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February 23, 2009

Jeff Smith, Chair
H.C. Planning Commission
3015 H Street
Eureka, California 95501

RE: Inclusionary Zoning

Dear Chair Smith and Commission Members:

Attached for your review is a packet which was sent to the Board of Supervisors for its public workshop on the subject of inclusionary zoning last March 11, 2008. Information is presented which details some of the problems associated with inclusionary zoning. Please note that in the attached letter, reference is made to two, state Housing and Community Development letters which addresses mandatory inclusionary zoning as a government constraint. Copies of these two letters were presented to the Planning Commission at its February 19, 2009 meeting. They are not included here again although we can provide additional copies if the Commission so desires.

We would appreciate your review of the attached material as you consider the important issue of inclusionary zoning.

Thank you

Bob Higgons
Government Relations Coordinator

attachments

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March 4, 2008

Humboldt County Board of Supervisors
Humboldt County Courthouse
825 5th Street, Room 111
Eureka, California 95501

RE: Inclusionary Zoning

Dear Chair Geist and Board Members:

On March 11th the Board of Supervisors is scheduled to hold a public workshop on the subject of inclusionary zoning. The Humboldt Association of Realtors® is writing to express our position on this controversial issue. The Association does not support inclusionary zoning. The Association feels there are many market related alternatives for achieving the result of affordable housing and we believe strongly in relying on market related incentives to support affordable housing instead of mandatory inclusionary zoning.

We note that the California Association of Realtors® opposes mandatory inclusionary zoning for several reasons. Among them that it is unfair to place the burden of providing affordable housing solely on builders and developers. The lack of affordable housing is a societal problem and as such all of society should share in the responsibility of addressing it.

We note also letters (copies enclosed) from two different directors of the California Department of Housing and Community Development who wrote that "local governments must analyze mandatory inclusionary policies as potential government *constraints* on housing production" [emphasis added].

We are providing this packet for your information in preparation for the March 11th workshop. There are two themes: why inclusionary zoning does not work and what can be done in-lieu of inclusionary zoning. We make several in-lieu suggestions. Many of them relate to proposed modifications in building codes and land use regulations which can also contribute to the goal of lowering housing costs. There are also several alternatives listed by Director Kirk Girard in his staff report for the meeting. We urge the Board to direct staff to pursue these suggestions and alternatives and reject inclusionary zoning because it is the wrong answer to the issue of affordable housing.

The Association appreciates your consideration of our viewpoint and looks forward to debate on this issue of inclusionary zoning.

Sincerely,

Tom W. Hiller
President

Attachments
cc: Kirk Girard, Director, H. C. Community Development Services Dept.
Michael Richardson, Senior Planner

Humboldt Association of Realtors®

INCLUSIONARY ZONING

Problems With Inclusionary Zoning:

Unfair to place the burden of providing affordable housing solely on builders and developers. The lack of affordable housing is a societal problem, and as such, all society should share the responsibility of addressing it.

Inclusionary zoning does not address the factors that contribute to the high cost of market rate housing, i.e., high land costs, lack of available sites, developer fees and exactions, cumbersome permitting process, etc. Moreover, inclusionary zoning only adds costs to the development of market rate housing.

Inclusionary zoning places financial hardships on developers. Ultimately, they will no longer be able to provide housing in the community because the costs are too high, or they will pass the costs on to market rate buyers, thus making it more expensive for them to buy a home.

Resale price controls eliminate homeowners' ability to realize a reasonable profit on the resale of their home and therefore takes away the incentive for them to maintain their home. This makes it difficult to resell inclusionary units, which lessens their availability to the housing market.

The cost of implementing an inclusionary zoning ordinance for a local government entity is significantly high. Most local governments cannot afford the amount of staff resources and experience required to implement and administer an effective program.

Ultimately, the best way for a local government to provide affordable housing for its constituents, at all income levels, is to make it easier for developers to develop such housing. Incentives such as reduced land costs and land restrictions, increased availability of housing sites, and reduced fees make the development process less costly and time consuming.

The practice of in-lieu fees is a tax on homeowners and renters.

Many jurisdictions collect in-lieu fees, but do not leverage the revenues to build more affordable housing. Instead, in some cases, the money is not spent to produce new affordable housing.

It is a form of subsidized housing. The low income units cost the same to build as market rate housing but since the inclusionary units must be priced lower, the developer makes up the difference by increasing the cost of the market rate housing. This serves to worsen the affordability crisis.

Inclusionary zoning actually compounds the housing crises as described in a November, 2004 letter from then Director of the California Department of Housing and Community Development (HCD) Lucetta Dunn and a December 13, 2007 letter from current Director Lynn Jacobs which each state "local governments must analyze mandatory inclusionary polices as potential government *constraints* on housing production" [italics added].

What To Do Instead of Inclusionary Zoning:

Use market based approach. Use market related incentives, for example:

federal and state tax incentives/reductions
fee reductions
fee waivers
density bonuses
zoning requirement reductions (see * below)
land or project banking

in lieu fee contributions
- timely use of public and/or Private Housing Trust Fund contributions
- secondary financing

downpayment assistance
tax credits
rental payment credit to purchase home

* Listed below are constraining factors which, if modified or removed, would aid private industry in reducing development/construction costs thereby facilitating construction of affordable housing (from October, 2007 letter to Jimmy Smith):

Primary (and secondary where applicable) residences:

relax solar shading (solar access) requirements
- reduce setback requirements
- reduce minimum space requirement between main building and uninhabitable structure
- reduce minimum space requirement between main dwelling and detached 2nd unit

relax parking-space dimension requirements
- reduce number of required on-site parking spaces
- reduce minimum lot size

2nd Units:
increase 35% maximum lot coverage (2nd unit foot print allowed to exceed 35% lot coverage) - relax level of service (LOS) standards (road standards) - allow for separate driveway - allow for one on-site parking space only (regardless of number of 2nd unit bedrooms) - relax the requirement that the entrance door to the 2nd unit be subordinate to the entrance door to the main house
Other:
increase the multi-family zoned land supply - encourage mixed commercial and residential development - increase overall density in new construction without requiring variances
elimination of covered parking requirement
20% reduction in open space requirement
20% reduction in minimum lot width
side and front setback reduction
allowance of other regulatory incentives that can be shown to effectively reduce costs

CALIFORNIA ASSOCIATION OF REALTORS®

Arguments and Counterarguments for Inclusionary Zoning

Argument For IZ	Counter-argument
Provides affordable housing at little or no financial cost to local governments	While there are no or little *direct* costs to the local government *at the time* of applying an IZ ordinance, there are *cumulative* and *indirect* ongoing costs due to IZ. The local government suffers losses from lower property tax revenue at the price controlled dwellings and incurs administrative costs related to the implementation and monitoring of the program. At the same time, the local government has to service the IZ dwellings at the same cost as any other dwellings. In other words, **IZ units cost the same to service but generate less revenue to cover those services.**
Creates income-integrated communities	Integrated communities are not guaranteed. IZ benefits only *very few* households within the community and effectively integrates them within a development. Given that IZ raises housing prices in the whole market, the final result is a polarized community with a dwindling middle class and a concentration of very poor and very wealthy households.
Reduces sprawl; a concentration of people provides the critical mass necessary to create a town center and reduce proliferation of sprawled bedroom subdivisions.	It has not yet been proven that IZ reduces sprawl. Based on statistics, IZ units typically form a very small percentage of the housing stock. This seems to indicate that IZ is not contributing significantly to stop or control sprawl. Finally, town centers have long existed before inclusionary zoning. IZ is not a pre-requisite for their existence.
Increases the production of affordable housing	The production of housing, and for that matter affordable housing, depends on a series of complex variables such as interest rate, housing market prices, population growth rate, fees, taxes, land availability, etc. To link the increase in the production of affordable housing –or any type of housing-- to a single factor is an oversimplification. IZ is effectively perceived by developers as a tax; therefore, the mix of housing

	produced is altered. Given that the production of affordable housing becomes more expensive due to IZ, developers favor the development of luxury units where they can recuperate the costs. This means that there is a potential loss of workforce housing that the numbers of IZ units produced are masking. While some "affordable" units are produced, many more are lost in order to recuperate costs. Is for this reason that HCD considers IZ has a housing constraint.
The costs of affordable housing requirements are treated like a cost of development and result in reducing the value of the land on a regional basis and these costs cannot be increased in a particular jurisdiction based on specific impact fees or development costs.	While it is true that the costs of affordable housing requirements are treated like a cost of development, that does not necessarily mean that the landowner will receive less money for its land. This is particularly true in localities that are built-out. The landowner has the option of selling to a developer for a commercial use, instead of residential, or as an alternative it will hold-on to the land until it can command a higher market price. When the price of land cannot be negotiated to the satisfaction of the developer, then the increased costs in developing housing will surely mean an increased in the price for-sale housing. Also, developers price their housing depending on housing costs and market value of housing in the area. They do incorporate specific fees in their pricing. Developers do change their pricing of housing depending on the area and market conditions, including fees and taxes. They sell the same type and quality of housing at different prices in different markets to reflect fees and housing market conditions.
IZ benefits homebuyers and creates affordable housing in the community.	IZ only benefits homebuyers in the short term by providing below market rate housing. However, IZ locks-in homebuyers of IZ-units and does not allow them to profit from renovations, equity gain and maintenance to the dwelling. Resale restrictions do not motivate owners to maintain the property, discourage upward mobility and <u>effectively and permanently remove the IZ dwellings from the housing market</u>, which means that the units "gained in construction" are immediately lost as soon as they are rented or sold to qualifying households.

INCLUSIONARY ZONING: A Public Policy Failure

A study of inclusionary zoning programs and practices in the San Francisco Bay Area was recently completed by Professors Benjamin Powell, PhD and Edward Stringham, PhD, both of San Jose State University. The following summarizes the critical findings of that study. For a copy of the complete study, visit www.rppi.org/ps318.pdf.

Annual housing production has chronically failed to meet the state's housing need, causing housing prices to escalate. The median home price in California is now upwards of $400,000 and in nearly all of the state's job centers fewer than 25% of households can afford the median-priced home.

Faced with demands to "do something" some local governments have turned to inclusionary zoning ordinances. Inclusionary zoning imposes price controls on a percentage of new homes to compensate for high housing costs. The adoption of inclusionary zoning ordinances raises important public policy questions:

- **Is it effective** – does inclusionary zoning lead to a substantial increase in affordable housing production?
- **Is it efficient** – how do inclusionary zoning's costs compare to its benefits?
- **Is it equitable** – does inclusionary zoning fairly apportion the cost of providing affordable housing?

This study answers those questions by filling the research void that's been in place for 20 years as the debate over inclusionary zoning has raged.

This study, after evaluating the effects of inclusionary zoning principally in the San Francisco Bay Area, shows that this price-control mandate is an ineffective public policy response to high housing prices. Among other things, the study reveals that inclusionary zoning is a poor affordable housing producer; imposes huge costs on middle income homebuyers; and robs lower-income homebuyers of equity.

The Bay Area was chosen because inclusionary zoning is particularly prevalent there – today more than 50 jurisdictions there have inclusionary zoning. But while the study focuses on the Bay Area, its findings are applicable to inclusionary zoning generally.

Finding: Inclusionary Zoning Generates Little Affordable Housing Production

Inclusionary zoning has resulted in few affordable units actually being built. In the 50 Bay Area communities with inclusionary zoning, only 6,836 affordable units have been produced in the last 30 years. This works out to just 228 units per year in the region. After passing an ordinance, the average jurisdiction produces fewer than 19 affordable units per year.

Inclusionary zoning has not come close to meeting the region's affordable housing needs. At current production rates, inclusionary zoning will only produce 4 percent of the region's affordable housing need as estimated by the Association of Bay Area Governments.

Looking forward, it would take 100 years for inclusionary zoning to produce enough housing to meet the region's current short-term affordable housing need.

Finding: Inclusionary Zoning is Exceedingly Costly

Inclusionary zoning is not cost-effective and is a very expensive means of helping lower-income families afford housing. The total cost to build just 6,836 inclusionary units in the Bay Area over the last 30 years is $2.2 billion – roughly $325,000 per unit.

Finding: Inclusionary Zoning Taxes Market-Rate Homebuyers

The high costs of inclusionary units are hidden from the public, at large, but are real costs for new homebuyers. It is estimated that inclusionary zoning causes the price of new homes in the median jurisdiction to increase by more than $37,000 – a direct tax on market-rate homebuyers.

Finding: Inclusionary Zoning Restricts the Supply of New Homes

In addition to increasing the price of new housing, inclusionary zoning profoundly decreases its supply, making the policy a potentially effective growth-control tool. By increasing housing costs through its price-control mandates, inclusionary zoning impacts land markets – creating disincentives for landowners to make their land available for residential use.

In the 45 cities where data is available, new housing production decreased dramatically the year after communities adopted inclusionary zoning. In the 35 communities with data for seven years prior and seven years following adoption of inclusionary zoning, 10,662 fewer homes were produced – despite rising demand – during the seven years after the adoption of inclusionary zoning.

Finding: Inclusionary Zoning Cheats Families out of the Full Benefit of Homeownership

Resale controls imposed by inclusionary zoning greatly restrict one of the principal benefits of homeownership – equity growth and earnings.
Inclusionary zoning programs typically require qualifying homebuyers to sell their homes at below-market prices, robbing them of equity created by maintenance of and improvements made to their homes.

Case studies show that many eligible households recognize this and refuse to buy inclusionary units without even deeper discounts.

Finding: Inclusionary Zoning Costs Government Revenue

Price controls on new development lowers assessed values and costs state and local government tax revenues each year. Because inclusionary zoning restricts resale values for a number of years, the loss in annual tax revenue can become substantial. The total present value of lost government revenue due to Bay Area inclusionary zoning ordinances is $553 million – enough to build more than 40 elementary schools.

Conclusion: Inclusionary Zoning does not Address California's Affordability Problem

The root cause of the California's housing affordability crisis is the lack of an adequate housing supply. Inclusionary zoning fails to address the housing supply problem and actually makes it worse. A far better approach to dealing with California's affordability crisis is that suggested by the state's Little Hoover Commission: "To increase the supply of affordable housing, communities need to zone more land for housing, increase general plan and zoning densities to allow for higher residential density and rethink other standards."

ROUTING

INDEPENDENT POLICY REPORT

Below-Market Housing Mandates as Takings: Measuring their Impact

Tom Means, Edward Stringham, and Edward Lopez
November 2007

Executive Summary

Housing affordability has become a major issue in recent years. To address the problem, many cities have adopted a policy known as below-market housing mandates or inclusionary zoning. As commonly practiced in California, below-market housing mandates require developers to sell 10–20 percent of new homes at prices affordable to low-income households.

Many developers, however, argue that the program is in violation of the takings clause of the U.S. Constitution because it forces developers to use some of their property to advance a public goal. Nevertheless, in *Home Builders Association of Northern California v. City of Napa* (2001), the court ruled against the regulatory takings argument, saying that below-market housing mandates are legal because (1) they offer compensating benefits to developers and (2) they necessarily increase the supply of affordable housing.

This study investigates these claims in the following way: Section 2 discusses the history of regulatory takings and discusses why below-market housing mandates may be considered a taking. Section 3 investigates how much below-market housing mandates cost developers. Section 4 investigates econometrically whether below-market housing mandates actually make housing more affordable.

Our research indicates that the decision by the California Courts of Appeal is on shaky ground. Below-market housing mandates require developers to forego substantial amounts of revenue and they provide little offsetting benefit. A mandate in Marin, California, for example, would require developers to forfeit roughly 40 percent of revenue from a project, and builders are offered almost nothing in return.

We can see how below-market housing mandates affect housing markets by using econometrics to analyze data of price and quantity for California cities in 1990 and 2000. Our regressions show that cities that impose a below-market housing mandate actually end up with 10 percent fewer homes and 20 percent higher prices.

For developers, inclusionary zoning has an effect similar to a regulatory taking. For society in general, affordable housing mandates decrease the supply of new housing and increase prices, which exacerbates the affordability problem.

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5. Conclusion

Our research provides answers to two important questions: How much do below-market housing mandates cost developers, and do below-market housing mandates improve housing affordability? After showing that below-market housing mandates cost developers hundreds of thousands of dollars for each unit sold, we discussed how developers do not receive compensation in this amount. Next we investigated how these policies affected the supply of housing. Using panel data and first difference estimates, we found that below-market housing mandates lead to decreased construction and increased prices. Over a ten-year period, cities that imposed a below-market housing mandate on average ended up with 10 percent fewer homes and 20 percent higher prices. These results are highly significant. The assertion by the court in *Home Builders Association v. Napa* that "the ordinance will necessarily increase the supply of affordable housing" is simply untrue.

The justification for the decision that below-market housing mandates are not a taking rests on some extremely questionable economic assumptions. We are not sure about the amount of economics knowledge of Judges Scott Snowden, J. Stevens, and J. Simons. Below-market housing mandates are simply a type of price control, and nearly every economist agrees that price controls on housing lead to a decrease in quantity and quality of housing available (Kearl et al., 1979, p.28). Because these price controls apply to a percentage of new housing, and builders must comply with them if they want to build market-rate housing, price controls also will affect the supply of market-rate housing. Because price controls act as a tax on new housing, we would expect a supply shift leading to less output and higher prices for all remaining units.

New names for price controls, like "inclusionary zoning," make the policy sound innocuous or even beneficial (who can be against a policy of inclusion?), but in reality the program is a mandate that imposes significant costs on a minority of citizens. The costs of below-market housing mandates are borne by developers and other new homebuyers who receive little or no compensation. From this perspective, below-market housing mandates are a taking no different in substance from an outright taking under eminent domain. Below-market housing mandates represent the sort of abuse the *Lucas* Court forewarned, and they should rightly be considered a taking. In terms of economics, below-market housing mandates only differ from an outright taking in degree—there is not a "total taking" but a partial taking and clearly a diminution of value without any compensation. The amount of harm imposed by below-market housing mandates should inform their status under the law.

Inclusionary Housing Study

PREPARED FOR

CENTRAL CITY ASSOCIATION OF LOS ANGELES

AND

GREATER LOS ANGELES/VENTURA CHAPTER OF THE
SOUTHERN CALIFORNIA BUILDING INDUSTRY ASSOCIATION

PREPARED BY

KOSMONT PARTNERS

June 2003

II. EXECUTIVE SUMMARY

This Executive Summary presents the conclusions regarding the implications of an inclusionary housing ordinance on the City of Los Angeles. It also presents the findings of a survey of jurisdictions (both inside and outside California) that have inclusionary housing as well as a survey of relevant literature. The findings of those surveys are the basis for the conclusions reached.

IMPLICATIONS FOR THE CITY OF LOS ANGELES

The following are the key implications for the City of Los Angeles housing market if an inclusionary housing program is implemented:

1. The values of properties to be used as sites for new residential development will be permanently lower than they would be without the implementation of an inclusionary housing ordinance.

2. Because the value of properties to be used as sites for new residential development will be lowered with the implementation of an inclusionary housing ordinance, new residential projects will be in a less competitive position in the market compared to alternative (or even existing) land uses.

3. With new residential development at a competitive disadvantage, there will be less new residential development than there would be without an inclusionary housing ordinance because fewer properties will be acquired as sites for new residential projects.

4. Existing uses on sites that would be suitable for new residential development will remain in place longer (and may deteriorate further) before being redeveloped as new residential projects. In some cases, this will contribute to blight conditions in the City.

5. Los Angeles is particularly vulnerable to this effect because there are few large unused sites available for new residential development and most new residential development will concentrated in areas that previously have been fully built-out.

6. For a variety or reasons, incentive programs often associated with inclusionary housing are unlikely to materially reduce the detrimental impact of an inclusionary housing ordinance in Los Angeles.

7. The City's residential market will become increasingly polarized at the high and low ends of the spectrum. Middle-income families whose income is only marginally higher than households that are eligible for inclusionary units will have to pay a larger percentage of their income for housing or move out of the City.

8. When the residential market softens, as it was in the first half of the 1990s, these impacts will be magnified and the disincentives to develop new housing will increase.