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Draft

**Guide
to Developing
an Inclusionary Housing Program**

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Guide to Developing an Inclusionary Housing Program

Introduction

This guide identifies the main aspects of inclusionary housing that should be addressed in order to implement an effective program, and also the main principles and key practices that should be followed when addressing those aspects.

It does not attempt to draft a model bylaw nor to set out specific regulations. In many cases, those regulations will depend upon the particular needs, conditions and priorities of each municipality. Also, in some cases (and as also noted here), they still will require further study and research.

The guide draws to a large extent upon the inclusionary housing practices used widely across the US. These practices in the main follow a common model and use a similar set of rules and procedures. This model is generally called inclusionary zoning, and might be described as American-style inclusionary housing. In any case, this particular model has not been used in Canada.

It is not expected that the American model will be fully adopted in this country. Different priorities, regulations and mechanisms are likely to emerge here. Also, some of the aspects of the US programs cannot be readily imported. Nevertheless, considering that these practices have been tried and tested for well over 30 years and in many different communities, this experience offers an invaluable starting point for developing corresponding programs in this country.

The guide is provided in three parts:

- the first looks at the overarching policy considerations that significantly affect the program, and so should be examined at the outset;
- the second identifies the aspects that should be addressed through the regulations, and the principles and practices that should be followed; and
- the last identifies two hurdles that currently limit the use of inclusionary practices generally in Canada, and that need additional research or action.

SUMMARY OF KEY PRINCIPLES

Inclusionary housing policies have this fundamental objective: to create a permanent stock of affordable housing located in every new housing development, and thereby spread across the community.

In order to translate this objective into a productive program, the regulations must support a number of key principles:

- The obligation to provide affordable housing should be imposed on virtually all multi-unit private residential developments.
- The subject developments should be obliged to provide a prescribed and fixed percentage of the total units as affordable units.
- The affordable housing should be provided at a prescribed fixed “below-market” price or rent. (This is a price or rent that substantially below the lowest market price or rent for the equivalent new unit.)
- The affordable units should be constructed on the same site as the market units and integrated with those units. Alternatives to the on-site construction should be allowed only when they better serve the affordable housing needs of the community.
- The affordability and occupancy of the affordable units should be controlled so that they remain affordable to, and are occupied by, eligible households over the long term, if not permanently.

The regulations also should ensure that the inclusionary units are built in the appropriate way, place and time.

Overarching Considerations

Ahead of developing the actual regulations, consideration must be given to a number of overarching policy choices that will affect how those regulations are formulated.

The policy choices needing consideration include the following:

- whether the provision of affordable housing should be mandatory or voluntary;
- whether the regulations (or what regulations) should be negotiable or fixed; and
- whether the program should affect all developments or just those proceeding through a re-zoning or similar approval process.

Mandatory vs Voluntary Programs

Inclusionary programs can be divided into two types:

- Mandatory programs require the developers to provide affordable housing as a condition of development approval, and then typically provide in return some form of regulatory concessions as cost-offsets.
- Voluntary (or incentive-based) programs encourage the developers to provide the affordable housing by using regulatory concessions as incentives.

The two are fundamentally different in this critical regard. In the mandatory, the developers have no choice but to provide the affordable housing if they wish to build anything on a particular site. In the voluntary, the developers have the right and choice to build under the as-of-right regulations, while not taking the incentives and providing the affordable housing.

Although the available evidence is not absolutely conclusive, there is ample and convincing support for saying that the voluntary programs don't work. In order to produce affordable housing at a sustained and on-going basis, the inclusionary programs must be mandatory.

For that reason, the advice provided in this guide is based solely upon the mandatory approach.

Negotiable vs Fixed Regulations

In inclusionary programs, there is a potential for using two types of regulations (or a mixture of both):

- flexible regulations that can be negotiated project-by-project or
- fixed regulations that are applied without changes to all projects.

In deciding which approach to take, a balance must be found mainly between these two considerations: the need to treat all developers fairly, and need (at least in some circumstances) to adapt the regulations to the site-specific conditions.

Inclusionary programs in the US are predominantly associated with “greenfield” areas – namely, low-density suburbs built on undeveloped lands around smaller towns and on the edge of cities. More recently, a number of big cities also have adopted programs already built-up areas. The two sets of programs differ in at least two ways.

The “greenfield” programs typically impose the inclusionary obligation on virtually all private residential developments, including those that proceed under the existing “as-of-right” provisions. They also typically fix all of the fundamental regulations, including those dealing with density increases. That means the density increases are offered on a pre-determined and automatic basis.

The more recent “big-city” programs, on the other hand, have been applied mainly (but not entirely) to residential developments that obtain additional development rights through a re-zoning or similar process. Also, they allow for determining the appropriate regulatory concessions – including density increases – on a negotiated and case-by-case basis.

(Many of the “big city” programs also extend the obligation to provide affordable housing to these additional developments:

- those proceeding under some comprehensive development and approval process;
- those built on lands sold for residential by the city or other public agency; and
- those receiving city funding.)

The changes in the “big-city” programs can be seen as an adjustment to their reality, where regulatory concessions like density increases cannot be given automatically and without consideration of the development context. Furthermore, the majority of developments typically seek re-zoning, and so would be subject to negotiation in any case.

In order to be fair to the developers, the regulations should be set well in advance and then applied consistently. Developers should be able to buy land and develop proposals while having some degree of certainty about the requirements they must meet. No developer should be able to negotiate an advantageous deal giving them a leg up over their competitors.

At the same time, in at least some developments, good planning will call for the flexibility to address specific site conditions. Development sites – particularly, those in built-up urban settings – can present unique local conditions that affect the appropriate scale and nature of the development. These are often worked out during the negotiations associated with the approval process, and the regulations must be capable of adjusting to those negotiations.

To balance these considerations, this guide takes this approach:

- The regulations affecting the value of the affordable housing obligation should be fixed. That means that all subject developments should be required to provide at least the equivalent amount of affordable housing targeting the same income levels.
- The regulations, on the other hand, can permit some flexibility in how that obligation can be met and what concessions are provided. That means, depending upon particular site conditions, the regulations might allow different ways of providing that housing (such as, fees-in-lieu or off-site development) and offer different regulatory concessions (such as, increased density and height limits, and reduced parking standards).

But, even where some flexibility is allowed, it should be generally allowed only within defined parameters or rules that limit the discretion of the municipality and the developers, and so add some consistency and certainty.

This approach is particularly relevant to how permitted density increases are determined. Granting density increases on an automatic and predetermined basis is not appropriate in most urban settings because local conditions can vary so much. So, this approach allows the municipality first to determine what density is appropriate for each site, rather than be trapped into giving the same density increase regardless of context.

As-of-Right vs Re-Zoned Developments

The inclusionary programs can be applied to two main categories of developments:

- 1) all residential developments including those proceeding under the existing as-of-right provisions, or
- 2) only those residential developments obtaining additional development benefits through a re-zoning approval or similar process – such as, one granting a change of use to residential or more development density.

While the above describes the key distinction, it must be noted that the latter category also can be expanded to include one or all of the following residential developments:

- those built on lands owned by the municipality but sold for private residential development;
- those receiving financial assistance from the municipality; and
- those involved in a comprehensive development and approval process that establishes site-specific development standards and requirements.

In order to maximize the production of the program, clearly the inclusionary obligation must be applied to the widest possible range of developments. This is the fundamental rationale for taking the first approach described above. This approach has the added justification of treating all, or virtually all, developers consistently.

The second approach represents a compromise that might be more acceptable in some communities. The rationale for targeting only the latter category of developments is that they receive additional development rights – and often considerable economic benefits – through the approval process, and so the municipality as a condition of that approval can and should recover some part of that benefit for the public good.

The second approach can be a productive alternative, where a substantial majority of the developments seek additional development rights and regulatory concessions through a re-zoning or similar process. These conditions occur in many cities and built-up areas, but not necessarily in smaller and suburban communities.

Key Aspects

The following identifies the aspects that should be addressed when developing an inclusionary housing program, and the principles and practices that should be followed in addressing those aspects.

Subject Developments

In principle, the obligation to provide affordable housing should be imposed on virtually all multi-unit private residential developments.

Only in this way will the program treat all developers fairly and consistently, and also produce affordable housing at an on-going and sustained rate.

One possible set of exceptions has just been noted (see As-of-Right vs Re-Zoned Developments). This would involve limiting the obligation essentially to developments receiving additional development benefits through a re-zoning or other process, but not to those proceeding as-of-right.

The other possible exception is for small developments, which might be defined as those containing less than somewhere between 5 or 30 units.

The rationale behind treating small developments differently is that the affordable housing requirements might affect them too adversely. On the other hand, because these developments could represent a significant portion of the total new housing on production, exempting them could considerably reduce the provision of affordable housing

There is an effective alternative for addressing small developments. That is to apply the affordable housing obligation to all multi-unit developments (including possibly even those down to 2 units), but accepting fees-in-lieu as the affordable housing contribution.

Housing Set-Asides

In principle, the subject developments should be obliged to provide a prescribed and fixed percentage of the total units as affordable units.

Set-asides ranging from 10% up to 20% have been proven to be possible and effective. The required set-aside could be affected by the degree of affordability required and the cost offsets provided.

The simplest way to apply the set-aside is to take as affordable units the same percentage of the various unit types being built by the developer.

As a general rule, the same set-aside requirement should be applied uniformly to all developments, but there is a potential for different requirements in particular circumstances:

- a lower set-aside when particular types of housing, such as housing for still lower incomes or for rent rather ownership, are provided; or
- a higher set-aside when an off-site option is used (see Compliance Alternatives).

There is a potential for requiring certain types of units like family units. It must be recognized that these additional requirements can impose additional costs on the developer (for example, in the form of additional design and construction costs). Those costs must be weighed against the benefits, and might merit additional concessions.

Targeted Incomes

In principle, the affordable housing should be provided at a prescribed and fixed “below-market” price or rent. A “below-market” price or rent is one that is substantially below the lowest market price or rent for the equivalent new unit.

To achieve this, maximum household income ceilings should be used to determine eligibility for the units, and the “below-market” price or rent should be set at a level that corresponds with those income ceilings.

These income ceilings will be needed to be differentiated by household size and/or type so that the households can be matched to suitably-size units. The ceilings, along with the prices and rents, will need to be adjusted at least annually.

A suitable approach for setting these income thresholds has not been developed so far in this country. Setting of the initial income thresholds (and related prices and rents) by itself is relatively straightforward. What complicates the matter is that these must be also linked by some suitable index or other method to the resale price (and the corresponding income ceiling) as part of the long-term affordability controls. It is an issue that needs further study (see Affordability Controls and Outstanding Issues).

The US programs typically require that the affordable units be delivered at a price or rent affordable at or below a prescribed maximum household income level.

They are commonly described as “below-market” prices or rents because they are set at a level that is substantially below the lowest market price or rent for the equivalent new unit.

The income thresholds are differentiated and broken down by household size. This allows for setting different price and rent limits appropriate to units of a different size according to bedroom count.

This approach is facilitated by the federal government, which annually updates and provides the median income by household size for every market area across the country. Each municipality then determines the corresponding maximum rents and prices that can be charged for the specific unit types.

These income thresholds are expressed as a percentage of the local median household income. The actual percentage varies from community to community, with the higher percentages associated with more expensive communities. The percentage used for ownership units most typically ranges from 80 to 120% of median income, but even higher thresholds are seen. The corresponding percentage for rental units is lower, most typically in the range of 60 to 100%.

Compliance Alternatives

In principle, the affordable units should be constructed on the same site as the market units.

Under certain circumstances, consideration can be given to allowing other alternatives, such as the following:

- payment of fees-in-lieu,
- construction of affordable units on another site,
- provision of developable land, and
- provision of upgraded existing units.

Experience has shown that the vast majority of developers will seek to use these alternatives – and, especially, fees-in-lieu – whenever the value of those contributions are determined in a reasonably favourable way. So, in the absence of some limits on these alternatives, any municipality allowing them will end up with few inclusionary units.

These alternatives should be permitted under clearly defined rules, possibly only at the discretion of the municipality, and in any case only when they clearly better serve the housing needs of the community. The last criterion, for example, might be

considered met when the alternative would support additional affordable units, affordable units of deep affordability, or units built in a more suitable location.

Fees-in-Lieu

Fees-in-lieu allow the developers to buy-out their obligation through a cash payment.

Although the use of fees-in-lieu should be limited for the reason just noted, they do have benefits in certain circumstances. They provide a feasible way for small developments to contribute toward affordable housing. They provide an alternative of last resort in the case of particularly difficult sites to develop.

Fees-in-lieu provide a local source of funding that can be used to provide for special needs and other housing that requires additional subsidies.

The fees-in-lieu should be set at least at a rate that fully reflects the value of the affordable housing obligation. For example, one way to determine that value is to take the sum of the difference in prices between the unprovided affordable units and their market equivalents.

This rate should be used when determining the obligation of small developments.

Consideration should be given to establishing a higher rate for developments buying out their obligation as a way of ensuring that the payment of fees-in-lieu in these circumstances clearly provides a greater benefit to the public than the on-site construction.

Cost Offsets

Consideration should be given to providing concessions available through the regulatory process that off-set the losses that the developers might incur by the developers in providing the affordable units.

These cost offsets should be limited to those available from the development regulation and approval process. The main alternatives include the following:

- regulatory relaxations;
- fee reductions or waivers; and
- fast-tracked approvals

Regulatory relaxations refers to changes to the development standards and requirements set out in the zoning by-laws. Where appropriate, these could such possibilities as increases in the permitted density, and reductions in the height, setback, parking and other requirements.

Where possible, these cost-offsets should be provided on an fixed basis and provided to all developments. However, in the case of many of the regulatory relaxations – including particularly density increases – the appropriate cost-offsets possibly can be

determined only on a negotiated and site-specific basis (see As-of-Right vs Re-Zoned Developments).

These cost offsets should not include financial subsidies. Inclusionary zoning is a way of providing affordable housing without relying upon conventional funding. Developers should and can be expected to provide affordable housing in these programs without financial subsidies. Any use of financial subsidies should be limited to very specific circumstances – namely, to supplement and enhance the affordability of the units already being provided by the developers.

In addition to the cost offsets, there is potential also for offering cost savings by allowing affordable units with less floor space or reduced interior amenities (see Development Standards).

Development Standards

The regulations should ensure that the inclusionary units are built in the appropriate way, place and time.

Depending upon the approach taken, regulations may be needed to address the following specific aspects of the affordable units:

- their minimum floor space;
- their construction quality;
- their delivery timing;
- their distribution and location; and
- their outside appearance.

The simplest way of addressing most of these aspects is by requiring that the affordable units match the market units. This approach can taken with regard to their floor space, construction quality, external appearance and delivery timing.

The regulations should prevent the affordable units being segregated in a separate area, and preferably should require them to be inter-mixed and dispersed through out the market units, and in a way that leaves to two indistinguishable.

Consideration should be given to providing cost savings to the developers by allowing a different standard of interior finishes and amenities in the affordable units, provided that standard is based upon acceptable building practices and the energy efficiency of the units is not diminished.

Setting minimum floor space standards for the affordable units would be needed only if the developers are allowed to reduce their size of the units as one of the cost savings. Otherwise, the standard provided in the market units should be considered acceptable for the affordable units.

Affordability Controls

In principle, the on-going affordability and occupancy of the affordable units should be protected in order to ensure that they remain affordable to, and are occupied by, eligible households over the long term.

The following focuses on the controls necessary for affordable ownership units because this type of housing is relatively new and untried in Canada. In contrast, the corresponding controls on affordable rental are well-developed and understood in this country.

The main aspects that need to be addressed are the following:

- legal agreements;
- control period;
- eligibility criteria;
- resale price; and
- occupancy controls

Legal Agreements

The controls should be embedded in a legal document that binds the initial and all subsequent owners over the prescribed period of control.

Ontario municipalities only have limited, and perhaps inadequate, options at this time to protect long-term affordability and occupancy (see Outstanding Issues). Their main resort appears to be an 'option to purchase', but this instrument has administrative burdens that the many municipalities might not wish to assume. The best solution would be new legislated authority, possibly based upon the approach already taken in BC.

Control Period

The affordability and occupancy controls should be put in place for a long period of time. Consideration should be given to 30 years as a minimum, if not maintaining the controls permanently or for the life of the units.

Eligibility Criteria

The controls should set a maximum household income ceiling differentiated by household size as the principle eligibility criterion for the affordable units. These thresholds will need to be adjusted regularly – probably, at annually – to allow for changes in household incomes and house prices over time.

The regulations should establish rules for ensuring the household type and size are compatible with the affordable unit being occupied.

In the US programs, the inclusionary ownership units are controlled almost universally through restrictive covenants registered on the title of the property. They can be used to bind the initial as well as all subsequent owners to the various affordability restrictions over the prescribed period of control. Through these covenants, the initial price reduction is locked in and passed on to the subsequent buyers, after allowing for some suitable inflationary adjustment.

The period of control varies, but it is generally now at least 30 years, and often in perpetuity or for the life of the building.

In some places, this primary legal instrument is also supplemented by an 'option to purchase'. This option allows the municipalities to buy the affordable units whenever offered for resale. They typically exercise this right, not by buying the unit, but by assigning the option either to a non-profit agency or to an eligible buyer on their waiting list.

Consideration also could be given to various supplementary criteria. Those criteria could require that the household:

- have completed an approved homebuyer education course;
- live or work in the community;
- have assets not exceeding a prescribed limit;
- be a first-time buyer; and
- be pre-qualified for a mortgage.

Resale Price

The controls should establish an index, formula or other method for determining the resale price whenever the affordable units are resold, or subsequently resold, during the control period.

Establishing the most appropriate method should entail finding a suitable balance between two objectives: protecting the affordability of the affordable units over the long term, while also allowing the seller to receive a fair and reasonable equity stake when selling.

There also will be a need to deal with an outstanding hurdle: the lack of good income and price data upon which to base these resale prices (see Outstanding Issues).

Occupancy Controls

The controls should ensure that the owner cannot rent at the unit, except possibly only for a short term, at an affordable rent and with the approval of the municipality or some delegated agency.

Outstanding Issues

Two major issues must be addressed before inclusionary housing practices can be widely readily adopted in this country. Both relate to protecting the long-term affordability of affordable ownership housing.

Appropriate practices for protecting the long-term affordability of these units have not been developed in Canada. This is because affordable ownership housing is a relatively recent and largely untried type of housing here. It has been provided only in limited and one-off circumstances in this country, and in most of these cases, the affordability has not been adequately protected.

The two hurdles that must be addressed revolve around these two aspects:

- establishing an effective and efficient legal mechanism that can be used to protect affordability over the long-term; and
- finding a way of setting income-eligibility thresholds that can be applied to subsequent purchasers.

Both of these aspects need further research and study. US practices offer some guidance, but for different reasons cannot be fully adopted here.

Legal Instruments

Controls must be placed on the affordability and occupancy of the affordable units in order to ensure that they remain affordable units whenever resold and then occupied by income-eligible households. This is fundamental to the inclusionary programs, which should be directed at providing affordable housing permanently throughout the community.

Municipalities in Ontario and elsewhere do not have effective legal tools to protect the affordability for this purpose.

First of all, they do not have the authority to use restrictive covenants as in the US. This legal instrument is used for this purpose almost universally by municipalities across the US, where the authority is conferred under common law and not by legislation. Common law practices as they have evolved in this country do not confer the same authority to the municipalities.

Second mortgages are most similar mechanism widely used in this country, but they are not adequate for securing long-term affordability. They can be used to recover the public interest these units – namely, the value of the concessions used to achieve the reduced price – when the units are resold for the first time. But they are not able to lock-in that reduced price for the succeeding buyers over the long term.

The only effective legal mechanism apparently now available to municipalities is to register an ‘option to purchase’ on the affordable unit when resold. This would give

the municipality the right to buy the unit at a prescribed price, or possibly to assign the right to an eligible buyer or agency. While effective, this mechanism might entail administrative demands that some municipalities might not care to undertake.

The best approach appears to that already taken in BC. The provincial government there has established a useful Canadian precedent by passing legislation that authorizes local governments to control the resale price, buyer eligibility and other matters necessary for sustaining long-term affordable ownership. Their approach is one that apparently can and should be adopted in Ontario and elsewhere across the country.

Income Thresholds

The inclusionary units are offered at a reduced price that falls below the market price for the equivalent unit. In order ensure that only eligible households occupy them, the programs must set an income ceiling on the buyers of these units that is commensurate with that price.

The central problem here is not with setting the income ceiling for the initial purchase, but in establishing a process for resetting the income ceiling and corresponding house price whenever the unit is resold.

The process raises various issues that still must be resolved. What is the best index, formula or method that can be used to calculate the resale price? Also, should priority be given to maintaining the affordability of the units for subsequent owners, or allowing the seller to realize a substantial equity gain from the sale (or some compromise between the two).

Setting these thresholds in Ontario and elsewhere in this country also faces a particular hurdle: the lack of appropriate income data upon which to base these calculations. The necessary data have never been collected by the municipalities nor provided by the senior levels of government in this country.

To provide an effective basis for setting the income thresholds, household income data must be available in a format that is:

- current and updated at least annually;
- differentiated by household sizes and/or types appropriate for unit allocation;
- relevant to the ownership housing market (and not rental market); and
- specific to the particular municipality or market area.

On top of this, the data should come from an independent credible source, in the very possible case that these particular controls are challenged before the courts.