

Critique of *The Economics of Inclusionary Development*, prepared by the Urban Land Institute and Terwillinger Center for Housing in 2016.

This report reviews the need and use of concessions (otherwise all known as incentives, compensation or cost offsets) in inclusionary zoning programs. The report serves as a useful introduction to this topic, but does not satisfactorily address all of its dimensions and nuances. In a sense, the need for concessions in IZ is much more limited than suggested, and their use much more complicated.

The underlying main problem with this report is that it seems to be based on a conventional way of thinking about affordable housing. Central to that is the notion that the cost burden of providing affordable housing always must be shifted to government. But IZ is part of a new way of thinking that looks to harnessing where possible the inflated land values associated with rapid growth to provide for affordable housing. This fundamental difference in viewpoint affects how the need and use of concessions are seen.

This critique has been prepared because the development industry in Ontario has been touting this report as supporting its claim that concessions are generally imperative in IZ for the provision of the affordable housing. As will be shown, the report in two significant statements does not support this claim. Furthermore, the need for concessions becomes even less certain when other aspects of the report are examined.

What the report says (but is being overlooked)

The report makes two significant statements about the need for concessions. Strangely, both are only contained in the conclusion, and not addressed in the main body. So, their implications have not been fully considered or explained.

1) Concessions are not needed in strong markets.

The report recognizes this position through the following statement: “In very strong development markets ... IZ policies can yield development of new workforce (that is, affordable) housing units without subsidy or other development incentive from the local jurisdiction”.

In other words, experience has shown that IZ can be successfully used in certain areas – namely, high growth areas – without compensation for the provision of affordable housing. The rapid growth in these areas generates a substantial increase in land values than can be harnessed under IZ to support the provision of affordable housing.

These conditions, it is reasonable to assume, would apply to places like Toronto, and possibly many of the surrounding jurisdictions as well.

This might be seen as arguing for use of concessions in slow and no growth areas. But it should be understood that IZ does not work in these sorts of areas in the first place. As already noted, IZ fundamentally depends upon harnessing market activity to provide affordable housing. Where there is little or no such activity, IZ is simply not capable of producing affordable housing. So, the provision of affordable housing in these areas should be looking at other tools than IZ.

2) Concessions are not needed as the cost burden can be absorbed by the land prices.

The report gives support to this position in these statements. First, "IZ may reduce what a developer can pay for land". And later, "(when) IZ policies remain in place over a sustained period of time, land prices may adjust and the IZ requirements absorbed as a 'cost of doing business' in the jurisdiction".

These statements are consistent with widely held views in the US. In mandatory IZ programs, the cost burden associated with affordable housing is passed by the developers back to the land in the form of lower purchase prices. In other words, the developers will offer correspondingly less for the land in order to control their overall costs and maintain their desired profit levels. This should occur whenever the affordable housing obligation is reasonable, fixed and known well enough in advance.

It is accepted that this pass-back will not occur immediately, but only over time as the land market adjusts to the obligations imposed by IZ. At worst, this means there is a short-term transitional problem, but this is probably best handled by phasing-in the affordable housing obligation rather than providing any temporary compensation.

In summary, these statements each separately and in a different way clearly contradict the development industry's claim that the use of concessions is imperative in IZ. They also raise critical issues that are not appropriately explored in the report, and not recognized nor addressed by the development industry to date.

What the report also did not examine

There are also a number of key distinctions that are either overlooked in the report or not fully examined. As a consequence, it does not adequately address how compensation might be needed or provided in the different types of IZ programs.

- Mandatory vs incentive-based programs.

In incentive-based (otherwise called voluntary or optional) programs, the developers have a choice about providing the affordable housing or not. So, in

order to get their voluntary participation, the municipalities typically have to make them “whole” again – that is, fully compensate them for the additional costs associated with the affordable housing. (Because this provision is voluntary and often negotiated, the cost burden generally cannot be passed back to the land price.)

Under mandatory programs, developers do not have that choice. If they want to build, they must provide the required affordable housing. But in these programs, as just noted, the developers will be able to pass the cost burden back to the land price. So, the municipalities need not to provide compensation in these cases.

This difference is clear and crucial. By not explaining it, the report serves to inflate where concessions are actually being used. In other words, the use of concessions occurs mostly in incentive-based programs, which happen to represent only a small minority of the IZ programs. Furthermore, they are a declining minority because they are no longer seen as being productive.

- Developments meeting the minimum or standard obligation vs those providing greater affordability.

The great majority of IZ developments under mandatory programs provide only the minimum or standard obligation. In other words, they typically proceed with no negotiation, and with no change to the required obligation nor the concessions offered.

There are also many other one-off developments that provide more than the minimum or standard. They might, for example, provide a larger number of affordable units and/or the units at a deeper level of affordability. To do this, the developments typically secure compensation specific to the added costs associated with the enhanced provision. In some cases, this will involve subsidies coming from federal and state governments.

There is an important distinction here. In the former and far more common cases, the compensation (if provided at all) is set in advance, applied across-the-board to all developments, typically limited in amount and type, and provided entirely by the municipality. In the latter and far less common cases, the types of concessions used are essentially unlimited because they are determined by case-by-case negotiation, and can tap into other government programs.

By failing to make this distinction, the report is misleading about the number and type of concessions in common use in IZ. For example, the report identifies a long list of various direct subsidies that might be used, but these sorts of subsidies are never made available in the vast majority of developments meeting the minimum obligation. Where they are seen is in the relatively few developments providing more than that minimum.

- Mandatory programs applying to all projects vs those only using a rezoning.

Most mandatory programs target most residential developments, including those going ahead as-of-right. The others – mainly, the programs in a dozen or more big cities – apply more narrowly only to residential developments getting a rezoning.

This difference is significant because the use of rezoning typically involves an increase in the permitted density. That increased density generally releases a substantial economic uplift that is sufficient to compensate the developers in full for the cost burden associated with the affordable housing. In these cases, no additional concessions are necessary.

The use of density increases is more varied in the other programs. There are many programs that offer no density increases; and there are others that offer them, but typically in a limited and prescribed way. So, it is hard to generalize about the effect of density increases in these programs, but it is unlikely to be as significant.

- Rental vs ownership developments.

Certain forms of compensation are more appropriate for one tenure than the other. Property tax abatements are a key example. They are effective in improving the affordability of rental housing because they can reduce rent levels. On the hand, they do not make ownership housing more affordable because they can not lower the purchase price.

The report fails to explain the limited application of property tax abatements. They are only actually used in some jurisdictions, mainly the big cities, where rental housing predominates. They do not occur in the vast majority of programs where affordable ownership housing mainly is being produced.

What further research should confirm

The report does not examine how individual IZ programs actually use compensation. It draws on other studies that look at these programs, but only in a generalized and aggregated way. It does not incorporate any new or previous empirical evidence about what the individual programs do.

What is needed is a survey of practices in a broad sample of existing IZ programs to show how concessions have been used. This is necessary to provide a more complete – and certainly more nuanced – understanding of the role of and need for compensation.

In the absence of such a survey, an initial picture can be formed from the detailed but limited case studies presented elsewhere on this website. (See the Case

Studies - American.) That picture is fundamentally different than the one suggested in the report in a number of key ways.

a) There are programs that offer no compensation whatsoever.

This is significant to note because it adds evidence showing that concessions are not always used or needed.

b) The programs generally do not rely on funding or other assistance provided by other levels of government.

IZ programs from the outset have been intentionally designed as municipal programs that operate on their own and independently of the federal and state governments. The municipalities did not want to tie the programs to the declining and on-again/off-again funding from these sources, nor to their dictates about what type housing must be provided or incomes served. This can be seen in the type of housing provided by IZ programs, which is quite different than that coming from federal/state programs.

There is, of course, the exception that has been already noted. Municipalities can and do sometimes use the assistance from senior governments to achieve more than the minimum standard. But this still remains more of an exception rather than a rule, and should not be seen as a widespread practice.

c) These programs generally do not use conventional cash subsidies as compensation.

It follows from the above that the programs do not use grants or other financial subsidies from federal and state governments, except in the circumstances outlined.

At same time, these programs do not use similar subsidies provided by the municipalities. The reason is very simple and obvious: municipalities there are as cash-strapped as those here. This is what drove them in the first place to regulatory tools like IZ. And, if anything, their cash resources have become even more limited over the years.

What municipalities are more likely to do is to waive various permitting fees and development charges. Some programs do, but others do not. These waivers are problematical because the cash must be replaced from other sources, or the cost passed on to other developments.

d) The programs that do offer compensation do so in a very limited way.

There is no evidence whatsoever – whether in their ordinances or actions – that the municipalities with mandatory programs have ever assumed any obligation to

make the developer “whole” again, or even to cover the cost burden in any calibrated or substantial way.

In most cases, the compensation provided can be best described as being notional or token. The amounts are arbitrarily set and not related to the cost burden. (In fact, most municipalities are not even aware of the dollar value of the cost burden). They are based on what the municipalities can readily provide, and not what they need to provide. Once set, the compensation is seldom adjusted, although the cost burden changes over time and project-by-project.

The exception to all of this, as already noted, are programs based on rezoning. In these cases, the increase in the permitted density typically will fully cover the cost burden associated with the affordable housing.

In conclusion

The need for and use of concessions in IZ programs is much more complicated and less certain than indicated by the ULI report.

In any case, the report does not support the development industry in their claim that concessions are imperative in IZ programs. More specifically, it identifies two (and widely accepted) circumstances where they are not needed:

- 1) in strong development markets, and
- 2) when the costs can be passed back to the land costs.

Also, by not making distinctions between various types of programs, the report also does not appropriately explain how they differ in their use and need for concessions. In doing so, it also serves to inflate how extensively they are used.

- Mandatory programs in general are not reliant on concessions because the cost burden can be passed back to the land. On the hand, all incentive-based programs are very much dependent upon concessions. In other words, the use of concessions occurs mostly in incentive-based programs, which represent only a small minority of the IZ programs, and furthermore a declining one because they have been found to be unproductive.
- Most developments under mandatory programs provide only the minimum or standard housing obligation, with no negotiation and with limited or no compensation. But there are also others that provide more than the minimum – for example, by providing more units and/or a deeper level of affordability. These developments will typically negotiate additional compensation specific to the costs associated with the enhanced provision. It is these non-standard and one-off developments that use the most and widest range of concessions, and these include many seen in the standard practices.

- Many programs offer density increases. These include notably the rezoning-based programs found in big cities, but also other programs as well. Where this happens, the increase in the permitted density generally releases an economic benefit sufficient to offset the cost burden of the affordable units. So, no other concessions are typically needed in these programs.

Finally, the report does not examine how individual IZ programs actually use compensation. It draws on other studies that look at these programs only in a generalized and aggregated way. The detailed but limited available case studies of these programs present a different picture than that in the report.

- a) There are programs that offer no compensation whatsoever. This is significant because it adds further evidence to that showing concessions are not always essential.
- b) The programs generally do not rely on any assistance provided by other levels of government. IZ programs from the outset have been intentionally designed as municipal programs that operate independently of the federal and state governments. Assistance from other governments is only seen in the one-off and non-standard developments.
- c) The programs also generally do not use conventional cash subsidies. While these subsidies are commonly provided by federal and state governments, the IZ programs do not typically use them for the reason just noted. At the same time, municipalities do not use their own cash resources because they are as cash-strapped as municipalities here. After all, this is why they turned to regulatory measures like IZ in the first place.
- d) The programs that do offer compensation do so in a very limited way. The compensation provided can be best described as being notional or token. The amounts are arbitrarily set and not related to the cost burden. They are based on what the municipalities can readily provide, and certainly not on what is needed to make the developers “whole” again.

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