

# Memo

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**TO:** City Council, Housing and Planning Commissions  
**Title:** Housing Incentives and Regulatory Barriers  
**Date:** September 30<sup>th</sup>, Special Study Session  
**Submitted By:** Brandon Goldman, Senior Planner

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## Housing Incentives and Regulatory Barriers

An examination of Housing Incentives and Regulatory Barriers was requested by the Ashland City Council on October 16<sup>th</sup>, 2007 following a discussion regarding the Lithia Lot affordable housing proposal. During that discussion it was noted by members of the City Council that the development of new multi-family rental housing has been hampered throughout Ashland by market conditions in the recent past. The issue of barriers to development of rental housing had also been raised in review of the Condominium Conversion Ordinance amendments by members of the Housing and Planning Commissions, as well as members of the City Council. Taking this into consideration the City Council suggested that the City should examine why this is the case, and further research what the City could potentially do to address this problem.

To undertake this examination, Council directed staff to invite members of the Housing Commission, Planning Commission, and City Council to explore ideas to make the construction of apartments cost effective, potentially through land use changes or incentives.

*Councilors Chapman/Hardesty m/s to host an informal meeting to research ideas to make building apartments cost effective through land use changes and incentives with representatives of the Council, Planning and Housing Commissions, planning and administration staff and report to the Council; and table any further action until the report is received. (Approved) (Minutes of City Council Regular Meeting October 16, 2007)*

To facilitate a better understanding of Housing Incentives and Regulatory Barriers that may effect the development of multi-family rental housing, and affordable housing in general, Staff has produced the attached listing of barriers and incentives employed in other communities.

To assist in identifying ways to realize the development of more multi-family housing and affordable housing, members of the development community have been asked to attend and share their experience and expertise to illuminate some of the conditions that have made the development of apartments difficult in Ashland's housing market.



The Rental Needs Analysis completed in 2007 addresses the underlying issue of multi-family development and concluded with the following policy considerations:

The analyses contained in this report clearly show there are two principal problems facing the Ashland rental market:

- 1) There is a lack of rental properties affordable to low-income households; and
- 2) Market conditions that have not resulted in the development of many rental units in the recent past.

The lack of rental property production is due to basic market economics. It is simply more profitable to build and sell a multi-family unit as a condominium than it is to rent it as an apartment.

The only way for the development community to have a financial incentive to build multi-family rental properties would be for rental rates to increase, which is detrimental to the overall affordability of Ashland's market. As a result, any solution to the problem will require balancing affordability while maintaining or promoting a market incentive for apartment development.

To give developers incentive to build affordable rental apartments, the City of Ashland could use direct subsidies to decrease construction costs, including land write downs and lower system development charges. The city could also research obtaining and directing federal Housing and Urban Development funds to assist new development. The city could also reallocate staff resources to grant writing and other efforts to raise outside funds to address the twin problems of affordability and production.

The city could recognize affordable housing as a greater community need worthy of tax credits and create strong policies that would help individual applicants obtain tax credits for their development. The tax credit program is a particularly powerful funding source because the value of the subsidy is usually equivalent to 25%-50% of a project's total development costs.

There are other regulatory tools that may also be considered, including a condominium conversion ordinance, which would limit the number of rental units that could be converted to for-sale properties. These policies are helpful, but they do not address the underlying problem, and do not represent a solution by themselves.

It is apparent that the city does not have an adequate supply of land for multifamily development. Based on the city's 2005 memo from Brandon Goldman to Bill Molnar, the city neither has enough land nor the right kind of land to meet its affordable housing needs. Most of the available sites are small infill lots that would allow the development of only one or two units. These lots are expensive to build on and therefore do not lend themselves well to affordable development. To realize development efficiencies, the city needs parcels large enough to accommodate development with at least 30-60 units.

Adding more land to Ashland's buildable inventory would decrease construction costs in two ways: by lowering land costs in the area and by providing sites large enough to realize development efficiencies. Lower land costs and the ability to build more cheaply could easily lower construction costs by as much as 20% to 30%, which could largely solve the economic problem. However, increasing the amount of developable land in the city should be accompanied by policies that promote or require the inclusion of affordable housing in new development. Without this requirement, the development community will probably build for maximum profit and may not deliver what the community needs.



Members of each Commission, and the Council had previously received full copies of the 2007 Rental Needs Analysis, and it remains available online at:

[http://www.ashland.or.us/Files/RentalNeedsAnalysis\\_2007.pdf](http://www.ashland.or.us/Files/RentalNeedsAnalysis_2007.pdf)

Review of the attached materials in advance of the joint study session scheduled for September 30<sup>th</sup> from 7-9:00pm, will help ensure that the discussion at this joint meeting is well informed.

The attached information was presented to the Housing Commission at their regular meeting on November 29<sup>th</sup> 2007 and presented at a Planning Commission study session on February 26<sup>th</sup> 2008.

**Attached:**

Housing Incentives and Regulatory Barriers Summary

Affordable Rentals to the Rescue, Article By Lisa A. Fowler, Planning Magazine





## Housing Incentives and Regulatory Barriers

In order to enable market forces to develop needed housing types a two pronged approach is needed. In identifying what regulatory barriers exist a community can take measures to limit such policies, rules, processes, or procedures that function to prohibit, discourages, or excessively increase the cost of new or rehabilitated housing without sound compensating public benefits. The other action communities can take is to identify what incentives are available to encourage the development of needed housing types. In October of 2007 the Ashland City Council expressed an interest in examining what could be done to promote the development of multi-family housing. To accomplish this goal it is important to evaluate the tools within the City of Ashland's control to promote the development of needed housing. These tools include the municipality's regulatory powers, taxing authority, and direct financial support.

The effort of reducing regulatory barriers involves identifying what local and state policies or procedures impede the production of housing that is most needed by the community. Many policies and regulations that restrict housing are implemented or promulgated with other worthy goals. Each community should aim to evaluate any and all restrictive policies or regulations to ensure that the countervailing interests that function to increase the cost of housing production are necessary to protect the public interest. In addition to removing existing regulations that impede affordable housing, cities and counties can enact new ordinances that support development of needed housing.

Listed below are a number of such policies and procedures to assist local governments in reducing the cost of producing affordable housing. Affordable housing in a community serves a vital public interest and removal of barriers is one step, within government control, to encourage well-designed, attractive affordable housing as an economic and social asset to a community. Instituting specific incentives to entice the development community to provide the needed housing types can be another effective means of fulfilling the City's housing needs.

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### Barriers

#### Barrier

Insufficient land zoned and available for multi-family development at medium and high densities.

#### Impact

A high percentage of total municipal land area is frequently zoned for larger lots and/or houses with lot coverage requirements that limit the number of units permitted per acre. Lack of land available at the densities necessary for high density development drives up land costs

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and limits opportunities for affordable housing development. Specifically in Ashland much of the land area outside the existing City Limits but within the Urban Growth Boundary has a Comprehensive Plan Designation of single family housing. The *Affordable Housing Action Plan* identifies rezoning of Single Family land to multi-family higher density zones as one strategy to promote a needed housing type (Goal 3, A.1)

### **Oregon Law**

197.307 Effect of need for certain housing in urban growth areas; placement standards for approval of manufactured dwellings.

(1) The availability of affordable, decent, safe and sanitary housing opportunities for persons of lower, middle and fixed income, including housing for seasonal and year-round farmworkers, is a matter of statewide concern.

(2) Many persons of lower, middle and fixed income depend on government assisted housing as a source of affordable decent, safe and sanitary housing.

(3) When a need has been shown for housing within an urban growth boundary at particular price ranges and rent levels, needed housing, including housing for seasonal and year-round farmworkers, shall be permitted in one or more zoning districts or in zones described by some comprehensive plans as overlay zones with sufficient buildable land to satisfy that need.

4) Subsection (3) of this section shall not be construed as an infringement on a local government's prerogative to: (a) Set approval standards under which a particular housing type is permitted outright; (b) Impose special conditions upon approval of a specific development proposal; or (c) Establish approval procedures.

### **Potential Remedies**

Evaluate existing land supply by zone and comprehensive plan designation to ensure adequate supply for medium and high density development. Evaluation should consider the percentage of total housing stock necessary to accommodate population growth within the established Urban Growth Boundary.

Additionally jurisdictions can examine existing densities allowed and consider increasing base densities to maximize the utilization of available land.

Zone a greater amount of land for medium and high density residential development to promote multi-family housing development.

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### **Barrier**

Density limitations do not currently provide a density bonuses sufficient to offset the cost of building below market units as an incentive for any market rate residential development that includes a portion of affordable housing.

### **Impact**

Developers can be enticed to build affordable housing if it is shown to be in their financial interest. Increasing the density allowed, without discretionary land use decisions, can be a valuable tool to encourage affordable housing development by the private sector. The same mechanism could be utilized to promote market rate apartment development if that was seen as a community goal.

### **Potential Remedies**

Increase or establish Density Bonus opportunities for affordable housing development. In cases where a developer can increase density 1 for 1 (meaning an increase equal to the % of affordable units provided) there is little incentive to build the additional affordable units. To develop an affordable unit it costs more to build than can be captured through rent and or sale price. Thus there is no financial incentive to take advantage of Ashland's existing density bonus allowance. A more attractive density bonus to developers would be one where additional market rate units could also be provided in addition to any affordable housing units. For example if a developer of a sixteen unit development could get a bonus of 25% where all



four bonus units had to be affordable, bringing the total number of units up to 20, they would forgo the density bonus and develop only 16 units. With an incentive based bonus if those four bonus units were allowed to contain two market rate units and two affordable units, there would be a financial incentive to develop the 20 unit development.

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### **Barrier**

Land zoned for multifamily uses can be developed as Single Family housing thereby reducing supply of land for higher density uses and reducing the development of multi-family apartments.

### **Impacts**

Urbanizable areas are developed inefficiently and the per unit cost of development is higher than if the properties were developed to maximum density allowed.

Multifamily zoned land is developed as ownership housing, even at intended densities. Land zoned for multi-family is in limited supply, its use for housing types that do not provide for the housing type of rental housing undermines Ashland's ability to meet our land/housing need balance.

### **Potential Remedies**

The City of Ashland established Minimum Densities within multi-family zones. This ordinance amendment passed in 2005 ensures maximum utilization of multifamily and single family zoned properties through adoption of minimum density requirements (i.e. 80% of base density). This effectively precludes large lot single family development in an area intended for apartments or small lot single family units.

Regarding the development of ownership housing on multi-family zoned property the *Affordable Housing Action Plan* addressed this concern in recommending the strategy of restricting or precluding Single Family development in Multifamily zones. By stipulating clearly that a multi-family zoned land must be developed as rental apartments the City would be assured that the limited land supply would be developed with this needed housing type.

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### **Barrier**

In Ashland Accessory Residential Units (also known as "Accessory Dwelling Units" and "mother-in-law units") are currently conditionally allowed in single family zones. In some communities they are permitted outright, and in others they are precluded entirely.

### **Impact**

ARUs address a needed housing type and are consistent with the infill strategies employed by many Oregon jurisdictions. It is important to note that evaluation of such units is necessary to ensure the additional dwellings can be appropriately accommodated on site. Evaluating issues such as parking availability, lot coverage, solar access are a few of the issues that are involved in the approval of such units.

The Conditional Use permit process can be seen as discretionary and a costly undertaking and as such may be a disincentive to creating accessory residential units, and thereby limit their development. Conversely it can be argued that a discretionary review process can function to encourage illegal secondary units completed without City oversight.

### **Potential Remedies**

Ashland could consider allowing ARUs as a permitted use subject to a staff review of parking, and other site design standards. Elimination of the Conditional Use Permit (CUP) process would encourage both the creation of new ARUs as well as provide a more streamlined

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opportunity to allow illegal units to be brought up to current standards to become legal dwelling units.

Further, without the complicating factor of CUP process developers can more readily incorporate ARUs into planned unit developments and subdivisions to provide a mix of housing types and maximize the use of common facilities.

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### **Barrier**

Discretion within the planning approval process leaves affordable housing projects vulnerable to NIMBY (not in my backyard) concerns and resulting appeals and possible denials.

### **Impact**

Elimination of discretion in the approval process for affordable housing units would require local governments to eliminate any such discretion for like, non-affordable, housing types per Oregon State Law. However, as noted above eliminating discretion (IE Conditional Use Permit requirement) on a specific housing type, such as Accessory Residential Units (ARUs) would encourage their production.

### **Oregon Law**

197.312 Limitation on city and county authority to prohibit certain kinds of housing. (1) No city or county may by charter prohibit from all residential zones attached or detached single-family housing, multiple-family housing for both owner and renter occupancy or manufactured homes. No city or county may by charter prohibit government assisted housing or impose additional approval standards on government assisted housing that are not applied to similar but unassisted housing

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### **Barrier**

Zoning ordinance that allows, as-of-right, the conversion of apartments to be individual condominiums.

### **Impact**

Condominium conversion of existing apartments effectively removes existing rental stock from the marketplace and displaces renters

### **Remedies**

The City of Ashland recently passed an ordinance limiting the conversion of multi-family housing into for-purchase housing to address this trend. Further the establishment of tenant rights was completed to protect households from some of the negative impacts of displacement.

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### **Barrier**

Commercial and Industrial Lands precluded from incorporating high density residential development.

### **Impact**

Limitations on Mixed-Used development opportunities essentially require housing to be outside of employment centers. Allowing High density development in Employment Centers (2<sup>nd</sup>, 3<sup>rd</sup>, 4<sup>th</sup>...stories) is a cost effective development strategy which encourages multi-family and affordable housing in areas with immediate proximity to jobs.

### **Potential Remedies**

Allow as a permitted use, high density residential development within commercial zones provided the target use of the zone (commercial development) is included.

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**Barrier**

Development of Commercial and Industrial Lands places additional demand on the housing market in its need for qualified workers to fill the jobs created.

**Impact**

The economic development fostered by the establishment of new businesses, or the annexation of new commercially zoned lands into the City, has many benefits to the community. However, if the jobs created by the new businesses do not provide wages that are not commensurate with existing housing costs this can place additional demands on existing transportation systems as workers commute from lower cost areas. Specifically if the employment created is essentially comprised of low-income jobs, that will place added demand on limited low-income housing stock and a need to develop new housing to accommodate the workforce.

**Potential Remedies**

Many communities have attempted to correlate the housing demand created by new businesses through the establishment of commercial “linkage fees” in which a new development contributes either housing for its workforce directly, or provides funding to assist in the development of housing elsewhere.

As mentioned above it is also possible to incorporate housing within commercial developments to create mixed-use areas which have the benefit of both providing additional housing, and reducing reliance on a commuting workforce.

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**Barrier**

Excessive off street parking requirements

**Impact**

Requiring a substantial number of parking spaces per affordable unit requires dedication of land area as well as the added cost of developing the excess spaces. Parking standards often do not relate to the number of cars or trips generated by a particular use. A small apartment may be required to supply the same number of parking spaces as a large single family home.

**Potential Remedy**

Local governments can evaluate their parking requirements to determine whether a reduction for multi-family units, or for affordable housing developments in the proximity of public transportation, is advisable. Further standards can be examined to see if dimensions of required parking spaces can be reduced (IE a percentage of compact spaces).

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**Barrier**

Landscaping requirements, such as large minimum tree sizes, inflexible street tree requirements, and screening buffer standards.

**Impact**

Landscaping requirements can add considerable cost both in terms of dollars as well as dedication of land area. The dedication of land and the expense of landscaping can limit development potential in some cases, and add upfront development costs. It is important to balance the long term value of the landscaping both to the housing development and the

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public (Street trees, stormwater retention, etc.) when evaluating the public benefit of landscaping requirements.

### **Potential Remedies**

Examine existing site design standards relating to landscaping to ensure they are appropriate and not too cumbersome for needed housing developments. In support of needed housing types (IE Affordable Housing) the City could consider financial assistance to help reduce the cost of public street tree installation, or through the planning review process consider reductions in landscaping and openspace requirements as a variance to established standards when doing so promotes a public benefit.

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### **Barrier**

Traditional zoning frequently uses a proliferation of residential districts with rigid prescriptive lot size, lot coverage and bulk requirements for each district.

### **Impact**

Performance zoning, as an alternative, recognizes that all land is not created equal. It tailors density to the natural carrying capacity of the site and protects environmental features. Care must be taken to avoid stifling construction of affordable housing by demanding excessive performance standards that reduce the net buildable area.

### **Potential Remedies**

Ashland currently allows for "Performance Standards" subdivisions which enables clustering on the "net buildable area". Further refinements to a form based approach to land development could allow for a broader mix of dwelling types and densities on a given property. This flexibility can both assist in accommodating natural conditions as well as being more responsive to the marketplace and housing needs. Further this approach can be used to incorporate mixed use developments clustering both commercial and residential uses.

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### **Barrier**

Lack of uniformity among land use ordinances adds time and, therefore, increases costs to developers.

### **Impact**

Land use ordinances vary tremendously from one community to the next. This lack of uniformity in format and substance adds time to the process of understanding the requirements. This confusion also adds unnecessary costs because small builders must hire a consulting planner or engineer.

Land use ordinances can be poorly drafted. Poorly drafted ordinances consist of a collection of amendments tagged onto an outdated base, lack an index or only contain an out-of-date table of contents, and are devoid of illustrative material. Confusing and vague ordinances are difficult to understand and administer, and engender appeals resulting in more expense and delay.

### **Potential Remedies**

Ashland has completed an audit of our land use ordinance and a number of recommended changes are presently being forwarded to the City Council for review. The intention of ensuring the ordinances is clear and free of conflicting provisions should clarify existing standards for both developers and the regulating body. Additionally coordination with nearby communities to identify areas where consistency between codes could be implemented could alleviate confusion by providing a uniform target for developers working within the region. The Uniform Building Code is a good example of consistent standards from one jurisdiction to the

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next, however in the Land Use Planning arena much of the land use code is reflective of community values that may differ from jurisdiction to jurisdiction, making such uniformity difficult to obtain.

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### **Barrier**

After planning approval, a long permitting process through the planning, engineering, and building departments can add significant cost to an affordable housing development

### **Impact**

Communities can consider “fast track” permitting and approvals for all affordable housing projects, or multi-family rental housing, as a way to reduce the costs associated the approval process.

### **Potential Remedies**

The issue of efficient use of the limited time available before the Planning Commission has been a topic of much discussion in recent years. However to be efficient it is incumbent upon applicants to ensure that their development plans are complete and include all required supplemental materials. (Most delays are due to incomplete plan submissions, the need for zoning amendments or prior zoning approvals and hearings related to special exceptions and conditional uses.)

Expedited reviews have been employed by other communities where the project proposed meets a specified target, such as affordable housing goals. In Oregon it would be imperative that an expedited review process did not have the result of delaying other projects beyond a 120 limit established by state law (see below)

### **Oregon Law**

Under Oregon State law there is established time limits for government review and approval or disapproval of development permits in which failure to act, after the application is deemed complete, by the local government within the designated time period (120 days), results in automatic approval. Typically applications are addressed on a first-come-first-served basis by municipalities. In “fast tracking” affordable projects a jurisdiction would have to ensure other applications did not inadvertently exceed the 120 day period to avoid automatic approval due to prioritizing affordable projects.

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# Incentives

## Land Use Incentives

### **Higher density allowance**

Examine providing a higher density allowance for development of apartments in exchange for commitment to retain as rentals for a set period (essentially a density bonus for workforce rental housing as opposed to condominium development).

### **Urban Growth Boundary (UGB) Expansion**

The City may be in a position to examine the potential for UGB expansion to meet the housing demand in keeping with the State law requiring municipalities to maintain at least a 20 year land supply. The inclusion of a property into the UGB, and ultimately City limits adds considerable value to a property due to the increased densities that can be achieved. This incentive would enable the City to balance the value of such an inclusion through application of specific affordable/workforce provisions. To consider an UGB expansion for affordable/workforce housing it would be necessary to ensure the benefit exceeds the minimums established through the annexation standards as part of the consideration.

### **Rezoning of lands within the Urban Growth Boundary**

Similar to the UGB expansion noted above, the rezone of property currently within the UGB that is anticipated to come into the City as single family, to a comprehensive plan designation of multi-family would increase the density allowable and as such provide a greater incentive to build multifamily housing. Coupled with the minimum density standards for multi-family zoned lands recently adopted by the City, such a rezone would ensure a greater number of units per available acre.

## Financial Incentives

### **Tax exemption for affordable housing**

Requires adoption of implementing ordinance with 20 year exemption for deed restricted low income housing (ORS 307.515) – units must be built by 1/1/2010 benefiting households at below 60 percent of median. The point of this exemption would be to encourage these project owners not to convert to market rents. Housing owned by non-profit organizations or the Housing Authority routinely receive a tax exemption or tax assessment reduction through the County Assessors. However this enabling legislation allows the City to adopt an ordinance, with concurrence of the School District and potentially the County, wherein privately owned low-income housing units could be exempt from property taxes.

### **Tax exemption for Multiple Unit Housing in Core Areas: ORS 307.600 to .637**

A municipality within Oregon can use its taxation power to promote the development of multi-family housing within core areas (designated by the City) by providing tax exemptions for a ten year period. The State has passed enabling legislation to allow for this incentive provided construction is completed by 1/1/2012.

Exemption covers the multiple-unit housing buildings only, not the land or any other buildings. The structure must have a minimum number of dwelling units as specified by the city pursuant to ORS 307.610. The city or county shall designate an area within which it proposes to allow exemptions provided for under the provisions of ORS 307.600 to 307.691. Core areas, light rail station areas or transit oriented areas may be designated by a city. A city may designate the entire city as the area in which the city proposes to allow exemptions under ORS 307.600 to 307.691 for housing subject to a low income housing assistance. Additionally the City could designate areas along transit that would be eligible for tax exemption provided they were apartments of a certain size as designated by the City. The point of this exemption would be



to encourage these developers to create market rate rental apartments and not convert to Condominiums and thereby promote multifamily development.

### **Waiver of development fees**

The City currently waives or defers the development fees for units sold to households earning 80% AMI, or rented to households earning less than 60% AMI. This program is an ongoing incentive which contributes between \$7,000 to \$10,000 in direct assistance to each affordable dwelling built within the City. We are the only jurisdiction to provide this incentive in the region and as such it provides an enticement to affordable housing projects to develop within Ashland.

### **Provide City owned property**

One way the City can facilitate the development of affordable workforce housing is through the supply of property to affordable housing providers.

Providing for a mix of incomes targeted (30, 60, 80, 120% Area Median Income) the City can promote “workforce housing” in addition to meeting affordable housing goals. This income mix also allows for some measure of recapture of subsidy provided to buy-down to affordable housing units.

The City can use its resources to purchase vacant property as is typically done with annual CDBG allocations.

The City can also dedicate the use of land, or airspace, currently owned by the City to promote the development of new affordable/workforce housing. An evaluation of City facilities and potential surplus property will be completed in the coming year and properties could also be examined to determine whether an intensification of use to accommodate affordable/workforce housing is feasible on given properties.

The City should continue to work with existing non-profits and affordable housing developers (ACCESS, HAJC, ACLT, RVCDC, Habitat, OnTrack) to identify available property and develop mixed income or low income tax credit projects.

The City has not been a “developer” of housing and has relied on development partners to achieve our housing goals. Given the capacity of each local housing provider it is likely that to meet the Council Goal of 200 units no single organization could achieve this output, but rather the City should anticipate working with all of them during the coming years to maximize their individual output, and specifically to promote their development activities in Ashland. It is important to note that these housing developers would be applying to the state for the same limited subsidy amount and thus the capacities of each organization can not be viewed as additive. Regionally there are approximately 50 units developed by all affordable housing providers on an annual basis. Through incentives the City can entice affordable housing providers to focus their efforts within Ashland. Ashland is at a competitive disadvantage in this arena due to our high land costs relative to the rest of the valley. Therefore the financial incentives provided must exceed the difference in land costs at a minimum to be effective.

### **Direct Financial Subsidy**

Land use requirements alone will not likely accomplish the goal of meeting Ashland’s unmet housing needs, and the limited annual CDBG subsidy provided for affordable housing (~\$160,000) is sufficient to create only 3-5 units. Thus an additional amount of subsidy will be necessary to comprehensively address our Housing needs.

In order to examine potential funding streams and a mechanism for distributing such funds to support needed housing the Housing Commission has been working on the establishment of a Housing Trust Fund (HTF). This effort is a significant undertaking and was a tentative City



Council Goal in 2006. To complete the development of a HTF the Housing Commission and Housing Program Specialist is aiming to complete the following over the next year:

- Establish award process and criteria for distribution of Trust Funds
- Establish administrative responsibility to oversee the operation of the Trust Fund
- Adopt ordinance establishing the Housing Trust Fund through public review process
- Determine ongoing (sustainable) funding sources to maintain the viability of the Trust Fund.
- Establish a sustainable funding stream to support the HTF



## Article Attachment

### **Affordable Rentals to the Rescue,** By Lisa A. Fowler

#### **Planning Magazine APA June 2008**

How to retain market-rate — but affordable — apartments in your community.

Arlington County, Virginia, is one of the most expensive communities in the Washington metro area. It is also home to Fillmore Gardens — a 559-unit apartment complex that is affordable to families earning 60 percent of the area median income. But unless Arlington County and other high-cost jurisdictions make a priority of preserving market-rate affordable properties, apartment complexes like Fillmore Gardens are in danger of disappearing.

The complex is within walking distance of a public library, a major bus route, and a revitalizing commercial district. Two-story brick buildings border courtyards of well-manicured grass and trimmed shrubs. The one- and two-bedroom units range in size from 650 to 800 square feet. In 2007, a two-bedroom apartment at Fillmore Gardens rented for \$1,085, whereas new two-bedroom apartments in the county can fetch upwards of \$3,500 a month.

Fillmore Gardens, built in the 1950s, is like other market-rate affordable rental properties. It is privately owned housing that does not receive public assistance but is nevertheless affordable by virtue of the fact that it is older and has fewer amenities. Properties like this served as middle-class family housing in the middle of the last century and now constitute some of the only options for moderate-income households living in expensive communities.

This housing choice is disappearing. In metropolitan areas where land values have increased dramatically, many owners of older multifamily buildings have sold to private developers who raze the buildings to build larger, high-end rental and condominium properties. However, for some owners of market-rate affordable rental properties — particularly those with strong ties to the community — maintaining and managing older rental properties as a source of affordable housing is a mission, not just a business.

#### **Why keep market-rate rentals?**

Many communities facing an affordable housing shortage focus primarily on tools to generate new affordable units or ways to extend expiring federal subsidies for subsidized units. But in many cities and inner ring suburbs, market-rate rentals make up a considerable share of the available affordable housing. Keeping them affordable is the tricky part.

Arlington County has about 10,000 market-rate affordable rental units, compared with fewer than 6,000 committed affordable rental units, or CAFs. (CAFs are units built at least in part with tax credit dollars and are negotiated through the county's planning process.)

While the county has succeeded in increasing the number of subsidized affordable rental units, it has not been able to stem the loss of market-rate affordable rentals. The number of CAFs in Arlington County increased by about 1,700 between 2000 and 2007, but nearly half the stock of market-rate affordable housing disappeared during the same period as a result of condominium conversion, redevelopment, and rent increases.

Preserving market-rate affordable rental properties is necessary to stem the "one step forward, two steps back" process occurring in many high-cost communities.



## **Saving the units**

Surprisingly few communities give private property owners incentives to maintain their properties as affordable. Instead, they may use other strategies, which typically fall into two categories: acquisition and property tax exemptions.

The best way to preserve at-risk properties permanently is to transfer them to organizations whose mission is to provide affordable housing, rather than to make money. Several states and localities have initiated programs to increase opportunities for local jurisdictions, nonprofit organizations, or tenants to stop the sale of affordable rental properties to speculative buyers. Referred to as "right of first refusal" initiatives, these policies require property owners to notify a specified group of interested parties when they plan either to sell the property or to terminate participation in a federal or other subsidy program. The right of first refusal can go to the tenants' association, local or state housing authority, nonprofit organization, or some combination of these groups.

Montgomery County, Maryland, enacted its right of first refusal policy in 2002. Owners are required to provide written notice of the sale both to all tenants and to the county within five days of entering into a contract with a private buyer. This notice must include an offer to the tenant organization, the Department of Housing and Community Affairs, or the Housing Opportunities Commission to purchase the property. The tenants or the county must usually match the contract made with a private buyer. Securing funding typically involves partnering with a nonprofit affordable housing developer and taking advantage of tax credit financing.

In Montgomery County, owners of multifamily rental properties are also required to give tenants at least 120 days notice before converting the property to condominiums. Further, the owner must provide tenant relocation assistance equal to two months' rent.

The first project preserved under the county's right of first refusal policy was Woodside Manor Apartments, a 221-unit complex in Silver Spring. The tenants exercised the right of first refusal, but lacked sufficient funds to buy the property themselves. Instead, the property was bought by a developer who used federal low-income tax credits to rehabilitate it and maintain it as affordable.

Having the right to purchase a property is futile unless the local jurisdiction, housing group, or tenants association can acquire the funds needed to meet a private offer. At the city or county level, these funds usually come from a dedicated pool of property tax revenue or broadly supported housing trust funds that generally are distributed to nonprofit housing groups to initiate the purchase or rehabilitation of a property.

In 2004, the board of supervisors in Fairfax County, Virginia, established the One Penny Fund, which dedicates revenue from the county real estate tax rate to the preservation of affordable housing. The fund, worth \$22.7 million in fiscal 2008, provides money to nonprofit housing developers who want to purchase and rehabilitate affordable housing. Rental projects funded by the One Penny Fund are required to remain affordable for 20 years. Units must be affordable to households earning no more than 120 percent of the area's median income.

The first project funded through the One Penny Fund was the 216-unit Madison Ridge apartment complex, which was purchased by the nonprofit Wesley Housing Development Corporation with \$2.5 million from the fund and other county funds. The final acquisition and rehabilitation cost was \$38.5 million.



Housing trust funds are another way localities generate additional resources for affordable housing preservation. In 1999, businesses in Santa Clara County, California, joined with nonprofit organizations and local governments to establish the Housing Trust of Santa Clara County. The Housing Trust raised an endowment of \$20 million in the first two years by asking local employers, foundations, governments, and citizens to make donations to the fund.

To date, the trust has focused on generating new affordable units, rather than on preservation. As of February 2008, the Housing Trust of Santa Clara has invested \$5.5 million in affordable multifamily rental development, creating 1,258 new rental units.

### **Property tax exemptions**

Even with additional revenue sources and a right of first refusal requirement, it can be prohibitively expensive for local jurisdictions or nonprofit developers to purchase a multifamily building. In many areas, it makes more sense to encourage current owners of affordable rental properties to hold on to their buildings and continue to maintain affordable rents.

Rising costs, especially high property taxes, make it particularly difficult for property owners in expensive areas to keep rents affordable to low- and moderate-income tenants. In some states and localities, however, affordable properties owned by nonprofit organizations are exempt from property taxes.

California provides a property tax exemption for low-income housing properties owned by nonprofit organizations or by limited partnerships in which the managing general partner is a qualified nonprofit organization. These properties are eligible for a 100 percent property tax exemption if all units are leased to qualified low-income tenants at specified rent levels. Partial exemptions are available for the portion of the property serving low-income tenants.

Some localities offer tax abatements to owners who substantially rehabilitate multifamily rental buildings. New York City's J-15 program provides tax exemptions for substantial improvements to multifamily rental buildings. The J-15 program exempts the property from an increase in assessed value that otherwise would occur as a result of significant renovation. Most exemptions last 14 years. The city does not place restrictions on rents, however, so the owner is not required to maintain the property as affordable.

### **What owners say**

What keeps some private owners from selling their properties to the highest bidder or raising rents to capture a share of what was an out-of-control housing market? In 2006, the Alliance for Housing Solutions, an advocacy group based in Northern Virginia, sought the answer by conducting interviews with owners and managers of market-rate affordable rental properties in Arlington County. The individuals interviewed owned or managed about 1,500 units that were affordable to households earning between 60 and 80 percent of area median income.

The data showed that Arlington County property owners held onto their properties even in the face of very lucrative offers, because the properties provided good cash flow and the capital gains taxes resulting from a sale would be too high.

For other property owners, however, particularly those who had owned their properties for 20 or more years or who grew up in Arlington County, maintaining and managing older buildings to provide housing that was affordable was also very important. Many of those owners said they kept rents low because they wanted to hold onto good tenants and they felt they were providing a service to the community. One owner who said it was the right thing to do worked with local community and church groups to help low-income renters find apartments.





All of the owners surveyed were clear: They did not want the government telling them what they could or could not do with their properties. They have avoided subsidies and other government programs because the programs "take away the power of owners to run their properties," according to one respondent.

However, property tax increases can make owners into sellers. In Arlington County, where land values have increased dramatically in the past decade, so too have property tax assessments and tax bills. Some owners of market-rate affordable rental properties saw their property taxes double between 2000 and 2007. In almost all cases, property owners indicated they had paid for these cost increases by raising rents. Landlords who had owned their properties for a long time or who have large holdings found it easier to absorb cost increases, but owners of smaller buildings said they often could not.

Because they tend to be older, most market-rate affordable rental buildings need major renovations. In Arlington County, those renovations will be needed soon. Buildings there are 50 years old on average. Most are two- to four-story garden apartment buildings with relatively small units that often lack dishwashers, disposals, central air conditioning, and other amenities that have become standard in rental buildings. The buildings are structurally sound, but many will need new windows, new heating and cooling systems, and amenity upgrades.

Tenants in market-rate affordable rental properties may not be needy. There are no rules governing the income limits of a tenant who rents an unsubsidized or unregulated apartment unit. According to the property owners, many of the people living in these units are "meaningfully" over the income limits. They simply choose to rent these properties for other reasons.

### **What local governments can do**

Local jurisdictions may be able to use several different tools to encourage the preservation of market-rate affordable rental properties. One is a requirement that owners sell to a local government or tenants association — in partnership with a nonprofit developer — if they can match an acceptable offer.

Enacting a right of first refusal law is another strategy. The two biggest challenges to this proposal are opposition from property rights groups and the money involved. In addition, in the 39 Dillon Rule states, localities can have very limited powers that are specified explicitly by the state. In most cases, local government officials cannot tell property owners what they can and cannot do with their property. Local jurisdictions would have to work with the state to craft a specific set of rules regarding sales of multifamily rental properties to ensure that they stayed within their authority.

The second challenge — money — may be even harder to address. In areas like Arlington County, a 60-year-old rental property could be sold to a private developer for \$10 million or even \$20 million. Even if localities partner with nonprofit housing organizations and leverage federal and state subsidies, they may find it difficult to match private offers. Local governments need to figure out how to generate more guaranteed resources for affordable housing to be able to compete with private offers.

Another strategy is to offer property tax reductions to owners of both subsidized and unsubsidized affordable rental properties. Such a system would reduce their cost burden and make it easier for them to keep rents low. Property owners could apply for a tax reduction and certify the property as an eligible affordable rental property, defined as one either with units



that have rents affordable to households earning 60 (or 80) percent of area median income, or units that house tenants whose incomes are 60 (or 80) percent of area median income.

The latter requirement would ensure that the units are affordable and that they are actually being occupied by low-income tenants. In order to qualify for tax reductions, property owners would be required to maintain the units as affordable for a specific period of time. While the property owners we interviewed said they would prefer a year-to-year affordability commitment, local jurisdictions would need a longer buy-in.

Another alternative is for the local government to help owners identify additional density potential on their property. In some cases, the parcels have been approved for much higher densities. Under local planning and special exception processes, owners might be allowed to build new, market-rate buildings on-site if some of the units were subsidized. That option would improve the owners' cash flow and make it easier for them to maintain their affordable projects.

Individuals who own multiple properties within a jurisdiction might be able to transfer density rights from one parcel to another in order to allow sufficient density for development. As with the tax abatement proposal, property owners who take advantage of density transfers would be required to keep their rentals affordable for a specified period of time.

In many cases, private property owners don't understand existing programs. Only one of the owners interviewed in Arlington County participated in the federal Section 8 program. But if private property owners were better educated about the Section 8 process — and the guaranteed rental income that results from participation — they might be more inclined to participate. Current program participants could be an excellent source of information because they could help clear up common misconceptions.

Without a serious effort to preserve the stock of market-rate affordable rental housing, communities will continue to see their affordable units disappear. In the meantime, the pressure on private owners continues to grow, especially in desirable communities. Just down the street from Fillmore Gardens in Arlington County, two new high-end multifamily residential buildings are under construction. And the owner of Fillmore Gardens is looking toward retirement. It may not be too much longer before market-rate affordable rental properties in this expensive jurisdiction are a thing of the past.

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