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The Ins and the Outs

A Policy Guide to Inclusionary and Bonus Housing Programs in Washington

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Introduction

Programs that result in the addition of low cost housing into projects that are otherwise market rate have been in existence across the U.S. for decades, but have been used in only limited ways in Washington. With authority for incentive and inclusionary programs clarified through legislation adopted in 2006, cities and counties across the state are considering such programs.

This paper provides an overview of the legal, economic and practical issues that arise when structuring inclusionary or incentive housing programs. The efficacy and fairness of inclusionary programs is a function of program structures that are not very difficult to figure out. If communities pursuing inclusionary and incentive programs pay attention to the issues raised below, they can structure programs that will produce some amount of new affordable housing while not penalizing the building industry and its market rate customers, or worse, inhibiting development in areas that need more housing.

In any case, no one should have any illusions that inclusionary or incentive programs will, by themselves, make a huge dent in the problem of housing affordability in Washington. This problem has always resisted simple solutions, and these programs are but one tool to supplement the efforts of housing authorities and non-profit builders. Cities and counties must continue to address the root causes of the high cost of market rate housing, recognizing that we cannot subsidize our way out of this problem.

Prices too high and subsidy dollars too low

The range of bonus and inclusionary programs discussed in this paper are the result of two trends.

High land prices drive housing prices up. In a healthy housing market, the for-profit housing industry is able to provide housing to all but the lowest income households. In such an area, the "affordable" housing stock consists of a combination of newer, low-amenity housing built in less desirable areas, and older, deteriorated housing throughout the market. In such areas, underlying land values are low, and therefore the buyer or renter is paying for the quality of the structure. If the structure is small, plain, or in poor condition, the price will be low.

All that changes when underlying land values rise substantially. In areas like Central Puget Sound, the value of a the underlying building lots in relatively conventional neighborhoods ranges from $200,000 to over $300,000, so even the least valuable home will come with a sales price of at least $275,000, which is out of reach of many households. And in high demand areas like East King County, prices start at $400,000, which requires 150 percent of the area median income to afford.

With these kinds of land values it is impossible to provide housing affordable to people of even median income, let alone lower income. Absent a massive increase in the supply of land available for homebuilding, land prices will not fall, and this affordability situation will not correct itself. And as land supplies become constricted in other areas of the state, communities outside of Puget Sound find themselves in a similar affordability crunch.

Subsidies inadequate to meet need Even in the healthiest housing markets there will be people who cannot afford a place to live. To ensure public health and safety, there is a floor below which housing providers cannot go in pursuit of tenants, and many people do not have enough money to rent even the lowest price housing that can legally be offered. For these people we have subsidies, either through projects that charge lower rent, or through vouchers that pay part of market rents.

As land and housing prices rise, more and more people cannot afford the minimum priced housing, but subsidy dollars cannot grow with the growing need. This gives rise to long waiting lists for subsidized housing and vouchers.

In the Puget Sound region and the rest of the state it is quite clear that we have a major housing affordability problem and that direct subsidies fall far short of solving it. The supply of housing affordable to moderate and low income households is already small, and continues to shrink rapidly, and with land prices as high as they are, market rate builders cannot afford to provide new housing at low price points. The result is that too many households must spend an unreasonably high percentage of their income on housing, and/or commute great distances to their jobs from more affordable areas.

The inclusionary/incentive option

One of the ways to address this problem is to have developers include subsidized units in their market-rate projects. This can be done in a variety of ways that will be discussed below, most of which do not cost governments much money directly, and which may or may not cost developers and their customers money.

As the debate over these programs has sharpened, it mostly boils down to two questions:

Are these programs effective? Critics point to data suggesting that even the most well-established programs have never produced housing units in great numbers. Proponents will admit that these programs are not a panacea, but argue that any new affordable housing is better than none.

Who pays? If the buyer or renter is paying less than the market rate, where is the rest of the money coming from? In the most draconian programs, where no incentives are offered, the builder pays the subsidy and passes as much on to the customer as price elasticity allows. Most programs involve some incentives to builders, such as density bonuses, but if these incentives do not fully cover the cost of the affordable units, the builder and buyers will pay the difference. And bonuses may be viewed as an imposition on the surrounding community: the neighborhood that must accept more density will feel it has paid the price.

For purposes of this paper, the broadest definition of the programs that fall under the rubric of "inclusionary" or "incentive" is:

> *A local government program that requires or incetivizes the inclusion of below-market-rate units in a development that is otherwise a market rate development.*

This definition requires that the affordable units in a development sell or rent for less than they are worth on the market and therefore receive some sort of subsidy that is generated within the context of the project development budget. That subsidy may be provided by the developer (with the cost passed on to the customers of the market rate units), or it may come through an offsetting benefit the developer receives through an incentive such as a density bonus, fee waiver or tax abatement.

Legal Framework

Inclusionary programs have their roots in two policy concerns. First, as noted above, they are a response to persistent high housing costs and the difficulty, because of land values, of building lower cost market-rate housing in many areas. Second, inclusionary programs have been mandated as a remedy for deliberately "exclusionary" zoning. In the famous Mount Laurel case in New Jersey, courts required communities that had previously had only very large lot zoning to make provision for affordable projects.

Few areas of Washington have ever had the kind of exclusive, large-lot zoning that is common in East Coast suburbs, and until the 1990s, affordable market-rate housing could be found within reasonable commute distances of major job centers. As that housing has evaporated, however, communities have felt a need to provide housing at below market rates. Some communities, most notably Bellevue and Redmond, experimented with inclusionary programs beginning in the 1980s, but these programs were not common.

The specter of RCW 82.02.020

Many jurisdictions felt they did not have the legal authority to require inclusion of affordable housing, and with good reason. Requiring developers to take actions for a public purpose that cost them money skirts dangerously close to the definition of a regulatory "taking" that is prohibited under the U.S. Constitution.

More specifically in Washington, the provision in state law that governs taxes on construction – RCW 82.02.020 – expressly prohibits "any tax, fee or charge, direct or indirect" on construction, except as expressly named. The law then goes on to name quite a number of ways that governments can tax construction, but prior to 2006, this did not include permission to require the inclusion of affordable housing. (A requirement to build affordable housing has been considered by courts as equivalent to a tax.)

In several high profile court cases in the 1980s the state Supreme Court invoked RCW 82.02.020 to disallow local government programs that required developers to preserve or replace low income housing. These cases asserted that governments could not impose on developers the burden of achieving a social goal, such as affordable housing. Because several Seattle officials continued to enforce these laws even after the court's decision, they were held personally liable for damages, producing a chilling effect on local governments around the state.

The law does, however, allow governments to require developers to mitigate the impacts of their developments on local infrastructure, such as roads and schools. This authority can extend to housing if the government can demonstrate a clear connection, or nexus, between a development and the supply of affordable housing. In other words, do market rate developments themselves generate demand for low wage service jobs, and therefore for affordable housing? If so, governments could require developers to mitigate a shortage of affordable housing. Some cities have undertaken "nexus studies" to show that market rate developments should include or pay fees for affordable housing.

So, prior to 2006, local government had three options with respect to connecting affordable housing to market rate housing. First, they could impose a mandatory inclusionary requirement and take their chances with the courts. Second, they could perform a nexus study to justify an inclusionary requirement. Third, they could have strictly voluntary incentive programs.

HB 2984 provides explicit authority

This murkiness of authority for inclusionary or incentive programs was cleared up by the 2006 Legislature in the form of Housing Bill 2984 (now RCW 36.70A.540, but referred to hereafter as HB 2984) which allows cities and counties to "enact or expand affordable housing incentive programs providing for the development of low-income housing units through development regulations." Importantly, the bill explicitly states that an inclusionary or incentive program that complies with the new law will not be in violation of RCW 82.02.020.

So after a couple of decades of uncertainty, court challenges, complex nexus studies and other work-arounds, HB 2984 clears the deck for cities and counties that want to enact programs. The law provides the basic parameters, but as will be shown below, successful programs must also take into account the market and economic realities of the local area.

Following are some of the key features and definitions provided in the law:

Voluntary or mandatory. The law provides for two basic types of programs: voluntary and mandatory. Under a voluntary program, a developer can decide to seek various incentives (options described below) in exchange for inclusion of a prescribed number of affordable units. Or, the developer can decide not to seek the incentives, and simply develop the property according to current zoning and regulations. The law explicitly prohibits the city or county from penalizing any developer who chooses not to participate in a voluntary program.

A mandatory program must be tied to a change in zoning or other regulations that increase the development capacity of an area. Thus, if a city decides to upzone a neighborhood, it can require that anyone building in that area include a certain number of affordable units regardless of whether they actually build up to the new zoning. The justification of this requirement is that the property owner has been given increased land value by virtue of the upzone, and that increased value is the equivalent of an incentive under a voluntary program. Court cases have made it clear, however, than jurisdictions cannot unreasonably downzone property and then upzone it again with an affordability requirement attached.

Location and features of affordable units. Although the law encourages affordable units to be dispersed within the market rate development, it allows alternatives. The affordable units can be included in an adjacent building. The developer also has the option of providing cash or land in lieu of building the units, with that cash or land being used to build an equivalent number of affordable units somewhere else.

In any case, the units themselves must be of a similar mix of sizes to the market rate units and have a similar array of bedrooms and bathrooms. Similarly, the affordable units must have the same functionality as the market rate units in terms of layout, appliances and fixtures. The affordable units can, however, be smaller and use a lower grade of appliances, fixtures and finishes. The importance of this provision will be shown below, as unit construction costs are compared.

Income levels: who is eligible? The law establishes guidelines for income eligibility, but also provides a substantial amount of flexibility to address local conditions.

For rental housing, the basic ceiling of eligibility is 50 percent of area median income (AMI), adjusted for household size. This can be raised to 80 percent of AMI if the city or county determines there is a need for rental housing at this level. Once a jurisdiction establishes its income level (which can be lower than the ceiling), it sets a rent level such that the target household will not spend more than 30 percent of its income for rent and utilities.

For ownership housing, the basic ceiling is 80 percent of AMI, adjusted for household size. This can be raised to 100 percent of AMI in high cost areas. Once a ceiling is established, the jurisdiction sets a maximum purchase price, although the law does not give specific guidance for setting this price.

The affordability restrictions on both rental and ownership units remain in effect for 50 years, with enforcement through covenants or other recorded documents. Prior to the 50-year timeframe a jurisdiction is permitted to accept a cash payment in lieu of continued restriction on rental or resale.

Incentives and bonuses. The law provides some suggestions for developer incentives, but leaves the door open for additional incentives. It is important to distinguish between two types of incentives: those that cost governments money and those that do not. This distinction comes into play when income eligibility moves above 80 percent of AMI, since state law only allows government subsidies for people below 80 percent AMI. HB 2984 allows ownership projects to target up to 100 percent of AMI, but these must not use any government subsidies.

The following incentives are named in HB 2984:

<u>Density bonus</u>. This is the most common type of incentive, and also the most powerful. By allowing the developer to build more units than the underlying zoning would allow, there is the opportunity to build new market rate units on what amounts to "free" land. An example of a density bonus program would be that for every 15 market rate units, one affordable unit is required, and one bonus unit is allowed. Thus, for a parcel that would accommodate 30 units under current zoning, the result under the bonus program would be 32 units, with two offered at below-market rate. The impact of these programs on the financial performance of projects will be discussed below.

<u>Height and bulk bonus</u>. Most zoning codes govern the building envelope and a bonus of height or bulk can add saleable floor area. If unit count is not governed, this can translate into more units. If unit count is still restricted on the site, this bonus would allow larger and, therefore, higher priced units. Building envelope bonuses usually work in conjunction with density bonuses to ensure that the affordable and bonus units can actually fit on the site.

<u>Parking reductions</u>. Parking can be a very expensive part of a project, especially when it is structured. A reduction in parking requirements can be a cost saving. This will be effective mostly in areas within walking distance to job centers and/or with good transit service, since developers may not want to risk the marketability of their project by having inadequate parking.

Fee waivers or exemptions. Although a waiver of permit fees is always welcome, this incentive will have the most impact in areas with significant impact fees. In single family neighborhoods with large school or infrastructure impact fees, a waiver of those fees will have a positive impact on lot development costs, and therefore on housing costs. Many areas do not impose high impact fees on multi-family housing, so this will be less of an incentive there.

Expedited permitting. Expedited permitting lowers the financing costs of projects by reducing the interest paid on money borrowed for land acquisition and up-front soft costs and by reducing the overhead charged against the project.

Also included as an incentive in HB 2984 is the authority to undertake mixed use development. Since mixed use development is already allowed in most areas where it is financially feasible, it is difficult to see the incentive value of this provision.

Other incentives that a jurisdiction might offer would include assistance with infrastructure, adjustment of lot coverage, open space or street standards, or adjustment of design standards. Jurisdictions could also rebate the local sales tax paid on construction of affordable and bonus units.

Will it work?

On its face, HB 2984 does not contain any provisions that make it impossible for a jurisdictions to structure an inclusionary/incentive program that would be both productive and fair. It gives local governments a high degree of leeway to draft a set of requirements and incentives that meet local market conditions. As with most provisions of the Growth Management Act, the devil is in the details, and those are decided at the local level.

One safeguard that is conspicuously missing from HB 2984, however, is any requirement to demonstrate that an incentive package will fully offset the cost of including affordable units. If the incentives do not cover costs of the affordable units, one of the two key criteria for a successful program will suffer. In a voluntary program, effectiveness will suffer, since few developers will undertake a program that costs them money (as seems to be the case currently with the many underused programs in the state). In a mandatory situation, fairness will suffer, since developers will be compelled to pay more in costs then they get back in incentives, thereby leading developers and their market-rate customers to subsidize the affordable units.

We can safely conclude that, since it gets around the strict provisions of RCW 82.02.020, the new law passed under HB 2984 will provide the parameters within which inclusionary and incentive housing program around the state will be structured going forward. We can expect to see efforts to adopt both mandatory programs tied to the rezone of multiple parcels, and voluntary programs applying to specific projects.

Economics

As noted above, the key to the fairness of mandatory programs is to ensure that the value of incentives fully offsets the cost of the subsidy to the included units. In the case of voluntary programs, the incentives need to more than offset the costs of included units in order to cover the added risk and complexity of participating in an affordable housing program. So, it is worth looking at how incentives interact with project budgets.

The easiest way to look at the economics of incentives is to determine the cost to the project of not getting full sales prices or rents, and then assembling a package of incentives to offset that cost.

Figure 1, adapted from a methodology developed by A Regional Coalition for Housing (ARCH) shows the cost of providing apartments in a typical urban center building at 50 percent AMI. (Rents in stacked flat apartments with underground parking generally start at about $1.75/foot.) When the lost rent is capitalized at a cap rate of six percent, the value of the units drops by $94,400 for the one-bedroom and by $160,400 for the two-bedroom. Those figures provide the goal for the value of the offsetting incentives.

Figure 1

Apartments Affordable at 50 % AMI

	One Bedroom	Two Bedroom
Market rent/month	$1,200	$1,600
Affordable rent/month	$728	$798
Monthly gap	$472	$802
Annual gap	$5,664	$9,624
Cap Rate	6%	6%
Value of gap	**$94,400**	**$160,400**

Source: A Regional Coalition for Housing (ARCH)

The following analysis will focus on the one-bedroom example, and the various places to look for the $94,400 that needs to be recovered. The first place to look is the features of the affordable unit itself that can be adjusted.

1. Smaller unit. As noted above, as long as an included unit is functionally the same as the market rate units, it can be smaller. A typical one-bedroom apartment in a stacked flat building might be 700 square feet, and this could be squeezed down to 625 square feet.

2. Lower construction cost. The law also allows included units to be less elaborate. So, if a typical stacked flat apartment costs in the neighborhood of $120 per square foot to build, it might be reasonable to whittle that down to $105 for the affordable unit. This means no granite counters, hardwood floors or jet tubs.

Combining the smaller unit size with the lower construction cost yields a savings of about $18,000, which is $76,400 short of the gap. That is where the incentives come in. If the developer were offered a bonus of two extra one-bedroom apartments, that provides two new sources of money.

3. Free land. If the parcel of land under this project was priced according to the underlying zoning, the bonus units can be thought of as having no land cost at all. Typical urban center buildings have a net floor area ratio of about 2.0, so a 700-square-foot apartment would have 350 square feet of land attributed to it. The going rate for urban center land varies widely, but stacked flat buildings are usually not built on land selling for less than $80 per square foot, so at that price, the value of the "free" land for the affordable unit is $56,000.

4. Profit from bonus units. If the building has a operating cost ratio of 30 percent, the bonus market rate units would each receive a net monthly rent of $840. With a cap rate of .06, this translates into a unit value of $168,000. If the builder is able to generate a 10 percent profit margin, the profit on the two bonus units would be $33,600.

Figure 2

Offsetting loss from rent affordable at 50 % AMI

Value of Rent gap	-$94,000
Smaller unit, lower grade	$18,000
Land for bonus units	$56,000
Profit from bonus units	$33,600
Net profit change	**$13,600**

Figure 2 shows the results of tapping into four sources of money to offset the loss of rental income from the included unit. After building both the affordable and bonus units, the project would have an additional $13,600 in profit. It is doubtful that, if the program were voluntary, a builder would find this extra revenue sufficient to offset the risk of adding a few hundred thousands of dollars to the project. If it is not, the city and builder would need to go back to the menu of incentives to look for other benefits such as fee waivers or a reduced parking requirement.

The thin incentive outcome of this example shows how difficult it can be to structure a bonus program that will be attractive, especially with the size of the rent gap shown here. Most existing voluntary programs are less generous than this example, offering only one bonus unit for each affordable unit. It is not surprising that they are seldom used. This is, of course, a hypothetical and highly simplified example, but shows the kind of thinking that needs to go into understanding the economics of inclusionary and incentive programs.

Program Questions

In working through the requirements of HB 2984 local governments will encounter a long list of policy decisions, most of which are described above. In addition, HB 2984 is silent on a number of other policy issues that will inevitably arise. Following are some of the key questions that will need to be resolved as each jurisdiction evaluates its particular needs and market conditions.

Program threshold. Small projects do not have the flexibility to include affordable units, and adding units to a small project will increase its density beyond what neighbors might consider acceptable. It is impractical to incentivize small projects and burdensome to require them to participate in a program. So, at what size project does it make sense to start?

There is no easy answer to this question, but a good way to look at it is the impact that a bonus would have on density. For example, a two-for-one bonus (such as the example above) on an eight unit project would increase the density by 25 percent and probably be quite noticeable. The same bonus on a 12 unit project increases density by 17 percent.

On-site versus off-site. While it may be good social policy to include affordable housing intermixed with market rate housing, the economics can be difficult when the market rate project is at the expensive end. Even if the bonus results in “free land” for the extra units, the cost of framing in concrete or steel, and provision of underground parking make the affordable units expensive to build, no matter how skimpy the interiors. The argument for doing affordable housing off-site is that the money is better spent on more units rather than on expensive shells and parking.

Having inclusionary units within a luxury building also raises a fairness question: should a lucky handful of people get access to luxury locations at the expense of fewer housing units being available for everyone. This is an accentuation of the “lottery” problem described below.

Voluntary versus mandatory. The programs authorized under HB 2984 would be, at their simplest, purely voluntary: a developer would decide whether the incentive package was sufficient to offset the costs of the included affordable units and to compensate for the added capital risk and headaches. Many such programs already exist, but are often criticized for offering too little in the way of incentives and, therefore, resulting in too few projects with included units.

HB 2984 allows mandatory programs in cases where a jurisdiction has upzoned an area. With these programs the jurisdiction can mandate a minimum amount of affordable housing in the upzoned area, with or without additional incentives. This approach is roughly analogous to the requirements for affordable units in masterplanned communities where a formerly rural area is allowed to be developed intensively.

The uncertainty in such an approach concerns land prices. Land for development is typically priced according to the number of housing units that can be built on it. This is particularly the case with lower density zones where the unit count is easy to estimate and the land cost is a higher percentage of overall project cost. Once land is upzoned, the owners of that land will attempt to reprice it to reflect the higher allowable unit count. During purchase negotiations the prospective buyer may be able to make the argument that they cannot pay for the land needed for the affordable units, but they will likely have to pay for the land for market rate units beyond those allowed under the original zoning. Thus, the "free land" for bonus units assumed in Figure 2 may not be free after all. The builder will certainly benefit from the profitability of the extra units added under the rezone, but will not get the benefit of the free land they might be able to get under a voluntary program.

An argument frequently heard against mandatory inclusionary requirements tied to upzones is one of fairness. Local governments rarely compensate land owners when the capacity of land is diminished due to environmental or zoning regulations, so why should they exact a price when the capacity is increased?

Unit types. Cities and counties need an accurate assessment of the housing needs of their community in order to determine the types of units to be encouraged through inclusionary or incentive programs. In most areas there is a reasonable supply of affordable one-bedroom apartments, so adding more of those may not be meeting a need. Similarly, there is a good choice of one and two bedroom condominiums in the urbanized areas of the state.

What is missing in many urbanized areas is affordable detached or semi-detached housing for first-time buyers and larger apartment and condominium units. Thus, a program might target three bedroom apartments or condominiums, or affordable townhouses. Also missing in many areas are small studio condominiums, and these can be encouraged as carriage houses over garages.

Accommodating higher density. If the incentive offered is a density bonus – more units than the property would accommodate under current zoning – it is likely that some other zoning regulations will have to budge in order to accommodate those new units. After all, it does no good to offer a bonus only to find out that other regulations preclude taking the bonus. Market considerations tend to dictate unit size, so developers may be leery of just squeezing more units into the same envelope.

Options for accommodating more units will vary depending on the building type. For example, in a detached fee simple development, some units could be attached as duplexes or triplexes or simply have the separation between units narrowed. Street widths can also be narrowed. Programs for multifamily buildings can adjust setbacks, expand lot coverage or increase height.

Fitting in the neighborhood. When affordable units are integrated into a market rate development, it is crucial that they do not stand out as obviously different. This is important for community character, as well as marketability of the rest of the project. One approach is to use design standards to require that the affordable units look the same as the market units on the exterior, while using lower grade fixtures and finishes on the interior.

Figure 3 shows an example of the per-square-foot construction costs of a 1,600 square foot 1 ½ story house. The R.S. Means Company provides cost estimates for four grades of home: economy, average, custom and luxury. Figure 3 shows the per square foot cost of elements of the house for the economy and custom grades, and then a hybrid that uses the custom grade for the exterior and the economy for the interior.

Figure 3

Per-square-foot construction cost
1,600 square foot house

	Economy grade	Custom grade	Hybrid economy/ custom
Foundation	$7.60	$9.98	$9.98
Framing	$10.16	$13.15	$13.15
Exterior walls	$12.60	$13.06	$13.06
Roofing	$2.04	$4.67	$4.67
Subtotal - exterior	$32.40	$40.86	$40.86
Interiors	$20.15	$32.93	$20.15
Specialties	$1.86	$5.60	$1.86
Mechanical	$5.62	$8.82	$5.62
Electrical	$1.99	$3.26	$1.99
Subtotal - interior	$29.62	$50.60	$29.62
Overhead	$9.58	$18.44	$12.49
Total	$71.60	$109.90	$82.97

Source: R.S. Means Per Square Foot Cost Data 2007

The exterior of the custom grade is somewhat more costly than the economy, since the custom home will have more articulation and expensive framing elements like dormers. But the real savings is found in the interiors, where the custom home will have much higher spending for finishes, plumbing and lighting fixtures and kitchen appliances. The hybrid version of this home could be included in a subdivision with little notice, until one goes inside.

Implications for home ownership. Subsidized rental housing is straightforward to manage over time, as new tenants can easily be found who fit the income and other criteria. Ownership housing is another matter. Buyers who pay less than the market price for a home are receiving a public benefit and should not be able to cash that benefit in by selling their home at market prices. At the same time, a major benefit of home ownership is the opportunity to realize the appreciation of the local real estate market. The subsidized buyers are paying less, but they are still investing their money and should expect some return.

Thus, below-market ownership units need some reasonable controls on resales that ensure that the units continue to be owned by households that qualify for the public benefit but that also offer the seller some fair return on investment. Furthermore, the opportunity for a return on investment must be enough to ensure that owners maintain their homes in good condition. If the resale price does not reflect the physical condition of the home, owners have a perverse incentive to defer maintenance.

Long term program management. This leads to the question of management of the affordable units over the long term. By requiring units to remain affordable for at least 50 years, HB 2984 presents a challenge of continuity. Few individuals remain in place for 50 years, and public and private organizations can change significantly during that time. So, with units dispersed across the community it maybe easy to lose track of restricted properties. Title restrictions may prevent outright sales of restricted units, but owners may rent or sublet them inappropriately with no one knowing.

In a time of perpetually underfunded and understaffed local governments, enforcement of housing affordability requirements may fall very low on the priority list. Smaller jurisdictions, where programs may result in a small number of dispersed units, need to think carefully about creating a management problem for future generations.

Political Questions

As communities consider inclusionary or incentive programs they will face some challenging political questions.

The easy way out? Even the most ardent proponents of inclusionary and incentive programs will admit that the programs are only a part of the solution to the state's housing affordability problems. But there is still a danger that these programs can be misrepresented as more productive than they can realistically be. The state has a need for tens of thousands of new units of affordable housing, and that need is growing daily, as prices increase faster than incomes. But because inclusionary and incentive programs cost little if any public money, they can be an easy way for governments to appear to be aggressively addressing the problem of housing affordability, while not making much of an actual dent. Local officials need to be clear to their constituents that these programs are part of larger efforts to increase the supply of affordable housing.

The "lottery" effect. In a market, when demand exceeds supply, prices rise to shake out excess demand. But when prices are fixed, as with affordable housing programs, there needs to be another method to allocate the scarce resource. In the case of inclusionary housing, many people who might decline to live in public housing would jump at the chance to get a brand new unit in a brand new community surrounded by stable middle class residents. Yet, these opportunities will be few, with governments and non-profit program managers in the position of determining which lucky people get the new home and which come away empty-handed. Such a decision process, no matter how well steeped in objective criteria, becomes a sort of lottery with a few winners and mostly losers.

How rich can incentives be? Mandatory programs are only possible in areas slated for general upzones, so most programs will be voluntary. This leaves the developer in the position of deciding whether the incentive package is worth the added effort and financial risk of inclusing affordable housing. Since many builders will take the view that they should be rewarded for helping achieve a public purpose, and not just reimbursed, incentive packages will need to result in increased profit margins across the entire project. But this may be politically difficult, and cities and counties may be accused to giving away too much, especially if bonuses result in higher densities or a larger building envelope.

Conclusion

Cities and counties now have a clear idea of what sorts of incentives and requirements they can adopt to try to increase the supply of affordable housing through bonus or inclusionary programs. The challenging part is that these programs cannot generate nearly enough affordable housing to meet present needs, and therefore must be packaged with other, more politically difficult actions. The worst outcome of HB 2984 would be to have cities and counties put weak incentive programs in place and then claim they have addressed their housing problems.

Like most areas of land use law in the state, HB 2984 provides a neutral framework within which local governments can build programs. The choices made by local governments with respect to the balance of incentives and requirements will determine whether these programs produce useful amounts of affordable housing or whether they are merely window dressing. The economics are not difficult to figure out, and a strong partnership between local governments and their housing industry can easily result in effective programs. But unfortunately, even the most effective program will benefit just a small fraction of the households priced out of today's blistering housing market.