Inclusionary Zoning: How to Make a Good Social Policy Better and More Fair

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Many developers have condemned inclusionary zoning ordinances, arguing that the ordinances allocate too much of affordable housing's financial burden to developers. The author of this article argues that incentives should be created for developers and the financial impact should be more broadly apportioned to narrow the gap between the relative costs of developing market-rate housing and affordable housing.

Nowhere in the United States is there a sufficient supply of affordable housing to meet demand.[1] In 2013, only 28% of low-income families could afford their rental payments.[2] To cite just one example, over the past 15 years Cook County, Illinois, has seen a 16.8% *decrease* in affordable units per 100 low-income households.[3] At the same time, residential segregation by income has increased in 27 of the 30 largest metropolitan areas in the U.S.[4] Since 1980, lower-income households have become ever more likely to live in areas with higher concentrations of lower-income households, and higher-income households have become more likely to live in areas with higher concentrations of higher-income households.[5]

In an effort to provide more affordable housing and to counteract this growing epidemic, cities across the country have instituted inclusionary zoning ordinances, which provide that if certain triggers occur (for example, an application to re-zone property to allow residential uses or higher residential density), then a portion of all new market-rate residential units must be permanently designated as affordable housing.[6] The ordinance with which I am most familiar and which is representative of such local ordinances requires that up to 10% of all units in qualifying developments be designated affordable.[7]

Many developers have condemned these inclusionary zoning ordinances, arguing that the ordinances allocate too much of affordable housing's financial burden to developers. In order to respond to these arguments and to encourage developers' participation in fulfilling the desirable social policy of providing affordable housing, this article argues that incentives should be created for developers and the financial impact should be more broadly ap-

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portioned to narrow the gap between the relative costs of developing market-rate housing and affordable housing.

The Importance of Residential Integration by Income

It seems a well-settled question that socioeconomic integration (or, if you prefer, residential integration by income) is desirable. Socioeconomic segregation harms families with low socioeconomic status. Residents in high-poverty areas typically have fewer and poorer schools, limited employment opportunities, and higher risk of disease and rates of mortality.

While socioeconomic segregation may seem to harm only individuals with low socioeconomic status, society as a whole bears the heavy cost of socioeconomic segregation. Socioeconomic segregation results in decreased residential property values (and, consequently, lower property tax revenues), increased costs to deliver public services to high-poverty areas (which leads to reduced government spending on productive public goods), a weakening of the competitiveness of society's workforce, and sustained stereotypes.[8] Furthermore, "[h]igh levels of segregation . . . constrains the vitality and economic performance of metropolitan regions by sustaining pockets of poverty and distress, thereby fueling flight and sprawling residential development, which raise commuting times and traffic congestion."[9] Studies on the effects of socioeconomic segregation by the American Psychological Association have shown that "[v]ariance in socioeconomic status"—that is, socioeconomic integration—"mitigate social problems. . . . Society benefits from an increased focus on the foundations of socioeconomic inequalities and efforts to reduce the deep gaps in socioeconomic status currently observed in the United States and abroad."[10]

There is a clear social value to inclusionary zoning. A 2012 study published by RAND found that 75 percent of required affordable units are located in tracts with low poverty rates—a stark contrast to eight percent to 34% of other affordable housing programs.[11] The study also found that "compared to other affordable housing programs, inclusionary zoning programs provide recipients with greater access to low-poverty neighborhoods, which are often correlated with high-performing schools."[12] The RAND study also found a correlation between the location of inclusionary affordable units in low-poverty areas and the quality of neighborhood elementary schools. Children in inclusionary affordable units had access to neighborhood elementary schools performing better than schools in the same jurisdiction that did not serve families occupying inclusionary zoning units.

Bridging the gaps between those with low socioeconomic status and those with high socioeconomic status may not be a simple task, but several studies show broad positive effects of policies that promote residential integration by income—such benefits for low-income households as better education, lower stress, higher aspirations, higher employment rates and better physical and mental health, and such benefits for households of all incomes as greater cultural diversity, more powerful societal bonds and more robust economic development.

Inclusionary Zoning as a Means of Promoting Residential Integration by Income

Inclusionary zoning, which produces affordable housing in desirable neighborhoods with better social services, is an effective means of combating socioeconomic segregation. Inclusionary zoning is typically understood to be a policy advanced to promote residential integration by income by requiring developers, often as a condition to the approval of a zoning application, to provide a certain number or percentage of affordable residential units on site in the project for which the zoning change is proposed. Often, as is the case in my home town of Chicago, a developer may opt to make a so-called “fee in lieu” payment to a local governmental agency rather than provide the affordable units on site.

Promoting true inclusionary zoning rather than offering the option of the payment of a fee in lieu is in most instances the best and fairest approach for all concerned. But, at the same time, it should not be left to private developers alone to bear the burden of a policy which has a broad social benefit. It is our collective responsibility to absorb the costs (direct and indirect) of this desirable policy. Whether by incentivizing developers with the opportunity to earn additional development rights or by reducing and redistributing the costs to be borne for pricing rents and purchase prices below market value, the laudable goals of inclusionary zoning should be embraced and the costs more broadly applied and allocated.

Inclusionary zoning ordinances rely on the private sector—developers—to allocate or reserve a portion of units for affordable housing and can produce affordable housing without requiring significant government spending. Inclusionary zoning may also generate public funding for additional affordable housing through in-lieu fees, land dedications, and other means.[13] Inclusionary zoning also stimulates the local economy: affordable housing creates more disposable income for lower-income households, translating to more money spent on goods and services. Due to the costs associated with socioeconomic segregation, sound public policy dictates that more socially and economically integrated and diverse residential areas be developed. By implementing inclusionary zoning programs, which are effective in producing affordable housing in desirable housing markets, we can more effectively combat socioeconomic segregation and mitigate the effects of, and reduce, residential segregation.

Incentivizing Development and Affordable Housing

If the creation of residential socioeconomic integration through inclusionary zoning ordinances is deemed to be desirable, it does not necessarily follow that the burden should be borne exclusively by the private developer creating the affordable housing. In fact, governments should neutralize or even reverse these ordinances' impact on private developers to incentivize the construction of affordable units. Creating affordable housing units through the vehicle of inclusionary zoning may never be as profitable for developers as creating market-rate housing units. But the financial gap can be narrowed considerably. Indeed, one developer in an anonymous survey encouraged governments to “stop building islands of affordable housing and integrate them. They should use the funds they already have to encourage the type of development they want to see built.”[14]

Local governments can lessen developers' financial burden by providing financial incentives. Costs to developers can also be reallocated to other entities, including land owners and adjacent beneficiaries. While no single incentive is a panacea for easing the financial burden of providing affordable units, by developing a menu of potential incentives, the cost of providing affordable housing relative to the cost of creating market-rate housing can be narrowed. By reducing developers' burden, building affordable housing can become more cost effective and, in turn, more prevalent. "No single reform can solve the problem" but every incentive is "just one more tool in the arsenal."[15] In keeping with that idea, the following are examples of ways local government can directly reduce developers' costs of building affordable housing.

Density Bonuses

By far the most common method to incentivize developers to create affordable housing is density bonuses. These allow developers to create more units than would be allowed otherwise under applicable zoning law.[16] Density bonuses benefit developers by increasing the number of units (and thus revenue streams) per lot. Density bonuses have been ranked by developers as the incentive most likely to induce developers to provide affordable units on site.[17] However, density bonuses alone may not sufficiently reduce the burden on developers of inclusionary zoning requirements.[18]

Parking Reductions

Reducing minimum parking requirements is another commonly used vehicle for incentivizing the construction of affordable housing. Parking is space intensive and expensive to construct, so reducing the mandatory ratio of parking spaces to units is often an attractive incentive.[19] Particularly in neighborhoods well-served by public transportation, recognizing that parking ratios can be reduced promotes increased public transportation ridership while reducing private development costs.[20]

Expedited Zoning and Permitting Process

Another vehicle for reducing the burden of inclusionary zoning on private developers is expedited permitting. Local governments can fast-track permit applications, waive or reduce fees associated with rezoning, and generally streamline the process in order to incentivize development. For example, in the Twin Cities, developers are offered an incentive of reduced impact fees, which are one-time fees charged to pay for new infrastructure like sidewalks and sewers.[21] Developers may be more able to absorb the costs of inclusionary zoning if they know that the rezoning process is expedited and cheaper.

Increased Floor Area

City ordinances regulate the maximum floor area a developer can build in a given project. An increase in floor area would allow developers to produce larger projects and more units. Several cities currently employ this incentive.

Tax Subsidies

Some local governments, in an effort to reduce developers' financial burden, give tax breaks to private developers who participate in providing affordable housing.[22] For the portion of the development that is affordable, developers receive tax breaks like property tax abatements.[23] State and local governments have experimented with awarding grants to communities actively creating affordable housing.

Low-Interest Government Loans

In a recent survey of private developers who had participated in mixed income developments, 71 percent of respondents said they had experienced significant difficulties obtaining financing on developments that included both market-rate and affordable housing units.[24] Developers routinely express concerns that banks struggle to successfully underwrite a project with an affordable component.[25] If local governments were to extend low-interest loans on the affordable housing portion of a project, it would be both cheaper and easier for developers to secure financing. Additionally, if local governments sponsored these projects, banks would have more confidence that these projects would be completed timely and their loan repaid.

Land Trusts

An effective way for local government to reduce obstacles for developers is making the acquisition of government-owned land more attractive. Local government can develop land trusts in exchange for commitments to build a certain amount of affordable units on site. In New York City, for example, developers were able to buy land from the city for $1 to build what eventually became Hunter's Point South, a $350 million mixed-use complex (75% of which is affordable housing).

Air Rights

New York City's Inclusionary Housing Program offers a creative incentive to affordable housing developers: the allocation of air rights, which may then be sold to third-party, market-rate developers, who in turn use those rights to build larger and denser buildings.[26] Proceeds generated from the sale of these air rights are then used to repay the underwriters. This system allows developers to create affordable housing and to assure their creditors of their ability to repay the loans. Additionally, reallocation of air rights is not a traditional outflow of cash from a local government's budget (if anything, it would be no more than a lost potential inflow of cash).

Linked Development

So-called "linked development" allows developers to satisfy affordable housing requirements by constructing affordable units within a certain radius of the property to which the affordable requirement would otherwise apply. Although linked development does not necessarily promote residential integration by income per se, if administered creatively it can produce affordable units in the same higher income neighborhoods in which new market-rate housing is being developed.

Promoting (Affordable Housing) Development Through Cost Reallocation

When new residential developments are built, private developers clearly benefit, but they are not the sole beneficiaries. Increasing the housing supply means more options and lower purchase prices and rents for consumers. Nearby shops and restaurants benefit by having more consumers in close proximity, and local employers enjoy the benefit of a workforce nearby. Why, then, do typical inclusionary zoning ordinances allocate virtually all of the costs to the private developer building the units?

Here are some possible ways to reallocate the burden.

Affordable Housing Trust Funds

Often, when developers choose to pay a fee in lieu rather than to provide units on site, the fee is paid to an Affordable Housing Trust Fund.[27] The money in turn is used to fund housing developments that are 100% affordable, usually located in neighborhoods with low land values and a greater concentration of low-income households.[28] However, might it not be a better use of these funds to instead subsidize the private development of mixed-income buildings in higher income neighborhoods?

Allocation to Land Owner

In cases where the underlying land is owned by a private party, some of the cost of affordable housing could be allocated to the private land owner. Land owners could be assessed a special surcharge on their taxes stemming from the land sale, and that surcharge could underwrite the costs of future affordable housing projects. Alternatively, land owners could elect to avoid the surcharge by charging the developers less for the land, i.e., taking a purchase price reduction roughly equal to the surcharge.

Adjacent Beneficiaries

Nearby shops, restaurants, and employers should all share in the burden of financing the construction of affordable units. One way to do this might be to assess a surcharge on these businesses' property tax. Businesses in a defined radial area (for example, 0.5 miles around the development) could be assessed a property tax surcharge to go into an Affordable Housing Trust Fund defraying the project's cost. Special assessments could also be levied against nearby commercial properties.

Conclusion

The lack of affordable housing is at crisis levels, and inclusionary zoning is an effective vehicle for creating more affordable housing in diverse neighborhoods. Reversing the trend of higher concentration of residential segregation by income is an important concomitant. But private developers—who are creating affordable units which benefit both future occupants and the public at large—should not exclusively bear the costs of inclusionary zoning. Direct and indirect incentives should be considered and authorized, and the burden and costs of providing below-market units should be more broadly allocated.

It is incumbent upon all of us to address the crisis in affordable housing and the costly, destructive consequences of the growing concentration of residential segregation by income. Through numerous incentives and subsidies, the financial burden of affordable housing projects borne by developers can be directly reduced or otherwise reallocated. In doing so, developers may be encouraged to more willingly participate in inclusionary zoning initiatives, thus helping to provide affordable housing for those in need.

NOTES:

[1]Kriston Capps, Every Single County in American is Facing an Affordable Housing Crisis, Citylab (June 18, 2015), http://www.citylab.com/housing/2015/06/every-single-county-in-america-is-facing-an-affordable-housing-crisis/396284/.

[2]*Id.*

[3]Josh Leopold, Et Al, Urban Institute, The Housing Affordability Gap For Extremely Low-Income Renters In 2013 at 23 (June 2015), *available at* http://www.urban.org/sites/default/files/alfresco/publication-pdfs/2000260-The-Housing-Affordability-Gap-for-Extremely-Low-Income-Renters-2013.pdf.

[4]Richard Fry & Paul Taylor, The Rise Of Residential Segregation By Income 1 (Pew Research Center 2012), http://www.pewsocialtrends.org/files/2012/08/Rise-of-Residential-Income-Segregation-2012.2.pdf.

[5]*Id.* at 10. To define "lower-income" and "higher-income" households, the study used figures that results in a "class distribution that roughly comports with the way that Americans self-identify as members of different socio-economic classes." *Id.* at 22.

[6]This article does not seek to debate what "afford-

able housing" should mean, but rather, will use the phrase with reference to Chicago's Affordable Requirements Ordinance (the "Chicago ARO"). With respect to rental housing, "affordable housing" means housing that is affordable to those earning up to 60 percent of the area median income. With respect to for-sale housing, "affordable housing" means housing that is affordable to those earning up to 100 percent of area median income. CHI. AFFORDABLE REQUIREMENTS ORDINANCE § 2-45-110(a) (2015).

[7]Chicago ARO § 2-45-110 (2015).

[8]This article does not seek to debate what "affordable housing" should mean, but rather, will use the phrase with reference to Chicago's Affordable Requirements Ordinance (the "Chicago ARO"). With respect to rental housing, *Id.*

[9]*Id.*

[10]AM. PSYCHOLOGICAL ASS'N, VIOLENCE & SOCIOECONOMIC STATUS 1, http://www.apa.org/pi/ses/resources/publications/factsheet-education.pdf (last visited Jul. 2, 2015).

[11]Heather L. Schwartz Et Al., Is Inclusionary Zoning Inclusionary? 14 (RAND 2012), http://www.rand.org/content/dam/rand/pubs/technical_reports/2012/RAND_TR1231.pdf.

[12]Hickey, *infra* note 23, at 4 (citing 2012 RAND study).

[13]For example, since 2007, the city of Chicago has collected over $11 million in in-lieu fees. Chicago Department Of Planning & Development, Inclusionary Housing In Chicago: The Affordable Requirements Ordinance (Aro) 1 (2014), http://www.cityofchicago.org/content/dam/city/depts/dcd/general/housing/AROFactSheet2014.pdf.

[14]Emily Talen, *Prospects for Walkable, Mixed-Income Neighborhoods: Insights from U.S. Developers*, 28 J. HOUS. AND THE BUILT ENVIRON. 79, 89 (2013).

[15]*Id.* at 89.

[16]SCHWARTZ, *supra* note 11, at 23.

[17]Talen, *supra* note 14, at 89.

[18]Mireya Navarro, Report Finds a City Incentive is Not Producing Enough Affordable Housing, Ny Times (Aug. 15, 2013), http://www.nytimes.com/2013/08/16/nyregion/report-finds-a-city-incentive-is-not-producing-enough-affordable-housing.html?_r=0.

[19]Michael Manville, Parking Requirements and Housing Development: Regulation and Reform in Los Angeles, Accessmagazine (Spring 2014), http://www.accessmagazine.org/articles/spring-2014/parking-requirements-housing-development-regulation-reform-los-angeles/.

[20]*See, e.g.,* City Offering Incentives for Affordable Housing Development Along Rail Route, Hawaii News Now (Sept. 1, 2014), http://www.hawaiinewsnow.com/story/26421112/city-offering-incentives-for-affordable-housing-development-along-rail-route.

[21]Tom Bydalek, Et Al, Mcknight Foundation, Planning For Affordable Housing In The Twin Cities Metro 11 (2009), *available at* http://www.homelinemn.org/wp-content/uploads/A-Vision-for-the-Next-Decade-Final-Version.pdf.

[22]*Id.* at 33 (describing Boulder, Colorado's program).

[23]Robert Hickey, After the Downturn: New Challenges and Opportunities for Inclusionary Housing, Center For Housing Policy (Feb. 2013).

[24]Talen, *supra* note 14, at 88.

[25]*Id.*

[26]Gregg Fairbrothers & Catalina Gorla, Affordable Housing: How the Public and Private Are Working Together, Entrepreneurially, Forbes (Jul. 11, 2013), http://www.forbes.com/sites/greggfairbrothers/2013/07/11/affordable-housing-how-the-public-and-private-are-working-together-entrepreneurially/.

[27]*See e.g.,* CHI. AFFORDABLE REQUIREMENTS ORDINANCE § 2-45-110 (b)(1) (2015).

[28]*See, e.g., Id.* § 2-45-110(e).