FINAL REPORT

ON

MPDU Program: Analysis of Current Program and Research On Other Localities' Inclusionary Zoning Programs

FOR

Montgomery County Department of Housing And Community Affairs

June 7, 2018

Urban Ventures®

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Table of Contents

Section I – Characteristics of Rental Moderately Priced Dwelling Units (MPDUs) Owned by Private Market Organizations

Household Characteristics

Household Characteristics are derived from a sample of 434 rental MPDUs owned by private market organizations. The 434 units provide housing to 778 individuals. (This is a 1 in 3 sample of households of 62% of all housing complexes containing MPDUs.) The information below presents the findings from the sample population for the following characteristics:

1. Household Income
2. Household Income as Percentage of Area Median Income
3. Percentage of Household Income Spent on Rent
4. Household Size
5. Address of Origin

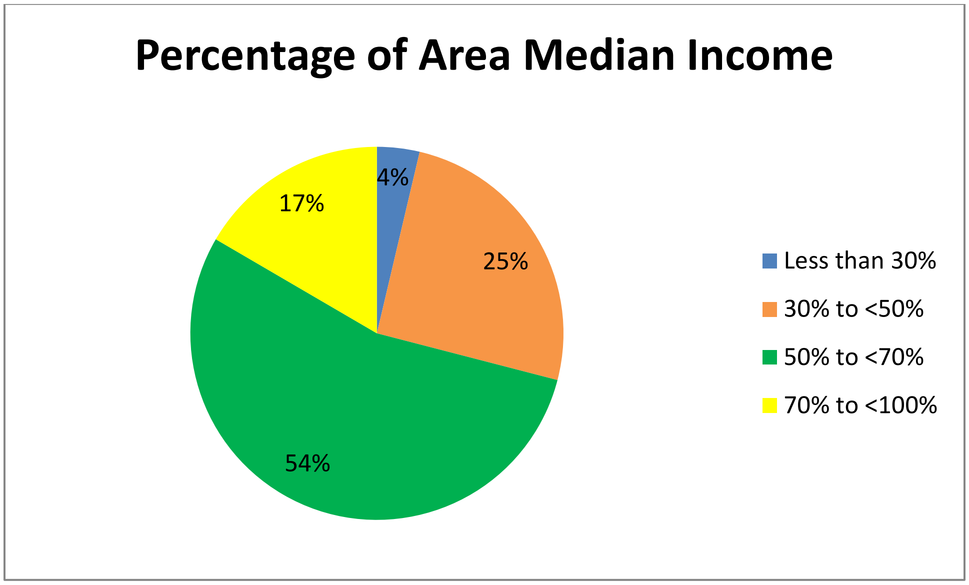
Household Income

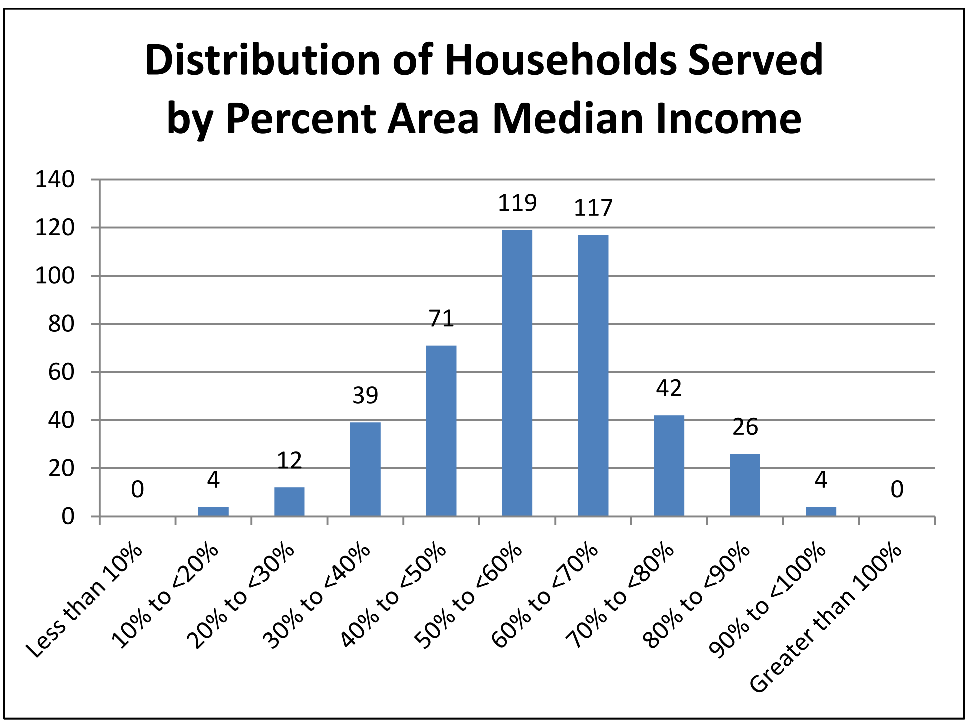
The Rental MPDU program serves households with a broad range of incomes. Individuals with incomes below $30,000 who have a rental subsidy can utilize the MPDU rental program. $8,796 is lowest income in the sample. The median income is $48,000 and the highest income in the sample is $90,000. However, income as a percentage of area median, adjusted for household size, provides more important information because it takes into account the impact of household size on the household economy (see below).

Household Income as Percentage of Area Median Income

This data is based on percentage of Area Median Income, adjusted for household size. The household with the lowest percentage of median income in the sample was 12% of AMI. The household with the highest percentage of median income was 96%. The average percentage of median income was 57%.

Twenty-nine percent of MPDUs sampled serve households below 50% of AMI, while 54% of MPDUs serve households between 50-70% of AMI. Seventeen percent of units serve households above 70% of AMI – with no households above 100% of AMI. Note that households over 70% AMI are MPDU households whose income has risen since their initial income certification. The program rules allow an existing MPDU tenant to remain in their home if their income rises – up to a maximum of 130% of maximum of household income for new tenants based on household size.

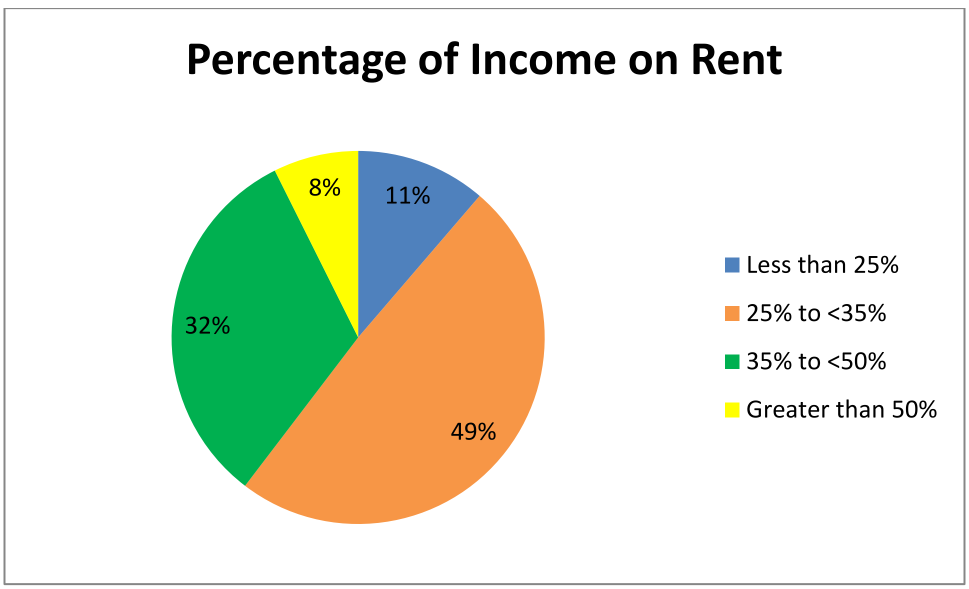

Percentage of Area Median Income
4%
17%
25%
54%
Less than 30%
30% to <50%
50% to <70%
70% to <100%


Distribution of Households Served by Percent Area Median Income
140
120
100
80
60
40
20
0
0
4
12
39
71
119
117
42
26
4
0
Less than 10%
10% to <20%
20% to <30%
30% to <40%
40% to <50%
50% to <60%
60% to <70%
70% to <80%
80% to <90%
90% to <100%
Greater than 100%

Percentage of Household Income Spent on Rent

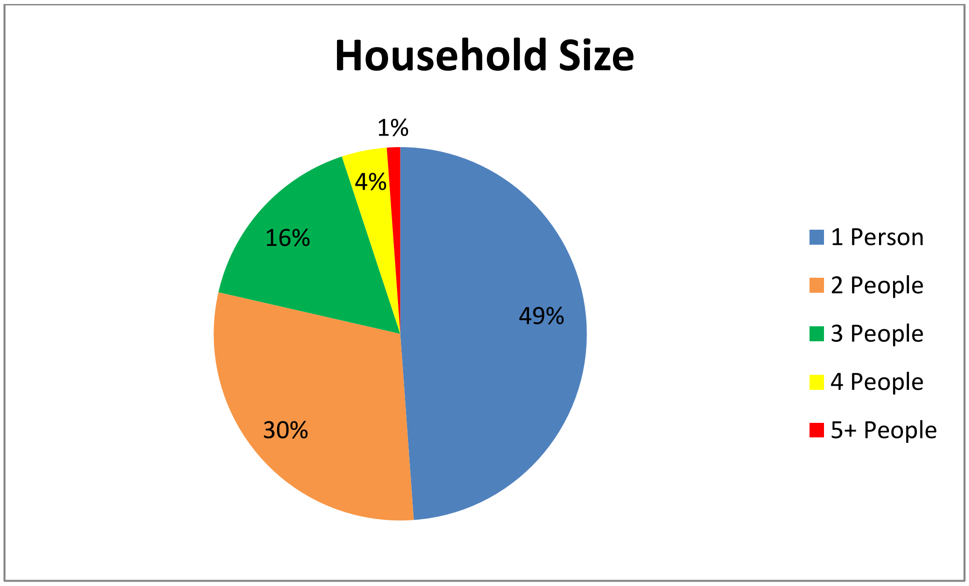
From a housing policy perspective, a renter is considered "cost burdened" when the cost of rent and utilities total more than 30% of household income, and "severely cost burdened" when the cost of rent and utilities exceeds 50% of household income. The data available on the MPDU program does not include the cost of utilities, so it is not possible to calculate the households who fall into the technical definitions of cost burden.

The 8% of households who appear to be spending more than 50% of their income on rent are receiving some form of rental subsidy, but the data is not specific enough to determine the type and depth of that subsidy. It is likely that many households spending in the 35%-50% are also receiving a rental subsidy.

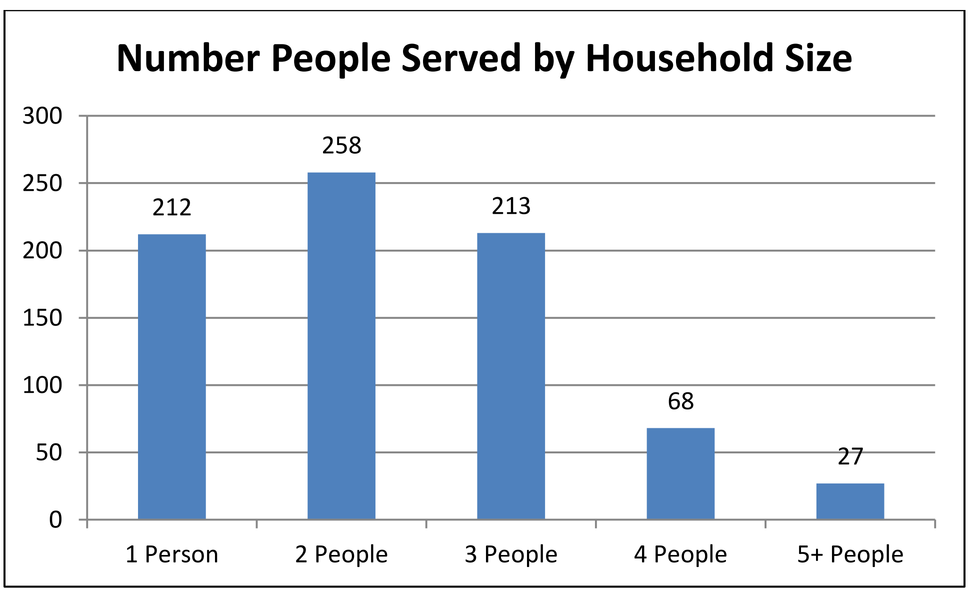


Household Size

Forty-nine percent of households sampled are single individuals. Two person households constitute 30% of the sample. Three person and larger households are 21% of the sample.

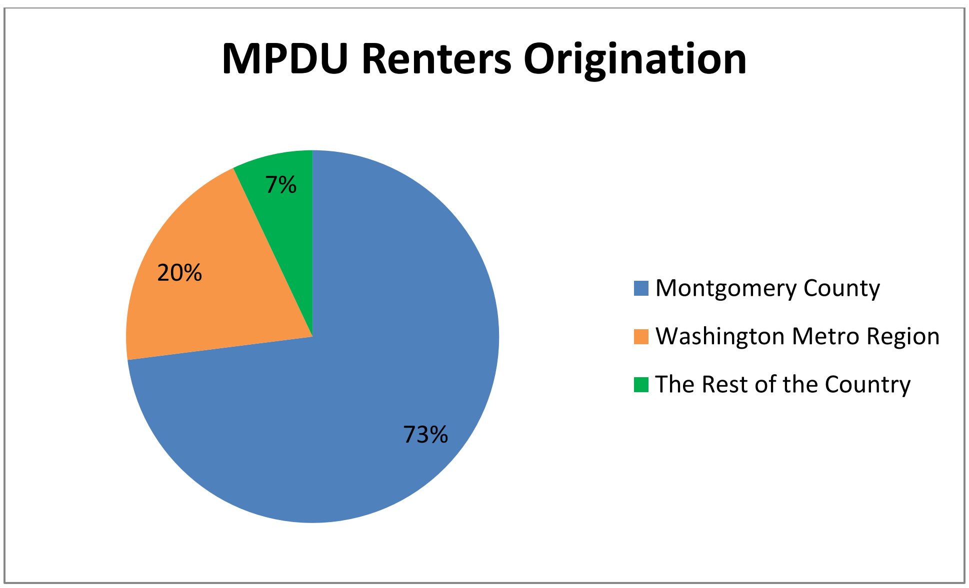


While one person households make up 49% of the households surveyed, 73% of the individuals served by the MPDU program are in households with two or more people.



Address of Origin

The MPDU program is not restricted to current Montgomery County residents, allowing it to serve individuals relocating for work or family considerations. Seventy-three percent of residents moving into an MPDU list an address in Montgomery County as their "address of origin" – their address when they are applying. Households moving within the Metro region account for 20% of MPDUs, while individuals moving from outside the Metro region, including from non-Metro areas of Maryland and Virginia, and a few from as far away as Alaska, account for 7% of MPDUs.

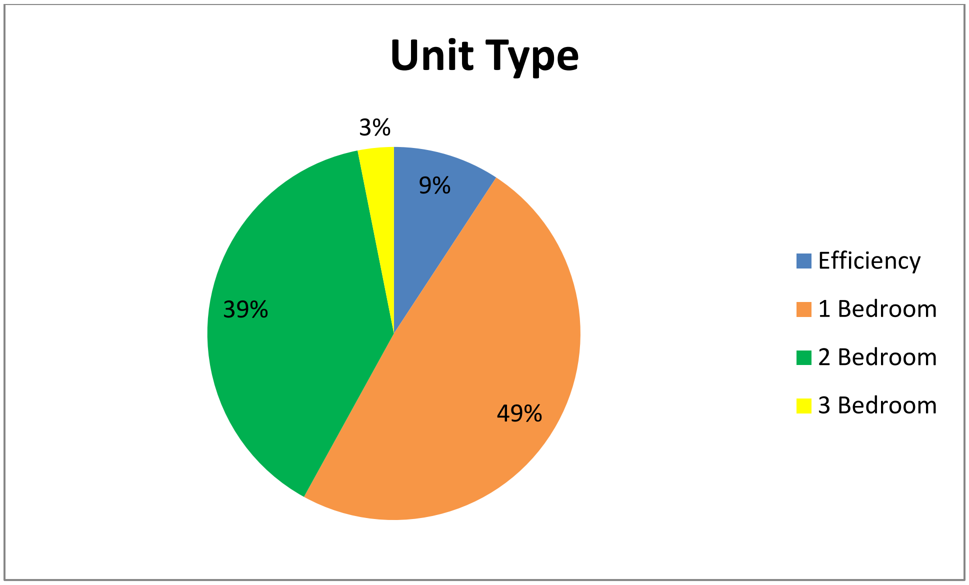


Unit Characteristics

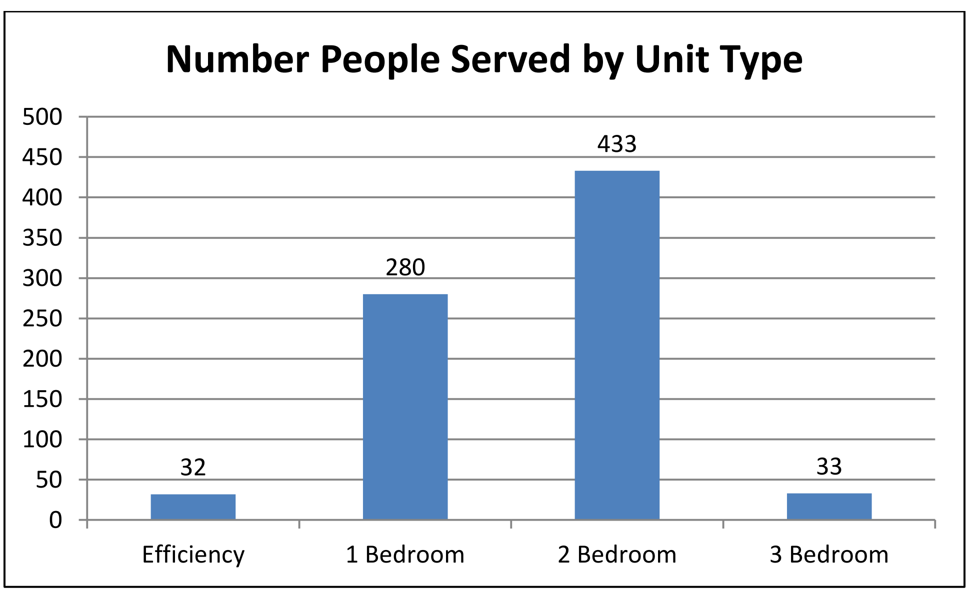
The data below reflects the entire current pool of rental MPDUs under private market ownership.

Bedroom Type

Efficiencies comprise 9% of MPDUs and one bedroom units make up 49% of the MPDUs. Two bedroom units are 39% of the total unit mix and three bedroom units are 3%.

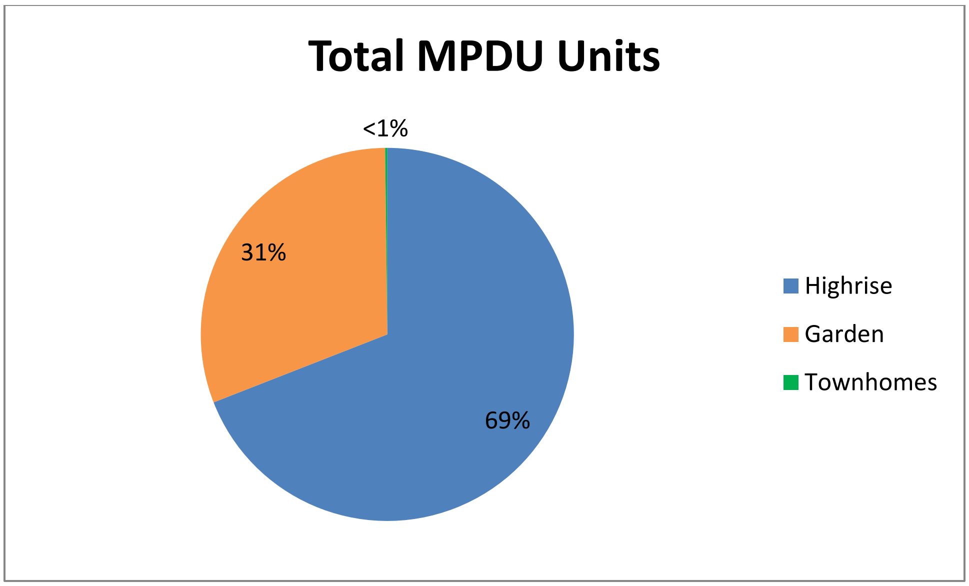


Though efficiency and one bedroom units make up a majority of the unit mix, 61% of the individuals housed by the MPDU program live in two and three bedroom units.



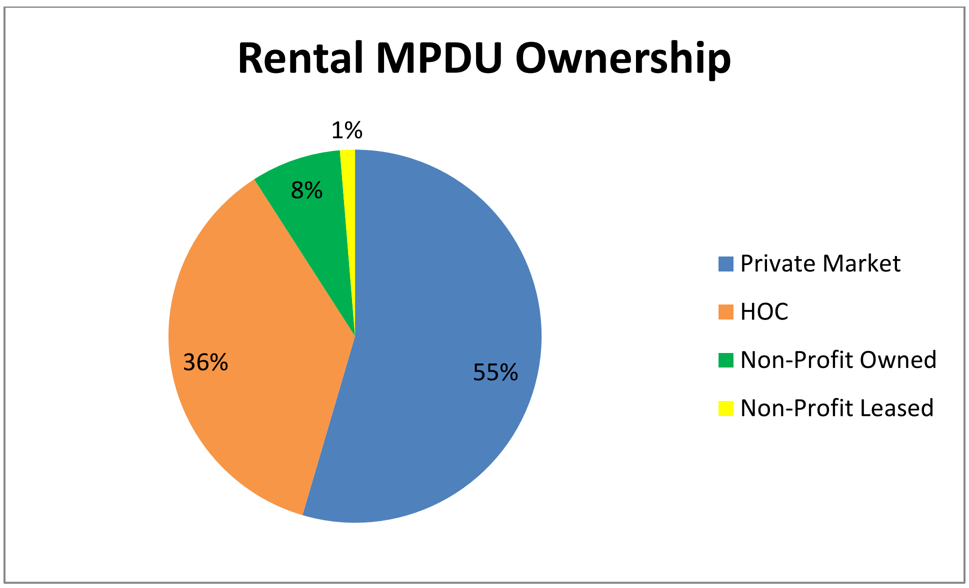
Type of Housing Complex

Units in high rise complexes account for 69% of rental MPDUs. Garden apartments comprise just less than 31% of MPDUs, while townhouse units make up 0.2% of rental MPDUs.



Ownership of Rental Units

There are approximately 3,850 rental MPDUs in service (as of November 2017), of which 55% are owned and leased by private market organizations (2,100). It is the characteristics of the units owned by private market organizations which are described above. However, there is another substantial body of rental MPDUs: public service entities control the remaining 45%. HOC owns 1,400 and other non-profits own 300. Non-profit organizations master lease an additional 50 units from private market owners. These master leased units typically serve households with special needs (all private market ownership numbers approximate).



Section II – Final Results of MPDU Rental Housing Vacancy Survey

Over the course of November 13, 14 and 15, 2017, Urban Ventures conducted a phone survey of all properties currently participating in the MPDU rental program. During those three days, 55 developments (89% of all properties) shared vacancy data, information on their waiting lists, and advertising policies. Those 55 developments include 91% of all active MPDU rental units.

The overall vacancy rate was 1.18%. The vacancy rate by unit type was:

Efficiency: 1.5%
1 bedroom: 0.6%
2 bedrooms: 1.4%
3 bedrooms: 2.9%

Due to the small total universe of 3 bedroom units (a total of only 67 units, 2 of which were vacant), the higher vacancy rate for 3 bedrooms should not be over-interpreted.

Each property was also asked about marketing strategies and waiting lists. Not all properties answered every question.

Wait List

Twenty-five properties maintain either a formal waiting list or an "interest list." Interest lists would typically receive simultaneous notification of an available unit, with the unit filled by the first complete applicant. Formal waiting lists typically sent out availability information to either only one, or up to 10 households simultaneously, with the unit offered to the first complete applicant.

Twenty-six properties did not maintain a waiting list, generally commenting that units filled very quickly. Two properties commented that they had previously maintained a waiting list but stopped because they found it was not necessary to fill vacancies.

Advertising

Craigslist

Sixteen properties mentioned that they advertise vacancies on Craigslist. One property mentioned Craigslist "and other social media."

No Need to Advertise

Sixteen properties commented that vacancies fill so quickly that neither a waiting list nor advertising is needed. At these properties, vacancies are typically filled with inquiries that occur after staff receive notice of a move out. Prospective residents "are just lucky" and call at the right moment, say staff.

Section III – MPDU Homeownership Analysis

The data below regarding For Sale MPDUs address the following characteristics:

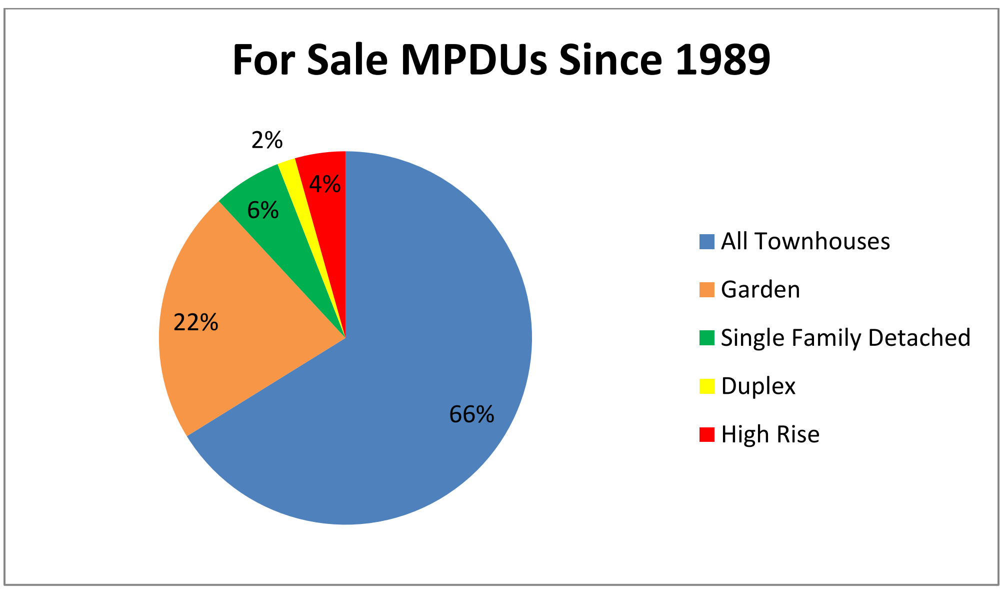
1. Unit Type (since 1989 and current portfolio)
2. Bedroom Count
3. Resales
4. Resales by Unit Type
5. Resales by Bedroom Count

For Sale MPDUs By Unit Type

For Sale MPDUs By Unit Type Since 1989

Of the 5,351 for sale units produced since 1989, 155 units (2.9%) are unidentified by unit type.

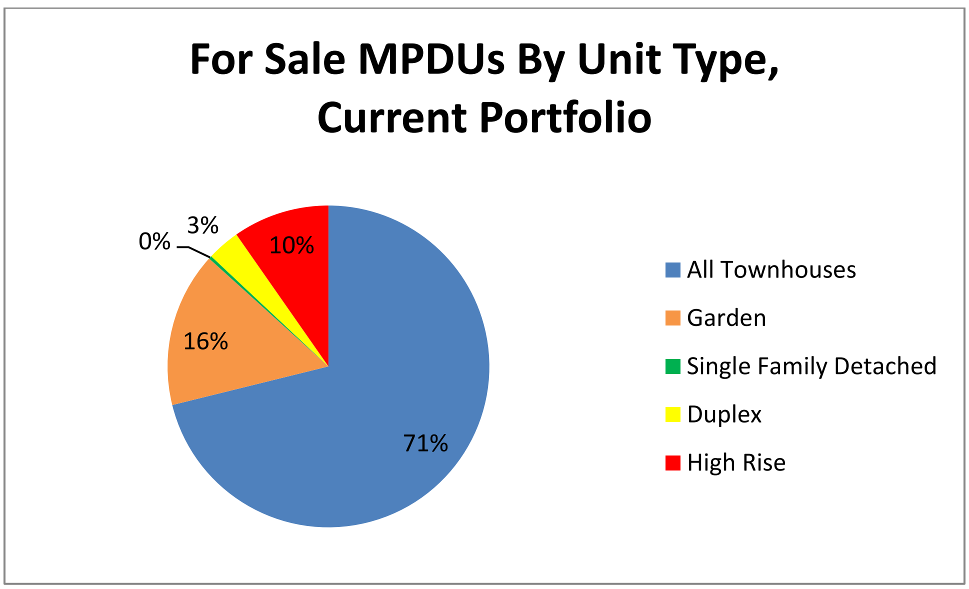
Of the 5,196 units identified by unit type, townhouses are by far the dominant unit type, with 47% of identified units. Variations on townhouse units account for another 19% (including 14% piggy back townhouse units, 4% back to back townhouse units, and 1% townhouse condo units). All townhouse construction totals 66% of identified units. Garden units are 22% of total production. Single family detached (6%), duplex (2%), and high rise condo (4%) each make up a much smaller portion of total production since 1989.



MPDUs By Unit Type, Current Portfolio

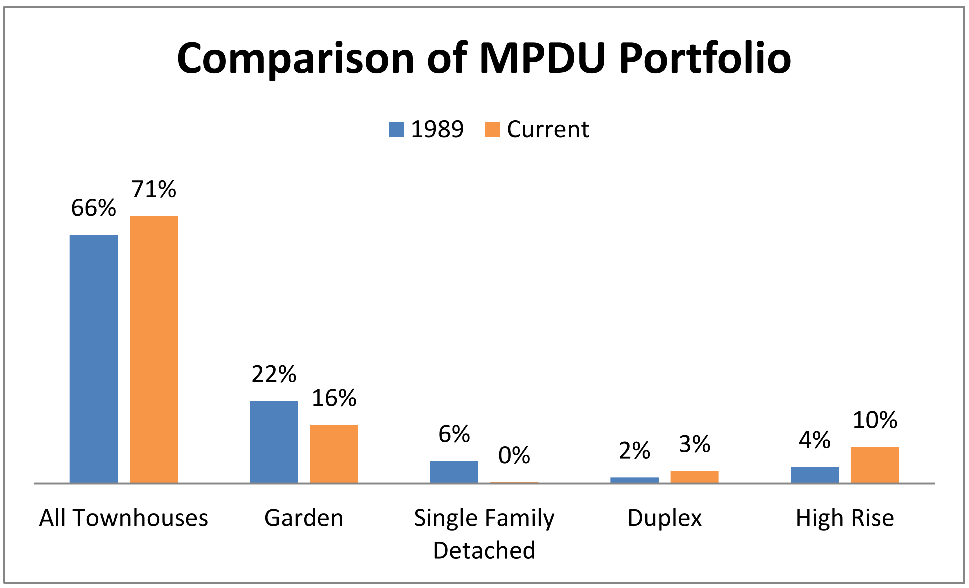
Of the 1,697 MPDUs currently under control, 3% are unidentified by unit type.

Of the 1,639 units identified by unit type, townhouses are still the dominant unit type, with 44% of all identified units. Variations on townhouse units account for another 27% (including 25% piggy back townhouse units, 0% back to back townhouse units, and 2% townhouse condo units). All townhouse construction totals 71% of identified units. Garden units are 16% of total production. High rise condo construction makes up 10% of current MPDUs. Single family detached (0%) and duplex (3%) each make up a much smaller portion of total production.



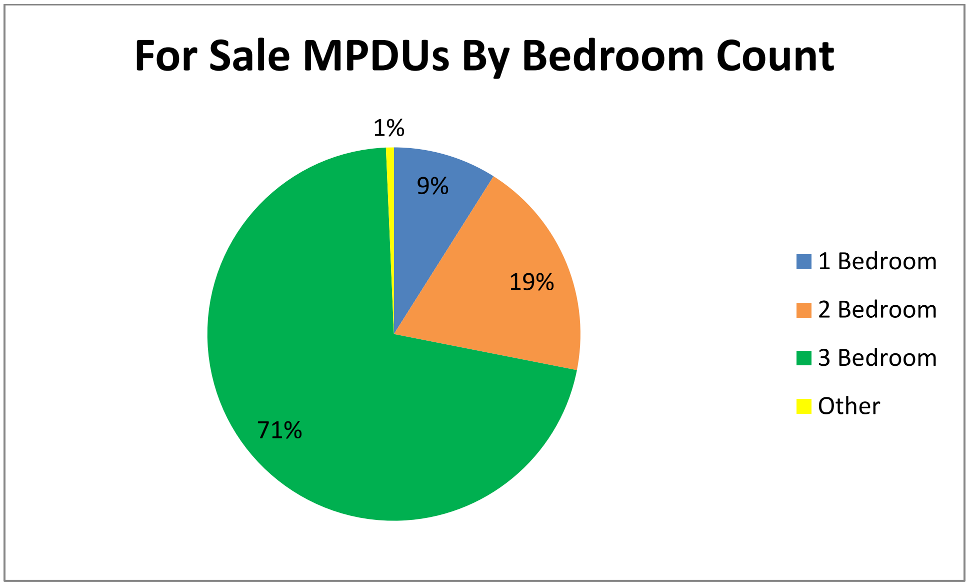
Comparison of MPDU Portfolio By Unit Type (Total Since 1989 vs. Current Portfolio)

The distribution of MPDUs by unit type has not changed substantially since 1989, with townhouse construction dominating the production at 66% and 71% (since 1989 and current portfolio, respectively). There have been some shifts as single family detached and garden unit production has shrunk, while high rise condos have grown from 3% to 10% of units produced.



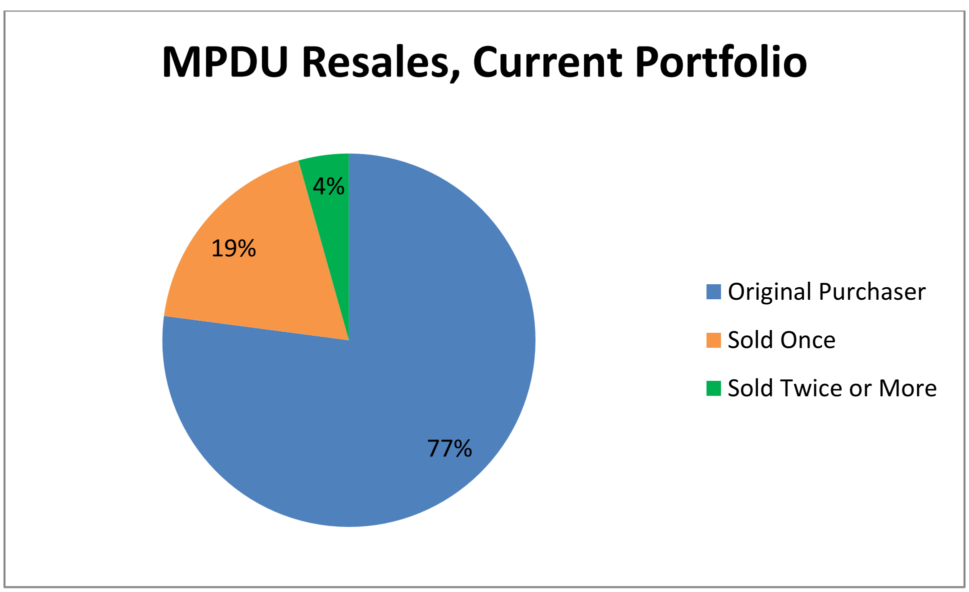
Current MPDUs By Bedroom Count

Current MPDUs with identified bedroom count total 1,616. Of these, 9% are 1 bedroom units, 19% are 2 bedroom units, and 71% are 3 bedroom units. The remaining 1% are made up of the very rare efficiencies, 2 bedroom plus den, and 4 bedroom units combined.



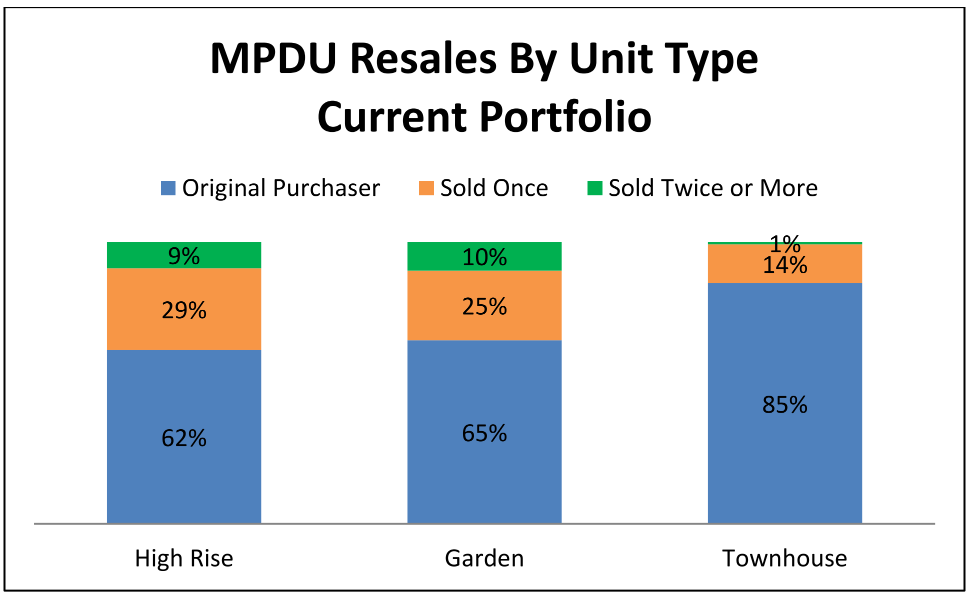
MPDU Resales, Current Portfolio

Of the current MPDU portfolio of 1,697 units, 77% are owned by the original purchaser. Nineteen percent of units have been sold once, while 4% have sold two or more times.



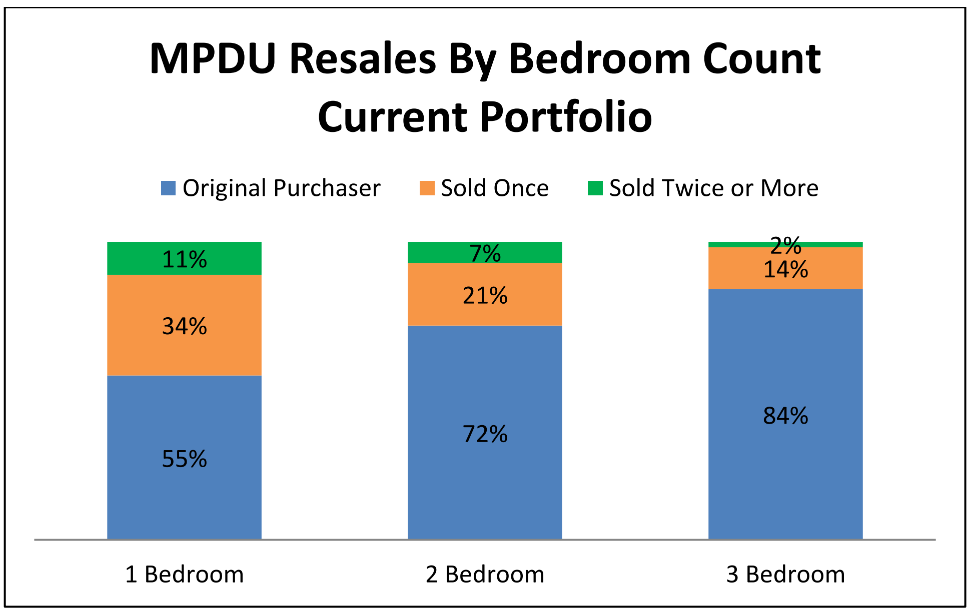
MPDU Resales By Unit Type

Looking at both MPDU resales since 1989 and MPDU resales in the current portfolio, resale activity by unit type is quite consistent. The units most likely to resell are high rise condominium units. In the current portfolio, 62% of high rise units are owned by their original purchaser, while 29% have been resold once, and 9% have resold two or more times. Garden units have a similar sales history. In the current portfolio, 65% of garden units are owned by the original purchaser, while 25% have been resold once, and 10% have been resold two or more times. Townhouses, the dominant type of housing unit, have a more stable ownership pattern. 85% of townhouse units are owned by their original purchaser, while 14% have been resold once. Only 1% have resold two or more times. Piggy back townhouses fall in between, with 74% owned by the original purchaser.



MPDU Resales By Bedroom Count

Predictably, resales activity and bedroom count are inversely correlated: the fewer the bedrooms, the more resales, and the more bedrooms, the fewer the resales. In the current portfolio, only 55% of 1 bedroom units are owned by the original purchaser, and 11% have been resold two or more times. Of 4 bedroom units, 88% are owned by the original purchaser. Of 3 bedroom units, which are the dominant MPDU housing stock, 84% are owned by the original purchaser, and only 2% have transferred two or more times.



Section IV
Achieving and Sustaining Affordability
In For Sale Moderately Priced Dwelling Units (MPDUs)

Summary

While most MPDUs experience stable ownership patterns and remain affordable at resale, some units experience significant price pressure due to repeated resales and become unaffordable to MPDU purchasers. Adjustments to the resale formula could reduce the number of units becoming unaffordable and slow the rate of price increases. For units which are already unaffordable, buy-downs would be necessary to reach and maintain an affordable price. To minimize the need to subsidize MPDUs, the County could consider shifting to an FAR (Floor Area Ratio) formula for units entering the program. This would offer the County the opportunity to negotiate for larger units with more stable ownership patterns.

The MPDU Ideal

Moderately priced units are sold to moderate income homebuyers, who can resell their unit for a price which ***both*** provides a fair return on their investment and also keeps the unit affordable for the next income eligible MPDU homebuyer.

The MPDU Reality

Most MPDU resales fit that broad vision. But some resales do not. For some units, the formula driven resale price is not affordable to a subsequent MPDU homebuyer, and for some of these units, the gap between the formula price and a price affordable to an MPDU purchaser is quite large.

What Makes a Resale Unaffordable?

The resale formula increases the price of the unit based on:

- Inflation (CPI-U) during the term of ownership;
- Improvements made by owner (and approved by DHCA);
- Real estate agent fees.

Each of these upward adjustments contribute to an unaffordable price:

- Inflation – in the last 10 years in Montgomery County, price inflation has exceeded wage growth. In this climate of falling real wages, adjusting unit price upward by CPI-U creates an affordability gap at every transaction.

- Improvements – if approved for inclusion in the formula, improvements are added to the sales price at their full undepreciated cost, up to 10% of the sales price. This creates an incentive for each homebuyer to make improvements. Not only will the homeowner get the benefit of improvements themselves, they will recoup their full expenditure on resale.
- Real estate agent fees – at 6% of the sale per transaction, this is a significant additional cost, especially if the unit is turning over frequently. A 6% price increase can be absorbed more easily over 12 years (1/2% price increase per year) than 2 years (3% price increase per year).

What Type of Units Become Unaffordable?

The units which become unaffordable are those which are turning over repeatedly. Improvements and real estate fees are capped at 10% and 6% of sales price respectively, unrelated to the length of property ownership. The formula driven upward adjustments accelerate with each transaction as the sales price rises. For instance, an initial $100,000 sales price + $10,000 improvements + $6,000 real estate fees results in a resale price of $116,000 on the first resale. On the next sale the improvement cap is $11,600 + $6,960 real estate fees for a sales price of $134,500 on the second resale – all without factoring inflation. With up to 16% price inflation PER TRANSACTION built into the formula, on top of inflation, any unit which is turning over repeatedly will not remain affordable.

The attached spreadsheet demonstrates how the current resale formula led two actual MPDUs (a one bedroom high rise condo and a three bedroom piggy-back townhouse) to become unaffordable to MPDU buyers over the course of two resales. In both cases, the unit price increase was more than ***three times*** the rate of wage growth during the period. In both cases, real estate agent fees contributed more than 40% of the price increase and were the single largest contributor to the price increases.

What Type of Units Turn Over?

One Bedroom Units

Functioning either as starter homes for young adults or empty nest units for older folk, neither of these populations are long term owners. The analysis of resale trends in current MPDUs found that, while 84% of three bedroom units are owned by the original purchaser, only 55% of one bedroom units are owned by the original purchaser.

Units Which Don’t Meet the Needs of MPDU Purchasers

Some units don’t meet the needs of MPDU purchasers. Units may be less than optimal for a range of reasons including:

- The square footage is too small for the number of bedrooms
- Too few bathrooms for number of bedrooms
- Issues with construction quality and need for systems improvements
- Damage by a prior owner
- Unappealing location
- Combination of all of those

How Could Affordability Be Preserved?

The resale formula is designed to balance a fair return to the seller and an affordable price to the purchaser. Looking at each component of the formula, there are ways to adjust to the formula to place greater emphasis on affordability to the purchaser.

- Inflation – instead of using CPI-U ie cost inflation, the adjustor could be wage growth. This maintains the relative affordability for the purchaser, but at the cost of not maintaining the seller's purchase capacity.
- Improvements – approved improvements could be limited by:
    - depreciating the value of the improvements (which increases the complexity of the formula substantially),
    - further limiting the type of improvement which is eligible to be included in the formula, or
    - setting the maximum level on an annual basis up to a total cap (say, up to 1% of sales price per year, up to a total of 10 years of ownership). This potentially reduces return to seller, but in a way which the seller can control and predict. It also provides a small incentive for longer term ownership and reduces the unintended consequence of encouraging improvements by short term owners.
- Real estate agent fees – rather than having sellers contract with real estate agents for the standard market fee of 6% of sales price, the County could approve and train a stable of real estate agents willing to work for a reduced fixed fee given the unique nature of MPDU sales. Sellers could of course choose their own agent, but in that case the fee above the negotiated rate could be excluded from the formula.

Reducing real estate agent fees adjusts the formula to benefit the buyer without reducing the return to the seller. Since real estate agent fees are the single largest component of price appreciation in units experiencing rapid turn over, controlling these fees is an important component of a formula which better supports affordability. Furthermore, since marketing an (affordable) MPDU is much less time consuming for the real estate agent than a market rate unit, there is a logical argument for the fairness of an alternative formula for compensation.

What Would Affordability Cost?

Even if the resale formula is revised to enhance affordability for subsequent purchasers, there are still units which are currently unaffordable and units which will *become* unaffordable when the existing formula is used at the next resale.

Using the same two MPDUs whose actual price increases served as examples above, the figures below help answer the following questions:

- What would it cost to reduce the price of currently unaffordable MPDUs to a level affordable to MPDU buyers (i.e., households at 70% AMI)?
- What would it cost to keep such units affordable over time?

7710 Woodmont (1 bedroom condo)

- Most recent sale price: $258,723 in 2016

- Subsidy to affordability with standard 6% real estate agent fees:

    - Initial **Subsidy**: $143,304
    - Total Subsidy (40 years): $323,478
    - Initial subsidy as percentage of total subsidy: 44%

- Subsidy with alternative real estate agent fees (budgeted at $3,000 fixed fee):

    - Initial **Subsidy**: $127,462
    - Total Subsidy (40 years): $252,580
    - Initial subsidy as percentage of total subsidy: 50%

229xx Arora Hills (3 bedroom Piggyback Townhouse)

- Most recent sale price: $252,066 in 2017

- Subsidy needed with standard 6% real estate agent fees:

    - Initial **Subsidy**: $56,018
    - Total Subsidy (40 years): $318,009
    - Initial subsidy as percentage of total subsidy: 18%

- Subsidy needed with alternative real estate agent fees (budgeted at $3,000 fixed fee):

    - Initial **Subsidy**: $40,899
    - Total Subsidy (40 years): $226,349
    - Initial subsidy as percentage of total subsidy: 18%

Lessons from the Projections

Real Estate Agent Fees and Alternative Agent Fees

The difference between standard 6% fee and an alternative fixed fee of $3,000 is approximately $71,000 and $92,000 over six transactions. This is not as stark a difference as it would have made over the past 10 years. In these projections, the price is constrained in ways which has not been the case in the last 10 years: both buying down each resale and limiting improvements to 5% (after the initial resale). Controlling the total price minimizes the impact of standard 6% real estate fee calculation, since the fee is a percentage of total price.

Unit Size

When adjusting a sales price down to affordability, it is necessary to define, "affordable to whom?" For the one bedroom condo, we assumed a two person household at 70% AMI. For the three bedroom townhouse, we assumed a four person household at 70% AMI. Since the two person AMI is much lower than the four person AMI, the initial subsidy for the one bedroom is much larger (and subsequent subsidies smaller, since the base price is now much lower). The initial subsidy for the three bedroom is smaller (since four person AMI is higher) but the annual subsidy is higher (since the formula adjusts upwards based on the percentage of a much higher base price). The total subsidy over 40 years is quite similar, despite the very different up-front investments.

High Transaction Units

Affordability is highly sensitive to number of transactions, since each transaction capitalizes real estate agent fees and improvements, as well as any CPI-U / wage gap. One way to minimize the on-going cost of maintaining affordability is to minimize the number of high transaction units in the pool of MPDUs. There are two kinds of units where transaction levels are likely to be high.

One Bedroom Units: Current formulas determining the units entering the MPDU program don't offer the County the opportunity to select for larger unit sizes with more stable ownership patterns. A Floor Area Ratio (FAR) based formula would give the County more flexibility in negotiating the type of units entering the program.

Units Which Don't Meet the Needs of MPDU Purchasers: Some units which don't meet the needs of MPDU purchasers (as evidenced by repeated sales) could be made more functional with a one-time capital investment. A one-time subsidy to make a unit more physically functional (and therefore lead to stable ownership pattern) may be a more efficient investment than repeatedly resubsidizing the unit as it turns over. However, if the fundamentals are wrong, the county will have to keep re-subsidizing. A unit which requires repeated subsidy due to frequent resales drains resources away from creating successful affordable housing without ultimately solving the underlying problem.

Assumptions

There are a number of critical assumptions on which these calculations are built. Number of sales over the term and 1st mortgage interest rate both make a substantial difference in the outcome. This model illustrates one set of assumptions, applied to two different properties. It is intended to provide a sense of the kind of investment needed to maintain affordability in one reasonable scenario, not make a prediction of actual outcomes.

Inflation is another critical assumption. Projected wage growth and CPIU growth for each property reflect the ACTUAL recent historical rates, rather than a forward looking estimate. Since price growth exceeded wage growth during this period, the price inflation exceeds the growth in buyers' ability to pay at every transaction, resulting in the need for a subsidy in every transaction, even if there were no improvements and real estate fees were paid by the County directly. If wage growth exceeds inflation, the County subsidy would not be as deep.

MPDU Sale Price History

Property		7710 Woodmont	229xx Arora Hills Clarksburg
Unit Type		HR 1 Bed	TH 3 Bed
Original Price		$ 190,575	$ 192,822
Original Year of Sale		2008	2011

Total Percentage MPDU Price Increase		36%	31%
In Number of Years		8	6
Percentage per Year		4%	5%
Total CPI-U Increase		12.7%	8.2%
Total HUD AMI Growth		9.7%	4.0%

First Resale

First Resale Price		$ 208,680	$ 226,585
Year of First Resale		2010	2014
CPI-U During Period		2.2%	5.3%
CPI Adjustment to Price		$ 4,109	$ 10,248
RE Agent Fee	6%	$ 12,521	$ 13,595
Homebuyer Assistance (pre 2015)	3.5%	$ -	$ 7,930
Improvements / Other		$ 1,475	$ 1,990
Total Price Increase		$ 18,105	$ 33,763
First Resale Percentage Increase		9.5%	17.5%
Per Year Percentage Increase		4.8%	5.8%

Second Resale

Second Resale Price		$ 258,723	$ 252,066
Year of Second Resale		2016	2017
CPI-U During Period		10.3%	2.7%
CPI Adjustment to Price		$ 21,474	$ 6,220
RE Agent Fee	6%	$ 15,523	$ 15,124
Homebuyer Assistance (pre 2015)	3.5%	$ -	$ -
Improvements / Other		$ 13,046	$ 4,137
Total Price Increase		$ 50,043	$ 25,481
Second Resale Percentage Increase		24.0%	11.2%
Per Year Percentage Increase		4.0%	3.7%

Percentage of Total Price Increase

Total Price Increase	$ 68,148	$ 59,244
CPI-U	37.5%	27.8%
RE Agent Fee	41.2%	48.5%
Homebuyer Assistance	0.0%	13.4%
Improvements / Other	21.3%	10.3%
Total	100.0%	100.0%

Price Projection for 7710 Woodmont (1 Bedroom High Rise)

Assumptions

Household Size	2
Years Between Sales	7
Annual Wage Growth Rate (Prior Actual)	1.2%
Annual Price Inflation Rate (Prior Actual)	1.6%
Improvements Next Resale	10%
Improvements Subsequent Sales	5%
Real Estate Agent Fee	6%
Alternative RE Agent Fee	$ 3,000

Costs to Maintain Affordability

Total Cost w Standard RE Agent Fee	$ 323,478
Total Cost w Alternative RE Agent Fee	$ 252,580
Savings from Alternative Fee	$ 70,898
Initial Subsidy as a Percentage of Total Subsidy (Standard RE Agent Fee)	44%
Initial Subsidy as a Percentage of Total Subsidy (Alternative RE Agent Fee)	50%

Standard Real Estate Agent Fee Scenario

	3rd Resale	4th Resale	5th Resale	6th Resale	7th Resale	8th Resale
Year of the Last Sale Plus Assumed Tenure	2023	2030	2037	2044	2051	2058
Previous Sale Price	$ 258,723	$ 189,563	$ 202,304	$ 216,009	$ 232,804	$ 248,054
Inflation	$ 29,430	$ 21,563	$ 23,012	$ 24,571	$ 26,481	$ 28,216
Improvements	$ 25,872	$ 9,478	$ 10,115	$ 10,800	$ 11,640	$ 12,403
Standard Real Estate Agent Fee	$ 18,842	$ 13,236	$ 14,126	$ 15,083	$ 16,256	$ 17,320
Total Price	$ 332,867	$ 233,840	$ 249,557	$ 266,463	$ 287,181	$ 305,993
Price Affordable at 70% AMI	$ 189,563	$ 202,304	$ 216,009	$ 232,804	$ 248,054	$ 263,690
Total Buydown Required for Affordability	$ 143,304	$ 31,536	$ 33,548	$ 33,659	$ 39,127	$ 42,303

Fixed Price Real Estate Agent Fee

	3rd Resale	4th Resale	5th Resale	6th Resale	7th Resale	8th Resale
Previous Sale Price	$ 258,723	$ 189,563	$ 202,304	$ 216,009	$ 232,804	$ 248,054
Inflation	$ 29,430	$ 21,563	$ 23,012	$ 24,571	$ 26,481	$ 28,216
Improvements	$ 25,872	$ 9,478.15	$ 10,115	$ 10,800	$ 11,640	$ 12,403
Alternative Real Estate Agent Fee	$ 3,000	$ 3,341	$ 3,721	$ 4,145	$ 4,616	$ 5,141
Total Price	$ 317,025	$ 223,945	$ 239,153	$ 255,525	$ 275,542	$ 293,814
Price Affordable at 70% AMI	$ 189,563	$ 202,304	$ 216,009	$ 232,804	$ 248,054	$ 263,690
Total Buydown Required for Affordability	$ 127,462	$ 21,641	$ 23,144	$ 22,721	$ 27,488	$ 30,124

Interest rate, PMI, and condo fee assumptions per White Flint 2018 spreadsheet, adjusted for inflation

Price Projection for 229xx Arora Hills (3 Bedroom Townhouse)

Assumptions

Household Size	4
Years Between Sales	7
Annual Wage Growth Rate (Prior Actual)	0.7%
Annual Price Inflation Rate (Prior Actual)	1.4%
Improvements Next Resale	10%
Improvements Subsequent Sales	5%
Real Estate Agent Fee	6%
Alternative RE Agent Fee	$ 3,000

Costs to Maintain Affordability

Total Cost w Standard RE Agent Fee	$ 318,009
Total Cost w Alternative RE Agent Fee	$ 226,349
Savings from Alternative Fee	$ 91,660
Initial Subsidy as a Percentage of Total Subsidy (Standard RE Agent Fee)	18%
Initial Subsidy as a Percentage of Total Subsidy (Alternative RE Agent Fee)	18%

Standard Real Estate Agent Fee Scenario

	3rd Resale	4th Resale	5th Resale	6th Resale	7th Resale	8th Resale
Year of the Last Sale Plus Assumed Tenure	2024	2031	2038	2045	2052	2059
Previous Sale Price	$ 252,066	$ 264,076	$ 271,604	$ 280,291	$ 288,399	$ 297,665
Inflation	$ 24,702	$ 25,879	$ 26,617	$ 27,469	$ 28,263	$ 29,171
Improvements	$ 25,207	$ 13,204	$ 13,580	$ 14,015	$ 14,420	$ 14,883
Standard Real Estate Agent Fee	$ 18,119	$ 18,190	$ 18,708	$ 19,306	$ 19,865	$ 20,503
Total Price	$ 320,094	$ 321,349	$ 330,509	$ 341,081	$ 350,947	$ 362,223
Price Affordable at 70% AMI	$ 264,076	$ 271,604	$ 280,291	$ 288,399	$ 297,665	$ 306,158
Total Buydown Required for Affordability	$ 56,018	$ 49,745	$ 50,218	$ 52,682	$ 53,282	$ 56,065

Fixed Price Real Estate Agent Fee

	3rd Resale	4th Resale	5th Resale	6th Resale	7th Resale	8th Resale
Previous Sale Price	$ 252,066	$ 264,076	$ 271,604	$ 280,291	$ 288,399	$ 297,665
Inflation	$ 24,702	$ 25,879	$ 26,617	$ 27,469	$ 28,263	$ 29,171
Improvements	$ 25,207	$ 13,204	$ 13,580	$ 14,015	$ 14,420	$ 14,883
Alternative Real Estate Agent Fee	$ 3,000	$ 3,294	$ 3,617	$ 3,971	$ 4,360	$ 4,788
Total Price	$ 304,975	$ 306,453	$ 315,418	$ 325,745	$ 335,442	$ 346,507
Price Affordable at 70% AMI	$ 264,076	$ 271,604	$ 280,291	$ 288,399	$ 297,665	$ 306,158
Total Buydown Required for Affordability	$ 40,899	$ 34,849	$ 35,127	$ 37,346	$ 37,777	$ 40,349

Interest rate, PMI, and condo fee assumptions per White Flint 2018 spreadsheet, adjusted for inflation

Section V
Comparative Inclusionary Zoning Policy Research

This document looks at Inclusionary Zoning (IZ) policy across the country, with a particular emphasis on the policies adopted by jurisdictions with more established, productive IZ programs. It also compares the policies of the other IZ programs in the region: Washington DC and Fairfax County. The following issues are addressed:

1. Fees
    a. Overview of Fees, Incentives and Alternative Payments
    b. Fee Reduction and Waivers
    c. Linkage Fees for Developments Excluded from IZ Requirements
    d. Uses of Alternative Payments

2. Affordability
    a. Term of Affordability
    b. Homeownership Units Which Become Unaffordable Over Time
    c. IZ Units in High Rise Condo Buildings

3. Miscellaneous
    a. Unit Negotiation Based on Floor Area Ratio (FAR)
    b. Occupancy or Work Requirements for Applicants

4. Regional IZ Policy Comparison Chart

Overview of Fees, Incentives, and Alternative Payments

There are Mandatory IZ programs and Voluntary IZ programs.

Voluntary IZ programs by their nature must rely upon sweetening the deal, with incentives for the developer to create affordable units. The incentives can include fee waivers, tax reductions, and design related waivers (with the most popular design waivers being density bonuses and parking requirement reductions). The incentive must be deep enough to make economic sense for the developer to make a long term commitment, or the program won't generate units. IZ programs which are exclusively voluntary are a minority; only 28% of IZ programs in the US are voluntary. (Thaden & Wang, 2017)

Mandatory programs also sometimes use sweeteners to incentivize developers to go beyond the minimum requirement for affordable units and agree to either an increase in the number of affordable units, or to make the units affordable to lower income households than required by the mandatory program. Mandatory programs make up 72% of IZ programs. (Thaden & Wang, 2017)

Linkage Fees and fee in lieu" are both funds paid by the developer to the jurisdiction instead of directly providing affordable units. Linkage fees are required by some jurisdictions (with mandatory IZ programs) for developments which are not required to provide affordable units, such as non-residential construction or a residential development smaller than the threshold for IZ units. Fee in lieu is an option provided to a developer in some programs – the developer provides funds to the jurisdiction instead of providing on-site affordable units.

Fee Reduction and Waivers for IZ Units

Overview

Nationwide, 66 programs report offering fee reduction or fee waivers. Of mandatory programs, 26% offer fee waivers as an incentive to make additional concessions (more units or more affordable). Of voluntary programs, 31% offer fee waivers. (Thaden & Wang, 2017) National trends show declining use of fee waivers in IZ program design: 28% of older programs (created before 2007) offer fee waivers, while 22% of newer programs offer fee waivers. (Thaden & Wang, 2017)

Regional

Neither Washington DC nor Fairfax offer fee reductions or waivers related to their IZ programs, both of which are mandatory.

Linkage Fees for Properties Exempt (by scale of development or project type)

Overview

Nationally, 65 jurisdictions have some type of linkage fee, 24% of jurisdictions reporting. Linkage fees are the ONLY IZ tool for 38 jurisdictions, while fees are combined with other program components in 27 jurisdictions, about 10% of reporting jurisdictions. Thirty-six jurisdictions report a commercial linkage fee of some kind, or 14% of reporting jurisdictions. (Thaden & Wang, 2017)

Due to state regulation, California IZ programs are more likely to include linkage fees; a full 1/3 of California programs include linkage fees. Of programs outside of California, only 15% include linkage fees. (Thaden & Wang, 2017)

Regional

Neither Washington DC nor Fairfax County charge linkage fees as part of the IZ program.

Uses of Alternative Payments

Overview

Payments from developers can flow to jurisdictions from either fee in lieu arrangements (where a developer chooses to pay a fee instead of creating an affordable unit), or from linkage fees (where a developer is required to pay a fee for a development which is not required to create units of affordable housing, such as residential developments below the program threshold or non-residential development). No study has systematically reviewed how these fees are utilized by the jurisdictions. Many jurisdictions place the funds in a locally controlled Housing Trust Fund, which does not describe which of many potential housing related end uses the funds might be utilized for. However, case studies provide some insight into the range of options, from offsetting administrative expenses to physical repairs of aging affordable units.

- Monitoring: San Francisco charges a 5% closing fee on IZ units, which is used to offset city expenses in monitoring sales compliance. (Hickey, Sturtevant, & Thaden, 2014)

- Stewardship fees: Several jurisdictions develop IZ units through or in collaboration with a Community Land Trust (CLT). Some CLT's charge a Stewardship Fee, which offsets support for homeowners over the life of their ownership. Chicago and Burlington, Vermont both use this approach. Stewardship fees charged monthly can not only offset costs of staffing, but also serve as early warning systems for financial distress for homeowners. (Hickey, Sturtevant, & Thaden, 2014)

- Maintaining affordability of units: In New Jersey, in lieu payments are required to be set aside for maintaining affordability of units. "About 30% of municipal housing trust fuds, supported by in-lieu-fee payments, must be used to assist on-going affordability. Some localities use fund dollars to help defray unaffordable condo fees, pay for overdue utility bills, and fund emergency repairs." (Hickey, Sturtevant, & Thaden, 2014)

- Physical maintenance of affordable units: In Chapel Hill, the City supports continued affordability by providing renovation funds to CLT's to repair property upon resale. In addition, the CLT's requires homeowners to contribute to a reserve fund for repairs. (Hickey, Sturtevant, & Thaden, 2014)

- Support down payment loan programs (or other alternative affordability strategies): In Santa Fe, administrators may collect a fee in lieu for housing developments not considered appropriate for low and moderate income households, "such as peripherally-located, large-lot developments that are removed from transit networks." The fee income is then used for down payment assistance loans for low and moderate income homebuyers. (Hickey, Sturtevant, & Thaden, 2014)

Regional

Neither Fairfax nor DC IZ programs assess linkage fees.

In Washington DC, IZ requirements apply to new residential construction of 10 or more units or residential renovation, which adds 10 or more units. However, no linkage fees are assessed and developers do not have a fee in lieu option.

Fairfax has two different IZ programs. One is applicable only to developments of 50 or more units with wood frame construction (i.e., non-high rise developments). The other applies to ANY development (of any construction type) proffered in conjunction with a rezoning. No linkage fees are assessed for projects which fall outside these criteria. Developers are strongly discouraged from the fee in lieu option which is available for the low rise construction IZ program.

Term of Affordability Requirements

Overview

Nationally, over 90% of programs require affordability of 30 years or longer (only 9% of rental programs reporting and 12% of homeownership programs reported affordability controls of fewer than 30 years). Permanent affordability (including life of improvements) is the requirement for 27% of rental programs and 34% of homeownership programs. (Thaden & Wang, 2017) The average duration of the affordability requirements across the country is trending upwards as new IZ programs are created; the average rental term of affordability in programs created since 2007 is 46 years, up from 43 years for older programs. The average homeownership term of affordability is 44 years in newer programs, up from 39 years in older programs. (Thaden & Wang, 2017)

The authors of "Achieving Lasting Affordability Through Inclusionary Zoning" ("Achieving Lasting Affordability") which provides a detailed study of 20 jurisdictions write:

> In addition, almost all of the programs studied that have less than perpetual affordability periods restart their affordability terms whenever a property is resold within the control period. (Hickey, Sturtevant, & Thaden, 2014)

Regional

Fairfax affordability periods are 30 or 50 years for rental developments and 30 years for homeownership units, with the affordability period reset upon sale within the affordability period.

Washington DC affordability periods are perpetual for both rental and homeownership.

Homeownership Units which Become Unaffordable Over Time

Overview

Resale restrictions on homeownership units attempt to strike a balance between two competing goals: providing the homebuyer the opportunity for wealth accumulation, and keeping the unit affordable for subsequent purchasers.

The most detailed study of IZ affordability mechanisms to date, "Achieving Lasting Affordability Through Inclusionary Zoning," by Robert Hickey, Lisa Sturtevant, and Emily Thaden, note that "To date, ongoing affordability of units generated by inclusionary housing programs has not been systematically examined in the literature." Their report profiles 20 jurisdictions with established, productive IZ programs. Most jurisdictions use a resale formula, typically tied either to Area Median Income or to the Consumer Price Index (11 of 20 case studies). Three offer fixed percentage appreciation, and four are based on shared appreciation after an appraisal. (Hickey, Sturtevant, & Thaden, 2014)

When resale restrictions alone are insufficient to maintain affordability, jurisdictions may choose to exercise their right of first refusal to purchase the unit at the formula price and resell at an affordable price. Virtually all jurisdictions profiled in "Achieving" include a right of first refusal in the covenants. Seven of the 20 profiled jurisdictions report exercising their right of first refusal in over 90% of resales. Other jurisdictions have policies of exercising their right of first refusal when ever the formula price exceeds an affordable price. (Hickey, Sturtevant, & Thaden, 2014)

Regional

Washington DC sets the resale formula based on changes in household income, rather than CPI, which helps maintain an affordable price for the target income level. DC also allows closing costs (including real estate agent fees) to be included only on an exception basis.

Fairfax is one of the seven jurisdictions profiled in "Achieving Lasting Affordability" which uses its right of first refusal in over 90% of resales. The County inspects the unit and requires the seller to make any needed repairs. The County then re-subsidizes the sale to an affordable price to the program's target income level. This prevents the loss of affordability of the unit, but requires on-going infusions of County capital to retain the affordability.

IZ Units in High Rise Condo Buildings

Overview

Maintaining affordability in condominium buildings is increasingly jeopardized by condominium fees. In "Achieving Lasting Affordability" the authors comment:

> Rising condominium fees are a growing problem for many municipalities that are seeing their new for-sale inclusionary homes primarily built as condominiums… (Hickey, Sturtevant, & Thaden, 2014)

Two ways to mitigate this risk are identified in the "Stewardship" case studies.

1. Initial purchase price agreement: After experiencing loss of affordability in condo units due to condo fee increases, Washington DC conducted a survey of condominium fees and lowered the maximum price of IZ units by 11% to better reflect the reality of condo fees and leave room for fees to rise over time.
2. Restricting growth of condo fees: Cambridge Massachusetts "requires that developers and HOAs assess fees based on the reduced value of the inclusionary home to ensure that owners of affordable units are not paying fees as high as market-rate owners. Fee increases must also be proportional." (Hickey, Sturtevant, & Thaden, 2014)

Regional

Washington DC, per above, reduced the initial acquisition price for condo units after a portfolio review revealed that condo fees were making condominium units unaffordable for the target purchasers.

Condo fees are not yet an issue in Fairfax. Until recently, Fairfax IZ policies did not cover most high rise development. It is only recently had an influx of high rise units, most of which are rental.

Unit Negotiation Based on Floor Area Ratio (not unit type)

Overview

Over 90% of existing programs set their IZ requirements using a unit based formula (153 of 169 programs reporting). (Thaden & Wang, 2017) However, the same study points to some benefit to using floor area ratio instead. "The use of floor area may give the program greater flexibility to negotiate with the developer on the size and number of bedrooms in affordable housing units. This would allow them to accommodate the needs of lower-income families who would not otherwise be served by the types of units most common in new construction." (Thaden & Wang, 2017)

The MPDU portfolio review reveals that frequent unit turn over is the driving force in loss of affordability, and that one bedroom units have significantly higher turn over than larger units. By moving to an FAR based formula, the County could select for larger units with improved ownership stability which would reduce the loss of affordability.

Regional

Washington DC regulates IZ through floor area ratio.

Fairfax regulates IZ through a unit type formula.

Occupancy or Work Requirements for Applicants

Overview

This question has not been tracked in national studies.

Regional

Fairfax County homeownership selection involves a point system, which grants a total of five points for either living or working in the County, one point for a household with a residential dependent, and one to three points for time on the waiting list. In the rental program, first priority is given to households which either live or work in Fairfax County.

Washington DC homeownership and rental units are allocated based on a lottery. First priority is given to households who live in the District. Second priority is given to households that work in the district. Unaffiliated households are only included in the process if there is not sufficient interest from residents or workers in the District.

Works Cited

Hickey, R., Sturtevant, L., & Thaden, E. (2014). *Achieving Lasting Affordability through Inclusionary Housing.* Lincoln Institute of Land Policy.

Thaden, E., & Wang, R. (2017). *Inclusionary Housing in the United States: Prevalence, Impact, and Practices.* Lincoln Institute of Land Policy.

Regional Inclusionary Zoning Policy Comparison Chart

Inclusionary Zoning Policy	D.C.	Fairfax County	Mont. County
Fee Reduction and Waivers	No	No	No
Linkage Fees for Exempt Properties	No	No	No
Duration of Affordability -- Rental	perpetual	30 or 50 years	99 years
Duration of Affordability – Homeownership	Perpetual	30 + reset on sale is effectively perpetual	30 + reset on sale is effectively perpetual
Ownership Units in High Rise Condos	Reduced initial sale prices due to loss of affordability from increasing condo fees	Condos only recently included in program.	
Maintaining Affordability	Resale formula is tied to wage growth, so affordability level is maintained. Closing costs allowed by exception only.	County repurchases almost every unit sold, resells at affordable price	Formula can become unaffordable if multiple sales.
Residence or Work Status Priority in unit allocation	1st priority to current residents; 2nd priority to employed in DC	Priority to either live or work in County	Open to all
Floor Area Ratio (instead of unit type)	Yes	No	No