

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

This report, as part of a wider examination of the economics of inclusionary zoning, reviews the use of incentives (otherwise more aptly known as concessions or cost offsets).

While a useful introduction to this subject, report does not address all of its critical dimensions. Most important, it accepts without questioning or testing the assumption that concessions are essential in IZ programs. As a consequence, it fails to see that the need for concessions is more limited and targeted than assumed, and their use less prevalent and consistent than suggested.

In large part, this is because the report builds on a conventional way of thinking about affordable housing. In 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 the inflated land values associated with rapid growth to provide for affordable housing. This fundamental difference in viewpoint affects how the need for 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 always imperative in IZ. As will be shown, the report in significant statements does not support this claim. Furthermore, the case for concessions weakens when consideration is also given to other aspects overlooked in the report.

### **What the report says (but is being overlooked)**

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

#### **1) Concessions are not needed in high growth markets.**

Support for this key point is given by the report in this 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 uplift in land values than can be harnessed under IZ to support the provision of affordable housing.

These rapid growth conditions are found most certainly in Toronto, and possibly even in many of the surrounding jurisdictions as well.

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

The report also supports this key point through these two 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 the now widely accepted premise that the cost burden associated with inclusionary housing is passed by the developers back to the land in the form of lower purchase prices. In other words, the developers will pay less for the land in order to control their overall costs and maintain their expected profit levels.

As indicated, this pass-back will occur only over time as the land market will need to adjust to the obligations imposed by IZ. This can be handled by phasing-in those obligations rather than providing any compensation.

In summary, these statements separately and in different ways contradict the development industry’s claim that concessions are imperative in IZ.

### **What the report does not examine**

The report does not examine how the concessions are used in different ways in various types of programs and developments. By failing to do this, the report suggests that they used much more widely and frequently than they actually are.

- Incentive-based programs

Concessions are imperative in certain programs, and specifically incentive-based (also called voluntary or optional) programs. Because the developers in these programs have the choice to provide the affordable housing or not, to get their participation, the municipalities must make them “whole” again – that is, compensate them in full for the costs associated with the affordable housing.

This is not true in mandatory programs. The developers cannot opt out in these programs. If they want to build, they must provide the affordable housing. Therefore, there is not the same onus upon the municipalities to provide compensation, particularly when the developers are able to pass the cost burden back to the land.

Although incentives are needed in incentive-based programs, they have lost all relevance because they have been proven to be ineffective in producing

affordable. So, while they were once widely used, they are no longer being implemented, and many have been converted to mandatory. Nevertheless, their legacy lingers on in this out-of-date belief that incentives are necessary. (Note the use of the term “incentives”, as in this report, is not appropriate for mandatory programs, but continues as another reflection of that legacy.)

- Developments providing greater affordability.

The great majority of developments under IZ programs provide only the minimum (or standard or de fault) affordable housing obligation. They typically proceed without negotiation using the basic (if any) concessions offered.

But there are also developments that provide more than the minimum – for example, through a larger number of affordable units and/or the units at a deeper level of affordability. To do this, the developments typically negotiate on-off deals for additional concessions to cover specifically the added costs associated with the enhanced provision.

In these cases, the concessions might be expanded to include others not used in the basic programs. Most notably, these might include financial subsidies from federal and state governments. So, while these subsidies are used in these programs, they are typically limited to developments achieving greater affordability.

- Developments involving density increases

Density increases in IZ are used two different ways: one through rezoning and the other through density bonusing. The distinction is important because only density bonusing, strictly speaking, can be considered to use increased density as compensation.

Most mandatory programs target virtually all residential developments, including those going ahead as-of-right. But there are a dozen or more big cities that apply IZ more narrowly only to residential developments getting a rezoning. (The latter programs still capture all or most developments because very few can proceed in these cities without a rezoning.)

Rezoning typically involve a negotiated increase in the permitted density that releases a substantial economic uplift, which in turn is sufficient to pay in full for the cost burden associated with the affordable housing.

While rezoning is an effective way of getting affordable housing, strictly speaking, it does not use density as compensation. The approved density is decided first upon the basis of good planning grounds, and then the affordable housing obligation applied according to fixed and standard rules. It does not, as

would be in the case in compensation, first set the affordable housing requirement and then calibrate the density to pay for that housing.

Outside of this handful of programs, the use of density increases is more limited and less consistent. Most programs offer no density increases when dealing with as-of-right developments, while others will use it in one-off spot rezonings.

In addition, there are also programs use density bonusing, in which density increases are offered as compensation for the affordable housing. Notably, the density is generally offered under fixed rules that do not necessarily compensate the developers in full. Furthermore, providing the density is not always guaranteed because approval is often made subject to local public input. The number of programs using density bonusing is not known, but it is likely to be relatively small.

- Rental developments.

Certain forms of compensation are appropriate for one tenure and not the other. Property tax abatements are a key example. They are effective in reducing rental levels but not purchase prices.

As a consequence, property tax abatements are almost exclusively used in some jurisdictions, and particularly the big cities, where rental housing predominates. They are not used in the vast majority of programs producing affordable ownership housing in the main.

### **What other research indicates**

The report does not examine how individual IZ programs have actually used concessions. It draws on studies that look at these concessions only in a generalized and aggregated way. When these programs are examined in detail, a significantly different picture emerges, particularly with regard to these key points:

a) There are programs that offer no compensation whatsoever.

This is significant because it adds further evidence to that showing that these programs are capable of producing affordable housing without providing concessions.

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

The municipalities with mandatory programs have never assumed any obligation to make the developers “whole” again, nor even to cover the cost burden in any calibrated or substantial way.

In most cases, the value of the concessions provided can be best described as notional or token. The amounts are arbitrarily set and not related to the cost burden. Once set, the compensation is seldom adjusted, although the cost burden changes over time and project-by-project.

The concessions are typically based on what the municipalities can readily provide, and so generally include waivers of municipal fees and development regulations. They are provided not out of any sense of obligation, but because the municipalities realize that it is unfair to add the costs of developing affordable housing while at the same time asking the developers to reduce its price

The exceptions to this, as noted earlier, are the programs using density increases. The most prominent of these are the big city programs that rely on rezonings, but strictly speaking, they do not off density as compensation. On the other hand, there are those that use density bonusing to provide density as compensation, but these are limited and circumscribed.

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

The municipalities do not use their own monies for an obvious and simple reason: they are too cash-strapped. After all, this is why they turned to regulatory tools like IZ in the first place.

And they do not use funding from other governments. The IZ programs have been intentionally designed to operate independently of the federal and state governments. The municipalities do not want to tie these programs to the declining on-again/off-again funding from these sources, nor to accept their dictates about what type housing must be provided or incomes served.

There is the exception already noted. Municipalities can and do use financial assistance from senior governments in order to achieve deeper affordability than required by their programs. But this still remains an exception rather than a rule.

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