has served as Executive Director and President of DHIC since 1986. Under his leadership, DHIC has developed 1,600 affordable apartments and another 240 homes for sale to first time homebuyers. DHIC has been

honored with numerous awards at all levels of government including five Sir Walter Appearance Awards from the City of Raleigh.

TAP Panelists

Jason Barron, Morningstar Law Group
David Cristeal, County of Arlington, VA
Jeff Furman, Northwood Ravin
Roland Gammon, White Oak Properties
Danny Kadis, Centrex Properties
Kellie Falk-Tillett, Drucker and Falk

City of Raleigh Representatives

Kenneth Bowers, Deputy Planning Director, City of Raleigh
Michele Grant, Community Development Director, City of Raleigh
Shawn McNamara, Community Development Planner, City of Raleigh

Resource Persons

Bill Rowe, NC Justice Center
Cliff Zinner, RD Construction
Robert Dowling, Orange Community Home Trust
David Cristeal, Arlington, VA

ULI Triangle

Julie Paul, Council Executive

THE EXERCISE

The panel convened on the afternoon of November 28 and received a briefing from the project sponsor. Ken Bowers, Deputy Director of Planning for the City of Raleigh, gave an overview of the major findings in the briefing book. Following Ken's presentation, the Resource Persons each presented on different aspects of affordable housing from governmental programs, to management of and pressing need for affordable housing. Panel deliberations continued throughout the day on November 29th, and the preliminary presentation was delivered to City officials that afternoon.

Summary of Findings

The panel's findings have three sources: the briefing book, resource interviews and conversations, and the deliberations where the diverse experience and expertise of the panel members was shared. This chapter summarizes the major findings by source.

FINDINGS FROM THE BRIEFING BOOK

As noted in the briefing book, the panel was not charged with examining mandatory inclusionary zoning models for the City of Raleigh. And while the briefing book observed that conditions could be imposed during a rezoning to include perhaps the provision of affordable housing, the panel would prefer to see that the new zoning maps have ample locations properly zoned for multifamily housing where most affordable housing developments will be located.

The new UDO, with its form-based mixed use districts with no density limits, presents limited opportunities to offer effective incentives to developers. Height bonuses offer little help since most multifamily builders are staying away from costly non-combustible framing that is required at heights above 4 or 5 stories. However, the panel does have recommendations that could be implemented in the residential districts.

The panel chose to focus its recommendations on strategies that the City should undertake to produce more affordable rental housing. Better than two-thirds of cost burdened households with annual incomes of less than $50,000 were renters. In addition, there are many homes in the marketplace that lower income homebuyers can afford—Raleigh is clearly a relatively affordable housing market.

FINDINGS FROM RESOURCE INTERVIEWS

Bill Rowe, NC Justice Center

Mr. Rowe indicated it is important for local government leadership to make affordable housing feasible. The City of Raleigh has a progressive history supporting affordable housing by offering low cost financing to both private for-profit and non-profit developers. Most of the developers that have participated in City housing programs specialize in affordable housing. The City has offered few, if any, land use incentives for market rate builders. HB148 passed by the NC Legislature in 2009 mandates that local governments that pass a local sales tax referendum to support mass transit must promote the production of affordable housing within a half-mile of transit stations. Durham County and Orange County are currently working on developing such plans. The work of this committee will be useful to these jurisdictions. Maintaining housing diversity along transit corridors should be a priority for the City of Raleigh.

Cliff Zinner, RD Construction

Mr. Zinner noted that he has worked in the Triangle area building starter homes for first time homebuyers for many years. He explained that it was not an attractive market segment for many builders given how small the margins were with little room for error. He was generally skeptical that sufficient land use incentives could be identified that would produce results from the larger development community.

Robert Dowling, Orange Community Home Trust

Mr. Dowling noted that Chapel Hill has a history of inclusionary zoning where developers of homes for sale are required to offer 15 percent of the homes built in a development at a price that is affordable to lower income households. In certain cases, developers will receive density and floor area bonuses. There is an option for developers to pay a fee-in-lieu producing an affordable unit. The fee is currently $85,000. Many of the developers in Chapel Hill sell their affordable homes to the non-profit Community Home Trust which identifies qualified lower income buyers and offers a leasehold interest to buyers who in turn secure mortgages for their leasehold interest in the property.

The lower income homebuyer in Chapel Hill must agree to re-sale limits and limits on equity appreciation in order to make sure that the home remains affordable over the long term. Mr. Dowling mentioned that there are very few lenders that will provide mortgage financing on a leasehold interest. Over the past 13 years, there are 200 homes in the Community Home Trust that have been provided through inclusionary zoning. Interestingly, the Chapel Hill ordinance does not cover rental housing developments, which Mr. Dowling believes is a significant shortcoming.

David Cristeal, Arlington, VA

Mr. Cristeal explained that Arlington is a high cost area with average two bedroom apartment rents running at $2,300 per month and average single family homes running at almost $800,000. Given the high costs of ownership and strong demand for affordable apartments, the County provides financing and planning incentives to preserve or produce rental housing. Its zoning ordinance has an affordable housing requirement for any Site Plan project with density that exceeds 1.0 FAR. Depending on the type of project, developers have the option to provide on-site affordable units or contribute funds that help capitalize its trust fund (the Affordable Housing Investment Fund). Because the County has a longstanding commitment to affordable housing and, given that the area is a high barrier-to-entry market, developers go along with the requirements and include the costs of compliance in their pro-formas and financing plans. Under this program, which was voluntary until 2006, Arlington has averaged about 25-30 rental homes and/or $4.5 million in developer contributions per year over the past 15 years.

FINDINGS FROM THE PANEL DELIBERATIONS

The panel was comprised of developers (non-profit and for-profit), an attorney, real estate manager, architect and engineer. The first question that the group tackled was to determine the level of financial compensation that a market rate developer of apartments would require in order to break even if the development were to include some apartments that rented at affordable rates. Knowing this number is the first step in determining the magnitude of the value of land use concessions a developer would require in order to produce affordable housing.

Two developers on the panel provided to the group sources and uses statements and operating pro formas for two apartment communities in the Triangle; one tax credit affordable development and the other, a Class A apartment community in a suburban location.

The market rate apartment developer anticipated charging rents that average $1,200 while the affordable housing developer could charge, at best, $875 (to serve those with incomes of less than 60% AMI) for a comparable apartment. This $325 gap would lead to an approximately $55,000 reduction of debt that the market rate owner could carry. Fifty-five thousand is the number that the panel looked for in the savings that the UDO could deliver.

Another way to look at the issue is as follows. For every $100 that a developer takes out of his monthly rent roll, he needs to offset this loss with about $17,500 of savings or subsidy.

This analysis is over-simplified. Would apartment developers consider undertaking this approach if there was no overall benefit other than making them whole? Many apartment developers seek to sell properties after several years of stabilized occupancy to institutional investors. Would these restrictions drive down the price investors are willing to pay? Finally, long-term use restrictions and oversight by city staff to insure compliance add to the complexity of deals at a time when lenders and investors are looking for simple projects to finance. Clearly, an incentive based, voluntary system will need to deliver benefits to the developer above and beyond what the simple financial analysis suggests.

With this analysis in hand, the panel next turned to the specific goal and the three questions provided in the City's TAP application and Briefing Book:

<u>City of Raleigh Goal</u>: Creation of Mixed-Income Neighborhoods and More Affordable and/or Workforce Housing.

The panel uniformly recognized that this goal is worthy, and yet there are challenges including:

- The integration of market-rate with affordable units can be challenging from a marketing and management standpoint, but can be surmounted if the income mix is thoughtfully balanced. Such developments work best in highly competitive and attractive sub-markets such as downtown.
- Multifamily developments often meet with neighborhood resistance. The addition of affordable housing to the mix will lead to more vigorous opposition.
- More public subsidy is required to build a mixed income rental development under tax credit programs since the loss of equity is greater than the additional debt the project could support.
- State criteria for tax credit developments make it difficult to secure financing.
- In Raleigh, there are very few sites that are easy to develop. Higher site development costs make affordable housing more difficult. Land costs in downtown neighborhoods make for an even greater challenge.
- Neighborhood resistance/Potential market stigma of mixed rentals.

Guiding Principles the of the Panel: Before turning to the specific questions posed in the Briefing Book, the Panel settled on the following Guiding Principles to inform how the Panel would approach the answers and recommendations:

- There are significant differences in downtown (and perhaps TOD sites depending on definitions) vs. suburban sites, including land costs, construction types and costs, and market rent levels.
- There is merit to dispersing affordable rental housing throughout the City with a priority to underserved areas close to employment centers.
- A mix of housing options in Downtown Raleigh is very desirable. Given the price of land, more public subsidy will be necessary to accomplish the mix.

- Affordable housing is a community issue, not solely a new development issue, and it's going to come at a cost.
- The panel does not favor a model where all the costs of inclusionary zoning are borne by successor tenants/owners.

Question 1. What subsidy level is necessary to provide affordability for different unit types?

The Panel believes that any program of incentives and benefits must be thoughtfully created so that it may be sustained by the City over the long term. As noted above, it is relatively simple to determine the minimum level of subsidy needed to make an apartment developer whole from a financial standpoint. For every $100 that rents are reduced in a market rate development, the amount of debt the project can support is reduced by about $17,500 under current financing terms.

Question 2. Is it possible to incentivize affordable units in a purely private housing development through density or height bonuses, and if so, how large would the bonuses need to be given a target set-aside of 5 to 15 percent?

The marginal savings from these bonuses will be well short of the needed subsidy. Under the existing ordinance, even doubling the density will not likely create sufficient financial offsets to subsidize the affordable units. For example, 100 units doubled to 200 will not likely cover the 20 units at 60 percent of AMI. The analysis conducted by the panel liberally considered that the land and site development costs would be reduced by half if density were doubled—an unlikely level of savings in practice. Further, most apartment developers would not to seek to double their density since most markets in Raleigh will not support rents that would be necessary to cover the increased construction costs entailed in building more than 4 stories with non-combustible construction.

Question 3. What other barriers might prevent a developer from taking advantage of a voluntary incentive program, even if the financial analysis indicates the inclusionary development would be as much or more profitable than conventional development?

Mixed-income developments are more complicated to underwrite and difficult to finance. Developers typically follow a proven model, and current financial hardships make them less likely to innovate. Given that Raleigh area is a low barrier-to-entry housing market, there are already a range of housing options and a lack of geographic constraints. Even if developers were provided the appropriate levels of financial incentives most will not choose such an option.

While the panel is doubtful that developers will pursue mixed income options, we believe that there are actions that the City should adopt in order to make it easier for affordable housing developers to undertake their work and, perhaps, encourage the very enlightened and innovative developer to undertake mixed income housing.

Recommendations

The previous section presented the major findings of the TAP panel. This section presents the specific panel recommendations that flow from the findings. It closes with a discussion of next steps for carrying the recommendations forward.

<u>Definitions: Let's make sure we are on the same page:</u> First, we think that the City should clearly define in the UDO what is meant by the term "affordable housing". After looking at existing city definitions and those used by other cities, the panel recommends adoption of the following definition:

1. An affordable rental housing unit has a rent that is affordable to those with incomes at 60% AMI or less, and occupied by same.
2. An affordable rental housing development has a minimum of 10% affordable rental housing units.
3. An affordable rental housing unit has a compliance period of at least 30 years.

The panel noted that the City Community Development Department already monitors developers for program compliance under the Joint Venture for Rental Housing Program. While to panel did not look at definition for homes for purchase by owner occupants, City Community Development staff are capable of developing a parallel definition for such developments.

Recommendation 1: Cash is Needed

Developers will need a number of tools to offset the costs for building affordable housing. While all these tools have varying benefits, there has to be upfront public subsidy in order to make the program successful. This subsidy can be in the form of a City grant or zero-interest forgivable City loan. The panel recognizes that funds are scarce for affordable housing and does not recommend reducing funding of existing programs to take on a new program. Instead, we believe that tax increment financing (TIF) may be the means to support these financial incentives. We understand that "synthetic" TIF financing has been undertaken in Charlotte.

Raleigh should adopt a policy in favor of TIFs for projects that include affordable housing. A back of the envelope calculation shows that the numbers work if 60 percent of the tax increment were set aside for a 30-year payment on a bond. Consistent with the city's comprehensive plan, affordable housing is an example of a public good that merits the use of TIF financing.

Recommendation 2: Code Options

The new UDO now has a provision for reduced parking requirements in affordable housing developments. The panel also believes that a density increase in the R-6 residential zone would be an appropriate incentive for affordable housing developments. For R-6 developments that include a minimum of 10 percent affordable units, townhomes should be permitted at development density of up to 10 units per acre.

Recommendation 3: Fee Rebates

Noting that no single action will produce affordable housing, the panel recommends that qualified affordable housing developments be eligible for a grant that is roughly equivalent to amount of impact fees that developers now pay (approximately $5,000 per dwelling unit). The City could consider offering this rebate across all dwelling units in a qualified affordable housing development.

Recommendation 4: Compliance Period Time Horizon

Generally, most inclusionary or financing programs promoting the production of affordable housing require a compliance period of at least 30 years. The panel noted that subsidies could be lowered if the units were returned to market earlier, i.e. the affordability requirement runs for 10 years then reverts to market rate.

Recommendation 5: Opportunity sites for the future

The City of Raleigh should proactively purchase land in downtown locations and transit corridors if it wants to insure a mix of housing types in these locations in the future. RFP's to dispose of such property should specifically require developments that offer a range of housing prices and rents. Examples of this land banking work can be found in Denver and other cities.

The panel noted that studies going back as far as 1986 have proposed that the City purchase strategic parcels of land for mixed income or affordable housing. Yet this has never been implemented as far as we know. We note, however, that the City did make a strategic purchase of the Salvation Army building adjacent to Moore Square for an end use that is still to be determined. That precedent should be continued in order to deliver more affordable housing located in strategic areas of the City.

NEXT STEPS

The panel recognizes that some of its recommendations go beyond the scope of the Unified Development Ordinance. Like any study the City commissions, some recommendations can be addressed immediately and others will require further study. For those items that will not be acted upon immediately, we think that a champion at City Hall needs to be identified by the administration to take charge of this critical follow-up work with clearly defined timeframes to report back to City Council.

ACKNOWLEDGEMENTS

The panel appreciates the work the City staff did to prepare the briefing book for this project and we recommend that it be made widely available to all interested parties who have an interest in this very important topic.

Appendices

Table 1: Cost of rent reduction to market rate development

Rent Reduction Amount		$100		
Interest rate on perm loan		4.00%		
Amortization term (years)		30		
DCR		1.20		
Reduction in loan amount per $100 monthly rent		$17,455		
		Rent	Difference	Subsidy Needed
Market rent in project		$1200		
Maximum rent for 2 BR Apartment @ 60% AMI		$875	$325	$56,729

Table 2: Overall Public Subsidy

Sources		Per Unit		
TIF		$ 52,000.00		
Fee Rebate	~	$ 5,000.00		
Total:		$ 57,000.00		
200 unit project				
20 affordable units = total upfront required TIF subsidy of $1.04 M				
To close the $57K subsidy per unit (from income analysis)				
$60,000 annual payment of to retire $1.04 M 30-year 4% bond				
Estimated COR project taxes annually = $100K				
Net COR taxes = $40K				