Walking the Inclusionary Zoning Tightrope

The Economics of IZ

Ian Carlton
February 2nd, 2017
Cornerstone Calculator

http://www.affordableownership.org/inclusionary-housing/inclusionary-housing-calculator-tool/
RLV = Developer Maximum Land Budget

Given a set of capital, construction, operating costs, and revenue assumptions
Residual Land Value by Construction Prototype

$ RLV = \$per gross square foot of land

Economics of Development

Strategic Flat

4 over 1 (podium)

Residential Tower

Rent per Square Foot

Tower

4 over 1

Stacked Flat
Housing Development Feasibility

Financially feasible building types if the land value is $0

- Residential tower
- 4 over 1
- Stacked flats
- Doesn’t pencil
- Insufficient data
Rent per Square Foot

Residual Land Value by Construction Prototype

RLV = $ per gross square foot of land

Stacked Flats
4 over 1 (podium)
Residential Tower

Tower
4 over 1
Stacked Flat
Economics of Development

Residual Land Value by Construction Prototype

Stacked Flats

4 over 1 (podium)

Residential Tower

Including Affordable Housing (e.g., 20% of units at 80%AMI)

Rent per Square Foot

RLV = $ per gross square foot of land
Economics of Development

Residual Land Value by Construction Prototype

RLV = $ per gross square foot of land
The Impact of Affordable Units Without Incentives

How does the setaside change feasibility?
- From res. tower to 4 over 1
- From 4 over 1 to stacked flats
- From stacked flats to infeasible
- No change (still feasible)
- No change (still not feasible)
- Insufficient data

IZ Policy
20% Set Aside
80% of MFI
$0 Land Price
No Incentives

https://commons.wikimedia.org/wiki/File:Radom_office_park.jpg
Austin Example

https://mapcraftlabs.github.io/austin/austin.html
**Offsetsing Financial Incentives**

<table>
<thead>
<tr>
<th>Construction-oriented</th>
<th>Revenue-oriented</th>
<th>Cost-oriented</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Operations-oriented</strong></td>
<td>Grants, tax credit equity, targeted loans (deferred interest, low-interest, etc.)</td>
<td>Land write downs, parking minimum reductions + maximum reductions, streamlined processes, fee waivers</td>
</tr>
<tr>
<td></td>
<td>Relaxed height and/or FAR restrictions, Section 8</td>
<td>Property tax abatements</td>
</tr>
</tbody>
</table>
IZ Policy Offset – Incentive Comparison

Stacked Flat $2.25 Market Rent

Residual Land Value $/SF (Land Budget)

$0

Infeasible

$210

Current Market

IZ Policy:
20% set aside
80% AMI target

$50

+$9 ($59)

+$7 ($57)

Full property tax abatement:
(1.5% rate reduction)

After Incentives

$66

($50 + $9 + $7)

Parking Reduction
50% of spaces
IZ Policy Offset – Incentive Comparison

4 over 1 Podium $3.25 Market Rent

Residual Land Value $/SF (Land Budget)

Current Market

$210

$145

$157

After Incentives

$210 ($80 + $35 + $95)

Parking Reduction

50% of spaces

IZ Policy: 20% set aside 80% AMI target

Full property tax abatement: (1.5% rate reduction)

$0

Infeasible

= Stacked Flat $3.25 Market Rent
Incentives are required to accompany inclusionary zoning (IZ) in most settings to ensure the desired development and avoid adverse effects in the market. The key question is: what type and mix of incentives make the most sense? The answer is that they depend on local market (and submarket) conditions.

Optimizing the Effectiveness of Incentives for Inclusionary Development

Financial Incentive Complications

**Direct Subsidies**
- Sources of grant funds?
- Opportunity cost of forgone revenues?
- Org capacity to streamline processes?
- Subsidizing land market?

**Reduced Parking**
- Not right-sized already?
- Incite affordable housing pushback?

**Operating Subsidies**
- Sources of grant funds?
- Tax abatements undermine TIF?
- How big is the tax burden?
- Funds to offset forgone $?

**Density Bonus**
- Not right-sized already?
- Valuable in desired geographies?
- Org capable of regular calibration?
- Incite affordable housing pushback?
IZ Tightrope or...
Economic Teeter-Totter?

Market-rate Housing

Deeply Affordable Housing

Supplemental Subsidy

Ubiquitous Subsidy
• Value is capitalized in the Land
  • Highest and best use can change with IZ impacts
  • Large-scale IZ programs generally require incentives to maintain housing production levels

• Flexible programs are less likely to cause market disruptions (unintended consequences)
  • One size fits all vs. sub-regional vs. project-based calibration
  • Revisiting requirements / incentives as realities change
  • On site requirement vs. offsite vs. opt-out

• So much unaddressed here!
  • Ownership vs. Rental Policy (e.g., TIF vs. property tax abatement)
  • Varied effectiveness of incentives, especially due to HOA
Market vs. Affordable Rent Varies within Cities

<table>
<thead>
<tr>
<th>Average Market Rent for High-Quality New Housing Units per square feet</th>
<th>Typical Two-Bedroom Affordable Unit at 100% AMI* per square feet</th>
</tr>
</thead>
<tbody>
<tr>
<td>$3.75</td>
<td>$1.65</td>
</tr>
<tr>
<td>$3.25</td>
<td>$1.65</td>
</tr>
<tr>
<td>$2.25</td>
<td>$1.65</td>
</tr>
</tbody>
</table>

*Affordable rents determined on a per unit basis, and per square foot rates will vary based on unit sizes.
IZ Setaside vs. Income Target Tradeoff

4 over 1 (podium) -- Rent @ $3.25/SF

Stacked Flat -- Rent @ $2.25/SF

% AMI

More affordable rent

% Units

More affordable units

Indifference Curve

21% vs. 17% setaside

62% vs. 31% setaside
Net Cash Flow Distributions ("Waterfall")

Internal Rate of Return %

- Initial Return Tranche
  - Equity: 60%
  - Developer: 40%

- Second Return Tranche
  - Equity: 25%
  - Developer: 75%

- Third Return Tranche
  - Developer: 75%