Evaluation of In-Lieu Fees and Offsite Construction as Incentives for Affordable Housing Production

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Abstract

Communities are beginning to offer options of in-lieu payments and offsite construction of affordable housing units required by inclusionary housing programs. An examination of experience with these options in Boulder, Colorado; Montgomery County, Maryland; and Pasadena, California, analyzed patterns of affordable housing production through the use of these options and explored reactions by program administrators, developers, and housing advocates. The findings indicate that the options can be effective in producing affordable units in satisfactory locations, while enabling developers to mitigate costs of supplying affordable units in high-cost neighborhoods. The programs that established specific in-lieu fees (periodically updated) appeared to avoid the controversies engendered by site-by-site determination of appropriate fees, especially for highrise construction.

Introduction

More and more communities are adopting programs that require or offer incentives for developers to build affordable, below-market-rate priced housing in market-rate residential projects. Often termed "inclusionary zoning," the programs are intended to increase the stock of affordable housing. The programs typically offer incentives such as increased density and waivers of fees to offset the additional development costs of such projects. Increasingly, communities are also providing options to the construction of affordable units within market-rate projects as a means of lowering development costs for affordable housing. Two such alternatives allow the developer to pay an "in-lieu fee" into a housing fund or develop affordable units on other, perhaps less costly, sites.

Information about the use and effectiveness of these alternatives to onsite inclusionary housing is not widely available; therefore, this pilot study seeks to determine the extent to which these alternative methods are effectively substituting for onsite development of affordable housing in three communities—that is, this study evaluates the successful use of these incentives. The authors hope that the study's indepth evaluation of experience with these incentive-zoning options will help other communities understand the rationales for offering such options, the procedures and requirements established to ensure production of below-market-rate units either on site or off site, and the successes and issues that have resulted from use of the options.

Goals and Requirements of Inclusionary Housing Programs

Communities adopt regulations and incentives in inclusionary housing programs to increase the stock of housing affordable to local and regional households and to promote development of mixed-income neighborhoods. Such programs can involve all types of residential development, including single-family and multifamily units; lowrise, midrise, and highrise structures; "stick-built" and manufactured housing; and housing mixed with retail and other uses. Inclusionary programs often are administered jointly through zoning requirements and procedures in combination with housing agency programs. They are contributing significantly to the supply of housing for low- and moderate-income households and, in addition, are helping communities to revitalize and stabilize urban and suburban neighborhoods.

Typical programs provide incentives for developers to incorporate housing for a mix of household incomes in their market-rate developments. Incentives often include zoning density increases, fast-track permitting, reductions in administrative and impact fees, relaxed parking requirements, and code requirements that allow adaptive reuse. These incentives may be employed across a community or within neighborhoods designated for revitalization.

Increasingly, some incentive-zoning programs also provide some flexibility in financing and siting the lower priced components of such developments. Developers are offered the option of paying fees into housing and/or land trusts or developing below-market-rate units on separate but nearby sites. These options appear particularly appropriate in cities and built-up suburban areas in which proposed developments involve highrise buildings that are costly to construct and include condominiums and apartment units that will charge monthly service fees. Such high unit costs complicate financing of a mix of market-rate and below-market-rate units. The option of making in-lieu payments can channel funds into housing trust funds and community land trusts that help cities and community organizations produce housing for lower income households. The offsite option allows developers to build on less costly but nearby sites and to contract the construction of affordable units with developers or housing organizations that specialize in developing and providing services for below-market-rate housing.

Some communities, however, decide against the use of fee payments and offsite production of below-market-rate units. They prefer that developers produce a mix of market-rate and below-market-rate housing within one site as a more certain and timely generator of below-market-rate units and a means of ensuring household diversity within projects. To date, however, little information has been made available, except by word-of-mouth, to document the effectiveness or difficulties of fee payments and offsite options in producing affordable housing that meets community goals. So-called "linkage" programs in San Francisco and Boston have generated substantial numbers of below-market-rate units by requiring fee payments or optional siting arrangements, but these programs have been directed primarily to requiring developers of commercial and institutional properties to produce below-market-rate units rather than develop mixed-income residential developments. It remains unclear whether separating the development financing or location of below-market-rate and market-rate units satisfactorily meets affordable housing goals.

Research Procedure

The study proposed to evaluate the pros and cons of alternatives to onsite development of affordable housing within market-rate developments by evaluating the experience of three communities that allowed developers to meet their inclusionary housing obligation by paying in-lieu fees or building affordable units at offsite locations. Through a review of existing studies of inclusionary programs, by networking with experts in the field, and in consultation with U.S. Department of Housing and Urban Development (HUD) staff, we selected for study three communities that have authorized fee and siting options within their inclusionary programs. We chose the following communities, which represent a variety of geographic areas, with varying housing markets and regulatory outlooks, with substantial production of affordable units, and with a history of allowing alternatives to onsite construction of affordable units:

- Boulder, Colorado, a city of 92,000 residents located 35 miles northwest of Denver, established a program in 2000 that has produced more than 306 affordable units as of 2007.
- Montgomery County, Maryland, a suburban county of 930,813 residents (in 2007), located north of Washington, D.C., has managed one of the best known programs in the nation, which has generated more than 11,400 moderate-income housing units; the county has permitted alternatives to onsite development since the program was established in 1974.
- Pasadena, California, a city of 151,000 residents in the Los Angeles metropolitan area, authorized a program in 2001 that has produced 351 affordable units and has another 250 units authorized or under construction.

The examination of each community's incentive-zoning process includes basic data describing the community's character and housing needs; the gestation, adoption, and administration of the program the area affected (if not the whole community); the targeted household types and incomes; the requirements and incentives included; the number of market-rate and below-market-rate units approved through the program; and the rental/for-sale breakdown of units actually constructed and occupied. The use of fee payments and offsite options to the onsite provision of affordable units is documented, including the procedures to approve such options; the involvement of organizations and other developers in financing, constructing, or otherwise participating in the production of below-market-rate units; and the current status of the program in the community's affordable housing efforts.

The research process included reviews of the local laws, regulations, and procedural steps to decisionmaking in each community, as well as project site visits, interviews with program staff and the developers involved in previous and ongoing projects, and reviews of staff and consultant studies that supported proposals for use of the options. Local program staff reviewed the resulting reports about each community's experience.

The Options

The study described in this article centers on the communities' experience with the use of the in-lieu fee and offsite development options.

In-Lieu Fee

The in-lieu-fee approach allows developers to contribute cash to the jurisdiction, its housing trust fund, or sometimes a designated nonprofit organization instead of building affordable units. The fee represents the construction cost for a developer to add one market-rate unit to a proposed development. In general, the fee does not include land costs and a variety of other costs incurred by the developer in preparing the site for the entire project. Communities have used three methods to calculate an in-lieu fee.

1. Measuring the difference between the cost to build a market-rate unit (excluding developer profit) and the sales price of a unit affordable to moderate-income households.
2. Determining the gap between the cost to build an affordable unit and the construction loan available to a developer of affordable housing.
3. Identifying the subsidy that public funds have provided for local developers of affordable housing in recent years, including new construction, acquisition and rehabilitation, and land costs.

The third method generally is considered inappropriate, because subsidies alone typically are not sufficient to construct an affordable unit. The other two methods require a financial "affordability gap" analysis that estimates the difference between operating costs and incomes for a variety of housing types (for example, single-family home, rental apartment) expected to be built in the jurisdiction (usually based on local project experience) and the sales prices or rents affordable by various types of households. The analysis then translates the affordability gaps into in-lieu fee amounts. In many cases, the outcome of the financial analysis is then subjected to intensive public discussion that determines the final fee. As with Pasadena, some jurisdictions adjust the fee according to designated areas with differing housing characteristics. Annual fee revisions generally are tied to the consumer price index, increases in household incomes, or a similar measure of economic conditions. Fees often are collected with funds from other sources to provide financing for city-managed development of affordable units.[1]

[1] This summarized methodology of determining in-lieu fees is drawn from two studies: Keyser Marston Associates (2005) and Bay Area Economics (2007).

Offsite Development

Developers may choose to produce affordable units in other areas of the jurisdiction where land costs are lower, housing characteristics are more compatible, or existing improved lots, city-owned properties, or housing suitable for renovation are available. Some inclusionary programs provide incentives, such as density bonuses and public subsidies, to encourage production or improvement of affordable housing that spurs neighborhood revitalization. In addition, city-owned sites may be involved. The programs may require that locations of offsite development be near the proposed market-rate developments. Pasadena, for example, requires that offsite units be provided in the same subarea as the market-rate development site, and Montgomery County calls for locating offsite affordable housing units "nearby."

Each of the jurisdictions reaches agreements with developers that may mix and match these alternatives with other incentives and provision of onsite affordable units. The developer of One Boulder Plaza, for example, was granted the right to transfer density from one parcel to another and was allowed to provide one-half of the required affordable units on the site and the remainder on other sites, by acquiring and renovating three existing single-family homes.

Research Findings

1. The strong housing market in recent years has presented challenges to inclusionary programs that often focused on leveraging the development of single-family detached and attached homes in developing areas. Changing demographic factors and increasing land prices have generated market interest in higher density development, including midrise and highrise residential buildings, and in infill sites considerably more expensive than rural land. Concerned about constructing affordable units in high-cost developments, developers have sought alternatives, especially for sites where density ceilings and environmental offsets impose limits on construction.

2. The alternative zoning incentives allowed in the three communities' inclusionary programs reflect a common underlying policy—explicitly expressed in Montgomery County's law and acknowledged by the administrators of Pasadena's and Boulder's programs—that the financial burden of providing affordable units should not erase developers' profit margin in their development of residential projects. The jurisdictions have therefore sought to widen developers' financial and locational choices for affordable housing production through a variety of incentives.

3. Boulder and Pasadena, in particular, have found that the availability of alternatives to onsite construction of affordable housing has provided acceptable incentives for producing affordable housing in association with market-rate residential development. Although individual project decisions about use of alternatives have proven politically fractious in Montgomery County, the jurisdiction has allowed 21 projects to provide in-lieu fees. The opportunity to offer in-lieu fees or offsite construction has proven especially significant for coping with escalating land and development costs in communities recognized as highly desirable residential and employment locales. Offsite production has gained attention as a means of improving the existing housing stock and generating neighborhood revitalization. In addition, the localities have succeeded in collecting and disbursing fee payments and managing offsite production to generate affordable units. (Specific production numbers are detailed in the individual case studies.)

4. The case-study research shows that developers clearly make choices of onsite production, fee payments, or offsite production that depend on the types of units involved, financial factors such as land and development costs, and city administrative procedures that promise an efficient means of meeting their affordable housing obligations. Developers' choices, however, can be subject to influence or negation by the local government.

   Pasadena's experience indicates that developers will make decisions about when, where, and how to meet affordable housing requirements based on the factors mentioned previously. In the first years of Pasadena's program, when developers were mostly building rental housing, they found it feasible to provide affordable units on the site. As development of ownership units boomed in the mid-decade years, especially in and near downtown and largely on infill sites, land and construction costs and sales prices escalated quickly. The market preference for condominiums also added sizeable service fees to housing prices. These factors encouraged developers to contribute fees rather than choose onsite production of affordable units. In recent years, as more developers have returned to producing rental housing, onsite development of affordable housing has increased. The flexibility of the program is demonstrated through the changing choices of developers, although Pasadena's program administrators have played a significant role in working out details of the resulting developments.

   Montgomery County officials, however, have taken a more active part in approving or limiting developers' choices. Theirs is fundamentally a case-by-case approval process in which citizens' concerns and attitudes have affected the county's decisions.

5. These programs in upscale communities have not yet included manufactured housing. Possibly, the absence of such housing is due in part to the small number of units in most projects and the project locations in built-up central areas in which manufactured housing is uncommon. Communities could readily apply inclusionary approaches and incentives that could be productive in housing markets suitable for manufactured housing.

Current Issues With Incentives

1. Montgomery County's experience highlights one difficulty with the use of in-lieu fees: the problem of explaining the basis for the fees. The economic relationships between the price or rental levels of market-rate and affordable units are complex, especially given the variety of housing types that may be developed over time. Experts can produce financial analyses that propose presumably valid fees, but the average person seldom cares to peruse the reports and relies instead on trusted officials to make the right decisions. Pasadena's fee levels might be questionable to some but appear acceptable to developers and to most citizens. Montgomery County officials, however, have encountered political turmoil over the use of in-lieu fees. In part, this problem may arise from the county's project-by-project studies and procedures that define appropriate fees based on individual project characteristics, rather than a single "master" study that establishes fees for development of certain types in certain areas, as is the case in Pasadena. According to interviews conducted for this study, it also appears that developers' use of in-lieu fees have become popular targets for antigrowth or slow-growth groups, which

characterize fees as developer "buyouts." To some extent, to such groups, the use of fees has become an unwelcome symbol of the eagerness of county officials to support new development in built-up areas.

2. Both in-lieu fees and offsite production tend to reduce the inclusionary aspect of the programs by allowing production of market-rate developments with less or no incorporation of lower income households. Some programs, however, require location of affordable units in nearby areas that can widen the neighborhood mix of housing. Also, to the extent that offsite development stimulates rehabilitation of existing housing and revitalization of neighborhoods, such development provides value for the community as a whole.

3. The three programs have demonstrated in a number of cases the willingness of administrators and public officials to combine a variety of measures for developers to contribute to the production of affordable housing—trading off some onsite development for construction or renovation of desirable housing types in other locations, for example. More applications of this flexible approach to reaching agreements with developers to improve the mix and location of affordable units would add value to the inclusionary concept.

4. The program managers in all three communities repeatedly underscored the fact that inclusionary program incentives for producing affordable housing should be considered as only one effort in an array of programs that provide financial support and management of the jurisdiction's stock of affordable housing.

Case Study 1
Boulder, Colorado
Inclusionary Zoning Program

Boulder, Colorado, lies about 35 miles northwest of Denver, in the Front Range of the Rocky Mountains. Its scenic setting has drawn many high-income residents and attracted substantial development of major corporations and technology companies. It is also the home of the University of Colorado at Boulder, which has a student body of about 30,000 students and about 7,000 faculty members. In the 1970s, Boulder won national attention because its citizens voted for a variety of regulatory controls on development that have successfully tempered its rate of growth. Arguably, growth controls contributed to a housing market featuring many high-cost homes and, at the same time, many low-priced rental units. In 2000, the increasing shortage of affordable housing led the Boulder City Council to adopt a housing policy to make 10 percent of Boulder's housing affordable by 2011. According to growth projections, this action would require the creation of 2,700 additional affordable units. In 2000, the council adopted an inclusionary zoning program as part of a series of programs to reach that goal. In 8 years, the program's requirements and incentives have resulted in the production of 306 residential units.

Overview of Boulder

As of 2006, the city of Boulder estimated a population of 92,474 (not including many university students in dormitories not counted by the Census Bureau). As the largest municipality in Boulder

County and its economic center, Boulder is home to the University of Colorado at Boulder and to a number of major corporations and technology companies. Because of Boulder's desirable location and the growth of the local economy, which has brought many new jobs to the area, demand for housing has increased rapidly.

Boulder is a wealthy community by many standards. As of 2006, the median household income in Colorado was $64,614, while in Boulder it was substantially higher at $89,184. According to the Census Bureau, more than 28 percent of Boulder household incomes topped $100,000, compared with about 20 percent of the households in Colorado. Boulder's high median income, however, is matched with a high poverty rate.

The Boulder housing market reflects the household and income distribution with many high-cost homes and many low-priced rental units. Owner-occupied housing is a smaller portion of the housing stock than in the county or state. The prices of single-family units are the highest in the county, but prices for attached housing, condominiums especially, have a wide range, depending on location and age. Rental units form a large portion of the stock, with rental rates close to the county average.

The housing market is strongly affected by the university population. Many students seek affordable rental housing. Also, many of the middle-income staff and faculty who work at the university seek housing affordable at their income level. Because of regulatory restrictions on the annual level of new construction and an urban growth boundary that restricts the area where new development can occur, the housing supply has grown very slowly. All these factors tend to push up the price of housing overall.

Housing Concerns

Boulder adopted an inclusionary zoning ordinance in 2000 in response to growing concerns about the lack of affordable housing and the declining diversity of the city's population. The shortage of affordable housing resulted in most of the labor force for Boulder's employers having to commute from more affordable locations, leading to traffic congestion, pollution, and urban sprawl. With housing construction not keeping pace with job growth, the price of housing has increased rapidly at the rate of 4.8 percent a year since 1980. In 2006, the median price of a single-family home in Boulder was $455,900, nearly double the median price of $232,900 in the state. Only 8 percent of the for-sale units in the city are affordable to the median-income household in Boulder. As of 2006, a more affordable segment of the housing market was the stock of condominiums, in which the median value was about $192,000. In addition, rents in the city of Boulder were comparable to rents in Boulder County, at $948 and $924, respectively. In addition, a very large portion of the households in Boulder is composed of unrelated individuals—58 percent—much higher than the percentage of households in that category in the state. The influence of the university, with many students living off campus, is a big part of this unrelated individuals household segment.

In 2000, the City Council began implementing recommendations in the *Housing Implementation and Funding Task Force Report*. The new housing policy called for 10 percent of the housing in Boulder to be "permanently affordable" by the year 2011. The city has defined "permanently affordable" housing as housing units under covenants recorded against the deed of the property that restrict the future rents or sale prices to be affordable to people within the income ranges specified. The city's definition of affordable is quite broad, and the categories of housing that come under this rubric are quite varied. The targeted household incomes range from under 30 percent up to 80 percent of the Area Median Income (AMI). The desired mix of household incomes served is to be as follows:

- 14 percent of new affordable housing available to households below 30 percent of AMI.
- 48 percent of new affordable housing available to households between 30 and 60 percent of AMI.
- 38 percent of new affordable housing to households between 60 and 80 percent of AMI.

The proposed affordable housing types range from homeless shelters, group homes, congregate care, and rental housing to homeownership.

The policy translates into a goal of 4,500 affordable units, based on the projection of 45,000 total households in the city by 2010. In 2000, 1,800 permanently affordable units existed, resulting in a need for 2,700 additional units to be provided. The goal is further broken down to a mix of 39 percent owner-occupied and 61 percent renter-occupied units. The city also recognized that the combination of growth restrictions and a shortage of developable land would require that 55 percent of the additional affordable housing, or about 1,500 units, would come from the existing stock, and 45 percent, or about 1,200 units, from new construction.

To achieve this goal, the city is using several housing programs in the Boulder toolbox, including the inclusionary ordinance. Other housing programs include the Community Development Block Grant (CDBG) program, HOME, federal Low-Income Housing Tax Credit (LIHTC) Program, Housing Choice Voucher Program (HCVP), public housing programs, local and state homeownership programs, and housing trust funds. The Department of Housing and Human Services of the City of Boulder administers these programs.

Annually, the city measures progress toward the affordable housing goal. As of early 2008, the city believes it is 65 percent of the way toward achieving the goal, with a little more than 1,000 units produced since 2000. The remaining units required to meet the goal would include 900 units from the existing housing stock and 571 units of new construction.

Inclusionary Requirements and Incentives

The inclusionary ordinance affects only developments of for-sale housing. For rental developments, no onsite units are required due to a state law that prohibits the city from controlling rents. Developers can purchase and rehabilitate units, however, and sell them to the Boulder Housing Authority for rental as HCVP units or public housing.

Minimum Development Size

Five units for onsite units. Some restrictions also apply to developments ranging from single units to four units.

Percent Affordable Required

20 percent.

Maximum Income Level

HUD low income or 68.5 percent of AMI (in Boulder, $41,700 for a one-person household to $53,650 for a three-person household).

Also includes an asset test. Adjusted periodically with new income statistics.

Term of Affordability

Permanent affordability is required, but no minimum time of occupancy by one household is established.

Sale Prices

Set by the city, based on size, number of bedrooms, and type of unit; based on affordability to people in the income range.

Maximum Size

1,200 square feet or 80 percent of the size of the market-rate units. Livability guidelines have also been developed to make sure the units are well designed.

Selection of Purchaser

After the city advertises the units, people who are interested in the housing units may sign up to be considered as purchasers. If more households are interested and qualified than the number of units available, the city conducts a lottery. Preferences are given to those who live and work in the city, with six categories of preference levels. Purchasers may not own another home at the time of purchase. Homeownership classes are required.

Resales

The city has a listing of resales available to the public in the designated income categories. Resale prices are set by including an appreciation rate equivalent to the increase in the median income and based on any capital improvements made by the owner that can be documented. Appreciation allowed per year has averaged 1.75 percent from inception of the program through 2006. In some circumstances, the city provides a downpayment assistance grant.

As of the end of 2007, the inclusionary housing program had produced 241 for-sale units and 65 rental units through onsite or offsite construction. In-lieu fees, however, are paid into a fund that includes other funding sources, and the production of affordable units by this fund cannot be traced directly to the in-lieu payments. Therefore, the total production by the inclusionary program is somewhat larger than the 306 units specified above.

Options Available to Developers

If developers want to avoid building for-sale affordable units on the site, they must fulfill one of the other affordability options, including making a cash payment, donating land, or rehabilitating an existing unit and selling it to an eligible household or turning it over to the city for low-income rentals. (According to city staff, the council wanted to give developers their choice of options to make the policy more flexible and not discourage new development.) In some unusual cases, the city manager must approve the agreement. For-sale developments are strongly encouraged to provide at least 50 percent of the affordable units on the site. The onsite portion is required to provide new homeownership units available to people whose incomes are 60 to 80 percent of AMI. A building permit cannot be obtained until the agreement between the city and the developer is executed. The options include the following.

Cash Payment

Called cash in lieu, or CIL, this fee is set each year as the required payment in lieu of providing an affordable unit on site. The fee in place in 2008 for the 50 percent of units not provided on site is $106,149.47 per unit for townhouses and multifamily units and $123,133.78 per unit for detached, single-family homes. If the developer chooses to provide less than 50 percent of units on site, the fee per affordable unit increases by 50 percent. The fee goes into an affordable housing fund administered by the city. The fund is used to subsidize other developments targeted to households under 68.5 percent of AMI, developed by nonprofit organizations or the Boulder Housing Authority. The cash-in-lieu payments typically are used to fund rental units for lower income households.

Because many developers have opted to pay the cash in lieu, $8.6 million has been collected since the program's inception. These funds have been merged with other funds, making it impossible to determine how many units or what type of units this money has provided.

Land Dedication

Credit for the number of units required is based on the value of the land plus a 50-percent add-on for development expenses. Land donations have not occurred to date, but, if they had, they could provide for new construction of units in a variety of income ranges.

Provision of Offsite Units

The offsite option allows a developer to acquire existing units and sell them to households with incomes up to 68.5 percent of AMI, thereby providing units out of the existing stock of housing. If a developer building a condominium buys and rehabilitates a single-family unit that the city views as desirable for affordable housing, the city may reduce the number of units required, because the single-family house is larger and more suitable for a family. Two developments have provided offsite units: one provided eight units and the other four units.

Project Examples

- One Boulder Plaza, a development of 300,000 square feet, is located in the heart of downtown Boulder on a redevelopment site. Completed in 2003, it is a mixed-use development, with office, retail, and residential development, served with structured parking. The site is close to all the desirable amenities of Boulder and many employment opportunities. The 3-acre site has a permitted floor-area ratio (FAR) of 2.2. It is divided by 13th Street, creating two parcels. The developers were granted the right to transfer residential and nonresidential densities between the two parcels. The residential units are on the eastern parcel. Of the 27 residential units, 3 are permanently affordable. The developer chose to provide one-half of the required units on site and to provide the remainder of the requirement by buying 5 existing single-family homes and making them permanently affordable. Because the single-family units were large enough for families, the city regarded them as “equivalent” to eight one- or two-bedroom condominiums on site. Recently, the developer asked to repurchase the onsite affordable units and sell them at market rates, then donate the proceeds to the city, a proposal that was turned down.

- The Holiday Neighborhood development is a redevelopment of a former drive-in theater in North Boulder at Lee Hill Road and US Route 36. The Boulder Housing Authority is the master developer of the property, known as Boulder Housing Partners (BHP). The city originally bought the property with a CDBG Section 108 loan. The city eventually sold the site to BHP, with the understanding that affordable housing would be a major element of the development. BHP selected four builders to build the units. The total number of units will be 333, of which 138 will be permanently affordable, a higher number than required by the inclusionary housing ordinance. These units are scattered throughout the development and include 56 rental units and 82 ownership units. The prices of the affordable ownership units range from $89,000 to $165,000. The prices of the market-rate units range from $240,000 to $500,000.

  The city provided several subsidies, such as reduced development fees, a density bonus, and waiver of excise taxes. These benefits allowed BHP to sell the lots at reduced prices to the four builders: Peak Properties, Coburn Development, Wolff/Lyon, and the Affordable Housing Alliance. The development also includes a cohousing development, a mixed-use main street area, and carriage houses over the garages of some units.

- The Dakota Ridge development of 57 acres was begun in 2001 and completion is expected in 2010. The development consists of 390 units, 260 of which will be multifamily. Of these units, 78 will be permanently affordable, at a price of $150,000 for an 1,100-square-foot house. In an earlier phase, the developer provided a cash payment of $220,000 to the city as a subsidy to the Boulder Housing Authority to purchase 13 townhomes, which will be made available and affordable to low-income renters as part of the Reduced Rent Program, which accepts HCVP vouchers.

Current Issues About Options

Based on discussions with city staff and several developers, reviews of city reports, and an indepth study prepared by the University of Colorado Real Estate Center and Leeds School of Business (Lewandowski, Thibodeau, and Wobbekind, 2008), three issues can be raised about the use of the alternatives offered as incentives in Boulder’s inclusionary program:

1. The cash-in-lieu payment amount is the same for all areas of the city. Because values of units vary considerably across neighborhoods, the cash option is very appealing in the expensive

areas of the city, such as downtown. This area tends to be developing with high-priced condominiums, which are not family oriented and have high condominium fees. In addition, Boulder's strong preference for the onsite location of one-half of the required affordable units may not be appropriate in these areas, where it might be better for the city to discourage onsite units and to accept cash-in-lieu payments.

2. Given the shortage of available land, the land donation option is not a realistic option for most developers.
3. The offsite option has been used only twice. Reportedly, the cost of buying an existing unit, the effort of renovating it to city standards, and the time and difficulty involved create financial uncertainty and extended effort by a developer. These factors may lead the development community to avoid using this option.

As a result of these issues being raised after several years of experience with the program, the city plans to reevaluate how the program is working within the broader context of the city's affordable housing needs.

Overall Program Issues in Boulder

Discussions with city officials indicated a number of issues arising from the inclusionary program to date. These issues may lead to future program alterations.

1. Targeted Households

The city's policy is oriented to serving low- and moderate-income workers, particularly those with families, yet the program is generating a substantial number of small condominiums that do not serve families. Developers are building apartments near the university intended for students, whereas the offsite option could produce units located in areas more desirable for the citywide needs of families and working people.

2. Condominium Prices and Fees

High condominium fees may make it difficult for moderate-income households to afford both the mortgage and the fees. The current pricing formula uses an average condominium fee. A requirement for payment of the full condominium fee would drive down the sales price of the unit, which then could lead developers to build fewer onsite units and pay the cash in lieu instead.

3. Price Appreciation

The current policy allows the unit owner to capture only 3.5 percent of home-price appreciation, and average annual appreciation allowed has been 1.7 percent, which increases the effective cost of housing and may discourage some buyers from purchasing affordable units. In comparison, the Leeds School of Business study observes the irony that it is more cost-effective for lower income householders to buy a market-rate unit in nearby areas, which defeats one purpose of the program.

4. Restrictive Conditions

A combination of factors has dampened production in the inclusionary program, including the lack of available land, the capping of the city's annual growth rate, and the 55-foot cap on building height that constrains density. Although the growth cap can be overridden if a development provides 35 percent or more affordable units, this approach may work well only for nonprofit developers or those using programs such as the LIHTC Program. In addition, the lack of available land has prevented the use of the option of providing land to the city.

5. Private vs. Public Subsidy

The Leeds School of Business study makes the point that the actual cost to the developer to produce units is much higher than the affordable unit sales price. Depending on the market, this privately borne subsidy could drive up housing costs for market-rate buyers. Others argue that the program decreases what developers will pay for land, or that a developer will charge what the market will bear anyway, so the cost of the market-rate units is no higher than it would be without the program; instead, the landowner's or developer's profit would decrease.

6. Narrow Range of Affordability

The program is expected to serve workers in critical industries, such as city employees, and those in needed industries, such as the university, health care, and retail. The narrow income range of the households allowed to participate in the program may not serve the full range of employees who are being targeted for assistance.

7. Consideration of Existing Assets

Potential owners and tenants can skirt the limits on their existing assets by transferring them to their businesses. The asset test allows some retirement savings but may be so strict as to rule out many people who are near retirement.

8. REALTORS'® Role

New buyers' limited use of a REALTOR® leaves buyers without an advocate, putting first-time buyers at a disadvantage. The city provides homebuyer counseling, and the REALTORS® have agreed to limit their commission to 2.5 percent, well below the typical commission rate of 6 percent.

Case Study 2
Montgomery County, Maryland
Moderately Priced Dwelling Unit Program

The Moderately Priced Dwelling Unit (MPDU) program of Montgomery County is one of the best known and most productive inclusionary zoning programs in the nation. The county's experience with the program, established 34 years ago, has been studied and written about by dozens of researchers, and many communities throughout the United States have borrowed aspects of the program. *Governing Magazine*'s cover story in April 2000 called MPDU the "nation's most innovative affordable housing program" (Swope, 2000: 18–22).

The Jurisdiction

Montgomery County, Maryland, lies on the northwestern boundary of the District of Columbia and is bordered on its western edge by the Potomac River. Once primarily agricultural, the county began suburbanizing in the 1890s with the development of Chevy Chase and other communities connected by trolley lines to the District of Columbia. The tremendous expansion of the Washington, D.C. metropolitan area following World War II spread quickly into Montgomery and other close-in counties in Maryland and Virginia, turning sedate older communities, such as Bethesda and Rockville, into bustling regional centers. Over a period of more than 60 years, the county has earned a reputation for comprehensive, imaginative, and aggressive planning and growth management. Basing development plans on its "Wedges and Corridors" General Plan approved in 1969, the county has actively promoted transit-oriented development and designated the northern one-third of the county as a farmland protection area conserved through zoning and transferable development rights.

The Census Bureau estimated the county's population at 932,000 in 2006. As much urban as suburban in character, the county represents the Washington, D.C. region's second largest employment base. Nearly 60 percent of the county's residents work within the county, and substantial intensification of development is taking place in regional commercial, employment, and residential centers. The residents of Montgomery County are well educated and receive high incomes relative to the region, the state, and the United States as a whole. The county's excellent educational and park systems continue to mark it as one of the most desirable residential areas in the Washington, D.C. region.

Especially during the past two decades, the county's population has been diversifying. In 2006, 17 percent of its residents were African American, 13 percent Asian, and nearly 9 percent Hispanic. Residents' housing needs also have been diversifying: townhouses and apartments now comprise nearly one-half of all homes.

Concerns for Affordable Housing

Like many other jurisdictions viewed as desirable residential areas, Montgomery County has experienced a continuing increase in housing prices over several decades. By 2006, the median price of a new single-family detached home was $881,600 and for a townhouse was $518,510. Through 2007, prices for older homes in some down-county desirable neighborhoods escalated by 10 or more percentage points per year. As early as the late 1960s, however, housing advocacy groups were concerned about the diminishing supply of affordable housing, especially for lower income workers migrating to the county. In 1970, a grassroots coalition led by the League of Women Voters and Suburban Maryland Fair Housing encouraged the Montgomery County Council to introduce a bill that called for builders to supply a share of all units in new residential developments at affordable prices—an inclusionary zoning program.

The idea was received with faint enthusiasm. At that time, a similar proposal introduced in Fairfax County, Virginia, just across the Potomac River, was successfully challenged in court as an unfair taking of private property. Other issues about Montgomery County's program quickly surfaced: resistance to the idea of requiring owners of expensive homes to live alongside lower income neighbors, possibly reducing the value of market-rate homes; the views of civic associations that density bonuses amounted to wholesale rezoning that left large-lot development unprotected; and the certainty of liberal groups that developers reaped earnings that made density bonuses unnecessary.

Nevertheless, the legislation was introduced in the spring of 1972 and the County Council worked for more than a year to assuage concerns. Several events helped swing council opinion in favor of the bill: A report issued by the Montgomery County Project for Low- and Moderate-Income Housing linked the county's continued economic growth to the availability of affordable housing; a housing advocate was elected County Council president; and the legal issues posed by the Virginia law (in a Dillon Rule state) were seen to be irrelevant in powerful Maryland counties, especially with the provision for compensatory density bonuses. Ultimately, the law was rewritten to emphasize its intent to aid young working families rather than to overcome racial and economic exclusion. The council unanimously approved the bill in October 1973. Although the probusiness Montgomery County Executive vetoed it, the council overrode the veto and the bill became law on January 21, 1974.[2]

As of 2005, the program had produced more than 12,000 MPDU units. The program has generated 8,527 for-sale units and 3,520 rental units since 1976. The average annual MPDU production rate of for-sale units has been about 280 units; another 200 units a year are protected from resale under the county's right-of-first-refusal policy. The county's housing programs have also produced a similar number of low- to moderate-income units through funding by federal and state subsidy programs. The Housing Opportunity Commission (HOC) of Montgomery County purchases units that are rented to households with low or very low incomes. The HOC currently owns more than 1,600 MPDUs, some of which are rented at market or moderate-income rates, and it has a waiting list for HCVP certificates of about 14,000 households. About 8 percent of residential construction permits per year are for MPDUs, and the average production rate ranges from 200 to 400 units per year, depending on levels of market-rate housing development.

The Evolution of the MPDU Program

Both public administrators and the private developers and builders who produce the housing units implement the MPDU program. For residential projects affected by program requirements, the county's MPDU office within the Department of Housing and Community Affairs (DHCA) enters into agreements with builders for staging the construction of the required units, establishes the MPDU sales and rental prices, and oversees the selection of potential buyers and renters. Builders acquire sites and prepare subdivision plans, obtain building permits, and construct the housing. DHCA, often working with the landlord/tenant section of the county attorney's office, enforces the occupancy and resale provisions of the law.

The basic program elements established in 1973 are as follows.

Application to Residential Projects

At the outset, all new residential developments of 50 units or more in areas zoned for 1/2 acre or smaller lots were required to include MPDUs. The law called for 15 percent of total units to be

[2] Montgomery County Zoning Ordinance (Chapter 59, Montgomery County Code 1994, as amended).

MPDUs and allowed a density bonus of 20 percent. In zoning districts for single-family detached homes, up to 60 percent of the MPDU units could be attached units. All MPDUs in for-sale subdivisions were required to be for-sale units.

Other Incentives

The law provided opportunities for developers to gain density bonuses, obtain waivers of code and impact fees, skirt limits established by adequate public facility requirements, and benefit from fast-track permitting procedures and cooperation in obtaining variances.

Eligible Occupants

Households with incomes at or below 60 percent of the AMI were eligible to apply for MPDUs. The county gave priority to buyers who live and/or work in the county. The council allowed the county's HOC and nonprofit housing organizations to purchase up to 40 percent of new units for rentals to households eligible for public housing.

Resale Controls

Unit resale was allowed after 5 years of occupancy. The owner and county split any profits from value escalation (accounting for owner improvements) with the county's share flowing into the Montgomery County Housing Initiative Fund (HIF) for reinvestment in affordable housing. In 2005, 1,881 for-sale units and 1,153 rental units remained under price controls. Eric Larsen, Montgomery County's former MPDU program director, reports that the county repurchases about 60 percent of recent resales through this procedure, but funding is inadequate to pay for many high-priced homes (Larsen, 2003).

Timing, Distribution, and Appearance of MPDUs

The agreements between developers and the county called for all required MPDUs to be constructed and offered for sale when one-half of the total units in a development have been built. MPDU units must be dispersed throughout the project and appear similar in design to market-rate units. MPDU units may be smaller in size (controlled by county minimum size schedules) and may have basic, rather than top-of-the-line, kitchen, heating, and other equipment.

Significant program changes have occurred based on administrative experience and political support over time. The principal modifications of the law occurred in 1981, 1989, and 2005, as follows:

- Building industry requests in 1981 for reduction of the proportion of MPDU units in subdivisions from 15 percent to 10 percent resulted in County Council approval of a 12.5-percent requirement, but the council also approved extension of the price control period from 5 years to 10 years and a requirement that all MPDUs be for-sale units unless located in an all-rental subdivision.

- In 1989, after a thorough program review, the county approved six modifications: (1) the bonus density was raised to a maximum of 22 percent, (2) the required percentage of MPDUs was set on a sliding scale of 12.5 to 15 percent depending on the bonus density achieved, (3) the rental control period was extended to 20 years, (4) a part of the appreciation in resale price after expiration of the price control period was required to be paid into the HIF, (5) permitted MPDU sales prices were increased to enable builders to improve the compatibility of MPDU designs with market-rate units, and (6) alternative methods were adopted for meeting the MPDU requirement where high condominium or homeowner's association fees made units unaffordable.

- In 2005, the county lengthened the control period for sales units to 30 years and rental units to 99 years and reduced from 35 to 20 the number of units in a development that triggered MPDU requirements.

Montgomery County's program serves a diverse group of participants. The size and increasing diversity of the county's population are reflected in the ethnic mix of MPDU participants. The most recent data, from 2008, show that, since 2006, minority households purchased 82 percent of MPDU for-sale housing units.

Other information about the types of households served by the program includes the following:

- In 2008, 17 percent of occupants were Caucasian, 27 percent African American, 44 percent Asian, 5 percent Hispanic, and 7 percent unknown, reflecting a striking change from 1994, when occupants were 46 percent Caucasian, 20 percent African American, 26 percent Asian, 9 percent Hispanic, and 2 percent unknown.
- Of 314 certified households in 2008, 21 percent had one-person occupancy, 21 percent had two people, 23 percent had three people, 25 percent had four people, and 10 percent had five or more people.
- Of the units occupied in 1999 (the last year this data was available), 81 percent had three bedrooms and 19 percent had four bedrooms. (Unit sizes varied significantly from year to year.)
- In 2008, household incomes of participants averaged $44,130, about 45 percent of AMI household income in 2008. Incomes ranged from $14,800 to slightly more than $73,500. (A new minimum income limit of $35,000 was implemented in 2007, which applies to all new program participants, although some existing participants were "grandfathered" in the program.)
- The average sales price of townhouse units sold since 2006 was $165,000.

Occupations of owners and tenants are not available; however, Larsen believed in 2003 that most were blue-collar employees of service industries (Larsen, 2003). Although some public service workers, such as teachers and police and fire personnel, live in MPDU units, he said many county employees earn too much money to be eligible for MPDU housing.

Program Administration

Unlike similar programs in other jurisdictions that are administered by zoning departments, the DHCA administers Montgomery County's MPDU program as one of several housing programs. The MPDU office works with developers to produce units that meet county standards for design and distribution, calculates the sales prices and rent levels for those units, accepts and reviews applications from prospective occupants, runs a lottery for each project to select occupants, writes ownership and rental agreements with occupants, and works with owners on resale options. Initially, marketing the finished units was left to the developers, but the county found that some developers favored friends and relatives and therefore assumed responsibility for occupant selection, which occurs through random-selection drawings.

The MPDU program enjoys broad general support from county residents and voters. After 28 years, the DHCA has developed a cadre of several dozen builders with experience in designing and completing MPDU projects. A typical year will see approximately 10 developers involved in projects (which proves that projects that include MPDUs can be profitable in many circumstances). Developers in Montgomery County sometimes claim that they either lose money or just break even on MPDU projects, but most accept the requirement as a cost of doing business in a highly desirable housing market. Developer David Flanagan of Elm Street Development, Inc., offered another view when he said that the willingness of county staff to work with developers to provide regulatory flexibility was the key to making projects financially viable. The principal obstacle to profitable MPDU production, he said, are limits on density posed by sites with environmental or compatibility issues, which fall under the Montgomery County Planning Board's purview (Flanagan, 2003).

Use of In-Lieu Fees and Offsite Development Options

Despite the regional bull market in residential development since the mid-1990s, Montgomery County's inclusionary program has experienced a slowdown in recent years. County officials agree that traditional suburban-style growth is tapering off, reducing the launching of projects that incorporate new MPDU housing. In part, this slowdown in new MPDU housing is occurring because fewer large, developable parcels are available for development, which has shifted much building activity in the county to small infill and redevelopment sites. Often such projects involve fewer units than covered by the MPDU requirements. Furthermore, especially during the housing boom in the years before 2007, proposed residential projects in built-up areas frequently proposed high-rise development of apartments and condominiums. These types of housing typically are expensive to build and maintain. In addition to high initial development unit prices, condominium or housing association maintenance fees can make units unaffordable for moderate-income families.

As a result, developers have objected to inclusion of moderate-cost units in these high-priced buildings. Increasingly, they turn instead to a previously little-used section of the law that provides alternative methods for satisfying MPDU requirements: developer payments, offsite development, or land donations in lieu of onsite production of moderate-income units. Many developers have proposed to pay in-lieu fees, which are directed into the county's HIF. They have hoped to pursue the alternative because of the financial impacts of including the required percentage of moderate-cost units in high-priced residential buildings, plus the ongoing owner/tenant cost of maintenance fees associated with such units. Some developers have claimed that the costs of providing onsite MPDUs would make projects infeasible. Nevertheless, the county has rejected a number of these proposals.

According to records provided by the MPDU office, from 1989 through 2006, 21 developments paid in-lieu fees as an alternative to providing all or some of required MPDUs on the site. Through this period, developers agreed to pay a total of about $2,010,000 into the county's HIF rather than include 332 MPDU units in their projects. Developers of 15 of these projects also agreed to provide a total of about 356 onsite or offsite MPDUs rather than make in-lieu payments. By agreement with the director of the DHCA, three such developments included units at a rental rate that was reduced but exceeded standard MPDU requirements.

Elizabeth B. Davison, director of the DHCA from 1996 to 2006, generally was sympathetic to developers' concerns about the financial pressures raised by MPDU requirements for highrise development on infill sites and luxury condominiums with high condo fees (Davison, 2008). Citing the affordable-housing law's provision that developers should "have reasonable prospects of realizing a profit" on MPDU projects, as well as the need to keep condo fees affordable to MPDU certificate holders, she undertook to work out agreements with developers to pay in-lieu fees based on individual projects' land and development costs, taking into account the MPDU law's allowance of reducing MPDU requirements by offers of land, provision of MPDUs at alternative locations, and making payments to the HIF. In addition, the Planning Board sometimes waived or reduced some site and housing design standards and legal or other restraints on density increases to offset MPDU costs. According to Davison (2008), discussions to reach acceptable agreements among public officials, neighborhood groups, and project developers and their financial backers frequently were lengthy and posed difficult issues, especially as market conditions changed and developers altered their plans. Also complicating decisionmaking is the increasing opposition to such projects by community and neighborhood organizations pressing for slowing or halting further development of the county.

The County Council brought the issue to a head in July 2003 by releasing a staff report that tacitly criticized the housing department for accepting in-lieu fees for nearly one-half of the 400 affordable units developers committed to build in 2002. A *Washington Post* article by Matthew Mosk on July 22, 2003, headlined "Waiver Deals Cut Affordable Housing in Montgomery," asserted that the MPDU law was allowing developers to "buy their way out of requirements to build affordable housing." In addition, although admitting that so-called "buyouts" were legal, council members were concerned that fees varied from one development to another and that little information was available to indicate that fee payments were resulting in significant construction of affordable units. Some council members responded to these questions by proposing to eliminate the in-lieu fee option.

The situation was complicated by the difficulty in explaining the rational basis for determining an appropriate level of in-lieu payment, which involves a variety of financial factors. In an interview conducted for this study, Montgomery County Council Member Nancy Floreen said, "The math is not understandable to the average politician or his/her constituents" (Floreen, 2008). For example, the executive director of the HOC wrote to a council member that the average in-lieu payment of $21,000 was far lower than the actual cost to produce a moderate-income unit—an oversimplification of the appropriate cost relationships. For most projects, economic analyses estimated appropriate in-lieu payments for specific projects, reflecting such factors as land costs, project size, anticipated market prices or rental rates, and limits on potential density increases caused by environmental constraints or imposed by adopted plans, zoning, and/or community concerns about the compatibility of the proposed development with the surrounding neighborhood. Essentially, individual project economics tended to reflect a variety of intricately related factors that affected the potential financial impact of incorporating MPDU units. One outcome was that proposed in-lieu fees varied from project to project. (Apparently, establishing a single in-lieu fee per MPDU unit that might not reflect the financial factors affecting individual developments was not found acceptable.)

After a considerable amount of political wrangling over this issue, in November 2004, the county adopted a new procedure for determining appropriate alternative measures for compliance with the MPDU law, effective April 2005.[3] Several text amendments to the zoning ordinance were also adopted to provide greater flexibility for the county's Planning Board in approving development applications involving MPDUs. The procedure established a committee composed of the director of the DHCA, the director of the Planning Board, and the executive director of the HOC. Detailed directions for applications for alternative measures and reviews and decisions about these applications were spelled out.

Unfortunately, the three-person committee, each member of which had a full roster of scheduled meetings, found it difficult to meet in a timely manner to reach agreement on issues raised by specific projects, often prolonging decisionmaking. Meanwhile, local investments in residential development were being affected by the nationwide real estate financial downturn. Project starts have slowed considerably during 2007 and through 2008. In addition, several projects changing from for-sale condominiums to apartments have slowed MPDU production. Applications for consideration of projects involving MPDUs, however, are still being submitted regularly to the Planning Board for projects to be developed for 3 to 5 years after 2008.

With a change in the administration in the 2007 election, the housing director and 20 other senior officials were replaced. Several council members and the county executive elected in 2007 declared during their campaigns for office that the in-lieu payment program—and perhaps the entire MPDU program—requires rethinking and possible reorganization. County Council Member Nancy Floreen said that it appears that support for the MPDU program has weakened over the past few years, a conclusion echoed by other sources. Although county voters may support the general need for adding to the stock of affordable housing, Floreen cites the continued opposition of many neighborhood organizations to county efforts to encourage such development in or near their areas. "Affordable housing doesn't come very high on the list of voters' political priorities," Floreen said. "The community wants transparency in county decisionmaking," she adds, but is unwilling to allow the development tradeoffs that would promote development of affordable housing (Floreen, 2008).

Steven Robins, an attorney involved with several developments, has concluded that the use of in-lieu fees has become unacceptable to county officials and is essentially "a thing of the past" (Robins, 2008). In addition, he says, "the MPDU program has become very rigid," with little flexibility allowed to respond to concerns for project feasibility, an opinion echoed by other developers (Robins, 2008). Robins (2008) cites a development incorporating both highrise and midrise buildings. The developer suggested that required MPDUs be placed in the midrise section to reduce the cost for providing MPDUs in highrise buildings. This opportunity to reduce MPDU construction costs, without affecting their location, was refused by the county. Robins believes the program is "broken" by not allowing residential developers to make a reasonable profit—it is no longer "revenue neutral." By comparison, Robins cites the County Council's recent approval of a policy supporting development of "workforce housing," which will allow buildings that exceed height limits to achieve greater density and also allow somewhat higher prices and rents than MPDU units

[3] For details, see "Requirements and Procedures for the Moderately Priced Dwelling Unit Program, Department of Community Affairs," Montgomery County Executive Regulation, No. 13-05AM effective on September 28, 2005.

(Robins, 2008). Another developer, Douglas Furstenburg of Stonebridge Development, agrees that the MPDU program has deteriorated and says that his current plans for development will focus on provision of workforce housing rather than MPDUs. In the next year or two, as the project plans come up for approval, he expects to engage in a "staring-down contest" with county officials to allow the higher prices and rents (Furstenburg, 2008).

Conclusion

Although Montgomery County's MPDU program has provided a model for many inclusionary programs across the nation, its future direction, for a time, seemed unclear. Although the need for improving the availability of affordable housing still receives broad support from county leaders and residents, the conduct of the MPDU program in recent years, especially the procedures allowing alternatives to onsite production, has touched off heated discussions, arising from residents' reactions to general growth issues and their tendency to believe the worst of developers' intentions. In the fall of 2008, county officials considered the elimination of alternative payments but eventually agreed to keep the option and to pursue additional approaches such as the production of workforce housing and accessory units.

One lesson from Montgomery County's experience is that even the most carefully tuned programs can be derailed in a turbid political environment. The double pressures of rapid development and a new focus on highrise development in the county threatened a backlash to a long-respected program.

Case Study 3
Pasadena, California
Inclusionary Housing Program
Requirements for In-Lieu Fees and Offsite Construction

Pasadena, a city of 145,000 residents located in the San Gabriel Valley 10 miles northeast of downtown Los Angeles, adopted an inclusionary housing program in 2001.[4] The program has produced 466 affordable units built by developers within market-rate projects over a 6-year period. In addition, developers paid fees into the city's Inclusionary Housing Trust Fund in lieu of building 160 housing units. The in-lieu payments, combined with substantial funds from state and federal programs, allowed the trust fund to create 1,575 additional affordable housing units, for a total production of 2,041 affordable units. This addition to the stock of affordable housing occurred during years when a strong housing market generated construction of more than 1,979 market-rate housing units. Recently approved projects will be constructing another 216 affordable units, and more affordable units are proposed in projects pending city approval.[5]

[4] City of Pasadena, California. An Ordinance of the City of Pasadena Amending Title 17 (Revised Zoning Ordinance) of the Pasadena Municipal Code to Require Inclusionary Housing, Ordinance No. 6868, 2001.

[5] Based on data summarizing characteristics of affordable housing projects, compiled in 2008 by the staff of the city manager's housing program (Housing Development Office, 2008).

Pasadena's Inclusionary Housing Program requires that all residential and mixed-use projects include a share of housing that is affordable to low- and moderate-income households, but the ordinance provides for several options to onsite development, including payment of in-lieu fees and offsite construction. Many developers have chosen to pay in-lieu fees rather than build affordable units in their developments. The city has used these fees and federal and state housing funds to help construct 1,775 units of affordable housing in 35 projects other than those produced through the inclusionary program. Several developers have worked out arrangements to build affordable units on sites outside their market-rate developments.

The City of Pasadena

Pasadena is well known for its annual Tournament of Roses Parade, initiated in 1890, and the Rose Bowl postseason football competition. The city's other sources of fame include the California Institute of Technology, the National Aeronautics and Space Administration's Jet Propulsion Laboratory, and many other scientific and cultural institutions. A handsome grouping of ornate civic buildings constructed during the 1920s marks the city's center, which has undergone a remarkable revitalization over the past decade. The city's strong economic base and notable cultural and educational institutions attract many new residents and visitors from within and outside the region, accounting for a population increase of 22 percent from 1980 to 2007, two-fifths of which has occurred since 2000. Pasadena's pleasant neighborhoods, many architecturally distinctive buildings, and bustling downtown provide a highly desirable quality of life.

The Planning Center, a consulting group, submitted a report entitled *Housing Agenda for Action* to the city in March 2007 (The Planning Center, 2007). It noted that Pasadena, in contrast with the rest of the San Gabriel Valley region, had been successful in producing housing commensurate with its population growth from the 1970s to the present day. The 2000 Census found 51,844 households in Pasadena, up from 47,056 in 1980. About 48 percent of housing units were owned and 52 percent rented. Most of the household growth since the 1970s has been due to proportional increases in single-person households and unrelated individuals sharing housing, although the 2005 American Community Survey showed a significant increase in the number of married couples with no children. The economic status of residents also changed, with a 77-percent increase in household incomes above $75,000 from 1990 to 2000. Although much of this increase was due to inflation, overall, Pasadena residents were becoming wealthier, a factor that tended to increase housing prices. The 2000 Census found that the median value of owner-occupied units rose by about 2 percent, but the nationwide surge in housing prices was just starting.

The city's racial makeup is quite varied: 39 percent of its residents are White, 33 percent are Latino, 14 percent are African American, 10 percent are Asian, and the balance of 4 percent is from other races.

Housing Concerns

Pasadena's concerns for production of affordable housing stem from the historic shortage of housing relative to growth throughout the San Gabriel Valley, changes in the city's population makeup, and what The Planning Center accurately describes as "the emergence of Pasadena as the major city center for employment, history and culture, and education" in the San Gabriel Valley (The Planning Center, 2007: 5-3). The key housing production issues identified by the city's

Housing Affordability Task Force in 2003 focused on (1) the projected need for 54 percent of new housing to be priced for very low-, low-, and moderate-income households and (2) the approach of residential buildout in the downtown area while residents wished to maintain the lower density character of existing neighborhoods. The Housing Affordability Task Force noted Pasadena's singular achievement among surrounding jurisdictions was meeting its needs for affordable housing. Nevertheless, the rapid escalation of housing prices has challenged the affordability of housing for even high-wage earners, and high rental housing prices in Pasadena mean that more than one-half of renters overpay for housing. The Planning Center's report concludes that rising home prices may have contributed to a decline in lower income families in the city (The Planning Center, 2007).

The city's vigorous response to affordable housing needs has been led in large part by the response of the city administration and Pasadena City Council to concerns of local voters and has been reinforced by the California state requirements for local governmental attention to housing issues. Indicative of the city's concerns are its preparation of a "Housing 2000 Vision" in that year, followed by sponsorship in 2001 of a series of community workshops leading up to adoption of the Inclusionary Housing Ordinance (The Planning Center, 2007). In turn, in 2005 the council adopted a 10-year strategy to end homelessness, established the Housing Affordability Task Force, and organized a monthly series of Affordable Housing Luncheons convened by the Office of the City Manager, concluding with the Pasadena Housing Summit in 2006.

Reports by The Planning Center and the Urban Land Institute's (ULI's) Technical Assistance Panel defining proposals for new initiatives came in 2007. Convened at the city's request, the panel, organized by the ULI's advisory services division, confirmed the problems identified by The Planning Center (2007), concluding that Pasadena's affordable housing program has not been able to stem the impact of market conditions, which have led to displacement of the existing population, less housing and social diversity, higher prices, gentrification, and young families leaving (ULI, 2007).

Pasadena's Affordable Housing Program

The city of Pasadena administers a broadly conceived housing program to support development and financing of new construction, rehabilitation, and preservation of rental and ownership housing primarily for lower income households. It adopted a "housing vision" that states that "all Pasadena residents have an equal right to live in decent and safe affordable housing in a suitable living environment" and that the city aims to "maintain a socially and economically diverse community of homeowners and renters whom are afforded this right" (Office of the City Manager, 2006b: 1). The city has not established a public housing program, but, for assisting with the production of affordable housing, it receives funding from federal programs, such as the Community Development Block Grant, the HOME Investments Partnerships Program, and the Housing Choice Voucher Program, and from state sources, such as the California "Cal Home Program" for first-time homebuyers. The city also seeks opportunities to leverage nongovernmental and private resources to make homes affordable. Aside from developments involving the inclusionary program, the city assists with the construction of affordable units by requesting proposals or responding to "walk-in" submissions of potential projects. Prospective developers submit housing development funding applications and reach development agreements with the city to undertake such projects (Office of the City Manager, 2006a).

In 2001, the city amended the zoning ordinance[6] to require developers to build inclusionary housing in residential and mixed-use projects, with options for paying in-lieu fees, building affordable units on other sites, or donating land. As of May 2008, the Inclusionary Housing Program had secured developers' construction of 466 affordable units within market-rate residential projects and approved additional projects in which developers will construct 216 affordable units (Pasadena Inclusionary Housing Program, 2008).

The ordinance also established the Inclusionary Housing Trust Fund to collect funds for affordable housing from various sources, including in-lieu fees that are paid into the trust fund.

Since 1999, the funding channeled through these various programs, including the developers' payments of in-lieu fees, has allowed the city to invest more than $21.5 million to assist with the creation of 1,575 affordable housing units.[7]

Affordable housing produced through the Pasadena Inclusionary Housing Program favors the city's residents. Attachment M of the city's regulations governing the affordable housing program provides that people who live and/or work in the city have priority over other people to rent or purchase affordable and workforce housing units sponsored by the city or the Pasadena Community Development Commission. Income-eligible households that both reside and work within the city have first priority for affordable housing. Income-eligible households that either reside or work within the city have second and third priority, respectively. Income-eligible households that have been involuntarily displaced from the city have fourth priority. The priority guidelines make no mention of allowing rental or purchase by citizens of other jurisdictions.

The Inclusionary Housing Program

The requirements of the Inclusionary Housing Ordinance apply to residential projects of 10 or more lots or units and mandate that 15 percent of newly constructed lots or units be affordable (although, for 1 year following adoption of the ordinance, that requirement was reduced to 6 percent for projects then undergoing review and approval). The ordinance allowed three alternatives to development of affordable units on the primary development site: constructing units on another site, donating a site, or paying a fee in lieu of constructing units.

Definitions of Affordability

The ordinance established four cost ceilings as a measure of affordability for inclusionary units, based on Los Angeles County AMI and adjusted in 2008 according to the household size.

1. **Very low-income households, rental units:** 30 percent of 50 percent of AMI—in effect, 15 percent of AMI, which in 2009 was determined as incomes no higher than $27,750 for one-person households and $39,650 for four-person households.

[6] City of Pasadena, California. Zoning Code, Ordinance #7000, Chapters 17-42 and 17-43, adopted by the City Council on January 10, 2005, effective February 26, 2005, with amendments.

[7] Compiled from the city of Pasadena's *Inclusionary Housing Performance Reports* (Pasadena Inclusionary Housing Program, 2008), tables A–E, July 25, 2008.

2. **Low-income households, rental or for-sale units:** 30 percent of 80 percent of AMI—in effect, 24 percent of AMI, which in 2009 was determined as incomes no higher than $44,400 for one-person households and $63,450 for four-person households.

3. **Moderate-income households, for-sale and rental units:** 40 percent of 110 percent of AMI—in effect, 44 percent of AMI, which in 2009 was determined as incomes no higher than $52,150 for one-person households and $74,500 for four-person households.

If the residential development consists of ownership housing, inclusionary units must be sold to low- or moderate-income households. For developments with rental units, a minimum of 10 percent of the units in the development must be rented to low-income households and the remaining 5 percent to moderate-income households. Reductions in the required number of units are allowed for substitutions of very low-income units for low- or moderate-income units, or of low-income units for moderate-income units, to allow for the reduced return on investment for constructing these units.

Standards for Design, Construction, and Availability

The ordinance requires that inclusionary units must be (1) reasonably dispersed throughout the development; (2) proportional in number, bedroom size, and location to the market-rate units; and (3) comparable with the market-rate units in terms of the base design, appearance, materials, and finished quality. Inclusionary units must be constructed concurrently with or prior to the construction of market-rate units. Rental units must be reserved for the target income level in perpetuity. For-sale units must remain reserved for the target income level for 45 years, subject to a renewable covenant or, if resold to a moderate-income purchaser, must allow the city the right of first refusal for recapturing a proportion of any appreciation in price.

Procedures

The inclusionary requirements are executed through an Inclusionary Housing Agreement between developers and the city, involving the developers' submission of a detailed inclusionary housing plan for approval by the program director. Until the agreement is approved, no discretionary approval, building permit, or certificate of occupancy can be issued for any part of the proposed development.

Alternatives to Onsite Construction

As alternatives to building inclusionary units in the proposed development, the ordinance provides the following three options:

1. **Payment of in-lieu fees:** Developers may choose to pay a fee per required unit as determined by the fee schedule established by the City Council, the fee to be deposited in the city's Inclusionary Housing Trust Fund. At least one-half of the fee must be paid prior to issuance of building permits and the remainder before a certificate of occupancy is issued. The fee was reduced to 40 percent of the scheduled fee during the year after the effective date of the ordinance.

2. **Offsite construction:** At the discretion of the director of the Inclusionary Housing Program, developers may opt to construct or substantially rehabilitate all or some of the required inclusionary units at a site different from the proposed development site.

3. **Land donation:** At the discretion of the program director, developers may convey land to the city for construction of all or part of the required inclusionary units.

The second and third options can be offered by developers but are approved or disapproved at the discretion of the director of the Inclusionary Housing Program. To exercise any of the three options, a developer's proposal is subject to official review and agreement on a plan for providing the required number of units. The Inclusionary Housing Ordinance and regulations lay out a number of requirements that generally require significant negotiations and agreements on details of the plan. Pasadena's public officials and developers, however, appear to have worked out a fairly amicable relationship to reach understandings acceptable to both parties.

Density Bonuses

The state's density bonus law requires the city to provide for increases in residential density for affordable housing production.[8] The law includes densities above those established in the zoning ordinance, based on the percentage of housing units affordable at specified income levels that are proposed for inclusion in a residential development. Pasadena provides for density bonuses of up to 35 percent (and up to 50 percent in some parts of the city's Central District), depending on the percentage of units of the various household income levels to be incorporated in the project. Several developers received density bonuses for constructing about 200 affordable units, but, in general, the existing zoning has allowed sufficient density standards to meet developers' requests for proposed developments. The city also has approved concessions and waivers of standards in situations in which development would be precluded or hampered by the strict application of requirements.

Program Experience

In the 7 years since its inception, the Inclusionary Housing Program has generated production or development approval of 466 units of affordable housing. Developers submit plans for residential development and reach agreements with city officials as to the number, type, and location of the required inclusionary units. Covenants are placed on rental projects to ensure protection of their affordability in perpetuity. Many projects are quite small—two or three dozen units—and generate requirements for only a few lower income units. Some are much larger: one of the first, Trio Apartments, proposed 286 market-rate units that required 18 lower income units, which were built on the site. Another, Westgate, a pending project by the Sares-Regis Group, plans construction of 820 rental units, which will include 96 affordable units built on site. The developer asked for and received a density bonus based on the proposed building of 96 rather than 40 units for very low-income households, using private activity bonds that allowed the developer to finance the greater number of units. A number of projects have required extensive negotiations between developers and public officials to reach agreement on tradeoffs among types of units and their locations on or off the site.

Since its adoption in 2001, the program has passed through two quite different stages, capped most recently with yet another shift, as demonstrated in exhibit 1. In the program's first 3 years

[8] California Government Code Sections 65915–65918 (date unknown).

(through 2003), all but one project (which paid a fee) was producing rental housing and all but two developers entered into agreements to include affordable units on the development sites. By 2004, the gathering strength of the condominium market enticed developers to undertake development of for-sale condominium apartments. Many developers, especially those building rather small projects, elected to make in-lieu payments or build offsite affordable units. Said one developer, "You pay your fee, you get approval to move ahead, and no worries about building affordable units. The time saved and pain avoided is worth it." The city's rather strenuous regulatory process may also affect the payment decision. The ULI panel noted that "more than one land use professional had described Pasadena as one of the most highly regulated and administratively restrained building environments within Southern California" (ULI, 2007: 13), including an emphasis on sustainable design guidelines and environmental considerations. Regardless of strong city staff support for projects generating affordable units, developers may choose to pay in-lieu fees rather than subject their projects to the intensive design and decisionmaking process associated with producing affordable units within market-rate projects. Other incentives for paying fees are the small size of many projects and the difficulty of obtaining density bonuses in many neighborhoods, both of which tend to mitigate against including affordable units on site.

Within the past 2 years, however, developers proposing new projects have made more balanced choices: developers of almost 40 percent of pending rental projects propose to pay in-lieu fees, while more than one-half of ownership project developers propose to build affordable units on site. Clearly, the city's program administration has won adherents to the notion of incorporating affordable units within market-rate developments. The housing industry's current market troubles,

Exhibit 1

Program Production of Inclusionary Units

Building	Rental			Ownership		
	Projects	Units		Projects	Units	
		Market Rate	Affordable		Market Rate	Affordable
Building at 6% requirement (2002–03)	8	939	64	0	0	0
Building at 15% requirement (2004–05)	5	73	268*	6	240	41**
Paying fees at 6% requirement (2002–04)	2	228	32	3	174	11
Paying fees at 15% requirement (2003–07)	1	32	6	26	927	131
Building offsite units at 15% requirement	0	0	0	2	90	16
Sum of constructed and approved units to May 2008	16	1,272	370	37	1,431	199
Pending building on site at 15% requirement	6	635	113	20	885	102
Pending payment of fees at 15% requirement	6	403	71	28	813	139

** This "bump" in the production of affordable units came after city acquisition of an apartment complex to be occupied by low-income households.*

***Project built 6 of 11 required affordable units off site and paid in-lieu fee for 5 units.*

however, suggest that a number of the pending projects will be altered or postponed, raising questions about the future production of affordable units through inclusionary requirements.

Every few years, the City Council formally establishes the levels of in-lieu fees and updates them annually according to changes in the housing price index published by the Federal Housing Finance Agency. Fees are based on a staff analysis of housing cost factors, which in turn are based on periodic financial analyses by real estate economic consultants who evaluate current market conditions and the "affordability gap" between market-rate and affordable housing prices and rents. (Keyser Marston Associates carried out the most recent study in 2005.) The fees are set separately for rental units and ownership units and vary across four city subareas, which are defined differently for rental and ownership units. Initially, in 2002, fees were set quite low—$10 per net square foot of floor space in proposed market-rate units in the most attractive subarea for development. The 2008 schedule set a fee of $40.55 for the same area. Fees for rental units have been highest in the southern, more developed half of the city. Exhibit 2 indicates the current range of in-lieu fees for rental and ownership units. The city's efforts to establish reasonable levels of in-lieu fees and to reflect differences in development costs among four city districts appear to be a worthwhile practice in an environment such as California, where legal challenges to municipal lawmaking are plentiful.

For example, fees for residential ownership projects proposed in subarea A, which is considered the most attractive area for development, are double those in subarea D south of the 210 Freeway. Fees for rental projects are highest in subareas C and D.

An example of a developer who elected to pay in-lieu fees is the MS Property Company, which in 2005 proposed construction of 56 condominium apartments on a 5.3-acre site in the Central District. The development, located in subarea D, was to include 175,000 square feet of net residential space. The fee schedule called for payment of $12 per square foot, or a total of $2,100,000, which was paid in full prior to issuance of a building permit. The first phase of 36 apartments was completed in the summer of 2008, and the developer is applying for the design review of the second phase of 20 units.

Few developers have opted to build affordable units off site, apparently because reasonably priced sites are difficult to find. At Delacey Place, however, a 34-unit condominium development approved in October 2004, Toledo Homes (as Delacey Place, LLC) built 5 moderate-income units as part of another project being developed by the same firm. On that site, the firm built 11 moderate-income units, which replaced some rundown commercial buildings.

Exhibit 2

In-Lieu Fee Schedule for Projects of 10 to 49 Units, 2008

Subarea	Rental Units	Ownership Units
A	TBD	$40.55
B	$ 1.07	$14.94
C	$23.48	$24.54
D	$21.34	$19.21

TBD = To be decided when sufficient market data are available.

Note: Fee per net square foot of floor space in market-rate units.

Current Affordable Housing Issues

Although Pasadena's affordable housing program has been quite productive, particularly in comparison to programs of nearby cities, high land prices driven by restricted supplies of developable land challenge production of affordable housing, especially in neighborhoods resisting the escalation of densities. In addition, the apparent preference of many developers to pay in-lieu fees rather than construct lower priced units makes the city, rather than experienced residential developers, responsible for producing much of the affordable housing. In effect, fee payments generate affordable units well after payments are collected rather than during development of the market-rate projects. To boost production of affordable units, the reports of The Planning Center (2007) and the ULI panel (ULI, 2007) identified several potential initiatives, such as the following, that city officials are considering:

- The ULI panel (ULI, 2007) strongly urged the city to leverage collected in-lieu and other funding by seeking grants and loans from corporate, nongovernmental, and other organizations to increase affordable housing investments and production.
- The Planning Center (2007) emphasized the need for generating affordable units large enough for families with children, in addition to the studio and one- and two-bedroom units now being developed by the program.
- The city could strengthen the Inclusionary Housing Program by allowing developers to meet requirements in three additional ways: by (1) encouraging rehabilitation of existing apartments for lower income households, (2) retaining affordable units in apartment developments being converted to condominiums, and (3) providing for production of workforce housing.
- The city should act to provide suitably priced sites for affordable housing in targeted areas best suited to accommodate higher density development, including city-owned properties and surplus school sites.

In addition, the development industry and the city will be adjusting to the current economic problems that suggest a possible major reduction in market-rate housing production. This situation may well change the course of the Inclusionary Housing Program and the city's overall housing program.

Conclusion

This preliminary investigation of three inclusionary housing programs that allow developers to pay in-lieu fees or develop offsite affordable housing finds that the availability of alternatives to onsite construction has won widespread program support from residential developers and residents alike; has helped to improve the existing housing stock, which has provided more housing options; and has contributed to the overall sustainability of the neighborhoods in which these programs were offered. In-lieu fees and offsite development options eased developers' concerns about building in high-cost areas, especially where density ceilings and environmental requirements imposed limits on construction. The communities under study established specific requirements and procedures for implementing these incentives. Future research intended to confirm these initial findings may want to focus on the clarity and specificity of the individual program requirements and various contextual factors, such as the political, economic, and social conditions that would support such strategies.

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