Increasing the Availability of Affordable Homes

An Analysis of High-Impact State and Local Solutions

Author: Jeffrey Lubell
Executive Director
Center for Housing Policy

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ABOUT THE CONTRIBUTORS

Research Conducted by the Center for Housing Policy

As the research affiliate of the National Housing Conference, the Center works to broaden understanding of America's affordable housing challenges and examines the impact of policies and programs developed to address these needs. Combining research and practical, real-world expertise, the Center lays the groundwork for the development of concrete and politically viable policies and programs that can be used to promote affordable housing across the country.

Research Report for Homes for Working Families

Homes for Working Families is a national, nonprofit organization dedicated to advancing policy changes that enable more of America's working families to find safe, good-quality homes they can afford. It focuses on the families of teachers, police officers, retail associates, office workers and others who struggle to find homes they can buy or rent in the communities they support. It pursues its mission at the local, state and national levels.

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The Annie E. Casey Foundation is a private charitable organization dedicated to helping build better futures for disadvantaged children in the United States. It was established in 1948 by Jim Casey, one of the founders of UPS, and his siblings, who named the Foundation in honor of their mother. The Foundation's philosophy is that children do well when their families do well and that families do better when they live in supportive communities. The Neighborhood Development Unit at Casey advocates for mixed-income communities, responsible relocation, responsible redevelopment and increasing the availability of affordable housing.

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Jeffrey Lubell

Executive Director

Center for Housing Policy

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INTRODUCTION

The purpose of this analysis is to identify promising strategies that states and localities can adopt to expand the availability of homes affordable to teachers, firefighters, nurses and other families who live or work in their communities.

In general, the strategies covered by this analysis focus on state and local policies for *expanding the supply* or otherwise *lowering the costs* of producing homes. Some policies also seek to *enhance families' buying power* or *more efficiently recycle* government funds. In selecting policies for inclusion in the report, priority has been given to those that are flexible enough to meet the varying housing needs of different families and communities, and, in particular, to those that serve families who are not well served by existing federal housing programs.

Housing costs, needs and challenges vary substantially from place to place. This is one reason why it is important for communities to conduct a thorough assessment of their specific housing challenges and develop policies that respond appropriately. Other reasons why states and localities should consider adopting their own housing policies include: a general lack of new initiatives at the federal level, the trend toward greater state and local control over federal housing programs, the fact that certain policies (such as changes in land-use policy) can only be implemented effectively at the state or local levels, requirements attached to federal housing programs that limit the scope of the needs they address, and a growing number of successful state and local policies that can be adapted to meet local needs.

Given the magnitude of the nation's housing problems, state and local governments cannot fully solve these problems by themselves. But, state and local governments *can* be strong partners with the federal government in meeting their constituents' needs for affordable homes. This partnership requires both continued and expanded federal housing assistance *and* housing strategies at the state and local levels that are innovative, proactive and comprehensive.

One particularly challenging issue concerns those families – including working families in lower-paying jobs – whose incomes are so low they cannot afford the costs of a home even in a relatively low-cost housing market. While the needs of this group are great, a comprehensive approach to meeting them would require both specialized housing solutions – notably, ongoing rental subsidies – as well as other interventions, such as stronger schools, improved workforce development policies, etc., that are beyond the realm of housing policy. This is an important subject that merits its own separate analysis. Accordingly, while we acknowledge these families' substantial housing needs and support efforts at all levels of government to address them, the policies discussed in this report are aimed at families with incomes above this threshold – working families with moderate incomes who nevertheless cannot afford the cost of market-rate homes in many markets.

Rather than the 'final word' on promising state and local housing strategies, the Center for Housing Policy views this analysis as a foundational document on which to base additional analysis and research. Of necessity, this initial inquiry relies heavily on the opinions of practitioners, policy-makers and other experts in the field. As the Center's work in this area proceeds, we plan to add additional layers of analysis and evaluation to strengthen and refine the conclusions. We also plan to provide a forum for feedback on this evolving analysis so that we can continually update and improve it. As an initial matter, readers are invited to provide feedback on this report by sending an e-mail to chp-feedback@nhc.org.

CHAPTER 1 – SCOPE AND METHODOLOGY

This chapter addresses several preliminary questions relating to the scope of this analysis:

- Why focus on state and local (rather than federal) housing policies?
- What housing challenges are addressed in this report?
- How were the conclusions in this report derived?

Why Focus on State and Local Housing Policies?

There are six main reasons to focus on state and local (rather than federal) housing policies:

1. *Housing needs vary locally*. Housing conditions, needs and challenges vary significantly from place to place, as do the fiscal and institutional resources available to meet these needs. This local variation is one key reason why it is important for states and localities to develop their own housing strategies.

2. *Limitations to federal housing policy*. Federal funding is critical for helping states and localities meet their needs for affordable homes. But these funds are not sufficient to fully meet communities' needs for affordable homes and often come with significant strings attached. By raising their own funds, states and localities can generate a more flexible stream of funds that can complement federal funds and fill in the gaps.

   Among these federal "strings" are the maximum income eligibility limits of federal housing programs. While the limits vary from program to program, in general, most federal housing assistance for renters goes to families with incomes below 60 percent of the area median income (AMI) and most assistance for homeowners and homebuyers goes to families with incomes below 80 percent of AMI. At the national level, these eligibility limits may well be an efficient way to target federal assistance to households with the most severe housing needs. But there are many communities in which families with incomes above these thresholds also have substantial housing needs. State and local programs are well-suited to addressing those needs.

   State and local action is also needed to address the overall shortfall in federal housing assistance for those who qualify for it.

3. *Opportunity for progress at state and local levels*. Eight years have passed since the passage of the last federal housing act, and more than 15 years have passed since the last major new

housing program (the HOME Investment Partnerships Program) was enacted. While the federal government has been treading water, states and localities increasingly have become active in adapting federal policies to local circumstances, and enacting state and local housing policies that pick up where the federal government has left off. This increase in activity, combined with substantial interest on the part of state and local leaders in making progress in addressing their jurisdictions' housing challenges, confirms that there are tremendous opportunities for making progress at the state and local levels that deserve further exploration and support.

4. *Local nature of key policies*. Some housing solutions *only* can be implemented effectively at the state and, particularly, local levels. For example, reforms to the regulatory environment to overcome obstacles to development – such as changes in local zoning policies to permit smaller lots and higher densities, or expedited permitting processes to cuts costs associated with development delays – require local action. Since states have the power to exercise general oversight for local land-use policies, there may be options at the state level to influence local practice, but there is comparatively little the federal government can do directly.[1]

5. *Local responsibility*. In general, there is a component of the housing affordability problem that relates to the basic fact that many families have incomes that are too low to afford the costs to construct and maintain a home. While the severity varies from place to place, this problem is fairly widespread across all cities and states. A second component of the housing affordability problem is more local, however. This component largely reflects constraints on the market's ability to produce new homes (or preserve existing homes) to meet increased demand, leading to increases in land prices, which drive up the prices of homes – often quite substantially. Because the regulatory environments established by state and/or local governments play a large role in establishing these constraints, one can argue that these same units of government should take the lead in determining how best to address the housing affordability challenges these constraints create.

6. *Devolution*. A more proactive role for states and localities is consistent with the overall devolution in housing policy that has taken place over the past 30 years. While the federal government continues to be the largest *funder* of subsidies for affordable homes, housing *policy* is increasingly being set at the state and local levels. In contrast to earlier decades, during which the federal government exerted greater direct control over housing and community development funding decisions, today, three of the largest sources of federal funding for the construction of new affordable rental homes – the Low-Income Housing Tax Credit, the Home Investment Partnerships Program and the Community Development Block Grant – are all allocated by state and/or local governments. This devolution of control over

[1] The federal government *could* provide incentives for state and local governments to make the necessary changes, but the policy changes would still need to be adopted at the state or local levels.

federal funding for affordable homes has been accompanied by a sharp decrease in federal commitments for additional project-based rental subsidies that are provided directly by the U.S. Department of Housing and Urban Development (HUD) to private owners, the partial devolution to state and local housing authorities of decision-making in the public housing and Section 8 housing voucher programs (along with project-based rental subsidies, the largest deeply subsidized federal rental assistance programs), and an increase in the number and sophistication of state and local programs that use non-federal resources to help their constituents access affordable homes.

What housing challenges are addressed in this report?

The tools included in this report have been selected for their potential to help communities expand the availability of homes affordable to moderate-income working families – teachers, firefighters, nurses, secretaries and others. Using these tools, communities can help meet the needs of families with substantial housing cost burdens, families living in overcrowded or substandard homes, and families who cannot afford to live near their workplaces.

Nationwide, some 5 million working families had critical housing needs in 2003 – an increase of 60 percent since 1997. For purposes of this calculation, working families are defined as families with earnings equal to at least full-time minimum wage work but less than 120 percent of AMI, and a critical housing need is defined as paying more than half of one's income for housing or living in a severely substandard home.[2] Millions of additional working families have moderate housing cost burdens or can only afford to live far from their places of work, forcing them to endure long commutes and spend much of their housing cost savings on transportation.

Some families facing housing challenges – including working families in lower-paying jobs – have incomes so low that they would not be able to afford a home even in relatively low-cost markets.[3] To comfortably afford a home in virtually any housing market, these families require ongoing subsidies such as those provided by the federal government through its various rental assistance programs.[4] Unfortunately, the supply of these subsidies falls far short of the need – a strong argument for continued and expanded federal funding for these programs.

While the needs of this group are great, a comprehensive approach to meeting them would require both a substantial expansion of the nation's ongoing rental assistance programs as well as other interventions, such as stronger schools, improved workforce development policies, etc., that go well beyond the realm of housing policy. This is an important and challenging subject that merits separate treatment in its own analysis. Accordingly, while we acknowledge these families' substantial housing needs and support efforts at all levels of government to address them, the tools discussed in this report are aimed at families with incomes above this threshold – working families with moderate incomes who nevertheless cannot afford the cost of market-rate homes near, or with

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[2] Barbara Lipman. 2005. *The Housing Landscape for America's Working Families.* Washington, D.C.: Center for Housing Policy. These are the most recent data available. Updated data will be available in 2007.

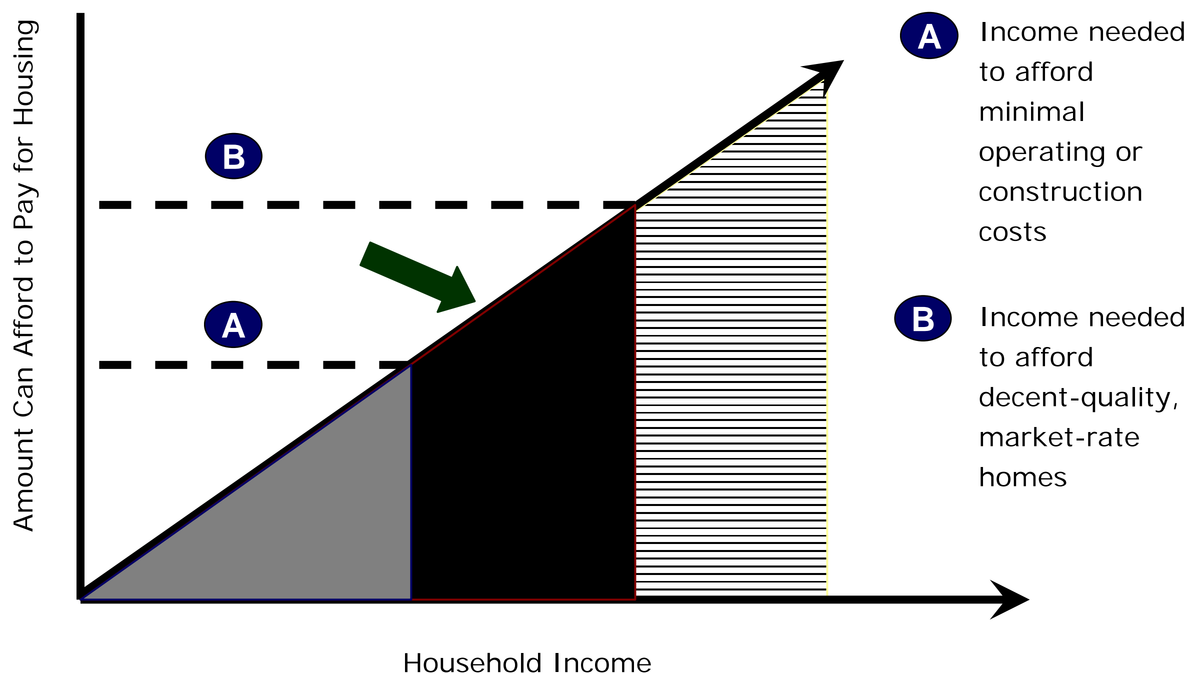
[3] Further research is needed to clarify precisely the income levels of this tier, but a good working assumption is that it includes renters with incomes below 30 percent of the area median (on a national basis, roughly the poverty line) and homeowners or homebuyers with incomes below 40 or 50 percent of the area median.

[4] The principal federal rental assistance programs providing ongoing, deep subsidies for extremely-low and very-low income families are: Public Housing, Housing Choice Vouchers, Project-Based Section 8, Section 202 Supportive Housing for the Elderly and Section 811 Supportive Housing for People with Disabilities.

good transit access to, their places of employment, with a particular emphasis on those who are not well served by current federal housing programs.[5]

Figure 1 illustrates the general scope of the housing cost challenges that are the focus of this report. As families' incomes increase (the horizontal axis), the amount they can afford to pay for a home (the vertical axis) goes up. Some working families (shaded gray) have incomes that are too low to afford basic operating (for rental housing) or construction (for homeownership) costs, even in relatively low-cost markets. The income needed to afford these minimal costs is represented on the figure by the letter A. Other families (shaded with horizontal bars) have incomes that are sufficient to afford the costs of market-rate homes; the income needed to afford market-rate homes is represented on the figure by the letter B. This report provides strategies aimed at the middle group (shaded black), which falls between these two extremes – working families with moderate incomes who cannot afford the costs of market-rate homes in their desired communities.

Figure 1: Housing problems addressed in this report
(black shaded section identified by arrow)



The housing needs of this middle group are quite diverse, with some families needing relatively modest amounts of assistance and others needing considerable assistance. Moreover, the income

[5] With some exceptions, most federal rental assistance is provided to families with incomes below 60 percent of AMI, and most federal assistance for homeowners is targeted to families with incomes below 80 percent of the area median.

levels that define this group vary from community to community. For this reason, this report has emphasized flexible solutions that can be adapted by states and localities to meet their specific needs.

How were the conclusions in this report derived?

Five main criteria have been used to evaluate and select strategies for inclusion in this report:

1. **Ease of Financing/Cost-Effectiveness.** In this analysis, preference has been given to policies that require minimal commitment of additional state or city funds, unless those funds are supported by a new revenue source or leverage significant federal funds that would not otherwise be available. Among other things, a focus on this criterion has elevated the importance of strategies that extend the duration of affordability periods and more effectively recycle existing subsidies to help more families.

2. **Magnitude of Potential Impact.** While the wide variation in the types of policy options considered in this report makes it extremely difficult to develop an apples-to-apples comparison of the likely magnitude of these policies, in general, this analysis focuses on policies that would, if adopted, have the potential to help a significant number of families in the applicable jurisdiction.

3. **Replicability.** While not all strategies will be appropriate for or capable of implementation in all jurisdictions, in general, this analysis focuses on policies that could be implemented across large numbers of jurisdictions without bumping up against significant legal constraints or limitations of federal funding.

4. **Flexibility.** Preference has been given to policies that preserve significant flexibility for local implementation, especially regarding the income levels of qualifying families.

5. **Ease of Implementation.** Preference has been given to policies that are easier to implement.

Given the great variation in the nature of the different policies considered for this report and the general lack of systematic data on their use and outcomes, these ratings are inherently subjective. Over time, however, the Center hopes to collect more systematic and uniform data that will allow more objective assessments.

The raw material for this analysis was a series of interviews with practitioners, policy-makers and other experts in housing policy, supplemented by a review of available literature. (See Appendix A

for a list of individuals interviewed and the Selected Bibliography for a list of resources reviewed.) While many of the conclusions expressed in this analysis are based on those sources, ultimately, the findings reflect the conclusions of the author, rather than those of the individuals surveyed, and the author bears sole responsibility for any errors.

CHAPTER 2 – STRATEGIES FOR BRINGING HOMES WITHIN REACH OF WORKING FAMILIES

This chapter summarizes the high-impact policies identified in this analysis for expanding the availability of homes affordable to working families. The policies fall into six broad categories, each of which describes an important strategy for state and local governments to consider in addressing housing affordability challenges within their communities:

- Expand the availability of sites for the development of affordable homes
- Reduce red tape and other regulatory barriers to affordable homes
- Harness the power of strong housing markets
- Generate additional capital for affordable homes
- Preserve and recycle resources for affordable homes
- Empower residents to purchase and retain market-rate homes

A list of the high-impact policy solutions recommended for implementing these strategies is provided on the next page. The balance of this chapter provides an overview of the analysis that led to the selection of these policies and a brief description of each. The next chapter reviews each policy in detail, providing assessments across five criteria, examples of how the policies have been implemented and suggestions on how to overcome likely implementation challenges.

State and Local Policies for Increasing the Availability of Affordable Homes

Expand the availability of sites for the development of affordable homes

1. Make *publicly owned land* available for affordable homes
2. Facilitate the reuse of *abandoned, vacant and tax-delinquent properties*
3. Expand the supply of homes through *rezonings*

Reduce red tape and other regulatory barriers to affordable homes

4. Ensure that zoning policies support a *diversity of housing types*
5. Adopt *expedited permitting and review* policies
6. *Revise impact fee structures*
7. Adopt *building codes that facilitate rehabilitation* of existing homes

Harness the power of strong housing markets

8. Utilize *tax increment financing* to fund affordable homes
9. Stimulate construction and rehabilitation through *tax abatements*
10. Create or expand *dedicated housing trust funds*
11. Establish *inclusionary zoning* requirements or incentives
12. Use *cross-subsidies* to support mixed-income communities

Generate additional capital for affordable homes

13. Expand use of the 4 percent Low-Income Housing Tax Credit
14. Provide pre-development and acquisition financing
15. Support housing bond issues
16. Ensure that housing finance agency reserves are used for affordable homes
17. Leverage employers' commitment to affordable homes for workers

Preserve and recycle resources for affordable homes

18. Preserve affordable rental homes
19. Recycle down payment assistance
20. Use shared equity mechanisms to create mixed-income communities

Empower residents to purchase and retain market-rate homes

21. Expand homeownership education and counseling
22. Help moderate-income homeowners avoid foreclosure and equity loss

Expand the availability of sites for the development of affordable homes

Why are homes more expensive in certain areas than others? There are a number of different ways to answer this question, but perhaps the most straightforward response is that home prices vary primarily because of variations in the cost of land. While construction costs do vary somewhat from area to area, these variations do not come close to explaining inter-area differences in home prices, nor do variations in the costs of materials. That leaves land costs as the primary driver of high home prices.

This response is a bit simplistic as it begs the question of *why* land costs vary so much from place to place. But even before one gets to that level of complexity, two important state and local policies stand out as direct responses to the problem of high land costs:

1. ***Make publicly owned land available for affordable homes.*** Identify publicly owned land that is either vacant or underutilized and facilitate the development or redevelopment of these properties for affordable homes.

2. ***Facilitate the reuse of abandoned, vacant and tax-delinquent properties.*** Acquire properties through foreclosure on tax liens, purchase or, where appropriate, eminent domain for reuse as affordable homes.

Why do land costs vary so much from area to area? Economists would (and do) say that housing prices are a factor of supply and demand. If there are no constraints on the supply of land for new development, an increase in the demand for housing should lead to an increase in the supply of housing so that, after an initial period of delay while the supply is being developed, the demand is met and housing prices stay fairly stable. In such an environment, land is relatively inexpensive as a fraction of overall home costs, with home prices primarily reflecting improvements to the land (i.e., the nature of the home built on the land) or other amenities, such as a desirable location. When there are constraints on the supply of sites for new development in an area of high demand, however, increases in demand cannot be met by new supply. Thus, land becomes more valuable as a commodity, driving up the price of homes.

There is strong evidence that local zoning and other land-use restrictions act as constraints on supply that drive up land costs and, thus, make homes significantly less affordable. For example, according to Glaeser and Gyourko,[6] home prices in 2000 were fairly close to or below construction

[6] Edward L. Glaeser and Joseph Gyourko. March 2002. The Impact of Zoning on Housing Affordability. Harvard Institute of Economic Research Discussion Paper Number 1948, Harvard University, http://post.economics.harvard.edu/hier/2002papers/HIER1948.pdf.

costs in most of the country. In those areas where home prices were much higher than construction costs, a home on a 15,000 square foot lot did not sell for much more than a home on a 10,000 square foot lot, suggesting that it wasn't land per se that was expensive, but rather the permission to build (i.e., zoning and permit approvals).[7]

This is not to say that zoning itself is a mistake, or that it does not confer certain benefits that help to offset the drawback of higher home prices. But it does mean that jurisdictions in which homes are priced out of reach of working families should strongly consider using their zoning and land-use controls as strategies for expanding the supply of developable sites and letting the market respond better to pent-up demand.

The third policy highlights the power of jurisdictions to use their zoning powers to increase the supply of developable sites:

3. ***Expand the supply of homes through rezonings.*** Many zoning maps were completed decades ago and are now outdated. By revising their zoning policies to make land available for residential development that is not currently zoned for that use, localities can increase the supply of land for development. Localities also can increase the supply of homes by increasing, in appropriate locations, the allowable densities within residential areas.

To contribute meaningfully to the supply of homes affordable to working families, these policies need to be implemented either on a broad enough scale to substantially increase the overall supply of homes – thus driving down prices for everyone – or in a manner designed specifically to lead to the production of additional affordable homes, such as through inclusionary zoning requirements or incentives.

Reduce red tape and other regulatory barriers to affordable homes

"We have met the enemy and it is us," asserted noted housing economist William C. Apgar, Jr., at a recent conference on high-cost housing markets.[8] By this he meant that a substantial factor driving up the price of housing is a variety of constraints on the supply of homes imposed by local

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[7] To buttress their conclusion that local land-use restrictions are driving up home prices by constraining the supply of developable land, Glaeser and Gyourko point to the lack of a correlation between higher housing prices and higher densities. According to economic theory, if there were no restrictions on supply imposed by government, owners who lived on valuable land would likely choose to subdivide their land and live on smaller lots. So, in areas where housing prices were higher, one would find higher densities. The fact that higher housing prices often co-exist with low densities suggests that there are significant artificial constraints on the supply of land imposed by zoning and other land-use controls.

[8] Presentation of William C. Apgar, Jr., on April 24, 2006, at the conference titled "Affordable for Whom?: Meeting Diverse Housing Needs in High-Cost Cities," sponsored by the New York City Housing and Preservation Department, the Federal Reserve Bank of New York and the Furman Center for Real Estate and Urban Policy.

governments in service of other objectives. While some of these objectives – such as environmental protection, preservation of green space and the separation of residential neighborhoods from industrial areas containing factories and manufacturing plants – are clearly legitimate governmental objectives, jurisdictions seldom consider the full impact of these regulations on the price of homes. Moreover, many regulatory obstacles to the development of homes serve no legitimate social interest and exist merely because of neglect or inertia.

In 1991, the official U.S. Advisory Commission on Regulatory Barriers to Affordable Housing estimated that regulatory constraints on the production of homes drive up home prices by as much as 35 percent.[9] A review of more than a dozen studies conducted since that time shows that all found significant negative impacts on home affordability due to a variety of regulatory constraints.[10]

The policies highlighted in this section all reflect ways that state and local governments can expand the supply of affordable homes by reducing regulatory constraints to new development or rehabilitation:

4. ***Ensure that zoning policies support a diversity of housing types.*** Multifamily homes, manufactured homes and accessory dwelling units are housing types that allow for the production of homes that can be less expensive than detached, single-family homes. By maximizing their availability, communities can both expand the supply of affordable homes and meet a wider range of their constituents' needs.

5. ***Adopt expedited permitting and review policies.*** In the development business, time is money. By providing for expedited permitting and review processes for developments that qualify as "affordable," communities not only can reduce the production costs of affordable homes, but also can provide an incentive for developers to produce them.

6. ***Revise impact fee structures.*** Many communities use impact fees to cover the estimated costs of expanding infrastructure and public services to meet the needs of newly added area residents. By moving from fixed impact fees, assigned on a per-unit basis, to fees that are proportionate to the size of a home, communities can enhance the affordability of modest-sized homes targeted to families with moderate incomes.

7. ***Adopt building codes that facilitate rehabilitation of existing homes.*** In many communities, older homes undergoing moderate levels of rehabilitation must also include additional renovations to bring them into compliance with current building standards. These requirements add significantly to the cost of rehabilitation and create a strong disincentive for

[9] U.S. Advisory Commission on Regulatory Barriers to Affordable Housing. 1991. *"Not In My Back Yard": Removing Barriers to Affordable Housing.*

[10] See Table 1 of U.S. Department of Housing and Urban Development. 2005. *Why Not in Our Community: Removing Barriers to Affordable Housing.*

updating existing structures. To remedy this problem, a growing number of communities have adopted special building codes designed to facilitate the moderate rehabilitation of existing structures while maintaining safety.

Harness the power of strong housing markets

Hot housing markets pose obvious problems for efforts to bring homes within reach of working families. With home prices rising faster than incomes, housing affordability challenges grow larger and larger.

The following policies turn the problem of strong housing markets on its head and use the power of strong markets to increase home affordability:

8. ***Utilize tax increment financing to fund affordable homes.*** Tax increment financing (TIF) is an increasingly popular approach to raise revenue for community redevelopment, including the production of affordable homes. This tool allows communities to pay for redevelopment projects, such as new roads, schools and homes, with the increased property tax revenues that these projects are expected to produce. To ensure that TIFs make a measurable contribution to the affordability of homes, the legislation authorizing the TIF should require that a minimum percentage of revenue be used for affordable homes.

9. ***Stimulate construction and rehabilitation through tax abatements.*** Tax abatements are similar to TIFs in that they involve the voluntary relinquishment of expected future tax revenue for a specified period of time in order to stimulate a public benefit. In the housing context, tax abatements most often are used as an incentive for the construction or rehabilitation of rental homes. Payments in lieu of taxes (PILOT) – essentially, partial tax abatements – serve a similar function.

10. ***Create or expand dedicated housing trust funds.*** Housing trust funds are flexible vehicles for financing affordable homes, ideally supported by a dedicated funding source, such as real estate transfer taxes or recording fees. Because of their flexibility, housing trust funds can be an invaluable tool for filling in the gaps in federal housing programs.

11. ***Establish inclusionary zoning requirements or incentives.*** Inclusionary zoning generally involves a requirement or an incentive for developers to include a modest percentage of affordable homes within newly created developments. While certain forms of inclusionary zoning can be controversial, when implemented appropriately it represents a promising approach for harnessing the power of the market to produce affordable homes.

12. ***Use cross-subsidies to support mixed-income communities.*** In strong housing markets, nonprofit or mission-driven for-profit developers can use profits from the sale or rental of market-rate homes to subsidize the costs of affordable homes. For example, some developers have used the profits from market-rate condominium units to subsidize for-sale condominium or rental units in the same development that are affordable to working families.

Generate additional capital for affordable homes

Imagine that the federal government developed a new housing program that provided a virtually unlimited supply of federal grants to subsidize the costs of rental homes affordable to moderate-income families. Some local match would be required to access federal funds under this new program, with the match higher for areas with higher home costs. The funds could be used either for new construction or rehabilitation. Eligibility would be limited to families with incomes below 60 percent of AMI.

Sound too good to be true in this era of fiscal austerity? Fortunately, the program already exists.

It's called the 4 percent Low-Income Housing Tax Credit. Long overshadowed by its more generous cousin, the standard 9 percent Low-Income Housing Tax Credit, the 4 percent tax credit program appears to be significantly underutilized relative to its potential. To avoid leaving federal dollars on the table, this analysis recommends that states:

13. ***Expand use of the 4 percent Low-Income Housing Tax Credit.*** Key steps include allocating additional private-activity bond cap authority to rental homes, developing a process for directing appropriate deals (particularly rehabilitation of existing structures) to 4 percent rather than 9 percent tax credits, and ensuring that sufficient locally controlled funds are available to make 4 percent tax credit deals work.

Low-Income Housing Tax Credits may only be used to serve families with incomes below 60 percent of AMI and, thus, help only a portion of the population that is the subject of this report. On the other hand, as families' incomes rise, it becomes easier to secure private-sector financing for the construction or rehabilitation of homes. Indeed, several of the individuals interviewed for this report noted the greatly expanded availability of private-market capital for all forms of housing investment, including affordable homes.

The wide availability of private-market capital suggests there is less need than there was in the past for state and local lending programs to provide capital for the construction of affordable homes. The principal exception appears to be in the area of pre-development and acquisition financing (and to some extent, more general working capital), where private financing is less widely available on

favorable terms, especially for smaller nonprofit organizations. (By contrast, this issue appears to be less acute for more sophisticated for-profit and nonprofit entities.) On a related note, loan guarantees or other forms of credit enhancement appear to be a useful technique for facilitating larger-scale community development transactions by nonprofits or mission-oriented for-profits.

14. ***Provide pre-development and acquisition financing.*** State and local lending programs to provide pre-development or acquisition financing and/or general working capital can be a useful tool for helping nonprofits to produce affordable homes. Loan guarantees or other credit enhancement techniques also appear to be useful for facilitating larger transactions that carry both high risks and high potential for reward.

While loans to finance the construction or rehabilitation of homes are widely available, grants are harder to come by, but are often necessary for producing homes affordable for working families. The next two policies are sources of funding for grants, or loans with very patient repayment terms that function like equity, for affordable homes:

15. ***Support housing bond issues***. While challenging to secure, general obligation bonds for affordable homes can provide an indispensable form of flexible funding to help bring homes within reach of working families.

16. ***Ensure that housing finance agency reserves are used for affordable homes***. In 2004, 13 state housing finance agencies reported that their fiscal reserves were tapped by the state for activities unrelated to the agencies' programs. States and localities should insist that housing finance agency reserves be used solely for purposes related to affordable homes, and work collaboratively with their housing finance agencies to determine whether some portion of the agencies' reserves or program revenues can support the jurisdictions' overall plans for increasing the availability of homes affordable to working families.

One final, emerging source of support and funding for affordable housing is employers:

17. ***Leverage employers' commitment to affordable homes for workers***. A growing number of employers in high-cost housing markets are worried that high home costs will threaten their ability to attract and retain qualified workers. There are a number of promising strategies for leveraging employers' commitment to produce more homes affordable to working families.

Preserve and recycle resources for affordable homes

Over the past decade, states and local governments have grown increasingly aware of the importance of preserving existing, affordable rental homes. The issue is most acute (and most widely recognized) for federally subsidized properties, whose owners have the option of opting out or prepaying their mortgages – both of which tend to result in the loss of affordable "hard" units in the markets where they're most needed. But the issue arises in the private market as well, where lower-cost homes are lost due to inadequate maintenance on the one end or substantial upgrading on the other. In general, preservation of existing, moderately priced homes – both formerly subsidized and unsubsidized – tends to be cost-effective.

18. ***Preserve affordable rental homes***. State and local governments should work to preserve both subsidized and unsubsidized rental homes affordable to working families. Preservation of unsubsidized but affordable rental homes is a particularly important policy in high-cost markets with a sizable stock of well-priced older rental homes.

The merits of preservation apply equally to state and local funding streams for affordable homes. To the extent that states and localities can recycle funds and/or ensure extended affordability periods, they can serve more people and, over time, make sizable dents in their affordable housing challenges. The following are two particularly important approaches:

19. ***Recycle down payment assistance***. A HUD study found that roughly half of down payment assistance programs funded with federal HOME funds provide assistance in the form of a grant or forgivable loan, while the other half utilize a deferred second mortgage in which the funds are required to be repaid – usually when the home is sold or refinanced. By recycling down payment funds, the latter approach allows jurisdictions to bring homeownership within reach of many more families.

20. ***Use shared equity mechanisms to create mixed-income communities***. In some communities, policy-makers have grown concerned that millions of dollars invested in fostering homeownership opportunities for first-time homebuyers may have provided only temporary relief because of the continuing rise in home prices. Homes that were once made affordable through large public subsidies or inclusionary zoning policies have become out of reach of working families upon resale. To address this problem, a growing number of states and localities have adopted "shared equity" approaches that balance asset accumulation by home purchasers with covenants that ensure ongoing affordability. In addition to preserving the value of public subsidies, these approaches are essential for helping to preserve a mix of homes affordable to families with varying incomes.

Empower residents to purchase and retain market-rate homes

As a group, the policies considered above have focused overwhelmingly on expanding the supply of homes, but there is also a "demand" side to the equation. To the extent that families have adequate incomes and credit to afford market-rate homes, the need for government intervention to provide affordable homes is greatly reduced. Demand-side solutions also have the advantage of improving families' lives in ways that go beyond affordable homes. For example, efforts to help families increase their incomes will help them better afford a range of goods, including child care, health care and retirement savings, as well as housing. Similarly, efforts to improve families' credits will lower their costs for car loans, car insurance and school loans, as well as homes.

By helping workers to expand their skills, workforce development strategies can help them obtain higher-paying jobs, putting them in a better position to afford market-rate homes. Most workforce development strategies, however, appear to be targeted at families with incomes below 30 to 50 percent of AMI, and thus fall outside the scope of this report.

Homeownership education and counseling, on the other hand, are valuable demand-side policies that are effective for families with both low and moderate incomes.

21. ***Expand homeownership education and counseling.*** These policies increase homeownership attainment and sustainability over time by helping families navigate the complicated homebuying process, improve their credit so they qualify for lower-cost private-market mortgages, prepare for the responsibilities of homeownership, and avoid predatory scams as well as more exotic financing that undermines homeownership stability.

Helping families to become homeowners is only half the battle, as many new and existing homeowners struggle to retain their homeownership status in the face of confusing mortgage products, rising interest rates and rising property taxes. Accordingly, the final high-impact policy considered in this report is to:

22. ***Help moderate-income homeowners avoid foreclosure and equity loss.*** Increasingly important complements to pre-purchase homeownership education and counseling are post-purchase counseling and foreclosure prevention programs that help moderate-income homeowners sustain their homeownership status over time. The recent spike in the use of exotic mortgage products, such as interest-only and payment-option mortgages, combined with a rise in interest rates and the slowdown in the homeownership market have greatly increased the risk of foreclosure and/or equity loss by homeowners and, thus, the importance of foreclosure prevention efforts. Homeownership sustainability is also advanced by helping low- and moderate-income families meet the challenge of rising property taxes during a time of rapidly increasing property values.

CHAPTER 3 –ANALYSIS OF HIGH-IMPACT POLICY SOLUTIONS

This chapter reviews each of the high-impact policies in detail, providing assessments across five criteria, examples of how they have been implemented and suggestions on how to overcome likely implementation challenges. The policies fall into six broad strategies, each of which describes an important role for state and local governments in addressing housing affordability challenges within their communities:

- Expand the availability of sites for the development of affordable homes
- Reduce red tape and other regulatory barriers to affordable homes
- Harness the power of strong housing markets
- Generate additional capital for affordable homes
- Preserve and recycle resources for affordable homes
- Empower residents to purchase and retain market-rate homes

Expand the availability of sites for the development of affordable homes

1. Make publicly owned land available for affordable homes

With a population of 26,401 per square mile in 2000, New York, N.Y., is the densest city in the United States.[11] So, if any city ought to have trouble finding land for affordable homes, it's New York City. Yet, despite its already high density, New York City is undergoing a development boom and recently announced plans to create and preserve 165,000 affordable homes over the next 10 years – one of the largest (if not the single largest) affordable housing plans in United States history.[12] Some 92,000 of these homes are proposed to come from new construction, with the balance coming through the preservation of existing affordable homes.

Where will the land come from? The answer to this question provides a number of lessons for other cities struggling to deal with high home costs. If one can find land for affordable homes in New York City, surely one can find it anywhere!

The first strategy highlighted in New York City's 10-year plan is the creative use of land controlled by state and local agencies. For example, the New York City Department of Housing Preservation and Development (HPD) is working with the city's school district to convert PS 109, an historic school in East Harlem, into affordable homes. The city is also working with the city agency in charge of hospitals to build housing for seniors at the former Sea View Hospital in Staten Island. Other sites HPD has identified for new affordable homes include underutilized land owned by the city's department of transportation (currently a surface parking lot), surplus land at the Kingsboro Psychiatric Hospital in Brooklyn, and surplus land owned by the New York City Housing Authority. The number of additional affordable homes to be built on these underutilized properties adds up; nearly 6,000 homes are planned for land owned by the New York City Housing Authority alone.

As this list reflects, New York City is not confining its attention solely to land controlled by agencies traditionally associated with affordable homes. To find land that could be used for affordable homes, HPD is working collaboratively with other city and state agencies to comprehensively examine the utilization of publicly controlled land. Where publicly controlled land is either vacant or underutilized (e.g., a surface parking lot or a low-rise structure in an area with mid-rise or high-rise buildings), the city plans to actively consider whether the land could be made available for the development of affordable homes or developed into a mixed-use property that could incorporate both affordable

[11] 2000 Census, as reported by Demographia at http://www.demographia.com/db-uscity98.htm. This statement is accurate for cities with a population of 100,000 or higher. The cities over 100,000 people with the next highest densities are: Patterson City, N.J. (17,674 people / sq mile), San Francisco, Calif. (16,633), Jersey City, N.J. (16,093) and Cambridge, Mass. (15,765).

[12] See *The New Housing Marketplace: Creating Housing for the Next Generation*. http://www.nyc.gov/html/hpd/downloads/pdf/10yearHMplan.pdf.

homes and the current use of the property (e.g., by incorporating a covered parking lot into a mid-rise structure).

New York City is not alone in making creative use of publicly controlled land. In 2004, the Greenbrier Heights development and community center in Woodinville, Wash., were completed on land that had been identified as surplus and made available for affordable homes by the King County government. Once slated to become a solid waste transfer station, the land is now the site of 170 affordable homes targeted to families with a range of incomes and includes a mix of rental properties and owner-occupied homes. The development is one of the first to be completed on land identified through an innovative King County ordinance (Ordinance 12394) that requires parcels deemed surplus by the county and suitable for homes to be sold or leased for affordable homes.[13]

Other examples include the use of vacant land in Camarillo, Calif., which was formerly part of the state mental hospital, to develop homes affordable to faculty and staff of California State University–Channel Islands; the adaptive reuse of South Rossville Elementary School in Rossville, Ga., for affordable homes for seniors; and the redevelopment of the former Stapleton airport site in Denver, Colo., into a mixed-use, sustainable, master-planned community with at least 10 percent of the homes affordable to working families.

To maximize the impact of this policy, communities may find it helpful to provide a formal structure to drive efforts to identify potential sites that could be used for affordable homes. The King County ordinance provides one example of such a structure – a generally applicable ordinance that applies to any surplus land that is suitable for residential development.

Another approach is to set up a task force to identify potential sites for affordable homes comprised of representatives from all the different agencies that own or control land. Effective task forces generally include representatives from such public agencies as school systems, hospitals, housing authorities, and police and fire departments. Depending on the local market, owners of large tracts of public land, including courts, prisons, railroads, the military and even airports, also can contribute to efforts to locate sites for the development of affordable homes. When implementing this solution, jurisdictions should seek to establish a fair and transparent public process to identify and make sites available for development that will include homes affordable to working families.

[13] For more information, see http://www.metrokc.gov/exec/news/2004/0517041.htm.

Assessment

While not without its challenges, this policy scores highly on most of the ranking criteria:

- **Ease of Financing/Cost-Effectiveness.** Moderate to High. Making underutilized publicly controlled land available for affordable homes carries little or no out-of-pocket expense for the government. It does mean giving up the potential revenue that could come from selling the land to the highest bidder, however. In some cases, it also may mean that the land is no longer available for the original intended use.

- **Magnitude of Potential Impact.** High. A surprising amount of land is controlled by public entities. A comprehensive interagency effort to identify underutilized land and make it available for affordable homes could likely have a major positive impact on the supply of homes for working families.

- **Replicability.** High. It is likely that most communities contain land controlled by city or state governments that could be utilized to produce more affordable homes.

- **Flexibility.** High. Once the land is made available for affordable homes, few restrictions apply.

- **Ease of Implementation.** Moderate. The challenges of getting multiple agencies to work together to make land available for affordable homes should not be underestimated. Certain agencies also are likely to be worried that land that is underutilized today may be needed tomorrow. And, of course, there always will be pressure to sell land to the highest bidder, but these challenges are all within the control of the public sector. So ultimately, it is a matter of political will. Where a city has the political will to expand the availability of affordable homes for working families, it ought to be able to overcome these obstacles.

2. Facilitate the reuse of abandoned, vacant and tax-delinquent properties

Whereas the first policy focuses on the reuse of land already controlled by state or local governments, this policy involves action by local government to acquire private land and make that land available for affordable homes.

The most common approach is to focus on tax-delinquent properties. There are two main reasons for this focus. First, the government has significant leverage over the disposition of these properties; second, these properties are often abandoned or contain vacant structures, which may present an obstacle to community development. By acquiring these properties through tax foreclosure and making the land available for development or redevelopment, communities not only can expand the availability of land for affordable homes, but also can contribute to community development as part of a comprehensive community revitalization plan.

In certain cases, communities have supplemented the tax foreclosure process with the purchase of land – either to assemble larger parcels for redevelopment or because they have largely exhausted the stock of properties made available through tax foreclosure. While the political climate surrounding eminent domain has become highly challenging since the U.S. Supreme Court decided *Kelo v. City of New London*, under appropriate circumstances, eminent domain can be another important complementary tool to facilitate the acquisition of properties necessary for comprehensive community revitalization.

It is important to recognize that there are many obstacles to the acquisition of tax-delinquent land. One cannot simply flick on a switch and make parcels available for affordable homes. Among other challenges are: complex, cumbersome and time-intensive tax foreclosure laws; multiple taxing jurisdictions that must agree to work together on the foreclosure process; laws specifying that properties acquired through tax foreclosure must be sold to the highest bidder; inadequate public funds to finance the redevelopment of acquired parcels; and often, lack of a clear plan for how to target the acquisition of parcels and utilize them as part of a larger community revitalization plan.

On the other hand, the rewards are great both for affordable homes and for community redevelopment more generally. The concentration of vacant, abandoned parcels in a community often is a major obstacle to private-market reinvestment and can be associated with higher crime rates. By acquiring these properties and putting them to good use as part of a larger community revitalization plan, communities can reduce crime, increase their tax base and expand the stock of decent, affordable homes.

An article by Paul C. Brophy and Jennifer S. Vey suggests 10 steps for redeveloping tax-delinquent and other vacant and abandoned properties:[14]

- "Know your Territory." At a minimum, map the location of tax-delinquent properties and, ideally, develop a more comprehensive map of land that is available or potentially available for redevelopment.

- "Develop a Citywide Approach to Redevelopment." Take a proactive approach to identifying the areas in which redevelopment is likely to be most effective, develop neighborhood-level plans for using the acquired land, take an aggressive approach to acquiring land in service of the plans, and work to build political consensus around their implementation.

- "Implement Neighborhood Plans in Partnerships with Community Stakeholders." Local governments cannot implement community revitalization plans all by themselves. Active involvement of the community and neighborhood organizations, as well as the private sector, is essential.

- "Make Government More Effective." Successful implementation requires government to effectively coordinate a large, complicated effort, both within various units of local government and in partnership with the nonprofit and private sectors.

- "Create a Legal Framework for Sound Redevelopment." Many communities will need to reform their property tax foreclosure laws, either at the city or state levels, to make them work more efficiently. Other communities may want to examine how they can use eminent domain more effectively, on a limited basis, to supplement the foreclosure process. A number of states have created "land banks" to facilitate the acquisition and redevelopment processes at the state and local levels. (See below for more information.)

- "Create Marketable Opportunities." To facilitate redevelopment, communities will want to consider clustering parcels into larger, more marketable sites; clearing away existing structures; upgrading existing infrastructure; and, where necessary, remediating environmental hazards

- "Finance Redevelopment." Among other strategies for financing the costs of making the land available and marketable, the authors recommend tax increment financing, tax incentive programs, and private-activity and general obligation bonds.

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[14] Paul C. Brophy and Jennifer S. Vey. 2002. Seizing City Assets: Ten Steps to Urban Land Reform. Washington, D.C.: The Brookings Institution. http://www.brookings.edu/es/urban/publications/brophyveyvacantsteps.pdf. The full article contains examples to illustrate each of the 10 steps.

- "Build on Natural and Historic Assets." Anchoring redevelopment around historic structures or such natural assets as a river or a park can increase the likelihood of success.

- "Be Sensitive to Gentrification and Redevelopment Issues." By increasing the utility and value of underutilized land, community revitalization will necessarily lead to higher property values, which will likely increase the value of nearby land and thus drive up the cost of homes for existing residents. Communities can mitigate this concern by including a strong affordable homes component in the revitalization plan and by working closely with community stakeholders in an open, transparent process.

- "Organize for Success." To be successful, these efforts will require leadership, collaboration and effective organization.

One particularly successful approach that communities have used to reclaim multiple land parcels is the establishment of a "land bank" to manage the planning, acquisition, disposition and financing process. A land bank is an institution chartered by state law to convert vacant, abandoned or tax-delinquent properties into productive use. Among other advantages, land banks can help resolve any confusion regarding ownership of properties, which can make it difficult to market the properties with clear title. Land banks also can provide a powerful framework for comprehensive community redevelopment by empowering a single entity to not only reclaim vacant and abandoned land, but also integrate that land into an overall plan for redevelopment in the community.

Whether communities choose to create a formal land bank or pursue tax foreclosures without one, many have found it useful to seek state legislation that streamlines the process for foreclosing on tax liens and ensures a reasonable share of tax-foreclosed properties remain reserved for affordable homes.

Examples

Flint, Mich. Through a combination of tax foreclosure reforms, the Michigan Land Bank Fast Track Act and amendments to the Brownfield Redevelopment Financing Act, the Genesee County Land Bank obtained broad and flexible authority to acquire, manage, clear, demolish, rehabilitate and develop tax-foreclosed land. Using these powers, the land bank acquired 3,400 parcels, cleaned thousands of empty lots and demolished hundreds of abandoned homes in just three years. The land bank has helped to preserve or develop affordable homes by, among other things, transferring at least 130 foreclosed, tenant-occupied properties to nonprofit housing organizations and assembling hundreds of empty lots for city development projects, as well as local nonprofit and community organization projects. One example of an affordable development built on land made available through the land bank is the Flint Gateway Initiative, in which Mission of Peace Community Development Corporation, a faith-based, nonprofit organization, sponsored the construction of eight new affordable homes.

Other examples include land banks established in St. Louis, Mo.; Cleveland, Ohio; Louisville, Ky.; and Atlanta, Ga. New York, N.Y., generated an inventory of more than 100,000 tax-delinquent and abandoned homes that served for many years as the cornerstone of a successful strategy for increasing the availability of affordable homes and revitalizing neighborhoods citywide.

Resources

While the process of reclaiming vacant, abandoned and tax-delinquent properties is a complex one, there are a number of excellent roadmaps to follow that build on a substantial amount of experience by other communities. Resources include:

- The National Vacant Properties Campaign (www.vacantproperties.org) – a joint project of Smart Growth America (SGA), Local Initiatives Support Corporation (LISC) and the Metropolitan Institute at Virginia Tech.

- Alexander, Frank S. 2005. *Land Bank Authorities: A Guide for the Creation and Operation of Local Land Banks*. New York, N.Y.: Local Initiatives Support Corporation. http://www.lisc.org/files/793_file_asset_upload_file465_7818.pdf.

- Mallach, Alan. 2005. *Bringing Buildings Back: From Abandoned Properties to Community Assets*. New Jersey: National Housing Institute and Rutgers University Press. The book may be ordered from Rutgers University Press. Summaries of various portions of the book are available at http://www.vacantproperties.org/resources/partner.html.

Assessment

- **Ease of Financing/Cost-Effectiveness.** High up-front costs, but more moderate on an ongoing basis. The initial costs of developing an effective system for reclaiming tax-delinquent properties are likely to be high, but once the system is established, out-of-pocket costs should decline significantly. The costs of any land purchases will vary significantly from community to community. The use of eminent domain is likely to carry significant legal and political costs.

- **Magnitude of Potential Impact.** High, particularly in "weak market" cities and in distressed neighborhoods within stronger markets. Cities that do not enforce their tax liens, or with cumbersome legal processes for releasing tax liens, may have large numbers of tax-delinquent properties even if their housing markets are otherwise strong.

- **Replicability.** Moderate. While the specific obstacles to be addressed will vary significantly from state to state, and to some extent from community to community within a state, this approach can be utilized in most markets.

- **Flexibility.** Moderate. There are no federal limits on who may benefit from the reclaimed land. Some state or local governments may have imposed limits, but these may be changed through the legislative process.

- **Ease of Implementation.** Low to Moderate. Many of the challenges are discussed in the policy description.

3. Expand the supply of homes through rezonings

Most communities in the United States have some form of zoning that specifies the allowable uses of land within the jurisdiction. Zoning policies generally divide land into areas in which residential development is or is not permitted. Within the land zoned for residential use, there are typically multiple classifications corresponding to various levels of density – R1, for example, corresponds to low-density single-family homes; R2 corresponds to somewhat denser single-family homes (i.e. detached homes); R3 corresponds to multifamily homes, etc. Some zoning maps include "overlay districts" or "overlay zones" that specify different standards for specific neighborhoods.

While some communities revisit their zoning maps on a regular basis, other communities have not revisited them in a comprehensive way in many years. As a result, some zoning maps have not kept pace with changes in the resident demographics or commuting patterns, or with the actual uses of land zoned for industrial or business use. Even when the zoning maps are not outdated per se, they may be functioning as a constraint on the availability of land for residential development – for example, by not making enough land available for development or by specifying too low a density – that may be contributing to high home costs.

To address this issue, some communities are comprehensively examining their zoning policies to determine if there is land that could be made available for residential use or land where allowable densities could be increased. One approach is to identify land that is currently zoned for industrial or business use that is not being fully or effectively utilized and could be rezoned for residential use. Another complementary approach is to identify land that is currently zoned for low-density use (e.g., single-family homes) where higher densities (e.g., attached or multifamily homes) might be appropriate. Higher densities can also be achieved by reducing minimum lot sizes, set-backs and/or street widths. By spreading out land costs over a greater number of units, increases in density can reduce the total cost of producing a unit, a cost reduction that can, with the appropriate companion policies (see below), be captured to increase home affordability.

For example, Fairfax County, Va., recently approved a plan to rezone an area near the Vienna Metro transit stop to substantially increase densities. By combining an older low-density subdivision that contained approximately 65 single-family homes with five acres that had previously been used for surface parking, the MetroWest redevelopment plan will provide approximately 2,250 condominiums, apartments and townhouses; up to 300,000 square feet of office space; and up to 190,000 square feet of retail space. As reported in the *Washington Post*: "The inescapable and inevitable fact is that we will continue to grow,' said William Lecos, president of the Fairfax County Chamber of Commerce. 'But the county must grow differently than it has… [MetroWest is] the right project in the right place at the right time, built to the right scale.'"[15]

[15] Lisa Rein. 2006. MetroWest Development is Approved in Fairfax, *Washington Post*, March 28, 2006.

During negotiations over the proposed MetroWest development with the developer, Pulte Homes, Fairfax County secured a promise that approximately 5 percent of the homes would be affordable – almost double the number required under current Fairfax County requirements for developments of this density. The County's Board of Supervisors commissioned a special panel to develop policy proposals for increasing the proportion of affordable homes in future such developments.

New York, N.Y., took a similar approach in the comprehensive rezoning of Greenpoint-Williamsburg in May 2005. As described by the city, the rezoning "sets the stage for the renewal of a vacant and underutilized stretch of the Brooklyn waterfront... It reclaims two miles of long-neglected East River waterfront to create over 50 acres of open space, including a continuous public esplanade and a new 28-acre park surrounding the Bushwick Inlet. The plan creates new opportunities for thousands of units of much-needed housing, including affordable housing, within a detailed urban design plan that addresses the scale of the existing neighborhoods."[16] The zoning plan includes a voluntary inclusionary housing program that provides a density bonus and tax abatements to developers who agree to certain affordability restrictions. Initial reports show a strong take-up of these incentives.[17]

In Massachusetts, the state has enacted legislation to create incentives for rezonings tied to both smart growth and affordable housing objectives. Under Chapter 40R, municipalities may apply to the state for approval of special overlay districts that provide for "as-of-right" development (i.e., without the need to apply for special approval) at higher densities in infill locations or around transit hubs that include at least 20 percent affordable homes.[18] Once the districts are approved, the municipalities receive financial bonuses, with a second round of bonuses provided once building permits are issued. While it is still too early to know how successful the law will be – it was only enacted in July 2004, with regulations issued in March 2005 – as of September 2006, five municipalities had received approval for overlay zones under Chapter 40R and approximately another 10 had initiated the process of applying for approval.[19]

As the above discussion shows, rezonings are often combined with inclusionary zoning or other policies designed to ensure that a portion of the additional homes made available through rezonings are affordable. Without commenting here on the appropriate form of the tie-in to affordable homes – which is discussed in greater detail below under policy 11 – this appears to be a prudent strategy.

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[16] New York City Department of Housing Preservation and Development. September 2005. *Greenpoint-Williamsburg Inclusionary Housing Program*, http://www.nyc.gov/html/dcp/pdf/greenpointwill/incl_housing_web.pdf.

[17] According to Mayor Bloomberg's June 26, 2006 press release. "The plan will spur 10,800 new units of much-needed housing, and through a powerful combination of zoning incentives, housing programs, and city-owned land, 3,500 of those units will be affordable. One year after the rezoning was enacted there are already 1,000 affordable units in the pipeline for near-term construction on the waterfront alone. That's 64 percent of the rezoning estimate of 1,563 affordable units on the waterfront." Available on the Internet at the Mayor's Web site, http://www.nyc.gov/portal/site/nycgov.

[18] For a preliminary analysis of Chapter 40R, see http://www.tbf.org/tbfgen1.asp?id=3134. See also Robert Fishman and Beth Mitchell. 2005. Op Ed, *American College of Real Estate Lawyers Newsletter*, August 2005. Available on the Internet at: http://www.nutter.com/publications_events.php?section=7&MediaID=34.

[19] Research by the Commonwealth Housing Task Force. Summarized at: http://www.tbf.org/uploadedFiles/060929%2040R%20Communities%20Map(1).pdf.

The issue arises because of concerns about the scale at which one needs to increase supply to affect prices significantly without an explicit requirement or incentive for affordable homes. While it's possible that rezonings will in and of themselves increase supply to such an extent that home prices will decline, it appears likely that the increase in supply needs to be very substantial for this effect to be felt in the marketplace. Merely granting a variance to allow a specific building in an area with high housing demand to increase its density is likely to lead to a few additional high-end homes without any significant supply effect that could lower prices across the board. Similarly, a more general rezoning that only modestly impacts the supply of homes will be unlikely to significantly increase housing affordability.

So that leaves two main choices – enact rezonings on such a scale as to substantially increase the supply of homes in the market, or tie rezonings of a more modest nature to requirements or incentives for affordable homes.

Assessment

- **Ease of Financing/Cost-Effectiveness.** High. Rezonings require little or no out-of-pocket outlays and, in fact, may lead to increases in the tax base. As is the case anytime the population is increased, however, the demand for city services also may increase.

- **Magnitude of Potential Impact.** Depends on how the policy is implemented. When the increased supply of homes made available through rezonings is specifically tied to affordable home incentives or requirements, the impact on home affordability is likely to be high. When rezonings are adopted without this explicit tie-in to affordable homes, their impact on affordability is likely to be tied to the scale at which they impact supply. In theory, substantial increases in supply can increase affordability without an explicit affordable homes component. However, no one is sure exactly what the threshold is for such an impact.

- **Replicability.** High.

- **Flexibility.** High. Can, and indeed must, be tailored to fit local needs.

- **Ease of Implementation.** The principal obstacle is likely to be community opposition to affordable homes and/or increases in density.

Reduce red tape and other regulatory barriers to affordable homes

4. Ensure that zoning policies support a diversity of housing types

In a healthy housing market, families have a range of housing choices suitable to their preferences and budget. Some families may prefer larger, single-family homes, while others may prefer the convenience of apartment living, the lower cost of a high-quality manufactured home or the ability to house an aging relative in (or lower costs by renting out) an accessory dwelling unit (i.e., a smaller home built next to or as a part of a principal home). By ensuring that these and other housing preferences can be met within close proximity to job centers or public transportation hubs, communities not only can help to meet their citizens' preferences but also can make homes more affordable. Multifamily homes, accessory dwelling units and manufactured homes can all be used to produce homes at lower final costs than standard, detached single-family homes because of an ability to put more units on a designated lot, lower construction costs or both.

Unfortunately, many communities have chosen to prohibit the use of these housing types or to erect such onerous obstacles as to effectively prohibit them:

- *Multifamily homes.* Some jurisdictions, for example, have outright bans on the construction of new multifamily homes. Others impose parking requirements that are significantly out of proportion with the actual parking needs and either make the development infeasible or raise costs to such an extent that the developments can only serve a high-end clientele.

- *Accessory dwelling units* – smaller homes attached to existing single-family houses that can be used to house an aging relative or rented out to lower a family's housing costs – are also frequently prohibited despite the fact that such units can contribute significantly to the supply of homes in a community.

- *Manufactured homes.* While the quality and appearance of manufactured homes – houses built in a factory to rigorous federal building standards – have continued to increase, many communities prohibit their use. This is unfortunate, as high-quality manufactured homes cost significantly less to construct and can blend well into a neighborhood.

By comprehensively examining their zoning, building codes and permitting policies to ensure maximal availability of these housing types, communities can significantly expand the supply of homes affordable to working families.

Much of the opposition to multifamily homes comes from a series of assumptions about the purported negative impact on communities of multifamily homes and, more generally, density. Many of these assumptions are flawed, however. A good overview of these assumptions and the countervailing data is provided in *Creating Successful Communities: A New Housing Paradigm* by the National Multi Housing Council and National Apartment Association.[20]

Examples

Cambridge, Mass. Auburn Court is an attractive mixed-income development that provides 137 homes in a multifamily setting spread along three residential blocks of garden courtyards. Established as part of the larger University Park development on land assembled by the Massachusetts Institute of Technology, Auburn Court consists of a mix of one-, two- and three-bedroom homes, flats and duplexes. Most buildings in the development are three stories, but several rise up to six stories to frame the entrance to University Park.

Other examples include Oakland Community Housing, Inc., in Oakland, Calif., which is using manufactured homes to provide affordable homes for working families in an infill setting, and Santa Rosa, Calif., and Mercer Island, Wash., which use accessory dwelling units to expand the supply of affordable homes.[21]

In December 2006, *The New York Times* published a thoughtful article documenting the increased interest in accessory dwelling units as a strategy for producing affordable homes.[22] Among other examples, the *Times* article cited recent changes to the zoning rules in Montgomery, N.Y., to facilitate the conversion of barns and outbuildings into rental homes, and the installation of apartments within larger homes. The article also quoted a town board member in East Hampton, N.Y., as saying that the process for obtaining approval for an accessory dwelling unit was so complicated that no one had applied to do so – a problem the town is seeking to fix by streamlining the process.

[20] http://www.nmhc.org/Content/ServeFile.cfm?FileID=2501. *See also* Richard M. Haughey. 2005. *Higher-Density Development: Myth and Fact.* Washington, D.C.: ULI–the Urban Land Institute, http://www.nmhc.org/Content/ServeFile.cfm?FileID=4647.

[21] For more information, see http://www.ochi.org/communities/recent.htm, http://www.transcoalition.org/ia/acssdwel/01.html and http://www.growsmartmaine.org/docs/Affordable-Housing.pdf.

[22] Janny Scott. 2006. The Apartment Atop the Garage Is Back in Vogue. *The New York Times*, Dec. 2, 2006.

Assessment

- **Ease of Financing/Cost-Effectiveness.** High. Revising local policies to make these housing types more available requires little or no out-of-pocket outlays and, in fact, may lead to increases in the tax base. As is the case anytime the population is increased, however, the demand for city services also may increase.

- **Magnitude of Potential Impact.** High, if implemented comprehensively.

- **Replicability.** High.

- **Flexibility.** High. Can be customized down to the block level, if jurisdictions wish.

- **Ease of Implementation.** The principal obstacle is likely to be community opposition to affordable homes and/or increases in density.

5. Adopt expedited permitting and review policies

Developers often say that time is money. The longer it takes to secure approvals and complete a development, the longer their capital is tied up and unable to be used elsewhere, and the higher their soft costs for legal and other related services.

Researchers agree. Glaeser and Gyourko,[23] for example, found a strong correlation between the cost of homes and the length of the permitting process. They compared home prices in 45 central cities to the average length of time between an application for rezoning and the issuance of a building permit for a modest-size, single-family subdivision of less than 50 units. Based on survey data, the permit issuance lag was assigned a value from "one to five with a value of one indicating the permit issuance lag is less than three months, a value of two indicating the time frame is between three and six months, a value of three indicating a seven- to 12-month lag, a value of four meaning the lag is between one and two years, and a five signaling a very long lag of over two years." Analyzing the data, they found that "increasing a single category in terms of permit issuance lag was associated with a nearly $7 per square foot increase in the implicit zoning tax," (i.e., the increased cost of homes due to regulation).

The more that jurisdictions can streamline their zoning and permitting approvals processes, the more costs can be shaved from the processes, reducing the costs of new construction. Among other strategies to consider for achieving this objective are:

- Streamlining time-consuming elements of the approvals process, for example, by allowing a single environmental impact statement for a neighborhood to be used to satisfy the environmental requirements associated with new development, rather than individual site-by-site assessments.

- Revising zoning rules to minimize the need for individual variances. The more flexibility property owners have to build "as of right" – without having to get a variance – the faster and less expensive the development process will be. Through careful planning, communities can set thoughtful development rules ahead of time that speed up the development process without compromising quality of life objectives.

- Shortening the length of time provided for approving or rejecting proposals for zoning variances or building permits. One way to accelerate the process is to deem proposals automatically approved if not acted upon within a certain amount of time.

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[23] Edward L. Glaeser and Joseph Gyourko. March 2002. The Impact of Zoning on Housing Affordability. Harvard Institute of Economic Research Discussion Paper Number 1948, Harvard University, http://post.economics.harvard.edu/hier/2002papers/HIER1948.pdf.

- Providing for expedited and/or reduced cost permitting and review policies for affordable homes.

- Developers also indicate that costs could be reduced by ensuring that more consistent standards are used in all aspects of the approvals process – especially in securing building permits. In many communities, additional training for and review of building inspectors is needed to ensure that standards are consistently applied. When the standards are clear and consistently applied, builders are more likely to get it right the first time, reducing development time and costs.

Examples

Austin, Tex. Austin's S.M.A.R.T. Housing Initiative is an innovative self-funded program that uses expedited reviews and fee waivers to stimulate the production of affordable homes in neighborhoods within the city limits. Residences built under this program are intended to be safe, mixed-income, accessible, reasonably priced and transit-oriented (thus the S.M.A.R.T. acronym), and also must meet Austin's "green" building standards. Eligible projects include single-lot and infill development as well as new subdivisions. Developers of projects meeting S.M.A.R.T. Housing certification standards receive an expedited review that averages about half the time of conventional projects. They also may receive waivers of the city's capital recovery fee, development review and inspection fee, and certain construction inspection fees. Typical cost savings for homes produced under the S.M.A.R.T. Housing Initiative are $600 per unit of multifamily homes and $2,000 per single-family home from fee waivers, as well as reduced carrying costs from the expedited review process.

Massachusetts. Another example is Chapter 40B in Massachusetts, which is a state statute that streamlines the approval of developments that include affordable homes. Under the statute, special expedited and flexible permitting rules apply to developments where at least 20 to 25 percent of the units include long-term affordability restrictions. Under the rules, local Zoning Boards of Appeal are empowered to grant comprehensive permits for qualifying developments, which typically results in a more streamlined approvals process. When a request for a comprehensive permit is denied and fewer than 10 percent of the homes in the community in which a proposed development are affordable to low- or moderate-income families, a developer may apply to the State Housing Appeals Committee, which may overrule the local decision. According to the Citizens' Housing and Planning Association, as of January 2006, some 43,000 units in 736 developments had been created under Chapter 40B statewide since the early 1970s.[24]

[24] Citizens' Housing and Planning Association. 2006. *Fact Sheet on Chapter 40B: The State's Affordable Housing Zoning Law*, http://www.chapa.org/40b_fact.html.

Assessment

- **Ease of Financing/Cost-Effectiveness.** Moderate to High. Shortening approvals processes involves little out-of-pocket expenses. Reducing permitting fees for affordable homes has a cost, but it is likely to be modest in light of the benefits of more affordable homes.

- **Magnitude of Potential Impact.** If adopted comprehensively, the impact may be high. If adopted on a smaller, piece-meal basis, the impact will likely be more modest.

- **Replicability.** High. These problems exist in most communities.

- **Flexibility.** High.

- **Ease of Implementation.** Moderate. Challenges include local opposition to affordable (and any) new development and coordination of multiple agencies.

6. Revise impact fee structures

Impact fees are one-time expenses charged to developers of newly developed homes that generally get passed on to purchasers in the form of higher home prices. Impact fees can be an important source of revenue for local jurisdictions to cover costs associated with new development, such an expansion of water and sewer systems, parks and other public services. In some states, impact fees are also authorized to pay for school construction.[25]

When impact fees are levied on a per-unit basis – as is often the case – they drive up the price of a modest home on a much greater proportionate basis than of a larger home. For example, a $15,000 impact fee charged on a $120,000 home will increase the cost by 12.5 percent. That same fee levied on a $650,000 home will increase the home price by only 2.3 percent, despite the fact that the family purchasing the $650,000 home is likely to be much better positioned to afford the increased costs.

Impact fees assessed on a flat, per-unit basis also tend to be disproportionate to families' actual usage of services. Smaller homes tend to have fewer residents than larger homes. As a result, families living in smaller homes tend to use less water and sewer, travel fewer vehicle miles and utilize less of other public services than larger homes.[26]

To address this problem, a number of communities have adopted different approaches to setting impact fees that more equitably distribute the costs of providing infrastructure to support new development. One promising approach is to utilize proportional impact fees that base the impact fee on the square footage of a home. This approach increases the affordability of homes for working families by reducing the impact fees charged on smaller homes. Another approach is to provide families with incomes below a specified level with a subsidy to help them pay for some of the costs associated with the impact fees. In Alachua County, Fla., the subsidy is provided in the form of a second mortgage that is forgiven if families remain in their homes for five years or more.

Other communities waive impact fees entirely for homes targeted to families within a certain income bracket, or vary the amount of the impact fees within a jurisdiction based on the level of public services already available in that particular location. The latter approach can result in substantially lower fees in certain areas — such as infill areas — and facilitate the development of homes affordable to working families.

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[25] For references to articles that discuss the use of impact fees to fund school construction, see http://www.edfacilities.org/rl/impact_fees.cfm.

[26] For more information, see U.S. Department of Housing and Urban Development. April 2006. *Impact Fees and Housing Affordability: A Guidebook for Practitioners*, Draft. Prepared by Newport Partners, LLC.

HUD is in the process of completing a comprehensive guide to impact fees that explores these and other alternatives to traditional, unit-based impact fees.

Examples

Alachua County, Fla. Based on a careful assessment of the county's need for affordable homes, as well as the expected infrastructure costs associated with new development, Alachua County adopted an impact fee schedule that sets impact fees for residential development based on square footage, rather than on the type of dwelling (i.e., single-family detached, townhouse, apartment, etc.). As a result, smaller homes tend to be charged lower impact fees, making them more affordable. The county also has allocated funds for forgivable second mortgages to cover the costs of impact fees for households with incomes less than 80 percent of AMI when buyers purchase a home below a specified price.[27]

Other examples include Albuquerque, N.M.; Lincoln, Neb.; and Martin County, Fla., which waive impact fees for households below a certain income level. Phoenix, Ariz., varies the size of impact fees by area based on the level of existing services and, in some areas, waives most fees.

Assessment

- **Ease of Financing/Cost-Effectiveness.** Moderate to High. Developing an alternative impact fee system to generate approximately the same amount of revenue as the current system will have little or no impact on revenues. Revising the system to reduce fees on smaller or less expensive homes, without an overhaul of the entire system, could have a significant cost, though it may be less than alternative approaches.

- **Magnitude of Potential Impact.** Moderate to High. According to HUD,[28] impact fees exceed $10,000 per unit in many communities, with some communities in California reporting fees of $45,000 per unit or higher. Reducing these fees for smaller homes can significantly reduce the costs of homes affordable to working families.

- **Replicability.** High. The potential to reform impact fee policies exists in many communities.

- **Flexibility.** Moderate to High. There are generally state limits on impact fees, but they should not stand in the way of approaches, such as proportionate impact fees, that more closely tie fees to estimated infrastructure costs associated with new homes.

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[27] Ibid.

[28] U.S. Department of Housing and Urban Development. 2005. *Why Not in Our Community: Removing Barriers to Affordable Housing.*

- **Ease of Implementation.** If accomplished through an open, transparent and data-rich process, the implementation challenges should be manageable.

7. Adopt building codes that facilitate rehabilitation of existing homes

In many communities, older homes undergoing moderate levels of rehabilitation also must include additional renovations to bring them into compliance with current building standards. These requirements add significantly to the cost of rehabilitation and create a strong disincentive for updating existing structures. Due to the costs involved, these older homes, which are likely to be more affordable than newer homes, often fall into disrepair instead of being rehabilitated. As a result, these homes cease to offer quality housing opportunities or end up being demolished and replaced by larger and more expensive homes that are out of reach of working families.

To remedy this problem, a growing number of communities have adopted special building codes designed to facilitate the moderate rehabilitation of existing structures, while maintaining safety. These alternative building codes tailor the level of regulation to the scope of rehabilitation, so more extensive rehabilitation requires stricter compliance with modern building codes, while less extensive rehabilitation triggers only those modern codes that are associated with ensuring residents' safety.

While some states, such as New Jersey, Maryland and North Carolina, have developed their own rehabilitation codes, other communities have adopted the International Existing Building Code (IEBC) – a model rehabilitation code issued by the International Code Council (ICC) in 2003. In general, many municipalities are not well positioned to conduct individualized assessments of the costs and benefits of particular building code elements, and thus would be well advised to adopt the most recent version of one of the model building codes, such as that provided by the ICC. In this regard, it is important to note that a jurisdiction does not automatically adopt the IEBC rehabilitation code when it adopts one of the ICC's other I-Codes. It must be adopted separately.[29]

In addition to adopting special rehabilitation codes, many communities have successfully encouraged the rehabilitation of older structures by adopting a more facilitative approach to building code enforcement. In these communities, building inspectors work with owners and developers to implement safe, reasonable solutions that make the projects feasible. This flexible, accommodating approach is designed to achieve the community goals of safety and ongoing affordability, rather than penalizing building owners for noncompliance.

Examples

New Jersey. In 1997, New Jersey adopted a new building subcode designed to facilitate rehabilitation of older homes. The new rules provide a sliding scale for determining when buildings must be updated to current building codes. The more extensive the rehabilitation in terms of structural, mechanical, electrical, plumbing or fire protection work, the greater the requirements to

[29] To find out whether the IEBC has been adopted on a statewide basis in a particular state, or by various local jurisdictions within the state, visit: http://www.iccsafe.org/government/stateadoptions.pdf.

update to current building codes. The cost savings have been significant. For example, the new subcode reduced the costs of rehabilitating the Bramhall Avenue Apartments in Jersey City by $1 million. The new subcode also appears to have led to a significant increase in the number of small rehabilitation projects being undertaken.[30]

Other examples include the state codes in Maryland and North Carolina, and the International Existing Building Code issued in 2003. Other rehabilitation codes and guidelines that have similar objectives include the Nationally Applicable Recommended Rehabilitation Provisions and parallel provisions in the building code of the National Fire Protection Association.[31]

Assessment

- **Ease of Financing/Cost-Effectiveness.** High. The adoption of new building codes carries little out-of-pocket costs other than training for building inspectors. A facilitative approach to code enforcement may lead to a modest reduction in fines associated with building code violations, but is likely to more than pay for itself over time through the facilitation of redevelopment that adds to the tax base.

- **Magnitude of Potential Impact.** Moderate. Early studies suggest the principal impact is to increase the number of smaller rehabilitation projects being undertaken.

- **Replicability.** This policy is easily replicated in different jurisdictions, but the problem does not exist everywhere. According to Mattera,[32] 13 states have already adopted the IEBC on a statewide basis and the code has been adopted by certain localities in another 13 states.

- **Flexibility.** High. States can modify the codes, as can localities in states that permit local variation. However, this is one area in which states and localities should think twice about varying from the national standards. Greater uniformity in building codes from area to area can lower barriers to entry of new builders, reducing costs.

- **Ease of Implementation.** High. Now that the ICC has adopted the IEBC, the code really seems to be catching on.

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[30] Raymond Burby, David Salvesen and Michael Creed. 2006. "Encouraging Residential Rehabilitation with Building Codes: New Jersey's Experience." *Journal of the American Planning Association* 72:2.

[31] For more information on rehabilitation codes, see Mattera 2006 and U.S. Department of Housing and Urban Development. *Smart Codes in Your Community: A Guide to Building Rehabilitation Codes.* http://www.huduser.org/Publications/pdf/smartcodes.pdf.

[32] Philip Mattera. 2006. *Breaking the Codes: How State and Local Governments are Reforming Building Codes to Encourage Rehabilitation of Existing Structures*. Washington, D.C.: Good Jobs First, http://www.goodjobsfirst.org/pdf/breaking%20the%20codes.pdf.

Harness the power of strong housing markets

8. Utilize tax increment financing to fund affordable homes

Tax increment financing (TIF) is a tool used by municipal governments to stimulate economic development. Authorized in 49 states and the District of Columbia, tax increment financing allows communities to capture future tax revenue increases resulting from public investment in a targeted geographical area. When a TIF is designated, a "base" amount of tax revenue is projected based on the status quo before improvements. If the public investments in the TIF district – such as new roads, water and sewers, and other public amenities – are successful in stimulating redevelopment, property values rise, leading to an increase in actual property tax receipts above the base. (In some states, sales taxes can also be TIFed.) The increase in tax revenue above the base (i.e., the increment) is captured by the TIF district as revenue, which is used to reimburse the community (or a partner developer) for the cost of the initial and subsequent improvements. Alternatively, municipalities can issue bonds, backed by the expected TIF revenue, in which case the TIF proceeds are used to pay back the bonds.

TIFs are popular because they provide a source of financing for capital improvements that does not require an increase in sales or property taxes. Moreover, once the TIF district expires, the municipality will receive the full benefit of the property taxes on a much higher property tax base than would otherwise have been present without the investments.

TIF funds can be, and have been, used to finance affordable homes. As one might expect, however, there tends to be great competition for the limited supply of TIF funds once they are generated. To the extent a community wants to use TIF funds for affordable homes, it is thus critical to require, as a condition for approving the TIF, that a minimum amount of TIF revenue be used for affordable homes. In California, for example, state law requires that at least 20 percent of any TIF revenue generated in a new Urban Renewal Area be applied to affordable homes. Some other states – such as Maine and Minnesota – allow for the creation of special housing TIFs, in which tax increment revenues are set aside for affordable homes.

There are a number of justifications for setting aside a portion of TIF revenues for affordable homes. First, there is a growing body of evidence that concentrated housing investments can contribute to economic revitalization. For example, in Richmond, Va., the city chose to concentrate its community investment in seven specific communities as part of its Neighborhoods in Bloom initiative. "In each neighborhood, increased police patrols were followed by aggressive code enforcement, setting the stage for block-by-block rebuilding, including existing owner improvements, rehabilitation of blighted properties and new housing construction to create mixed-income homeownership possibilities." Five years later, the Federal Reserve Bank of Richmond commissioned a study of the initiative, which

found that "crime in the targeted areas is lower, blight is diminished and newly occupied homes are generating new tax revenues."[33]

Second, to the extent a TIF is successful in revitalizing neighborhoods and increasing property values, existing properties will become *less* affordable in the TIF district – both because of rising property taxes for existing homeowners and because the TIF motivates existing property owners to improve and/or sell their properties to owners interested in building more expensive homes. While this economic development is precisely why the TIF was established in the first place, it is imperative that communities preserve ongoing affordability in the face of increasing property values. This requires some form of plan for affordable homes. TIF revenues are a logical source of funding for this activity.

One general question that has been raised about TIFs concerns the extent to which some or all of the tax increment captured by the TIFs would have been generated even without public investment. In this case, the TIF increment captured and spent on capital improvements is not really "new" money, but rather a portion of the community's overall tax base. A study by the Neighborhood Capital Budget Group (NCBG)[34] examined 34 TIF districts in Chicago, Ill., and concluded that when TIFs are targeted at areas with declining property values, new public improvements and developer subsidies do help attract new businesses and industries to unused or under-used land, add jobs and grow the tax base. However, when TIFs are established in areas already increasing in value, the "natural growth" of the property tax revenue is captured by the TIF district and diverted away from other public priorities – such as education and safety – towards economic development.

This analysis suggests that TIFs are most cost-effective when adopted in areas with declining property values. However, housing TIFs can still be a smart strategy in areas with rising property values by providing funding that helps preserve the availability of affordable homes for existing residents as property values rise.

Examples

California. Under California's redevelopment law, local redevelopment agencies are required to set aside 20 percent of revenues from tax increment districts for a separate low- and moderate-income housing fund to address the state's need for affordable homes. These revenues have made redevelopment agencies one of the biggest sources of funding for affordable homes in California. In the 2004-2005 fiscal year, for example, California redevelopment agencies deposited more than $1.2

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[33] John Accordino, George Galster and Peter Tatian. 2005. *The Ripple Effect: Economic Impact of Targeted Community Investments*. Richmond, Va.: Local Initiatives Support Corporation.

[34] Neighborhood Capital Budget Group. *TIFs – Who Pays for the Only Game in Town?*, http://www.ncbg.org/tifs/tif_pays.htm.

billion into low- and moderate-income housing funds and helped some 20,493 households secure affordable homes.

Chicago, Ill. Despite state-level restrictions on how tax increment funds can be spent in connection with residential development, Chicago has used tax increment financing to develop thousands of homes. According to NCBG, at least 25 TIF projects within Chicago "have included some residential development. NCBG can document 4,471 units of housing constructed as part of those projects, 1,832 of which are listed as affordable. A total of $179.7 million of TIF money has been promised to housing development projects (including the $9.1 million in direct rehab grants provided through the Neighborhood Investment Fund program), which has resulted in $549.4 million of additional investment."[35]

One specific application of tax increment financing in Chicago is to support the ambitious Plan for Transformation to redevelop the city's high-rise public housing. As part of the plan, Chicago is borrowing up to $15 million from private lenders to front eligible costs of the development of new homes. The loans, which are guaranteed by a program-related investment from the MacArthur Foundation, will be repaid with tax increment revenue generated through increased property taxes in the tax increment financing districts established in the areas surrounding the new homes.[36]

Another application of tax increment financing in Chicago is the Tax Increment Financing Neighborhood Improvement Program (TIF-NIP), which provides existing homeowners and rental property owners with grants for exterior repairs and safety upgrades. Single-family homes are eligible for grants of up to $10,000 and multifamily developments are eligible for grants of between $12,500 and $50,000, depending on the number of units.[37] In the neighborhoods of Woodlawn and Bronzeville, for example, more than 350 home and building owners received grants to improve their homes. An initial $2 million loan from LISC to advance the grants was repaid seven years ahead of schedule.[38]

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[35] For more information, see http://www.ncbg.org/tifs/housing.htm.

[36] Fannie Mae, ed. 2005. *Tax Increment Financing: Chicago Housing Authority's Plan for Transformation*. New York, N.Y.: Local Initiatives Support Corporation, http://www.lisc.org/content/publications/detail/933.

[37] For more information see, http://www.ncbg.org/tifs/housing.htm. See also Lori Healey and John F. McCormick. 1999. Urban Revitalization and Tax Increment Financing in Chicago. *Government Finance Review*, December 1999, http://www.gfoa.org/services/dfl/ed/documents/UrbanRevitalizationandTIFinChicago.pdf. NOTE: In some sources, this program is called the Tax Increment Financing - Neighborhood Investment Program.

[38] See Local Initiatives Support Corporation, June 21, 2004 Press Release. TIF/NIP Works for Homeowners in Woodlawn, Bronzeville, http://www.chicago-lisc.org/documents/TIF_NIP_Release_1.doc.

Assessment

- **Ease of Financing/Cost-Effectiveness.** High, especially if well targeted on areas not likely to recover without public investment.

- **Magnitude of Potential Impact.** High. This is a major potential funding source for affordable homes.

- **Replicability.** Moderate to High. TIFs are authorized in 49 states. However, significant TIF revenues are only generated if a community succeeds in fostering redevelopment. It would seem reasonable to expect that TIFs are most likely to work in depressed neighborhoods of otherwise thriving metropolitan areas.

- **Flexibility.** Moderate to High. There are no federal limits on who may benefit from TIF revenues. However, some states place limitations. In California, for example, communities must use at least 20 percent of their TIF revenues in new Urban Renewal Areas for housing affordable to families with incomes below 50 percent of AMI.

- **Ease of Implementation.** Moderate. Where TIFs are well-established, they are fairly easy to set up. Where they are not well-established, it may be somewhat challenging to secure cooperation from all of the various taxing jurisdictions. There also will likely be opposition from constituencies seeking to use the TIF revenues for other purposes. Finally, to generate significant revenue, the TIF-funded investments have to be successful in fostering redevelopment.

9. Stimulate construction and rehabilitation through tax abatements

Tax abatements are similar to TIFs in that they involve the voluntary relinquishment of expected future tax revenue for a specified period of time in order to stimulate a public benefit. In general, however, tax abatements are narrower in scope than TIFs. In contrast to TIFs, which apply to all properties within a designated TIF district, tax abatements are granted on a case-by-case basis to property owners that meet the conditions of the tax abatement policy.

In the housing context, tax abatements are most often used as an incentive for rental home construction or rehabilitation. Tax abatements are also commonly used to help seniors cope with rising property taxes, though that use falls outside the scope of this analysis. Although apparently less common, some jurisdictions also use tax abatements to stimulate the production of owner-occupied homes.

Tax abatements can be a particularly important vehicle for stimulating the preservation of existing rental homes. Consider, for example, an aging residential development providing 40 units of moderately priced rental homes that is owned by a single individual as a supplement to his or her day job. As the property ages, the owner tries to keep up with repairs, but finds that the rents the market is willing to bear do not provide enough income to cover the costs of repairs. In this situation, the owner is likely to take one of three courses: (a) let the property gradually deteriorate; (b) renovate the property to a sufficiently high standard so that the property can command higher rents; or (c) sell the property to someone else willing to undertake this level of renovation. Under any of these scenarios, the community will eventually experience a loss of affordable homes.

Here's where tax abatements come in. To facilitate and encourage this owner to make the necessary improvements to keep the property up without a wholesale upgrading, a jurisdiction could provide the owner with a five- or 10-year abatement of property taxes in the form of either a lower overall rate of assessment or a frozen basis that ignores property value increases resulting from improvements. If calibrated correctly, such an incentive could give the owner the boost he or she needs to make the improvements feasible, ensuring the property is maintained. To ensure the property remains affordable, the jurisdiction could condition the tax abatement on an agreement that the owner will rent to families with incomes below a specified level. (Some practitioners, however, feel that such covenants are not necessary or desirable. This question merits further research.)

Tax abatements also can be used to encourage the new construction of both rental and owner-occupied homes. For examples, see the discussion of Portland, Ore., below.

In developing tax abatement policies, jurisdictions need to be careful to ensure they are securing a real public benefit that would not have occurred without the tax incentives. In New York, N.Y., for example, a tax abatement program intended to stimulate new construction during a period of low

building activity has remained on the books long after market conditions have changed. At present, a debate is underway about how to revise the policy to confer a clearer public benefit. One of the options being considered is to provide tax benefits only to owners that agree to meet more rigorous affordability restrictions.

Examples

Portland, Ore. Portland has a range of tax abatement programs designed to promote increased development near public transit, rehabilitation of rental homes, construction or rehabilitation of owner-occupied homes in certain "opportunity areas," and nonprofit ownership of affordable rental homes. As of fiscal year 2004-2005, some 12,725 homes were receiving one of these abatements, contributing significantly to the city's objectives for affordable homes and community development.[39]

Another example is Cook County, Ill., which has a special property tax classification (Class 9) designed to stimulate the rehabilitation of affordable rental homes. "Class 9 is a real property classification that offers a 50 percent reduction in assessments and taxes to developers who complete major rehab on multifamily buildings and keep rents below certain levels. At least 35 percent of the apartments must be leased at rents affordable to low- and moderate-income households. With Class 9, properties are eligible for a 16 percent assessment level for a period of 10 years. Owners may renew the reduction for additional 10-year periods."[40]

Assessment

- **Ease of Financing/Cost-Effectiveness.** Moderate. Tax abatements that are narrowly tailored to stimulate improvements unlikely to have occurred without the incentives are likely to be the most cost-effective.

- **Magnitude of Potential Impact.** High, at least over the relatively short-term period (generally five or 10 years) of the tax abatement. Once the abatement period ends, the specific affordability of the qualifying units may be lost, but there should still be an overall increase in the supply of homes.

- **Replicability.** High.

- **Flexibility.** High. Tax abatements can be tailored to any income group by tying tax benefits to specified affordability restrictions. To be effective, however, the policies need to be

[39] Presentation to Portland Joint City Council/PDC Commission Meeting, January 2005, Examining Tax Exemption Housing Policies, http://www.pdc.us/pdf/housing_serv/pubs/nmuh-docs_6-06/03_lta-presentation.pdf.

[40] See http://www.cityofchicago.org (Search for "Cook County Class 9").

financially advantageous for the taxpayers, which means they are likely to be most effective in helping moderate-income (rather than very low-income) families.

- **Ease of Implementation.** High. In general, tax abatement policies are likely to be easier to implement than programs requiring the expenditure of general revenues or new taxes.

10. Create or expand dedicated housing trust funds

While the term "housing trust fund" is used differently in different states and localities, as used here it means a flexible vehicle for financing affordable homes supported by a dedicated funding source, such as real estate transfer taxes or recording fees. Just like highway trust funds, which provide a dedicated source of revenue for highway construction, housing trust funds provide funding that can only be used for affordable homes.

In some cases, housing trust funds lack a dedicated funding source and, instead, are funded through either one-time or annual appropriations by the legislature or city council. While discretionary appropriations are not as reliable as dedicated funding sources, trust funds financed in this manner still can be important tools for increasing the availability of affordable homes. They also can lay the groundwork for the addition, at some future date, of dedicated funding streams.

The most comprehensive source of information on state and local housing trust funds comes from the Housing Trust Fund Project of the Center for Community Change. According to the Project's Web site, as of July 2005, some 37 states administered 43 housing trust funds. In addition, there were 293 housing trust funds operated by cities and 76 housing trust funds operated by counties.[41] Together, these funds provide more than $750 million per year in funding for affordable homes.

According to the Center for Policy Alternatives, "The most common revenue source for state housing trust funds is the real estate transfer tax. Other options include interest from state held funds (unclaimed property funds, budget stabilization funds, among others), interest from real estate escrow or mortgage accounts, and document recording fees. City housing trust funds are most often financed by impact fees placed on non-residential developers to offset the impact of their development's employees on the housing supply. Cities have also committed condominium conversion fees or demolition fees, real estate excise taxes, and hotel and motel taxes. Counties most often use real estate document recording fees."[42]

While housing trust funds come in all shapes and sizes, as a class, they confer two main benefits that are extremely important for efforts to expand the availability of housing affordable to working families. First, they provide additional, ongoing revenue to support affordable homes that can be used to fill in the gaps of federal housing programs. Low-Income Housing Tax Credit developments, for example, frequently require additional "soft" financing to make the deals work. Second, they carry no federal restrictions, so they can be used for families at any income level that face housing affordability challenges.

[41] For a list of trust funds as of July 2005, see http://communitychange.org/issues/housingtrustfunds/whatarehousingtf/index.php?#5.

[42] See Center for Policy Alternatives, http://www.stateaction.org/issues/issue.cfm/issue/HousingTrustFunds.xml.

High-cost communities seeking to use housing trust funds to expand housing opportunities for families with incomes above 50 percent of the area median may experience challenges from housing advocates seeking to reserve those funds for families with lower incomes. Communities may find it useful to address this difficult question in the broader context of an overall affordable housing plan that considers the full range of housing challenges identified in the community and the full range of resources available to meet those needs. By developing a comprehensive and coordinated approach to addressing their housing needs, communities will have a better idea of the pros and cons of using different funding sources to meet different housing needs.

Two excellent resources for communities interested in starting a housing trust fund are *A Workbook for Creating a Housing Trust Fund*[43] and PolicyLink's Equitable Development Toolkit.[44]

Examples

Arizona. The Arizona Housing Trust Fund was established in 1988 and is funded by 55 percent of the revenues from "unclaimed property," such as inactive bank accounts, bank deposits, lay-away fees and unclaimed refunds from lending institutions, insurance companies and commercial retail operations. To date, this funding stream has provided more than $150 million for affordable homes, with revenue rising to about $20 million per year. Approximately one-third of the trust fund's revenue must be spent in rural areas. The trust fund also supports affordable homes on tribal lands.[45]

Other examples include trust funds, such as those in Washington, D.C., and Ohio, that started out without a dedicated funding source, but later secured one.

Assessment

- **Ease of Financing/Cost-Effectiveness.** Moderate. A dedicated funding source may be difficult to establish, but once established, it is generally reliable. Once an ongoing revenue source has been identified, no annual appropriations are needed.

- **Magnitude of Potential Impact.** High.

- **Replicability.** High.

[43] Mary E. Brooks. 1999. *A Workbook for Creating a Housing Trust Fund.* Frazier Park, Calif.: Housing Trust Fund Project of the Center for Community Change, http://communitychange.org/shared/publications/downloads/workbook.pdf.

[44] http://www.policylink.org/EDTK/HTF/.

[45] Carolina Reid. 2005. State Housing Trust Funds: Meeting Local Affordable Housing Needs. *Pacific Mountain Review* 24(1).

- **Flexibility.** High, assuming states and localities do not unduly constrain their own flexibility.

- **Ease of Implementation.** Moderate. Key challenges include identifying and agreeing on an ongoing revenue source and agreeing on an appropriate approach for spending the funds.

11. Establish inclusionary zoning requirements or incentives

Few housing policies have generated as much attention (and in many communities, controversy) in recent years as inclusionary zoning. Inclusionary zoning generally involves a requirement or an incentive for developers to include a modest percentage of affordable homes within newly created developments. It's one way of harnessing the power of the market to produce affordable homes.

The nation's first inclusionary zoning law was enacted in the 1970s in Montgomery County, Md. The law specified that in any new housing development of 50 or more homes, at least 12.5 to 15 percent of the homes must be made affordable to families with incomes at or below 65 percent of AMI. In exchange for this requirement, developers received a density bonus allowing them to build up to 22 percent more homes than otherwise permitted. The affordable homes were originally required to remain affordable for 20 years.[46] While the Montgomery County ordinance has been modified many times over the years, it has endured and produced a significant number of moderately priced homes – estimated at almost 11,000 as of 2000.[47]

Since that time, numerous other jurisdictions have adopted inclusionary zoning – especially in high-cost markets like California. According to a survey conducted by the California Coalition for Rural Housing and the Nonprofit Housing Association of Northern California, as of 2003, some 107 cities and counties had adopted inclusionary zoning within California alone, producing more than 34,000 affordable homes.[48] An updated survey is presently in the process of being administered and is expected to reveal numerous additional jurisdictions in California that have adopted inclusionary zoning policies and more complete totals of affordable homes produced. Inclusionary zoning ordinances have also been passed in Washington, D.C., Fairfax County, Va., and in many communities around Boston, Mass.

A number of states – notably Massachusetts and New Jersey – have enacted statewide laws that achieve similar effects. Under Chapter 40B in Massachusetts, each jurisdiction is expected to ensure that at least 10 percent of its homes are affordable; in jurisdictions that fall below this threshold, developers have the right to appeal the denial of a comprehensive permit to a special state-level appeals board, which can overrule the local decision.[49] Under New Jersey law, as established in the *Mount Laurel* court decisions and subsequent legislation, each community is required to meet its fair share of the region's need for homes affordable to low- and moderate-income families. As a safe

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[46] Business and Professional People for the Common Interest (BPI Chicago). Undated. Inclusionary Housing in Montgomery County, MD. *Issue Brief #4*, http://www.bpichicago.org/rah/pubs/ci_issue_brief4.pdf.

[47] David Rusk. 2000. Inside Game/Outside Game: The Emerging Anti-Sprawl Coalition. In *Inclusionary Zoning: A Viable Solution to the Affordable Housing Crisis?* Washington, D.C.: The Center for Housing Policy.

[48] California Coalition for Rural Housing and the Nonprofit Housing Association of Northern California. 2004. *Inclusionary Housing in California: 30 Years of Innovation*.

[49] More details on Chapter 40B, and references, are provided in the discussion of expedited permitting policies in policy 5.

haven, jurisdictions have the option of obtaining certification from the state's Council on Affordable Housing for their plan to meet their fair share obligations.[50]

While a complete analysis of this complicated subject is beyond the scope of this report, the following are some of the key issues for localities to consider:

- *Equity*. Advocates of inclusionary zoning argue that because land is in limited supply and home prices in high-cost markets are so out of reach of working families, inclusionary zoning is the only cost-effective way of ensuring the production of units affordable to working families. Opponents, on the other hand, argue that it is unfair for the government to require one class of individuals – property owners – to subsidize the public good of affordable homes.

- *Incentives/Offsets*. Consensus around the adoption of inclusionary zoning is generally easier to achieve when well-crafted incentives (also known as offsets) are included to compensate property owners and developers for the foregone revenue associated with producing below-market units.[51] The most common and effective incentive/offset is a density bonus to allow the production of more units than would normally be permitted under the jurisdiction's zoning rules. Another useful incentive is to provide developers proposing projects that meet specified affordability guidelines with a fast-track approval process or pre-approval to build "as of right." When inclusionary zoning facilitates an increase in density in otherwise low-density areas, greater speed and certainty in the approvals process and more affordable homes, it's a win-win for everyone.

- *Process Matters*. Consensus is more likely to be achieved when the process for developing recommendations includes both developers and advocates for affordable homes. It also helps to "get into the numbers," examining the real-world impact of various proposed policies and offsets, as well as the applicability of the proposed policies to local market conditions and housing needs.

- *Voluntary vs. Mandatory*. The consensus view of practitioners working in this area is that mandatory requirements work better than voluntary policies that rely entirely on incentives. On the other hand, New York, N.Y., appears to have had significant take-up of its voluntary, inclusionary housing incentives for Greenpoint-Williamsburg. Chicago, Ill., has a cross between voluntary and mandatory policies, with the policy optional for those that do not seek financial assistance from the city, but mandatory for those that do. It remains to be seen whether the voluntary approach can be extended effectively to other contexts.

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[50] For more information, see http://nj.gov/dca/coah/about.shtml.

[51] By ensuring that development continues to be an attractive financial proposition, well-crafted incentives are also likely to blunt the critique offered by some critics that inclusionary zoning policies may lead to an increase in the price of market-rate homes or a decrease in the supply of market-rate homes in the area (because developers do not want to build there).

- *Target Income Levels*. In general, inclusionary zoning appears better suited to producing homes affordable to families with moderate incomes than families with very low incomes. This is due both to the economics – moderate-income families can afford to pay more than very low-income families, meaning there is less foregone revenue associated with those homes – and the fact that inclusionary zoning is more feasible politically when focused on moderate-income families.

  To ensure that very low-income families have access to some of the homes produced through inclusionary zoning policies, jurisdictions may want to authorize a local housing authority or other public entity to purchase a portion of the units – as is the case in both Montgomery County, Md., and Fairfax County, Va. After purchasing the units, the housing authorities can combine them with other subsidies to make them affordable to lower-income families.

- *Duration of Affordability*. One of the limitations of many inclusionary zoning ordinances is that they guarantee affordability for only a limited time period. While 15 or 20 years may seem like a long time, such affordability periods limit the effectiveness of inclusionary zoning policies in contributing to a lasting increase in affordable home opportunities for moderate-income families. As discussed in greater detail in policy 20, a number of solutions exist to extend the affordability period indefinitely, while still ensuring opportunities for individual asset growth. Such solutions are generally preferable to more limited affordability periods.

- *On-Site vs. Off-Site*. Some advocates of inclusionary zoning insist that each development include a percentage of affordable homes, while others believe it is sensible to allow developers to provide an equivalent number of homes off-site or pay a fee "in lieu" of providing on-site affordable homes that can be used for affordable homes elsewhere in the community. In general, it appears easier to gain consensus around inclusionary policies that permit off-site affordability or in-lieu fees. This approach also may increase the number of affordable homes constructed by shifting the production of affordable homes to sites with lower land and/or production costs.

- *Market Variations.* It is important to be sensitive to market realities. Inclusionary zoning mandates probably do not make a lot of sense for declining neighborhoods struggling to attract any development whatsoever. While inclusionary zoning is likely to be more effective in hot markets, it will likely be most effective if enacted while there are still a significant number of developable parcels. Interested communities should try to anticipate areas of future growth.

- *Relation to Other Housing Policies*. While inclusionary zoning is a promising tool for harnessing strong markets to produce affordable homes, it is not a panacea. Inclusionary housing policies will ultimately be most effective if they are part of a larger and more comprehensive approach to solving a community's housing challenges.

There are a number of excellent resources on inclusionary zoning, including BPI Chicago,[52] PolicyLink[53] and the Innovative Housing Institute.[54] Communities interested in maximizing consensus around inclusionary zoning policies may be particularly interested in a set of principles jointly developed by home builders and advocates in Northern California[55] as well as recommendations developed by John McIlwain of the Urban Land Institute.[56]

Assessment

- **Ease of Financing/Cost-Effectiveness.** Very High.
- **Magnitude of Potential Impact.** High. While critics argue that the number of homes produced thus far through inclusionary zoning is relatively small relative to the overall need, the numbers compare favorably with other low-cost solutions.
- **Replicability.** Moderate. Most likely to work in high-cost markets.
- **Flexibility.** Moderate to High. This policy works well for making homes more affordable to moderate-income families. It is not well-suited for making homes deeply affordable to extremely low-income families, unless layered with other subsidies.
- **Ease of Implementation.** Moderate. Main obstacles are political opposition and the technical questions of how best to design a policy.

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[52] http://www.bpichicago.org/rah/rihi_pubs.html#works.

[53] http://www.policylink.org/Projects/IZ/.

[54] www.inhousing.org.

[55] Home Builders Association of Northern California and Nonprofit Housing Association of Northern California. 2005. *On Common Ground: Joint Principles on Inclusionary Housing Policies*, http://www.nonprofithousing.org/attachments/Inclusionary_Principles.pdf.

[56] John McIlwain. 2005. Inclusionary Zoning: Cure or Curse. *Multifamily Trends*, September/October 2005. Washington, D.C.: Urban Land Institute, http://www.nhc.org/index/policy-action-hot-issues-IZ-ULI.

12. Use cross-subsidies to support mixed-income communities

In strong housing markets, nonprofit or mission-driven for-profit developers who build affordable homes can use profits from the sale or rental of market-rate homes to subsidize the costs of affordable homes. For example, some developers have used the profits from market-rate condominium units to subsidize for-sale condominium units or rental units in the same development that are affordable to working families.

This policy also has been used to create mixed-income developments comprised entirely of rental homes. In areas with very high market rents for non-luxury homes, such developments can work without significant public subsidies or with only a modest subsidy, such as the 80-20 program that allows tax-exempt bonds to be used to finance the construction of a development comprised of at least 20 percent affordable units. (The other 80 percent can be market rate.)

In recent years, however, rising land costs have made it more expensive to develop market-rate rental units, leaving little profit available in most markets to subsidize the affordable units. To use cross-subsidies successfully in an all-rental context outside of very high rent areas, communities may need to combine cross-subsidies with other approaches, such as making publicly owned land available for little or no cost, or increasing the allowable density.

Many of the more recent examples of cross-subsidies involve HOPE VI, a federal program that provides large grants to help public housing authorities redevelop distressed public housing. The HOPE VI program has emphasized that redeveloped communities should include housing targeted to families with a mix of incomes – including moderate-income families as well as families paying market rents or purchasing market-rate homes – and many HOPE VI sites have succeeded in achieving this goal. Among the many prominent examples of mixed-income HOPE VI developments are Centennial Place and The Villages of East Lake in Atlanta, Ga.; Park Du Valle in Louisville, Ky.; the Townhomes on Capitol Hill in Washington, D.C.; and the massive Chicago Plan for Transformation, which is replacing some of the most challenging high-rise public housing in the country with smaller, mixed-income communities.

In light of the sharp reductions in HOPE VI funding in recent years, many housing authorities have started to do HOPE VI-like projects by borrowing against their expected revenue stream from the public housing capital fund – one of two major federal funding streams for public housing. Capital fund financing gives housing authorities access to financing for the major capital investments needed to demolish distressed public housing developments and rebuild smaller, mixed-income developments, but does not replace the component of the HOPE VI grant used for social services. The social services component is important to help maximize residents' opportunities for self-sufficiency, as well as to provide amenities that attract middle-income families to ensure a successful mixed-income development. By combining HUD's family self-sufficiency program – a well-designed program that helps low-income families build assets and make progress toward self-sufficiency and

homeownership – with services provided by other community partners, housing authorities can ensure the provision of many of the same services that would have been provided with a HOPE VI grant.[57]

While many of the recent affordable developments with a cross-subsidy component have involved housing authorities, there is no reason why the same policy cannot be applied in other contexts. If one steps back and analyzes what makes the market-rate component of a HOPE VI or HOPE VI-like project successful from a funding perspective (there is obviously a social dimension as well), the answer is, essentially, free land and, in many cases, free infrastructure contributed by the city or county. Communities that wish to develop a mixed-income development with a market-rate component can achieve essentially similar results outside of the public housing context by providing free or low-cost land and infrastructure. Depending on the level of market rents, this may free up a portion of the rents paid by market-rate tenants to provide a cross-subsidy to lower the rents on the other units. To achieve a further mix of incomes, communities can layer Low-Income Housing Tax Credits (4 percent or 9 percent) onto the affordable units, and public housing subsidies or project-based Section 8 vouchers onto a portion of the affordable units.

Alternatively, the subsidy can be provided through innovative financing mechanisms. One innovative example is the 50/30/20 mixed-income program offered by the Housing Development Corporation of New York City. Under this program, the city provides tax-exempt financing along with a subsidized second mortgage provided through the New Housing Opportunities Program (New HOP) to finance developments with a mix of incomes. At least 20 percent of the units must be affordable to families with incomes less than 50 percent of the median income, at least 30 percent of the units must be affordable to middle-income households (as defined by the New HOP program), and the remaining 50 percent may be rented at market rents.[58]

Among the many challenges involved in developing mixed-income developments are obstacles to using Low-Income Housing Tax Credits in a mixed-income context. Since Low-Income Housing Tax Credits are central to the development of much of the non-luxury rental homes that are currently being constructed, this is a serious problem that needs to be addressed. The obstacles reported by practitioners include the following:

- In many states, mixed-income developments with a market-rate component do not score well enough under the state's allocation policies to obtain Low-Income Housing Tax Credits; and,

[57] For more information on borrowing against public housing capital funds, see http://www.hud.gov/offices/pih/programs/ph/capfund/cffp.cfm. For case studies on the use of capital fund financing, see the following from LISC: http://www.lisc.org/files/932_file_asset_upload_file850_8250.pdf, http://www.lisc.org/files/935_file_asset_upload_file592_8243.pdf and http://www.lisc.org/files/934_file_asset_upload_file301_8251.pdf. For more information on the family self-sufficiency program, see www.fsspartnerships.org.

[58] For more information, see http://www.nychdc.com/.

- Tax-credit investors are less comfortable with developments that are not 100 percent tax-credit eligible – apparently because of the extra risk of keeping the market-rate units occupied and the challenges that market-rate units add to compliance monitoring.

States interested in promoting the increased use of cross-subsidies and mixed-income developments should consider convening a task force comprised of nonprofit and for-profit developers of affordable homes, affordable housing advocates and tax credit investors to discuss what steps, if any, the state can take to better support these strategies. In particular, states should look at the tax credit allocation policies contained in their Qualified Allocation Plans.

Other obstacles to the use of Low-Income Housing Tax Credits in a mixed-income context are a function of federal law and include:

- The ineligibility for the tax credit of units rented to families with incomes above 60 percent of AMI; and,

- The inability to concentrate credits in particular units to serve families with incomes substantially below 60 percent of AMI without substantial additional subsidies.

These issues are addressed in the federal policy recommendations that follow discussion of this policy.

Assessment

- **Ease of Financing/Cost-Effectiveness.** Very High. Profits from market-rate units carry little or no cost to the municipality or state.

- **Magnitude of Potential Impact.** Moderate. Under current market conditions, it is difficult to utilize cross-subsidies in an all-rental context without the use of additional strategies, such as free or low-cost land. On the other hand, cross-subsidies from for-sale condominium units can provide profits to subsidize low-cost rental or for-sale condominium units.

- **Replicability.** Moderate. Most likely to work in high-cost markets.

- **Flexibility.** Moderate. While cross-subsidies can be used now, they would be easier to use if the barriers to the use of the Low-Income Housing Tax Credit in a mixed-income context were lowered.

- **Ease of Implementation.** Moderate. Outside of market conditions – the policy works best in high-cost markets – many of the biggest challenges are essentially self-imposed, including government policies that discourage mixed-income developments and some affordable housing developers that are not comfortable including significant market-rate components in their developments.

Federal Policy Recommendations to Facilitate the Use of Low-Income Housing Tax Credits for Mixed-Income Developments

To facilitate the use of Low-Income Housing Tax Credits in a mixed-income context, Congress should consider allowing states to concentrate their 9 percent credits on a smaller than usual number of units. For example, instead of allocating 9 percent credits to 100 units, a jurisdiction would be allowed to allocate the same amount of credits over some smaller number of units – for example, 12 percent credits to 75 units or 18 percent credits to 50 units.

Jurisdictions could use this flexibility in several valuable ways. First, a jurisdiction could choose to serve lower-income families than typically served with tax credit developments. Alternatively, a jurisdiction could choose to use the extra equity to free up Community Development Block Grant (CDBG) or HOME funds that would otherwise have been required to make the deal work. The freed-up HOME or CDBG funds could then be used to leverage additional 4 percent tax credits or to serve a population with unmet housing needs, such as households with incomes between 60 and 80 percent of AMI.

The proposal also could help make tax credits more useful in locations in which families with incomes between 50 and 60 percent of AMI are already able to afford market-rate housing, or where there are already sufficient affordable housing resources available for this population. By making tax credit developments more feasible without additional subsidies for lower-income populations, the proposal would expand the market of potential renters for tax credit developments.

As an alternative or supplement to this proposal, Congress may wish to allow tax credits to be used to serve families with incomes higher than 60 percent of AMI in exchange for serving a like number of families with incomes below 60 percent of AMI. For example, under this proposal, a 100-unit tax credit development could target 20 of its 100 units to families with incomes up to 80 percent of AMI so long as it also targeted 20 units to families with incomes below 40 percent of AMI.

This alternative would help to expand the mix of incomes in tax credit developments, while also providing a mechanism for facilitating the integration of market-rate units into tax credit developments to provide a cross-subsidy for lower-income units.

Generate additional capital for affordable homes

13. Expand use of the 4 percent Low-Income Housing Tax Credit

Every year, hundreds of millions of dollars in federal funds for affordable homes are left on the table, unclaimed. The unclaimed funds are unutilized 4 percent Low-Income Housing Tax Credits. Accessing these unclaimed funds is one of the more important ways that states and localities can meet the housing needs of working families with incomes below 60 percent of AMI.

In chapter 2, the seemingly mundane 4 percent Low-Income Housing Tax Credit was analogized to an exciting new federal grant program in which a virtually unlimited stream of federal funds is available for the construction or rehabilitation of rental homes for families with incomes below 60 percent of the area median. Some local match is required to access these funds, with the match higher for areas with higher land costs, but that match can come from other federal funds, such as funds from the federal HOME or CDBG programs.

Unpacking this analogy may help to explain both the potential and the challenges associated with accessing these funds. The bottom line, however, is that the 4 percent tax credit program is one of the largest sources of untapped federal financing available to support affordable homes. Jurisdictions would be well served by developing a process for tapping these unclaimed funds for affordable homes.

What is the 4 percent Low-Income Housing Tax Credit program? Federal law provides for two different types of Low-Income Housing Tax Credits to subsidize the costs of rental homes affordable to families with incomes below 60 percent of the AMI. The larger of the two credits – the 9 percent credit – is allocated to states on a per-capita basis. Because the credit is large and the supply is limited, competition for these credits tends to be fierce.

The second, and less-well-known, type of Low-Income Housing Tax Credit is the 4 percent credit. The 4 percent tax credit is worth only about half as much as the 9 percent credit. (The 4 percent and 9 percent figures refer to the approximate percentage of the eligible project costs that may be claimed on a federal tax return for each of 10 years.[59]) Nevertheless, the equity raised through the 4 percent tax credit is substantial. In one sample transaction involving the preservation and renovation of an older 94-unit federally insured complex in an Eastern inner city whose owner had prepaid its mortgage, for example, the equity from 4 percent tax credits contributed $3.1 million toward total project costs of $8.2 million. Operating income during renovation, deferred developer

[59] The statute authorizing the Low-Income Housing Tax Credit actually refers to credits of 30 and 70 percent, rather than 4 and 9 percent. The Low-Income Housing Tax Credit is designed to provide 30 or 70 percent of the qualified basis of a qualifying development. Because the credits are paid out over a 10-year period and need to address the estimated impact of inflation, these credits generally provide a 10-year revenue of approximately 4 or 9 percent of the qualified basis, respectively.

fees and the original development's replacement reserve contributed another $1 million, with the balance financed through tax-exempt bonds. Aside from the tax-exempt bonds (see below), no state or locally controlled funds were needed to make this deal work.[60]

In other cases, state and locally controlled funds are needed to make 4 percent tax credit deals work. For example, in the planned rehabilitation of ParcView Apartments by Wesley Housing Development Corporation in Alexandria, Va., the city is contributing $9 million (in the form of a deferred loan) toward project costs of $31.6 million. Other financing includes $14.7 million in tax-exempt bonds, $6.2 million in 4 percent tax credit equity and deferred developer fees.[61]

Many states already make good use of the 4 percent tax credit to finance affordable rental homes. In Texas, for example, approximately 22 percent of the state's tax-exempt bond authority has been allocated to multifamily homes in recent years, financing the new construction of nearly 100 multifamily developments and the acquisition/rehabilitation of some 14 multifamily developments in the three-year period from 2004 through 2006. These developments included more than 24,000 homes and leveraged more than $70 million in 4 percent tax credits.[62]

What are the ideal uses of 4 percent tax credits? The 4 percent tax credit can be used for new construction of rental homes or for the rehabilitation of an existing rental development. However, state and local matching funds are less likely to be needed for preservation or rehabilitation projects than for new construction. In particular, 4 percent tax credit deals seem to work well as part of preservation of project-based Section 8 properties through HUD's Mark-to-Market programs. Other contexts in which 4 percent tax credits appear to work well with minimal commitment of state or local dollars include the revitalization of distressed public housing developments through HOPE VI or capital fund financing, new Section 202 developments for the elderly (where the 20-year Housing Assistance Payment (HAP) helps support debt), and projects that involve a moderate amount of rehabilitation. As existing Low-Income Housing Tax Credit properties age, the 4 percent tax credit also may be a good source of funding for their recapitalization and modernization. Of course, states and localities willing to commit matching funds should be able to make 4 percent tax credits work well in other contexts as well, including new construction.

States should consider developing a process for steering appropriate projects that are originally proposed for 9 percent tax credits to 4 percent tax credits, freeing up 9 percent tax credits for projects that really need the extra equity. This may mean allocating other funds to make the 4 percent tax credit deals work, but this allocation will be leveraged significantly through the equity

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[60] Vincent O'Donnell. 2006. PowerPoint presentation made by Vincent O'Donnell, Local Initiatives Support Corporation, through KnowledgePlex.org on July 18, 2006.

[61] Data provided by W. Matthew Perrenod, chief lending officer, Housing Partnership Network.

[62] Data provided by Robbye Meyer, director of multifamily finance, Texas Department of Housing and Community Affairs, in an e-mail to the author dated Nov. 26, 2006.

made available through the 4 percent tax credits, which would not otherwise have been available for affordable homes in the state.

How many 4 percent Low-Income Housing Tax Credits are available? Unlike 9 percent tax credits, there is no formal limitation on the number of 4 percent tax credits that states may use. The only condition is that 4 percent tax credits can only be used for projects financed with federal funds, which generally come from tax-exempt bonds. Tax-exempt bonds used for rental homes are charged against the state's total private-activity bond cap, so in states using all or nearly all of their bond cap, tax-exempt financing for rental homes may have to compete with other uses, including mortgage revenue bonds (which states use to offer mortgages at below-market rates), bonds issued for certain types of eligible industrial facilities, bonds used to finance student loans and certain other uses.

As of 2004, most states had substantial excess private-activity bond capacity. According to the 2004 State Housing Finance Agency Fact Book,[63] the combined amount of state private-activity bond authority in 2004 totaled $26.3 billion, of which $7.5 billion was allocated to housing finance agencies (HFAs). HFAs also received transfers from other agencies of $2.5 billion and carryover from prior years of $13.7 billion for a total of $23.7 billion in available bond authority. They used $7.8 billion of this amount – $5 billion for mortgage revenue bonds, $2.6 billion for rental housing, and $217 million for mortgage credit certificates – carrying over $15.4 billion into 2005 (with $420 million of carried-over 2001 cap authority expiring). The only states without significant carryover into 2005 were: Arkansas, Kansas, Massachusetts, New Jersey and Oregon.

With the recent rise in interest rates, however, most observers believe that competition for bond authority has grown since 2004 and will continue to grow in the coming years. The reason is that, with higher taxable interest rates, the break that comes from tax-exempt financing becomes more valuable, and thus tax-exempt financing becomes more attractive for all uses.

The expected increase in competition from other uses of private-activity bond cap makes it all the more important for states to understand the inherent advantages of using tax-exempt bonds for rental homes. The use of tax-exempt bonds for rental homes affordable to families with incomes below 60 percent of area median brings automatic qualification for 4 percent tax credits, which are many times more valuable than the tax-exempt authority alone.

Without the 4 percent tax credits, the only benefit from tax-exempt bond authority is the marginal reduction in the costs of funds relative to taxable financing (net of the increased costs of tax-exempt financing). In the context of home purchases – one of the alternative uses of private-activity bonds

[63] National Council of State Housing Agencies (NCSHA). 2005. *State HFA Fact Book: 2004 NCSHA Annual Survey Results*. Washington, D.C.

– Chris Tawa of MMA Financial estimates this benefit at about 75 basis points, a reduction in interest rates of less than 1 percentage point.

The 4 percent tax credits are much more valuable than this interest-rate savings. For example, an analysis that David Smith and Ethan Handelman of Recap Advisors recently prepared found that private-activity bond cap was worth 3.5 times as much when used for rental homes than when used for other activities. They found that the interest-rate savings from tax exempt bonds was worth approximately 17 cents per dollar of bond cap, as compared with 43 cents per dollar of bond cap from 4 percent tax credit equity. So, the total value of $1 in bond cap used for qualifying rental homes was 60 cents, as compared with 17 cents when used for other activities.[64]

The key conclusion here is that states interested in expanding the availability of affordable homes would be well advised to make as much bond cap available for rental homes as they can possibly use, even if it means using taxable financing for other purposes, such as home mortgages. With a modest contribution of state-controlled funds, states can buy down the interest rate on standard home mortgages, duplicating the interest savings of mortgage revenue bonds and preserving bond cap for rental homes where it is much more valuable as a result of the 4 percent tax credits it leverages.

Assessment

- **Ease of Financing/Cost-Effectiveness.** High. While this policy is not inexpensive for local jurisdictions, it is extremely cost-effective in leveraging additional federal dollars for affordable homes. While local matching funds will often be needed to make deals work, those funds may include federal HOME or CDBG funds, and will leverage significant amounts of federal funding in the form of tax credit equity.

- **Magnitude of Potential Impact.** Extremely high, especially for preservation deals and other projects focused on rehabilitation. The 4 percent tax credits work for new construction too, but will generally require additional state or local matching funds to make them work.

- **Replicability.** High. While the amount of state or local matching funds needed will vary from area to area, 4 percent credits can be used in every market.

- **Flexibility.** Moderate. The 60 percent AMI threshold is a significant limitation, but otherwise the credits are quite flexible.

[64] See David Smith and Ethan Handelman. 2006. "The best use of volume cap is affordable rental housing." Boston, Mass.: Recap Advisors. Available at: http://www.recapadvisors.com/pdf/wu57.pdf.

- **Ease of Implementation.** Moderate. The Low-Income Housing Tax Credit market has become significantly more efficient. One big challenge will be securing state or local matching funds, where needed, to make deals work. States with tight private-activity bond caps also may find it difficult to persuade other users to rely on other sources of financing.

Federal Policy Recommendation to Reduce Costs of Tax-Exempt Financing

Practitioners report that tax-exempt bond financing carries very high transaction costs – a typical rule of thumb is about 5 percent of the total amount of the bond – related to the complicated nature of bond financing. While some of these costs are unavoidable, there are a number of steps that could be taken to reduce the costs of tax-exempt bond financing, and, thus, increase the net loan proceeds available for affordable homes. For example, establishing standardized forms to cover the multitude of standard, federal bond requirements for all bond transactions in the United States (to be supplemented by any requirements applicable to a specific state or transaction) could reduce the time and costs related to legal fees and document production. Similarly, the increased use of electronic transmission methods – common in other forms of financing, but apparently not with bonds – could help save time and money. Likewise, with the growing efficiency of the bond markets, it may be time to look again at the standard fees charged by investment bankers to market the bonds to determine if these are still commensurate with the work and responsibility.

14. Provide pre-development and acquisition financing

There is little question that the housing finance markets have evolved significantly over the past decade. For example, home mortgages are now available to far more families and with much greater variation in terms. While the multifamily markets are not perceived to be as efficient as the single-family markets, capital is also widely available to support the construction of affordable multifamily homes – both for sale and rental.

This is not to say there is no room for improvement. For example, the subprime market for home mortgages lacks the pricing transparency of the prime market, which likely means that many families are paying significantly higher rates than warranted by the risks. The growing number of home mortgage options also complicates matters by making it difficult for families to compare mortgage products and understand why it might be more advantageous to pass on a low introductory rate that could lead to unaffordable home costs just a few years later.

On the development side, practitioners report that capital is much easier to access than it was; however, it appears that at least smaller nonprofits (and possibly larger ones as well) continue to have a need for pre-development and, in some cases, acquisition financing to help them study the feasibility of potential projects and compete in the marketplace with more sophisticated nonprofits and for-profits. Loan guarantees or other credit enhancement techniques may also be helpful to facilitate the financing of larger transactions by nonprofits and mission-driven for-profits, where both the risks and potential rewards are particularly high.

Examples of programs that meet these needs include:

- Through the Housing Enabled by Local Partnerships (HELP) Program, the California State Housing Finance Agency provides local governments with an unsecured 10-year loan at a 3.5 percent interest rate, which they can use to meet locally determined priorities for affordable homes. Established in 1998, the HELP Program has provided about $160 million in funding to support the development of more than 19,000 affordable rental and owner-occupied homes statewide. One example is a $1.85 million award to the city of Escondido to assist with site acquisition, development and rehabilitation of the Via Roble and Orange Place Apartments. In 2006, California added a second, complementary, short-term loan program — the Residential Development Loan Program — to focus more specifically on site acquisition and pre-development expenses related to the development of owner-occupied homes in infill settings.

- The Florida Housing Finance Corporation's Predevelopment Loan Program (PLP) provides low-interest loans for qualified pre-development expenses, such as engineering fees, title searches, feasibility analyses, and marketing and acquisition expenses for the development of affordable homes. Eligible borrowers include community organizations, nonprofits, local governments and public housing authorities. Loans are limited to $500,000 and have a non-

amortizing 3 percent interest rate with principal and interest deferred until either the construction/permanent loan closes or three years have passed since the original PLP loan closed. The loan can be forgiven if the borrower is not successful in obtaining construction or permanent financing for the development. To increase the likelihood of success, each applicant is assigned a technical assistance provider to assist in creating viable strategies for construction and permanent financing.

In 2005, the PLP provided over $10 million in pre-development loans for 239 affordable single-family homes and 1,052 affordable rental homes in complexes that also included 702 market-rate rentals. Recently funded developments include an assisted living facility in Wakulla County with 34 studio and one-bedroom homes, and an East Gainesville community of 43 for-sale homes with attached garages. Funding for PLP comes from the State Housing Trust Fund.[65]

- In October 2005, Mayor Bloomberg announced the New York Acquisition Fund – a $230 million fund to facilitate the acquisition of properties that would lead to the production or preservation of 30,000 units of affordable homes. Key to the success of the Acquisition Fund was the contribution of $32 million in loan guarantees by four charitable foundations – the Ford Foundation, the John D. and Catherine T. MacArthur Foundation, the Rockefeller Foundation and the Starr Foundation. The Open Society Institute provided operating support for the start-up of the fund and the city of New York contributed $8 million from the corporate reserves of the New York City Housing Development Corporation. By accepting much of the risk of the property acquisitions, these charitable and public sector contributions have helped leverage more than $190 million in private-market funding to augment the fund's purchasing power. The fund is managed by Enterprise Community Partners and LISC.[66]

In addition to developing specific programs to provide pre-development and acquisition financing, jurisdictions may want to consider a more generous attitude overall toward the accumulation of working capital by developers of affordable homes. Fierce competitions for limited funds, such as the 9 percent Low-Income Housing Tax Credit, have the advantage of creating strong incentives for the inclusion of desirable supportive services (such as child care centers and after school programs) and lowering the costs of any particular project. But, they also tend to leave developers of affordable homes – both for-profit and nonprofit – with very little margin to augment the working capital they need to investigate potential new deals and purchase properties. While states and localities can and should develop special financing programs to meet these pre-development and

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[65] For more information, see the Florida Housing Finance Corporation Web site (http://www.floridahousing.org/Home/Developers/SpecialPrograms/PredevelopmentLoanProgram.htm) and the following: Jaimie Ross and Mark Hendrickson. 2000. Affordable Housing in the 2000 Florida Legislative Session. *Housing News Network: The Journal of the Florida Housing Coalition, Inc.* 15(3): 4, http://www.flhousing.org/forms/Summer2000.pdf; Florida Housing Finance Corporation. *2005 Annual Report*, http://www.floridahousing.org/NR/rdonlyres/01719BBE-EC40-4F24-A0F6-134E2759EE57/0/2005ARlayout_BWreduced.pdf ; Florida Housing Finance Corporation. *2004 Annual Report*, http://www.floridahousing.org/NR/rdonlyres/17C1FF9D-49CE-410A-9580-651D825F88F8/0/2004ARlayoutforweb.pdf.

[66] For more information, see http://www.macfound.org/atf/cf/%7BB0386CE3-8B29-4162-8098-E466FB856794%7D/Housing%20Fund%20Release%2010%2005.pdf.

acquisition needs (see above), the need for these programs would be reduced if states and localities allowed developers of affordable homes to accumulate more working capital in their ordinary course of business. One policy option to consider for putting this principle into practice is to ensure that required social services are covered by project financing rather than taken out of developer fees.

In general, the particular financing needs of nonprofit and for-profit developers in each state and locality can be best assessed through open lines of communication and periodic meetings to discuss key concerns on all sides. In addition, in light of the rapid pace of change in the capital markets, housing finance agencies, nonprofits, and state and local governments would be well-advised to continually monitor the appropriateness of existing programs to the new marketplace. It makes little sense to try to compete with the private sector or with programs offered by government-sponsored enterprises, such as Fannie Mae, Freddie Mac or the Federal Home Loan Banks. Rather, the goal should be to identify and fill gaps that are not being well-served by these other actors.

Assessment

- **Ease of Financing/Cost-Effectiveness.** High. These are short- and medium-term loans, with the funds recycled once the transactions move forward. Assuming the program is well managed, losses should be minimal.

- **Magnitude of Potential Impact.** High. As the New York City example shows, it is possible to implement this policy on a large scale.

- **Replicability.** High.

- **Flexibility.** High. Depending on the funding source, these programs can be tailored to almost any income group.

- **Ease of Implementation.** Moderate. While development lending expertise is required, jurisdictions can partner with intermediaries like LISC or Enterprise Community Partners, or develop that expertise internally. To ease concerns of the rating agencies like Standard & Poor's, jurisdictions might want to start with a modest-sized pilot to demonstrate that the loans perform well.

15. Support housing bond issues

In 2002, California voters approved Proposition 46: The Housing and Emergency Shelter Trust Fund Act of 2002, which authorized the state to issue $2.1 billion dollars in bonds to fund the "construction, rehabilitation and preservation of affordable rental housing, emergency shelters and homeless facilities, as well as funds that can be used to provide down payment assistance to low- and moderate-income first-time homebuyers."[67]

With Proposition 46 funds nearly depleted, California asked voters in November 2006 to approve another bond issue for affordable homes – this time for $2.85 billion. Again, California voters responded positively, with 57.5 percent voting to approve the latest bond issue.[68]

In Los Angeles, voters were asked to approve a $1 billion bond issue for affordable homes to fund 1,000 units per year of affordable homes for the next 10 years. The initiative garnered over 62 percent of the vote – enough to pass with flying colors in much of the country – but narrowly missed the two-thirds vote required by state law.

The use of general obligation bonds (or other forms of government bonds) to fund affordable homes is not limited to California. For example:

- In 2006, voters approved $55 million in bonds for affordable housing in Austin, Texas.[69]
- In 2001, Phoenix, Ariz., "voters approved $33.7 million in General Obligation Bonds to create affordable rental housing... The properties provide housing to lower-income senior citizens and families at rents that are below market rates."[70]
- In 2004, voters in Florida authorized the Miami-Dade County Building Better Communities General Obligation Bonds, totaling almost $3 billion, to be funded over 30 years. Up to $195 million of the bond proceeds were authorized for "constructing and improving affordable housing for the elderly and working families to encourage home ownership through the acquisition, construction and renovation of residential units."[71]

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[67] California Housing Finance Agency. *Proposition 46 Overview*, http://www.calhfa.ca.gov/prop46.htm. For a complete list of housing programs funded by Proposition 46, see http://www.calhfa.ca.gov/hcd-prop46.pdf.

[68] For a history of California bonds for affordable homes, including a description of Proposition 1C, the new bonds authorized in 2006, see http://www.hcd.ca.gov/Housing_Bonds.pdf.

[69] For more information, see http://www.ci.austin.tx.us/housing/2006/bonds.htm.

[70] For more information, see http://phoenix.gov/HOUSING/gob.html.

[71] For more information, see http://www.miamidade.gov/Build/bonds.asp.

While challenging to secure, general obligation bonds for affordable homes can provide an indispensable form of equity to help bring homes within reach of working families. Because these bonds are repaid out of general revenue (or in some cases, a small increment on existing property or sales taxes), rather than from the specific projects being financed, these bonds can provide an indispensable source of gap financing to bridge the gap between the costs of projects and the financing they can support through expected rents or home sales.

Assessment

- **Ease of Financing/Cost-Effectiveness.** Low to Moderate. General obligation bonds generally need to be repaid out of a jurisdiction's general revenue or a specific new tax approved by the voters. To the extent that voters approve a new dedicated tax source, however, these bonds will not cut into existing revenue.

- **Magnitude of Potential Impact.** High, particularly when used as gap funds to leverage other federal funding streams, such as 4 percent tax credits.

- **Replicability.** Moderate. Different states have different legal and political environments.

- **Flexibility.** High.

- **Ease of Implementation.** Depends on the jurisdiction. Key obstacle will be securing voter approval.

16. Ensure that housing finance agency reserves are used for affordable homes

In the course of financing affordable homes, housing finance agencies generate revenue that they use to support ongoing program operations and to build equity (i.e., reserves) that improves their financial strength and bond rating. The revenue comes from fees they charge on outstanding bonds – generally both an origination fee and an ongoing fee – as well as from the spreads between their cost of funds and the rates they charge borrowers.

There is nothing wrong with the generation of revenue by housing finance agencies. In fact, it is one of their great strengths, as it makes them substantially less vulnerable to the vagaries of the annual appropriations process. Unfortunately, a significant number of state housing finance agencies report that portions of their fiscal reserves are taken by the state for activities unrelated to the agencies' standard housing programs.

Sometimes, the uses for which reserves are diverted are still related to housing. For example, the Oregon Housing and Community Services agency was asked to spend $3.8 million of its reserves to cover a shortfall in the agency's homeless programs. Similarly, the Virginia Housing Development Authority was asked to purchase a portfolio of state affordable housing loans, which led to the capitalization of a new state revolving loan fund.

In other cases, however, the reserves are diverted for non-housing uses. For example, the Housing and Community Development Corporation of Hawaii reports that "over $200 million was transferred from various housing related funds to the State General Fund for various programs." Similarly, the Illinois Housing Development Authority reports that "approximately $4 million was transferred out of the Affordable Housing Trust Fund by the State to the State's General Revenue Fund in Feb. and Oct. 2004."

In all, some 13 state housing finance agencies reported in 2004 that they were required to use fiscal reserves for non-agency purposes: Alaska, Connecticut, Hawaii, Illinois, Nevada, New Jersey, New York, Rhode Island, South Carolina, Tennessee, Virgin Islands, Virginia and Wisconsin.[72] While similar data are not available for local housing finance agencies, it is likely that many experience similar diversions of funds for non-housing purposes.

The diversion of housing finance agency reserves for non-housing uses is clearly problematic for states and localities experiencing affordable housing challenges, as it depletes funds that could otherwise be available to support affordable homes. Moreover, the very source of housing finance agency reserves are fees and spreads that, while necessary for housing finance agencies' ongoing

[72] National Council of State Housing Agencies (NCSHA). 2005. *State HFA Fact Book: 2004 NCSHA Annual Survey Results*. Washington, D.C.

operations, lead to a reduction in the net availability of bond funds for affordable homes. At a minimum, therefore, policy-makers should work to ensure that housing finance agency reserves remain dedicated to affordable homes.

At the same time, policy-makers should work collaboratively with housing finance agencies in their states and localities to determine whether some portion of the agencies' reserves or program revenues can support the jurisdictions' overall plans for increasing the availability of homes affordable to working families. For example, in 2004, New York, N.Y., announced a 10-year, $7.5 billion plan to address the city's need for affordable homes. The multifaceted plan calls for the preservation of 73,000 affordable homes to benefit 220,000 people, and the development of an additional 92,000 new affordable homes to benefit another 280,000 people. Among other sources of funding, the plan utilizes $540 million in funding from the reserves of the New York City Housing Development Corporation, a local housing finance agency in New York City.[73]

While there is no one measure that policy-makers can use to determine whether a housing finance agency's reserves can be utilized to support additional investments in affordable homes – and some level of trust of housing finance agency staff is essential – one broad measure to consider is the agency's debt-to-equity ratio, which varies significantly from agency to agency.[74] Agencies with lower debt-to-equity ratios are more likely to have funds that could safely be tapped to support a greater investment in affordable homes without unduly impacting their bond rating (and thus their cost of capital). It is also important to note that most tax-exempt bonds for housing come with credit enhancement from the Federal Housing Administration (FHA), Fannie Mae, Freddie Mac or others, which means the bonds can carry a very high rating notwithstanding the finance agency's own general rating.

[73] New York City Department of Housing Preservation and Development. 2004. *The New Housing Marketplace: Creating Housing for the Next Generation: 2004-2013*, http://www.nyc.gov/html/hpd/downloads/pdf/10yearHMplan.pdf; Remarks of New York Housing Commissioner Shaun Donovan in Chicago at a summit sponsored by the National Housing Conference, Oct. 11, 2006.

[74] One source of detailed information on the relative fiscal strength of housing finance agencies is Fitch Ratings, which regularly produces a report providing statistical information on all state housing finance agencies. Standard & Poor's also produces a "Public Finance Report Card: U.S. Housing Finance Agencies," which includes information on the 24 state housing finance agencies that they rate.

Assessment

- **Ease of Financing/Cost-Effectiveness.** Very High. This funding stream does not require additional appropriations or taxes. It is not an unlimited piggy bank, however, as agencies require a healthy amount of reserves to back their obligations, keep up their bond rating and ensure stability of their ongoing operations.

- **Magnitude of Potential Impact.** High.

- **Replicability.** Depends on the state or locality. Some states and localities are likely to have more room to tap their reserves or program revenues than others. While there are exceptions, as a general rule, newer agencies have issued fewer bonds and have had less time to accumulate reserves than older agencies.

- **Flexibility.** High.

- **Ease of Implementation.** High.

17. Leverage employers' commitment to affordable homes for workers

A growing number of employers in strong housing markets are worried that the high cost of homes will threaten their ability to attract and retain qualified workers. In some cases, this has led employers to provide employee benefit programs to offset the costs of homes or to otherwise assist employees in finding affordable homes. In other cases, employers have supported more general efforts to increase the availability of affordable homes in the community by funding the development of affordable homes, advocating for the appropriation of funds for affordable homes at the state or local levels, or supporting applications for zoning variances and other necessary approvals to facilitate the construction of affordable homes.

Communities have adopted a number of strategies to engage employers in leading or assisting efforts to increase the availability of affordable homes. Under one successful approach, states give employers who invest in affordable homes a credit against their state income taxes, providing a powerful incentive for employers to make this investment. The state of Illinois, for example, provides a state tax credit on qualified affordable housing investments made by employers that is equal to 50 percent of the employer's investment.[75] Practitioners report that the credit has been very effective in stimulating interest among employers in investing in affordable homes for their workers.

Another successful approach has been to enlist a local nonprofit organization to manage employee benefit programs related to affordable homes. Under this approach, communities assist the nonprofit to build its capacity to handle these programs for multiple employers. A number of models have sprung up that use centralized servicers who provide a full range of housing services for the employees of participating employers, such as homeownership education and counseling, down payment assistance, below-market mortgages, assistance with security deposits, rental subsidies, etc.

For example, in Illinois, more than a dozen nonprofit organizations have joined forces to establish the Regional Employer-Assisted Collaboration for Housing (REACH).[76] Interested employers contact REACH, which helps the employers identify their needs, understand their options and connect with participating nonprofits. The work of REACH's two anchor organizations – the Metropolitan Planning Council and Housing Action Illinois – are supported by a broad consortium of funders, including Bank One Foundation, the City of Chicago Department of Housing, Fannie Mae Corporation, Fannie Mae Foundation, the Federal Home Loan Bank of Chicago, The John D. and Catherine T. MacArthur Foundation, Illinois Housing Development Authority, McCormick Tribune Foundation, National City

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[75] Metropolitan Planning Council. 2005. Employer-Assisted Housing State Tax Credit: A New Financial Incentive, http://www.metroplanning.org/cmadocs/EAH-taxcredit.pdf.

[76] For more information, see http://www.reachillinois.org.

Bank, Polk Bros. Foundation and Washington Mutual.

A third strategy for states and localities to consider is to use their bully pulpit to encourage employers to offer affordable homes as a benefit for their workers. For example, on Feb. 8, 2005, Chicago, Ill., Mayor Richard M. Daley met with over 120 business leaders at a breakfast to spotlight employer-assisted housing.[77] By recognizing the business leaders that had already agreed to participate, and publicly encouraging other leaders to participate, Mayor Daley elevated the profile of employer-assisted housing within the business community.

State and local leaders also can encourage the business community to assume a leadership role in efforts to increase the availability of affordable homes in their communities. Employers interested in providing homes for their workers can be a potent political force advocating for approval of affordable developments that might otherwise get hung up in the planning or zoning processes. Business leaders also can help support needed changes in state or local housing policy.

In some cases, they also can provide much needed funding to support general efforts to increase the availability of affordable homes. For example, due to low vacancy rates and rising home prices, Rochester, Minn., was rapidly becoming unaffordable. Recognizing the need for more affordable homes for its 26,000 employees and other community residents, the Mayo Clinic pledged $7 million toward a regionwide affordable homes effort. Together with $3 million in contributions from other employers, $1 million from local foundations, $3 million from the Minnesota Housing Finance Agency and $5.5 million in financing from the Greater Minnesota Housing Fund, the project raised $19.5 million to support its ambitious goals. By year end 2006, the effort produced 486 affordable single-family homes and 313 affordable multifamily homes. Local leadership by the city of Rochester and the Rochester Area Foundation played important roles in the project.

Similarly, working families in Charlottesville, Va., are benefiting from an affordable housing trust fund established by the Charlottesville Area Association of Realtors (CAAR). The trust fund finances the CAAR Workforce Housing Plan, a program that provides no-interest second mortgages to Charlottesville area teachers, police, nurses and firefighters. Homes must be purchased in the jurisdiction where the borrower works. Upon sale of the home, the loan must be paid back and is then available to assist another family. This program demonstrates the capacity of Realtors to assist in working families' search for affordable homes. Contributors to the trust fund include foundations, corporate donors, individuals and CAAR.

[77] Rita Padawangi. Feb. 22, 2005. Mayor Daley Supports Employer-Assisted Housing in Chicago. Metropolitan Planning Council, http://www.metroplanning.org/articleDetail.asp?objectID=2639.

Finally, states and localities can offer employer-assisted housing as a benefit for city workers. This approach not only will help meet unmet housing needs in the community, but also will offer an example for the private sector to follow, and will allow the city to attract and retain high-quality workers. For example:[78]

- *Columbia, S.C*. The Employee Home Loan Program provides city employees with below market-rate financing (including a low down payment requirement of just $1,000) for the purchase, rehabilitation or construction of a home in the city. The Police Homeowner Loan Program, winner of a 1993 Innovations in American Government Award, offers low-interest, no down payment, 20-year mortgages for police officers to rehabilitate a residence in the city. Police officers who are city residents receive additional incentives in the form of bonuses and increased promotion eligibility.[79]

- *Maryland*. State government employees can receive up to $10,000 in down payment and closing cost assistance from the state through the House Keys 4 Employees (HK4E) program. The HK4E program also will provide up to $5,000 in funds to match contributions by other participating employers in Maryland. Many county and local governments, as well as nonprofit and for-profit businesses, are participating employers, expanding the reach of this employer-assisted housing program. HK4E assistance is provided as a 0 percent deferred loan payable upon sale of the property or refinancing.[80]

- *Lexington, Ky*. The Lexington-Fayette Urban County Government's Live Where You Work program offers forgivable loans of up to $7,400 for down payments on homes purchased by full-time employees of the county. Lower-income employees qualify for larger loans, up to $14,999. The University of Kentucky also administers a Live Where You Work program with down payment loans of up to $15,000. Under each program, the loans are forgiven after five years of owner-occupancy.[81]

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[78] These examples come from: Bonnie Mann. 2006. *Housing Assistance for Municipal Employees: A Municipal Action Guide*. Washington, D.C.: National League of Cities.

[79] For more information, see http://www.nal.usda.gov/pavnet/cp/cppolhom.htm.

[80] For more information, see http://www.morehouse4less.com/hk4Employees.aspx.

[81] For more information, see ftp://ftp.lfucg.com/LFUCG/EAHP_Brochure.pdf and http://www.uky.edu/HR/benefits/EAHP/.

Assessment

- **Ease of Financing/Cost-Effectiveness.** High to Very High. Many employer-assisted housing programs require little or no commitment of public funds. A state or local tax credit for employer-assisted housing obviously has a cost in terms of reduced tax revenue, but to the extent such funds would have been spent anyway on affordable homes, this approach helps to increase their impact.

- **Magnitude of Potential Impact.** Moderate. Most employer-assisted housing programs are relatively small in scope, but as the principle becomes established, interest is expected to grow.

- **Replicability.** High.

- **Flexibility.** High. Employer-assisted housing can be tailored to any income group.

- **Ease of Implementation.** Moderate. Requires one to sign up employers individually. As employer-assisted housing campaigns gain critical mass, however, some employers may feel competitive pressure to offer the program in order to remain competitive. The local chamber of commerce can be helpful in recruiting participants.

Preserve and recycle resources for affordable homes

18. Preserve affordable rental homes

Over the past decade, there has been a growing awareness of the importance of preserving the existing inventory of affordable rental homes. Especially in cities with an older, high-quality rental stock, preservation can be a highly cost-effective policy for ensuring the availability of affordable homes for working families.

In many cases, preservation efforts have focused on ensuring the ongoing affordability of developments with expiring federal or state subsidies. In other cases, efforts also are underway to preserve the ongoing affordability of unsubsidized developments that provide quality, affordable homes. Every year, a portion of this unsubsidized but affordable inventory is lost because of either inadequate maintenance or substantial upgrades that price the homes out of reach.

To preserve the affordability of unsubsidized rental homes, several cities have worked with nonprofit lending institutions to help smaller property owners access affordable capital to modernize their properties and provide capital for larger rehabilitation projects that help maintain the supply of affordable rental homes. Some cities also have established incentives, such as abatements of property taxes, to encourage owners of these properties to reinvest in their properties and maintain ongoing affordability.

Among other notable examples of nonprofit lending institutions with a specific focus on rental home preservation are the following:

- *New York, N.Y.* The Community Preservation Corporation (CPC) is a nonprofit organization, sponsored by more than 80 prominent banks and insurance companies, which provides loans to support the construction and rehabilitation of multifamily homes — both for rent and for sale. CPC functions as a one-stop shop for owners and developers seeking to build or rehabilitate properties, providing both technical assistance and attractively priced financing. In its 32 years, CPC has financed more than 117,000 new or rehabilitated units, providing or facilitating some $5.3 billion in investment. CPC works closely with New York City's HPD and Housing Development Corporation (a local housing finance agency) to advance their shared goals of stronger communities and more affordable homes.[82]

- *Chicago, Ill.* Community Investment Corporation (CIC) is a nonprofit mortgage lender, sponsored by more than 45 banks as well as Fannie Mae, the United Methodist Pension Fund and Peoples Energy. These investors have pledged in excess of $550 million through 2010 for

[82] For more information, see http://www.communityp.com.

CIC's revolving loan pool, which CIC uses to fund reasonably priced loans to support the rehabilitation of older multifamily and other homes. Since 1984, CIC has made 1,286 loans totaling $720 million for the rehabilitation of 35,300 units of quality affordable homes for about 110,000 Chicago area residents. CIC also administers: a property management training program to provide landlords with the knowledge to better market, manage and maintain residential property; the Troubled Building Initiative, which targets the worst buildings in a neighborhood for transfer to a new owner who will rehabilitate them with CIC funds; technical assistance to support rehabilitation activity by borrowers; and a variety of other grant and loan programs. CIC works closely with the city on many aspects of its operations, including the Troubled Building Initiative and a subsidy program that CIC administers in targeted areas.

A third notable example is Shorebank, which is active in Chicago, Ill.; Cleveland, Ohio; Detroit, Mich.; and other locations.[83]

Developing a preservation strategy

As part of an overall approach to meeting the housing needs in their communities, states and localities should consider including a specific focus on the preservation of affordable rental homes. The following are some general observations about how state and local governments can do this effectively:

- *Include a specific focus on housing preservation in your overall housing plans*. Start by assessing the importance of housing preservation in your community. Preservation is likely to be particularly important in communities with an aging stock of rental homes that nevertheless could be maintained as an asset for the future, as well as in communities with significant numbers of properties with expiring affordability covenants. Consider developing separate policies to address the preservation of both federally subsidized homes and affordable unsubsidized homes.

- *Monitor the expiration of federal subsidies or insurance*. States and localities should keep track of federally assisted or insured properties with expiring subsidies or affordability restrictions or, where there is a high risk of prepayment, to help identify the extent of this component of the preservation challenge and be prepared to help meet it. The National Housing Trust provides a good database.[84]

[83] For more information, see http://www.shorebankcorp.com.

[84] For more information, see http://www.nhtinc.org/data_map.asp.

- *Educate owners of federally assisted or insured housing about the latest incentives available from the federal, state and local governments to facilitate the preservation of affordable homes.* Federal incentives include Mark-to-Market (a program for project-based Section 8 properties with above-market rents that provides for restructuring at market rents, which may include an infusion of new capital for renovations), Mark-Up-to-Market (a program to allow project-based Section 8 properties with below-market rents to raise their rents to market), and budget-based rent adjustments (which allow rent increases tied to certain increased expenses). Some localities, like Los Angeles, Calif., have appointed a preservation coordinator to facilitate this work.

- *Provide additional incentives to ensure continued affordability.* A number of state housing finance agencies have adopted programs to provide incentives to rental property owners either to remain in federal subsidy programs or to continue to provide affordable homes, even after they choose to opt out of federal subsidy programs or prepay their federally insured mortgages. Colorado, Maine and Virginia are among a number of states that provide incentives to property owners in the form of mortgage refinancing, loan modifications and interest-rate reductions in exchange for extended affordability commitments. The state of Michigan has an array of state programs to preserve affordable rental homes, including a set-aside of $325 million in private-activity bond authority in 2006 to support the preservation of various types of HUD-assisted properties through tax-exempt financing and 4 percent tax credits, a set-aside for preservation projects of 30 percent of its annual 9 percent Low-Income Housing Tax Credit authority, and a Preservation Fund to provide additional gap financing where needed. States also have encouraged owners not to sell off affordable developments by providing access to accumulated equity in the form of equity takeout loans.[85]

- *Provide tools to facilitate the rehabilitation and/or recapitalization of both subsidized and market-rate affordable rental homes*. The Housing Preservation Corporation and Housing Investment Corporation, discussed above, are good examples of nonprofit lending corporations that play a vital role in making capital available for preservation efforts, in partnership with local government. Key examples of government tools include tax abatements for rehabilitated properties and the use of 4 percent tax credits for rental housing preservation – both of which are discussed elsewhere in this analysis. Many states also prioritize preservation deals for a portion of their 9 percent tax credits, which can be helpful for deals that require a significant amount of rehabilitation to generate a quality, lasting affordable housing resource.

- *Facilitate the transition of expiring properties to nonprofits or mission-driven for-profits*. Another approach is to facilitate transfer of properties with expiring affordability covenants to

[85] See generally National Housing Trust. 2006. Working Paper: State and Local Housing Preservation Initiatives, http://www.nhtinc.org/documents/Pres_Scan_May2006_final.pdf and Brian Galle. October 1999. Preserving Federally Assisted Housing at the State and Local Level: A Legislative Tool Kit. *Housing Law Bulletin* 29: 183-190. National Housing Law Project.

nonprofits or mission-driven for-profits willing to maintain the properties as affordable. For example, Washington, Minnesota and California all have allocated funds to subsidize these transfers, as has San Francisco, Calif. To help developers of affordable homes or public agencies gain site control, a number of state and local governments have adopted policies providing these developers with "rights of first refusal" for formerly subsidized properties.[86]

- *Facilitate the transfer of federal subsidies or mortgage debt to other properties*. Under Section 318 of the 2006 HUD Appropriations Act, various federal subsidies and mortgage debt can be transferred from properties that are aging and in poor condition to other properties that promise a better living environment.[87] Facilitating this transfer – especially to a nonprofit or other owner interested in maintaining the property as affordable over the long run – can help ensure the limited supply of federal subsidies are used effectively to maintain long-term affordability.

- *Build the capacity of nonprofits, housing authorities or mission-driven for-profits to handle the often complex work of housing preservation*. Jurisdictions should recognize that housing preservation can be complicated, especially when there are multiple layers of federal financing involved. Nonprofits, housing authorities and mission-driven for-profits are an indispensable part of the preservation team, but may need assistance building their capacity to complete these deals.

- *Tap the national expertise on this issue*. Among other groups with substantial expertise on housing preservation are the National Housing Trust (www.nhtinc.org), LISC (http://www.lisc.org/section/areas/sec4/preservation), Enterprise Community Partners (http://www.enterprisecommunity.org), the National Housing Law Project (www.nhlp.org) and the Housing Assistance Council (www.ruralhome.org).

- *Ensure that newly subsidized rental properties are both adequately capitalized and affordable for as long as possible*. Long affordability periods have become the norm for affordable rental homes. To ensure there is a decent chance these periods can be satisfied, it is important that properties be adequately capitalized to generate sufficient funds for maintaining the properties in strong physical condition over the long term. Even with more generous coverage ratios, some infusion of additional equity may be needed down the road to ensure properties can be modernized to keep up with current standards.

[86] A list of states providing rights of first refusal is available at www.nhlp.org/html/pres/state/state_chart.htm.

[87] Technically, this authority lasts only for one year. Advocates and practitioners hope that the authority will be extended.

Assessment

- **Ease of Financing/Cost-Effectiveness.** High. Most practitioners agree that housing preservation deals tend to be less expensive than new construction, in part because they involve rehabilitation rather than new construction, and in part because they often come with other long-term subsidies, such as Section 8, that can support debt.

- **Magnitude of Potential Impact.** The overall impact of housing preservation work is high, but much of it is focused on subsidized properties serving families with incomes somewhat below the core focus group of this analysis. As communities gain more experience with preserving unsubsidized properties, it is possible that tools will emerge that have the potential for a wider impact for families in the 50 to 80 percent of AMI group. (Except in the very highest cost markets, most families with incomes above 80 percent of the area median can afford decent-quality, unsubsidized rental homes.)

- **Replicability.** High.

- **Flexibility.** Moderate. Many of the federal tools are very prescriptive, but state and local tools can and should be very flexible.

- **Ease of Implementation.** Low to Moderate. The preservation of subsidized properties is often complicated and time-consuming, but there is a substantial body of experience in how to do these well and a lot of technical assistance available. Also, some of the other tools – notably, tax abatements for rental housing rehabilitation – are much easier to administer.

Federal Policy Recommendation to Support Exit Tax Relief Legislation

A number of aging properties are in danger of falling into disrepair due to the properties' tax status. These are properties whose owners benefited from accelerated depreciation under federal laws in effect until the mid-1980s. Many such properties would, if sold, carry a tax liability that would be greater than the properties' residual value. While these owners have already received tax benefits associated with these properties, the fact remains that owners are hanging on to properties they have no interest in managing anymore simply to avoid this tax liability. Many of these properties also have structures that inhibit the injection of additional capital for rehabilitation without the sale of the property. The result is their gradual deterioration.

By exchanging relief from this "exit tax" with a requirement to sell the property to organizations willing to maintain affordability for at least 30 years, federal exit tax relief would contribute greatly to affordable housing preservation efforts.

19. Recycle down payment assistance

State and local down payment assistance programs are extremely common. By helping moderate-income families provide a down payment on a home and reducing the amount of mortgage required, these programs help to expand homeownership opportunities for thousands of families.

The great variation in the structure of down payment assistance programs from community to community makes it somewhat difficult to generalize about these programs. However, a HUD study of homebuying activity funded with HOME Investment Partnerships funds found that roughly half of down payment assistance programs provided assistance in the form of a grant or forgivable loan, while the other half utilized a deferred second mortgage in which the funds were required to be repaid – usually when the home was sold or refinanced.[88] While anecdotal reports suggest there may be a trend toward deferred second mortgages, there are still numerous down payment programs that utilize outright grants or forgivable loans.

While often preferable to outright grants, forgivable loans are essentially similar to grants because they permanently transfer funds from the government to the home purchaser. The concept of a forgivable loan appears to be related principally to federal requirements in the HOME program that tie the duration of home affordability to the level of HOME funds invested. At a minimum, the HOME program requires owner-occupied units financed with HOME funding of less than $15,000 to be affordable for five years. Owner-occupied units financed with HOME funds of between $15,000 and $40,000 must remain affordable for at least 10 years, while those with more than $40,000 of HOME investment must be affordable for at least 15 years. *(24 CFR 92.294.)* Jurisdictions have the option of forgiving a portion of the assistance each year or waiting until the end to forgive it all at once.

While down payment assistance programs that provide assistance in the form of a grant or a forgivable loan meet the technical requirements of the HOME program (and also of other common sources of funding, such as the CDBG program), they are much less efficient than programs that require 100 percent of the funds to be repaid so they can be used to help other families.

There are a number of different approaches to requiring down payment assistance to be repaid in full. Some programs provide assistance in the form of a fixed, below-market second mortgage and, thus, require regular, monthly payments. Others defer payments for a period of time – such as five years – after which regular monthly payments start. But, the most common approach appears to be to utilize a so-called "silent second" or "due on sale" mortgage that defers all repayment of principal or interest until the home is resold.

[88] Jennifer Turnham, Christopher Herbert, Sandra Nolden, Judith Feins and Jessica Bonjorni. 2004. *Study of Homebuyer Activity through the HOME Partnerships Program*. Prepared for the U.S. Department of Housing and Urban Development by Abt Associates, Inc. Washington, D.C.

Because no monthly payments are required until the home is sold (or in some cases refinanced), a silent second mortgage is just as effective as a grant in reducing the first mortgage requirements of home purchasers. Under both approaches, the family's monthly payment is the same. The difference is what happens when the home is sold. A family that has received assistance in the form of a grant will get to keep the assistance, while a family that received assistance in the form of a second mortgage will be required to pay it back so the funds can be used to assist other families. A family that received assistance in the form of a forgivable loan also does not have to pay the assistance back provided the family stayed in the home long enough to achieve full forgiveness.

The Center for Housing Policy is in the process of collecting and analyzing data on precisely how many more families could be served by recycling down payment assistance rather than giving it away in the form of a grant or a forgivable loan. Our preliminary calculations suggest that, due to repayments of silent second mortgages, a jurisdiction that shifted from a grant (or forgivable loan) approach to a silent second mortgage approach could gradually serve more and more families such that, by about the eighth year, they could be serving 50 percent more families per year.[89]

An example of this policy in action may be found in Tucson, Ariz., where the city provides down payment assistance in the form of a silent second mortgage with 2 percent simple interest. (The interest is forgiven if a family stays in a home for 20 years.) Since the program's inception in 1994, Tucson has invested about $9.5 million and generated approximately $4 million in program revenue – mostly through repayments of silent second mortgages. From 2002 until May 2006, for example, 213 families repaid their second mortgages, returning program funds to help many more families become homeowners.[90]

Deferred mortgages also give jurisdictions a way of keeping pace with hot housing markets. Some jurisdictions require that, in addition to paying back the principal of a deferred or silent second mortgage, families repay a portion of home price appreciation. This approach helps the jurisdiction keep pace with the rapid rise of housing prices, while ensuring that the participant retains a portion of home price appreciation for investment in future homes or other asset needs.

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[89] This assumes a relatively conservative repayment rate of 6 percent per year. Jurisdictions that require repayment upon refinancing, as well as resale, are likely to experience much higher repayment rates.

[90] Data provided by Tucson Community Development Administrator Ron Koenig in May 30, 2006 e-mail to author.

Assessment

- **Ease of Financing/Cost-Effectiveness.** Very High. Recycling down payment assistance allows a jurisdiction to serve more families with the same amount of funds.

- **Magnitude of Potential Impact.** High. While the exact amount of funding spent on government down payment assistance programs each year is unknown, the HOME program reports that HOME jurisdictions spent $832,547,207 on this activity between 2002 and 2006 (four full years and one partial year). Other major sources of down payment assistance include the Community Development Block Grant program and housing trust funds.

- **Replicability.** High.

- **Flexibility.** High.

- **Ease of Implementation.** Moderate to High. While some new procedures are required to shift from grants to second mortgages, in general, this activity is not difficult to implement and can be done unilaterally by a jurisdiction. The principal administrative burdens associated with this activity come from the need to monitor home sales to make sure loans are repaid and the responsibilities associated with accounting for and spending the recaptured funds (known as program income). In general, it makes sense for the amount of monitoring to be commensurate with the amount of outstanding loans. While accounting for and spending program income involves an administrative cost, it more than pays for itself through increased benefits to the community.

Federal Policy Recommendations to Facilitate and Incentivize the Recycling of HOME Funds

HUD should recognize the increased costs associated with administering a HOME or CDBG program that maximizes program income through the effective recycling of funds and work to: (a) streamline the administrative process associated with the generation of program income; and, (b) provide jurisdictions with incentives to recycle funds, such as somewhat higher administrative fees to cover their higher administrative costs.

20. Use shared equity mechanisms to create mixed-income communities[91]

In some communities, policy-makers have grown concerned that millions of dollars invested in fostering homeownership opportunities for first-time homebuyers may have provided only temporary relief because of the continuing rise in home prices. Homes that were once made affordable through large public subsidies or inclusionary zoning policies have become out of reach of working families upon resale.

Sharp increases in home prices also have jeopardized efforts to preserve or foster communities with a mix of incomes. By buying down the cost of a modest number of homes in neighborhoods with good access to jobs or public transit, communities have helped to ensure that opportunity-rich neighborhoods are accessible to families with a mix of incomes. As home prices increase, however, the affordable homes become unaffordable on resale, undermining the neighborhoods' mixed-income character.

This problem exists even if the homes have resale restrictions preserving affordability for 20, 30 or even 40 years. Whenever they expire, time-limited resale restrictions ultimately allow the homes to be sold for full market value, eliminating the home from the affordable stock and providing the lucky beneficiary with a huge windfall that combines both the initial public subsidy and subsequent home price appreciation. This problem is less acute when the public subsidy is small – say $2,000 or $5,000 – but becomes more serious as the public subsidy increases. In some parts of the country, it is not uncommon for homeownership subsidies to exceed $25,000 per unit or more. (In parts of California, deep homeownership subsidies may even exceed $100,000.)

The problem is not that the moderate-income homeowner accumulates assets – that's a positive – but rather that the individual's gain has come at the expense of the home's ongoing affordability, undermining efforts to sustain mixed-income neighborhoods. The expiration of the resale restrictions also sets back the community's long-term efforts to reduce its need for affordable homes.

A growing number of states and localities have addressed this problem by adopting "shared equity" approaches that balance asset accumulation by home purchasers with ongoing affordability. Under these approaches, families that benefit from large public subsidies to purchase a home agree to share any home price appreciation that occurs with the entity that provided the subsidy. Well-designed shared equity approaches allow working families to purchase a home and generate a healthy return on their investment, while simultaneously ensuring the public's investment keeps

[91] Portions of the analysis of this policy option were previously prepared by the author in connection with other projects funded by the Annie E. Casey Foundation.

pace with the market, so there is no reduction in the number of families that can be assisted over time.

Balancing long-term affordability and individual asset accumulation

The three most common shared equity approaches are as follows:

A. Subsidy recapture. Under this model, assistance is generally provided in the form of a silent second mortgage, on which no payments are owed until the home is resold. Upon resale, the second mortgage is repaid, usually without interest. This is a fairly common approach, especially for revolving loan funds maintained by nonprofits, as well as for some government-funded down payment programs.

B. Shared appreciation. Under this model, a silent second mortgage is provided that is then repaid upon resale, plus some additional amount intended to help the original subsidy pool keep pace with the market. The additional payment can be structured as a share of home price appreciation (e.g., 50 percent of home price appreciation), as interest (e.g., 5 percent annual interest), or as a combination (e.g., 75 percent of home price appreciation, but not to exceed deferred interest of 5 percent per year). This is one of several models that have emerged in California and other locations where large amounts of down payment assistance (in some cases as much as $75,000 per unit or more) are needed to help low-income buyers purchase homes. The city of Santa Cruz, Calif., for example, collects 1 percentage point of home price appreciation for every percentage point of the purchase price funded by the city's second mortgage program. For example, down payment assistance equal to 20 percent of the home purchase price would, upon sale of the home, require repayment of the principal balance plus 20 percent of home price appreciation in lieu of interest.[92]

C. *Indexed affordability*. Under this model, the subsidy is structured so that the unit remains affordable on an ongoing basis to the target income level. Usually, this is accomplished by writing down the initial sales price to a level affordable to a purchaser at the target income level and then linking the resale price to an index, such as changes in AMI, and requiring that the home be sold to someone with a qualifying income (or back to the subsidy sponsor). (More complicated versions ensure strict affordability by taking into account changes in interest rates.) Among other sites that have adopted an indexed affordability approach are the Massachusetts Department of Housing and Community Development (change in AMI); the city of Boulder, Colo., (either the change in AMI or the change in the Consumer Price Index, whichever is less, with an annual cap of 3.5 percent); and A Regional Coalition for Housing

[92] Other locations that have employed the shared appreciation model include Howard County, Md.; San Diego, Calif.; Stanford University; University of Colorado at Boulder; and Northbay Family Homes in Marin County, Calif. Similarly, the Sawmill Community Land Trust in Albuquerque, N.M. seeks to maintain affordability by allowing buyers to retain only 25 percent of home price appreciation.

(ARCH) in Eastern King County, Wash., (average of change in AMI and change in home resale prices). In California, one particular indexed affordability approach – a complicated formula that requires that homes remain affordable to families at 80 percent of AMI, even if interest rates change – has been incorporated into state law and, as a result, is utilized in many publicly funded programs.

The following example shows how these models might play out over the course of 21 years in the event that home price appreciation outstrips income growth. For the purposes of this example, take a home with an initial market value of $227,750 that requires $104,265 to be made affordable to a family with an income of $50,540 a year (in this particular location, 70 percent of AMI). Assume home prices rise 5 percent per year and incomes rise 3 percent per year, with the homes resold every seven years. (The full set of assumptions is shown in the box below.[93])

Assumptions:

Initial market value/purchase price:	$227,750
Initial AMI (4 persons) =	$72,200
Initial family income =	$50,540/year (70 percent AMI)
Family down payment =	$5,000
Property taxes (monthly) =	$347
Insurance (monthly) =	$114
Condo/HOA* fee (monthly) =	$50
Mortgage insurance =	$0
Initial mortgage =	$118,485 (6 percent fixed, 30 years, 29 percent front-end ratio)
Subsidy =	$104,265

Home prices rise 5 percent per year (simple, not compounded)
Incomes rise 3 percent per year (simple, not compounded)
The homes are resold every seven years
Interest rates stay constant (a simplifying assumption)
Sales commission = 6 percent

*HOA = Homeowners Association

The charts on the next page show the outcome of five different approaches to that subsidy. Under the baseline scenario, the subsidy takes the form of a forgivable loan, in which 10 percent is forgiven each year. Under option A, the subsidy is provided in the form of a silent second mortgage, in which 100 percent of the subsidy is repaid upon resale of the home, but without any interest. Options B1 and B2 show the results of two different shared appreciation models – the first in which the owner receives 75 percent of the home price appreciation and the source of the fund receives 25 percent,

[93] Cost differences are sensitive to the "base" on which both home price appreciation and brokers' fees are calculated. For all models except the indexed affordability model, these calculations assume that homes are sold at full market values, with deep second mortgages retained by an equity fund. Calculations for the indexed affordability model, by contrast, assume that the subsidy is used to write down the initial purchase price, and so sales price growth is calculated on this reduced base.

and the second in which the appreciation is split 50/50. The last option – option C – shows what happens when the sales price of the home is tied to changes in AMI.

The rows under each scenario show what happens every time the home is sold, with the last column in each row showing the amount of new subsidy that would be needed to make the home affordable again to someone at the target income level of 70 percent of AMI. That last column is the key variable used to compare the costs of the different approaches over a 21-year period.

Baseline. Forgivable Loan. Subsidy takes the form of a forgivable loan, in which 10 percent is forgiven per year.

	Sales Price	Income	Mortgage	Down Payment	Recaptured Subsidy	New Subsidy Needed
Year 0	$227,750	$50,540	$118,485	$5,000	0	$104,265
Year 7	$307,463	$61,153	$131,435	$6,750	$31,279	$137,998
Year 14	$387,175	$71,767	$144,356	$8,500	$41,399	$183,535
Year 21	$466,888	$82,380	$157,426	$10,250	$57,876	$228,916
TOTAL						**$654,714**

A. Subsidy Recapture. Subsidy is provided in the form of a silent second mortgage, which is repaid on resale without interest.

	Sales Price	Income	Mortgage	Down Payment	Recaptured Subsidy	New Subsidy Needed
Year 0	$227,750	$50,540	$118,485	$5,000	0	$104,265
Year 7	$307,463	$61,153	$131,435	$6,750	$104,265	$65,012
Year 14	$387,175	$71,767	$144,356	$8,500	$169,277	$65,041
Year 21	$466,888	$82,380	$157,426	$10,250	$234,319	$64,893
TOTAL						**$299,211**

B1. Shared Appreciation. Subsidy is provided in the form of a silent second mortgage, with home price appreciation split 75 percent to owner, 25 percent to fund.

	Sales Price	Income	Mortgage	Down Payment	Recaptured Subsidy	New Subsidy Needed
Year 0	$227,750	$50,540	$118,485	$5,000	0	$104,265
Year 7	$307,463	$61,153	$131,435	$6,750	$119,581	$49,696
Year 14	$387,175	$71,767	$144,356	$8,500	$183,398	$50,921
Year 21	$466,888	$82,380	$157,426	$10,250	$247,243	$51,968
TOTAL						**$256,850**

B2. Shared Appreciation. Subsidy is provided in the form of a silent second mortgage, with home price appreciation split 50/50 between owner and fund.

	Sales Price	Income	Mortgage	Down Payment	Recaptured Subsidy	New Subsidy Needed
Year 0	$227,750	$50,540	$118,485	$5,000	0	$104,265
Year 7	$307,463	$61,153	$131,435	$6,750	$134,897	$34,380
Year 14	$387,175	$71,767	$144,356	$8,500	$197,518	$36,800
Year 21	$466,888	$82,380	$157,426	$10,250	$260,168	$39,043
TOTAL						**$214,488**

C. Indexed Affordability. Subsidy stays in unit. Resale price = original price plus (original price times change in AMI).

	Sales Price	Income	Mortgage*	Down Payment	Recaptured Subsidy	New Subsidy Needed
Year 0	$123,485	$50,540	$118,485	$5,000	$0	$104,265
Year 7	$149,417	$61,153	$143,368	$6,049	$0	$0
Year 14	$175,349	$71,767	$168,250	$7,098	$0	$0
Year 21	$201,281	$82,380	$193,132	$8,148	$0	$0
TOTAL						**$104,265**

* Slower property tax and insurance growth leads to greater borrowing power.

As these examples illustrate, the total amount of subsidy needed to ensure continued affordability over a 21-year period can vary significantly, depending on the model chosen. In this case, the costs over 21 years range from $104,265 under the indexed affordability model to $654,714 under the forgivable loan scenario. As this analysis shows, the indexed affordability model is by far the most cost-effective model.

The amount of wealth accumulation by individual homeowners runs in the opposite direction, with maximum wealth-building occurring with the forgivable loans and the least amount of wealth accumulation under the indexed affordability model. This does not mean, however, that the indexed affordability model leaves *no* opportunity for wealth creation. To the contrary, the initial purchaser under this model would build $12,275.98 in equity over seven years through the pay-down of principal and then realize another $16,966.84 on home price appreciation (even after a 6 percent broker's fee), plus return of their $5,000 down payment, for a total take-away of $34,242.82 on an initial $5,000 investment. This is equivalent to a 25 percent annual return on the purchaser's investment – a return that dwarfs any other investment other than standard fee-simple homeownership!

Between 1974 and 2001, median incomes rose at an annual rate of 5.36 percent in the United States. This is nearly the same rate as the increase in average home prices between 1974 and 2004 (5.95 percent), suggesting that, over time, the indexed affordability approach can provide asset accumulation that is similar to the other approaches.[94] Home prices generally are more volatile than incomes, however, meaning that in any given time frame, the potential for sharp increases in asset accumulation, or on the flip side, a loss of equity, is greater under a model tied to home prices than one tied to income. The increased costs of the models based on a share of home price appreciation, over those tying home prices to income, come from letting individual families benefit from those home price spikes, and then writing down the sales price for the next purchasers to a more affordable level.

The Center for Housing Policy is working on a policy brief that will study this issue in greater detail, providing examples of how these and other models perform in different market conditions. The

[94] See Rick Jacobus. 2005 draft. *Limited Appreciation, Transformative Wealth.* Oakland, Calif.: Burlington Associates.

bottom line conclusion is that there *are* effective models for balancing the competing goals of asset accumulation and ongoing affordability, and that jurisdictions willing to make large investments in owner-occupied units – either directly, through subsidies, or indirectly, through inclusionary zoning or other requirements – should take a hard look at these models as an effective way to add permanently to the stock of affordable homes. Of the various options, indexed affordability appears to represent the best balance of ongoing affordability and individual asset accumulation.

In considering this issue, it is important to recognize that the affordable homes created through large public subsidies are not necessarily the only homes these families will ever own. For example, evidence from the first 100 resales of homes sold in Burlington, Vt., using a shared equity formula shows that a majority moved on to standard fee-simple homeownership, opening up affordable homes for other families.[95]

Alternative Ownership Models

Three main approaches have emerged for putting into practice these and other models for sharing equity and, thus, balancing ongoing affordability with individual asset accumulation:

- *Deed-restricted homeownership*. Under this very common approach, the subsidy is generally applied to reduce the purchase price to a level affordable to homeowners at the target income level. Then, restrictions are put into place requiring that the units be sold to buyers meeting certain qualifications – for example, incomes below 80 percent of AMI – at an affordable price as defined according to a formula set in the sales agreement. While these agreements are sometimes assumed to be self-executing, experience suggests they need to be actively monitored by an entity with an interest in maintaining ongoing affordability.

  An alternative approach would be to sell the units at market levels, with a large second mortgage retained by the sponsor's equity fund. Under this approach, covenants would be put into place requiring that subsequent purchasers have incomes below a certain level and be acceptable to the equity fund, but no purchase price restrictions would be included (or, if they are included, they would specify the home would sell for then-current market values). As a practical matter, the only way the unit would be affordable to someone at the target income level, however, would be for the equity fund to provide a deep second mortgage to the new purchaser.

- *Limited Equity Cooperative*. Under this approach – typically, but not exclusively, applied in a multifamily context – families purchase a "share" in the cooperative, rather than a standard property interest in the home. Members of the cooperative receive a right to occupy one unit, as well as a vote on matters of common interest. Cooperative members share responsibility

[95] John Emmeus Davis and Amy Demetrowitz. 2003. *Permanently Affordable Homeownership: Does the Community Land Trust Deliver on Its Promises?* Burlington, Vt.: Burlington Community Land Trust.

for maintaining common areas and other areas of joint responsibility (e.g., maintaining the roof), as well as the admittance of new members. Share prices are set by formula.

One of the principal distinctions of this model is the concept of common ownership and shared decision-making. Proponents of cooperatives also point to financial advantages stemming from economies of scale and the fact that the mortgage is held by the collaborative, rather than by individuals. There are roughly 400,000 to 500,000 limited or no-equity cooperative units in the country.

In California, legal considerations have apparently led nonprofits interested in developing limited equity multifamily buildings to structure them as limited equity condominiums instead. These are similar to ordinary condominiums except the units have resale restrictions. Mixed-income condominiums – with some of the units having resale restrictions and others not – have been developed in a number of locations.

- *Community Land Trust.* Under this approach, the land is owned by a community land trust (CLT) and then leased to individual home purchasers. The ground lease establishes the conditions under which ongoing affordability is maintained, with the CLT always having the right to repurchase the property. While a purist approach might seek to split costs based on land value versus structural value, in practice, the CLT model is probably capable of incorporating any of the equity sharing formulas discussed above.

  One common approach to governing CLTs is to establish a board of directors consisting of an equal number of representatives of the following three groups: existing owners of homes on land leased from the CLT; homeowners from the surrounding community; and, public officials or other funders of the CLT. Examples of community land trusts include the Dudley Street Cooperative in Massachusetts, the Champlain Housing Trust in Vermont and the Sawmill Community Land Trust in Albuquerque, N.M.

In 2006, the National Housing Institute (www.nhi.org) released *Shared Equity Homeownership: The Changing Landscape of Resale-Restricted Owner-Occupied Housing* by John Emmeus Davis,[96] which provides a thorough overview of this subject for those interested in more details on how the various options work and compare to one another.

[96] John Emmeus Davis. 2006. *Shared Equity Homeownership: The Changing Landscape of Resale-Restricted Owner-Occupied Housing*, http://www.nhi.org/pdf/SharedEquityHome.pdf.

Assessment

- **Ease of Financing/Cost-Effectiveness.** While the initial cost of these programs is high, an indexed affordability approach maximizes the value of public investment by ensuring that the subsidized homes remain affordable over time. There are administrative costs, however, associated with maintaining a community land trust or monitoring the sales of homes with resale restrictions.

- **Magnitude of Potential Impact.** Moderate. While these units are expensive to produce, this approach will ensure that their number grows over time, adding to the nation's stock of affordable homes.

- **Replicability.** High.

- **Flexibility.** High.

- **Ease of Implementation.** Varies. Resale restrictions are fairly easy to implement. CLTs are somewhat harder and require an indefinite commitment from some organization realistically expected to be around for decades into the future. Limited equity cooperatives also may require training and other administrative support.

Empower residents to purchase and retain market-rate homes

21. Expand homeownership education and counseling

Homeownership education and counseling offer important benefits that help families to both attain homeownership and sustain it once they're in place. Among other benefits, homeownership education and counseling prior to purchase (pre-purchase counseling) helps families:

- Determine if they are ready for homeownership;
- Better understand the different mortgage options and access products with favorable terms;
- Improve their credit so they can qualify for lower-cost mortgage products with more reasonable terms;
- Better understand the responsibilities associated with homeownership, including payment and maintenance; and,
- Better understand the dangers of predatory lending and what to do if they run into trouble paying their mortgages.

Continued homeownership and counseling following purchase help families keep up their homes, avoid predatory schemes, and avoid defaults and foreclosure. Some homeownership counseling groups also offer special foreclosure avoidance programs that work with families who are in default to avoid foreclosure.

Although more research is needed, an analysis of Freddie Mac data indicates that certain types of pre-purchase homeownership education and counseling – specifically, classroom education and individual counseling, but not telephone education – can significantly reduce default rates.[97] There is also some initial evidence for the cost-effectiveness of foreclosure prevention counseling.[98]

[97] Abdighani Hirad and Peter M. Zorn. 2002. Prepurchase Homeownership Counseling: A Little Knowledge is a Good Thing. In *Low-Income Homeownership: Examining the Unexamined Goal*, (ed.) Nicholas Retsinas and Eric Belsky. Washington, D.C.: Brookings Institution Press.

[98] See Roberto G. Quercia, Spencer M. Cowan and Ana Moreno. February 2004. *The Cost-Effectiveness of Community-Based Foreclosure Prevention.* Harvard University, Joint Center for Housing Studies Working Paper BABC 04-18, and Ana Moreno. 1998. *Mortgage Foreclosure Prevention: Programs and Trends*. Minneapolis, Minn.: Family Housing Fund. A more complete analysis of the benefits of homeownership education and counseling may be found in *Strengthening the Ladder for Sustainable Homeownership*, 2005, which the National Housing Conference prepared for the Annie E. Casey Foundation.

Much of the research on the benefits of homeownership education and counseling has focused on reducing defaults and foreclosures – a particularly critical issue today in light of the rising use of nontraditional mortgage products in which families never pay down principal and/or are exposed to interest-rate fluctuations after just a few years at a low teaser rate. With interest rates nearly doubling in just a few years, many of these families will not be able to afford to refinance with a conventional product once their introductory periods end. Unfortunately, it seems likely that increases in defaults and foreclosures will become a growing issue in coming years.

But, there is also an important front-end benefit to homeownership. Many families with incomes that are otherwise sufficient to afford to purchase homes with conventional mortgage products (or well-priced subprime products) are nevertheless unable to access these favorably priced mortgages because of poor credit. By helping families to improve their credit, intensive homeownership education and counseling (often in partnership with credit counseling) can help families improve their credit to the point where they can then access the more favorably priced products.

There are a number of challenges facing the homeownership education and counseling industry that are important for state and local governments to be aware of. These include:

- *Ensuring quality*. There is no single definition of what quality homeownership education and counseling consists of. NeighborWorks America – a national intermediary – is working to develop standards. Jurisdictions concerned about this question should contact them (www.nw.org) for more information.

- *Timing*. Many local governments require families to go through homeownership education and counseling before they receive down payment assistance. Unfortunately, many families often go through these courses *after* they have already signed a home purchase contract – perhaps even the weekend before the home sale closes. In general, counseling and education will be much more effective if they take place well in advance of the home purchase so that families can take advantage of the guidance in negotiating a home purchase and mortgage terms.

- *Outreach*. There is a substantial need for groups to conduct outreach to educate a wider group of renters aspiring to be homeowners, as well as vulnerable homeowners, about the homebuying process. These efforts will require partnerships with community organizations as well as funding.

- *Coordination*. In many communities, there is little coordination among the different organizations involved in homeownership education and counseling, and no single point of entry for families to enter the system and ensure they receive the appropriate level of services. Communities that wish to strengthen their homeownership pipelines should

consider efforts to evaluate, coordinate and streamline the existing delivery systems to maximize awareness and utilization of counseling among the target beneficiaries.

Examples

Montana. Between 1998 and 2006, the Montana Homeownership Network created 3,159 homebuyers and graduated more than 10,000 families from homebuyer education. With 23 service delivery partners spread across the state, the network has served families in 201 Montana communities. Through the Montana Board of Housing, the state has supported the Network's efforts by providing $65 million in set-aside funds for first and second mortgages to assist home purchasers counseled by the Network, as well as $500,000 in federal HOME funds for deferred mortgages to be used for down payment and closing costs. The Network also has developed, with the assistance of the Montana Board of Housing, a mortgage-backed security bond that is used to fund amortized down payment assistance loans.[99]

Tennessee. The Tennessee Housing Development Agency (THDA) has increased the quality, quantity and consistency of pre-purchase education programs throughout the state by coordinating nonprofit agencies' homebuyer education efforts through the Tennessee Homebuyer Education Initiative. From 2003 to 2005, the Initiative certified 181 educators at 105 nonprofits, and 12,000 prospective homebuyers received pre-purchase education from certified educators. THDA started the Initiative by surveying Tennessee's nonprofits to determine the state of the state's homeownership education programs. The survey found a strong desire for high-quality programs, but inconsistencies in execution. To address these issues, THDA formed a partnership of nonprofits engaged in homeownership education in the state. Partners have increased the consistency of pre-purchase education programs by following NeighborWorks America's homeownership education curriculum and participating in THDA-coordinated "Train the Trainer" certification. The Initiative, which includes ongoing partner communication and an annual meeting for updates and networking, costs THDA an estimated $250,000 per year. THDA has one full-time employee who manages, evaluates and maintains the Initiative. Nonprofits receive financial incentives to provide quarterly reports on time in order to facilitate THDA's evaluation efforts.[100]

Assessment

- **Ease of Financing/Cost-Effectiveness.** High. While different housing counseling and education groups report very different costs, in general, the costs appear to run between $750 and $3,000 per household. If these costs help to keep down defaults and also improve families' access to private-market capital, they are well worth it.

[99] For more information, see http://www.nw2.org/InnovationContest_2004/rview.asp?entry=12036&back=index%2Easp.

[100] For more information, see http://www.nw2.org/WinningStrategies/display.asp?strategy=1288&offset=304.

- **Magnitude of Potential Impact.** High. Given the growing complexity of the mortgage markets, this service is needed now more than ever.

- **Replicability.** High.

- **Flexibility.** High.

- **Ease of Implementation.** It is easy enough to give more money to existing homeownership education and counseling groups. It is more challenging, though ultimately equally important, to ensure they maintain good data, provide a high level of service and are held accountable for outcomes.

22. Help moderate-income homeowners avoid foreclosure and equity loss

Foreclosures are on the rise in many parts of the country. The cause appears to be the more liberal extension of credit to low- and moderate-income families by so-called subprime lenders and through more exotic financing provided by prime lenders. While increased access to credit and subprime lending generally is not necessarily a bad thing – indeed, it appears to have played an important role in increasing the nation's homeownership rate – foreclosures generally have a devastating effect on the lives of families affected and, when concentrated in particular neighborhoods, also can lead to community instability and decline.

Pre-purchase homeownership education and counseling – policy 21 – play a vital role in reducing foreclosures by helping families avoid predatory or other exploitative financing, prepare for their homeownership responsibilities and access more favorable products. To maximize efforts to prevent foreclosures, however, communities also need to consider post-purchase counseling and foreclosure prevention programs.

Central to such programs is the early referral of families with mortgage defaults to homeownership counseling agencies, which help families understand their options for getting back on track. Some programs also promote toll-free hotlines that families can call if they run into trouble. In addition, post-purchase programs conduct outreach to educate families about the availability of help if they are in danger of foreclosure and the dangers of predatory lending schemes that offer refinancing on highly unfavorable terms. Other programs encourage first-time homeowners to enroll in post-purchase classes to help them fully understand their responsibilities as homeowners as well as the various pitfalls that can lead to the loss of their homes.

Other options available to state and local governments to help reduce the risk of foreclosure include:

- Stronger predatory lending laws and guidelines to reduce the incidences of mortgages and refinancings with unfair lending terms, which are more likely to lead to foreclosure.[101]
- Attractively-priced refinancing products to help families refinance high-cost or other troubled mortgages.
- Emergency loan funds, such as Pennsylvania's Homeowners' Emergency Mortgage Assistance Program (HEMAP), to help families address short-term crises that threaten their ability to stay current on their mortgages.[102]

[101] For more information on strategies for combating predatory lending, see http://www.responsiblelending.org/issues/mortgage/.

To better understand the causes and locations of concentrations of foreclosures in their communities, localities may wish to conduct a study of foreclosure patterns and causes. Examples of such studies are available on the Web site of The Reinvestment Fund.[103] NeighborWorks' Center for Foreclosure Solutions is another valuable resource on foreclosure prevention strategies.[104]

Examples

- *Chicago, Ill.* In 2003, Neighborhood Housing Services of Chicago, in partnership with the city of Chicago and more than 30 partner lenders, launched the Homeownership Preservation Initiative to combat rising foreclosure rates in various parts of the city. The initiative combined intensive counseling for borrowers in serious delinquency, a telephone hotline linked to 24-hour credit counseling services, a faith-based outreach initiative to combat mortgage fraud and workshops to help borrowers better understand how to avoid foreclosure. In its first three years, the initiative helped more than 1,300 families avoid foreclosure and educated thousands more about the issue of foreclosure and how to avoid it. An evaluation estimated the initiative saved the city $9 million in police, fire, security, legal, and other services and fees associated with foreclosure and vacant or abandoned properties. The evaluation also estimated that financial institutions saved as much as $77 million in costs associated with repossession, retention and resale of foreclosed homes. Since high rates of foreclosure in particular neighborhoods drive down property values of surrounding properties, the initiative also may have saved the city millions in property tax revenues.[105]

- *Seattle/King County, Wash.* In 2001, local officials in the Seattle/King County area convened a meeting of government agencies, nonprofits, lawyers and consumer advocates to discuss their concerns about predatory lending in the area. The group decided to continue working together as the Coalition for Responsible Lending (CRL) to address the issue and began providing services to the public in 2003. Through community outreach, workshops and a consumer hotline, CRL helps to generate awareness of predatory lending in the community and helps homeowners who have been victimized by the practice to understand their options and remain in their homes. CRL partners assist victims of predatory lending through referrals, education, one-on-one counseling, legal support and even a special "Preferable Loan to Achieve Community Empowerment" (PLACE) loan if a traditional refinance loan is not an option. By June 2006, CRL partners had provided counseling to 50 to 75 households,

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[102] For more information, see http://www.phfa.org/consumers/homeowners/hemap.aspx.

[103] See http://www.trfund.com/resource/policypubs.html.

[104] See http://www.nw.org/network/neighborworksprogs/foreclosuresolutions/default.asp.

[105] Neighborhood Home Services of Chicago. 2006. *Home Ownership Preservation Initiative: Partnership Lessons and Results: Three-Year Report*. Chicago, Ill.

conducted around 40 legal consultations, helped victims reach settlement or negotiate more favorable loan terms, created outreach materials in 10 languages including English, and initiated the refinance process for six PLACE loans. Principal funders include Freddie Mac's Don't Borrow Trouble campaign and the state attorney general's office.[106]

- *Rochester, N.Y.* Customers who have purchased homes through the city of Rochester or Neighborhood Housing Services of Rochester (NHSR) lending programs are required to participate in post-purchase education at NHSR. Topics covered in the three-class series include home electrical and mechanical systems, property management, budgeting, and annual and seasonal maintenance. Funding for the program comes primarily from the city of Rochester with NHSR and other local businesses and agencies providing trainers, educational materials and supplies. There are no fees for lending customers of NHSR or the city. Other households are charged $75 per class. In three years, over 1,000 people have attended the courses and become more prepared to manage and maintain their homes, helping them to avoid major maintenance problems that can cause them to lose their homes or experience a significant loss of value.[107]

Assessment

- **Ease of Financing/Cost-Effectiveness.** High. The costs of foreclosure – for both the individual and the community – far exceed the costs of preventing it through early-intervention counseling and aggressive marketing of refinancing products. Additionally, as Pennsylvania shows, emergency loan funds can be self-sustaining.

- **Magnitude of Potential Impact.** High. Given the growing complexity of the mortgage markets and rising foreclosures, foreclosure prevention services are needed now more than ever.

- **Replicability.** High.

- **Flexibility.** High.

- **Ease of Implementation.** Moderate. Effective foreclosure prevention programs will require the collaboration of multiple entities, including mortgage servicers, homeownership education and counseling organizations, and state and local governments.

[106] For more information, see http://www.nw2.org/WinningStrategies/display.asp?strategy=1331&offset=0.

[107] For more information, see http://www.nw2.org/WinningStrategies/display.asp?strategy=1235&offset=32.

CHAPTER 4 – DEVELOPING A COMPREHENSIVE STRATEGIC HOUSING PLAN

As expected, this analysis did not uncover a single magic bullet for solving the nation's housing challenges at the state or local levels. The analysis did, however, identify a range of potentially powerful policies, which, if adopted in conjunction with one another as part of a comprehensive strategic housing plan, can make a big difference.

The key words here are "comprehensive" and "strategic." While any one of the policies discussed in this report might make a modest difference if implemented in isolation, the overall impact on home affordability will be magnified significantly if the policies are implemented as part of a comprehensive package involving multiple agencies and actors, and driven by an overall strategic plan that ensures the policies are well-coordinated and well-tailored to meet the jurisdictions' objectives.

This chapter briefly summarizes some of the general conclusions and recommendations that emerge from this report regarding the development of a comprehensive strategic housing plan for working families.

Table 1: Developing and Supporting a Strategic Housing Plan for Working Families

1. Assess housing needs and resources	8. Build public support for affordable homes
2. Know your market	9. Create open lines of communication
3. Be comprehensive	10. Involve the business community
4. Foster interagency collaboration	11. Insist on excellent design
5. Exercise leadership	12. Promote a mix of incomes
6. Set and track progress toward goals	13. Continually evaluate and refine your strategies
7. Proactively plan for future growth	14. Think locally and regionally

1. *Assess housing needs and resources*. Preparing a needs assessment is a key first step in developing an effective strategic housing plan for working families. The goal of this assessment is to define the nature and scope of the problem. Some communities may find that working families face relatively few challenges affording quality homes, while others may find that they face very substantial challenges. In some communities, the nature of the challenge may vary for workers at different salary levels. For example, workers within income range X may have difficulty finding affordable rental homes, while workers within income range Y can afford market-rate rentals, but have difficulty purchasing a home.

   Start by defining one or (ideally) more income ranges for analysis that reflect the incomes of working households living or working in the community. For each income range, the needs assessment should examine the housing cost burdens, and the extent of housing quality problems and overcrowding for existing residents within that range. The needs assessment also should examine the extent and condition of the existing stock affordable to these families and the challenges faced by renters in each income range that wish to purchase a home in the community.[108] To the extent communities are interested in attracting more working families as residents, they also should identify and quantify the challenges these new residents would likely face securing affordable homes – whether renting or buying – within the community.

   On the resources side of the equation, it is important to inventory all of the producers of homes affordable to working families – including governmental agencies, nonprofits and for-profits – and honestly assess their capacity for effectively serving more families.

2. *Know your market*. The housing needs of working families, and the resources available to meet those needs, must be judged in the market context, which means it is essential to understand the dynamics of the market. For example, at what price point can private or nonprofit developers build different types of homes? What is preventing them from producing homes at lower costs? Do for-profit and nonprofit developers have ready access to financing for new projects? Do existing rental property owners have access to financing to maintain their properties? Is there a high-quality older rental stock that could be preserved as an affordable resource for lower income families?

   Clearly, the role of government is to complement and empower the private sector, rather than compete with it. Understanding the housing needs the private sector is already meeting, or could meet with some relatively modest changes in state or local policy, will help identify the gaps that could be filled by the government or nonprofit sectors. This process also may uncover policy changes that could be made to reduce the costs of market-rate homes.

[108] It also would be useful to examine the extent to which current subsidized properties are at risk of opting out of government subsidy programs.

3. *Be comprehensive.* Once the housing needs of working families, and the resources available to meet those needs, have been identified and set within the market context, the next step is develop a series of integrated strategies that address these needs. In constructing a housing plan, it is important to realize that there is not likely to be one single answer to meeting families' housing needs. Rather, it is likely that a combination of strategies will be needed along many of the dimensions identified in this report – for example, combining regulatory reform to reduce barriers to new development with mechanisms for generating additional capital for homes affordable to working families and strategies for strengthening families' capacity to obtain a reasonably-priced private mortgage.

4. *Foster interagency collaboration.* By necessity, a comprehensive plan to meet the housing needs of working families will require the participation – and ideally, the collaboration – of multiple governmental agencies. The following are some of the key government actors whose involvement will be necessary for the successful implementation of a comprehensive housing plan:

   - **Taxing entities** (to facilitate the reuse of tax-delinquent property, and implement tax abatements and tax increment financing).

   - **Zoning and planning boards, building departments and other agencies involved in the zoning, planning or permitting processes** (to reduce regulatory barriers to development).

   - **City and state housing finance agencies and community development departments** (to provide project financing, implement efficient practices and oversee projects).

   - **State and local legislatures** (to pass necessary legislation).

   - Depending on the community, **state and local housing authorities** also may have a prominent role to play in implementing some of these policies. In any event, they should be included on the core implementation team as they bring a number of key complementary tools to the table, including the ability to attach Section 8 housing vouchers or public housing subsidies to rental developments to increase the range of incomes that can be served.

   Other government agencies also may need to be involved, especially if a community is searching for publicly owned land that could be made available for the development of affordable homes. Examples include school systems, public hospitals, community colleges,

municipal courts, fire departments, etc. A range of nongovernmental actors is also needed for the effective implementation of a comprehensive strategic housing plan, including both nonprofit and for-profit developers and builders, lenders, community development corporations and other housing counseling entities.

5. *Exercise leadership*. Securing the collaboration of multiple agencies that are not used to working together will require strong leadership. Ideally, there should be both high-level commitment to the development and execution of a plan and someone playing a more hands-on role to keep the process moving and monitor results.

6. *Set and track progress toward goals*. Clearly articulating a plan's overall goals and monitoring progress toward those goals is one way to keep the project on track.

7. *Proactively plan for future growth*. In developing and implementing a strategic housing plan, it's critical to stay ahead of the curve. In particular, it's important to understand where future growth is likely to take place as it will generally be easier and less expensive to intervene in the market *before* a neighborhood has "taken off" rather than afterwards. Planning for future growth also involves coordinating housing, transportation and economic development plans so that working families can afford to live near (or with good transportation access to) employment centers.

8. *Build public support for affordable homes*. Public opposition to new development is one of the biggest obstacles to expanding the supply of homes affordable to working families. State and local leaders can help expand public support for new or rehabilitated homes by working to educate the public about their benefits for the community, as well as the importance of providing homes for essential workers. Among other groups, Homes for Working Families and The Campaign for Affordable Housing specialize in providing guidance on how to help build public support for affordable homes.[109]

9. *Create open lines of communication.* In a rapidly changing business like housing, it's essential to stay in close contact with practitioners in all sectors of the business, including nonprofit and for-profit developers, lenders, mortgage servicers, rental property owners and managers, low-income advocates, and architects and planners. Most communities have provisions for one or two formal public input sessions per year, often in connection with the HUD-mandated Consolidated Plan, but these generally are not conducive to the kind of intensive, fact-gathering, iterative analysis and open exchange of views that are necessary to improve housing policy. In addition to these formal sessions, state and local governments should ensure there are open channels of communication with practitioners throughout the year – perhaps as part of a task force or some other regularly scheduled setting – to review

[109] For more information see http://www.homesforworkingfamilies.org and http://www.tcah.org.

and refine public policy to provide maximum support for practitioners' efforts to expand the supply of affordable homes.

10. *Involve the business community*. While nonprofits are essential, they cannot meet the nation's housing needs all by themselves. Ultimately, the private sector has a major role to play in expanding the supply of affordable homes. A big part of housing policy is ensuring the correct configuration of incentives and other supports to ensure the private sector is motivated to provide more affordable homes.

11. *Insist on excellent design*. Like any other form of housing, affordable homes can be designed well or designed poorly. Governments should insist that any affordable homes they support be well-designed – both to ensure that they remain durable assets for the residents and the community, and to minimize public opposition. The Affordable Housing Design Advisor[110] provides a good primer on this subject.

12. *Promote a mix of incomes.* There is a general consensus among practitioners that neighborhoods that include families with a mix of incomes tend to be more successful over the long term than those that include very low-income families exclusively. This does not necessarily mean that every single development of affordable homes must include families with a mix of incomes. In general, however, jurisdictions should aim to ensure that their investments help to facilitate the creation of healthy, vibrant neighborhoods that provide homes affordable to families across the income spectrum.

13. *Continually evaluate and refine your strategies*. Central to any strong housing policy is the continual monitoring of results and the corresponding refinement of strategies. Among other data, communities should keep track of the numbers of families served by each program, the costs and the amount of unspent funds, relative to expectations. When funds are not being spent as quickly as assumed, why not? Are changes in program rules needed? If programs are costing more than expected, what is the source of extra costs? What additional changes do practitioners recommend to make programs easier to use and thus more effective?

    As they consider updates to program rules, communities should be aware that frequent rule changes may be counterproductive, unsettling existing expectations and forcing beneficiaries to change their business plans midstream. Ideally, programs would be well-designed from the start, reflecting feedback from practitioners *before* the programs are implemented, and thus minimizing the need for subsequent change. When data or other feedback demonstrate a need for program changes, by all means, make the changes; but again, it's best to solicit input on the specific changes *before* they are implemented.

[110] See http://www.designadvisor.org.

14. *Think locally and regionally*. Like labor markets, housing markets are regional in nature. While families tend to live in the same metropolitan area in which they work, they do not always live in the same city or even the same county as their workplaces. For this reason, the housing policies that one community adopts may affect other communities in the same metropolitan area. For example, when one community restricts new development or sets up conditions that effectively preclude the development of affordable homes, other communities end up picking up the slack. Since the housing policies of communities are rarely coordinated with one another, the end result is often sprawl: affordable homes get built in the areas of least resistance – often on the fringes of the metropolitan area – and traffic increases as these families travel long distances to and from work.

    While each community can and should develop its own local strategic housing plan, it is important to open a dialogue with other communities to determine the optimal role of each community in addressing the broader housing needs of the region. To reduce sprawl, for example, communities may want to focus energy on infill development in areas with existing infrastructure and on areas with good access to public transportation.

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APPENDIX A – COMPLETED INTERVIEWS

William C. Apgar, Jr., Lecturer in Public Policy, Senior Scholar, Kennedy School of Government, Harvard University

Doug Bibby, President, National Multi Housing Council

Laurel Blatchford, Chief of Staff and Deputy Commissioner for Strategic Planning, Policy and Communications, New York City Department of Housing Preservation and Development

Thomas Bledsoe, President, Housing Partnership Network

Michael Bodaken, President, National Housing Trust

Frank Cardone, COO and Director of Development, The Related Companies of California

Sarah Carpenter, Executive Director, Vermont Housing Finance Agency

Kent W. Colton, President, K Colton LLC

Larry Dale, Executive Vice President, Capmark

Shaun Donovan, New York City Housing Commissioner, New York City Department of Housing Preservation and Development

Helen Dunlap, Former President, ShoreBank Advisory Services

Conrad Egan, President and CEO, National Housing Conference

David Engel, Director, Affordable Housing Research and Technology Division, Office of Policy Development and Research, U.S. Department of Housing and Urban Development

Jonette Hahn, Principal, Reznick Group, P.C.

Sheila D. Harris, Director, Arizona Department of Housing

David K. Hill, Founder, Chairman and CEO, Kimball Hill Homes

Hunter L. Johnson, President and CEO, LINC Housing

Hal Keller, President, Ohio Capital Corporation for Housing

Peter Lawrence, Legislative and Policy Associate, National Council of State Housing Agencies

William C. Perkins, Executive Director, Wisconsin Partnership for Housing Development

W. Matthew Perrenod, Chief Lending Officer, Housing Partnership Network

J. Michael Pitchford, President and CEO, Community Development and Preservation Corporation

Nicolas P. Retsinas, Director, Harvard Joint Center for Housing Studies

Peter Richardson, President, Housing Strategies Inc.

David Smith, President, Recapitalization Advisors, Inc.

Michael A. Stegman, Director of Policy, The John D. and Catherine T. MacArthur Foundation

Jeff Stern, President, Riverside Advisors, LLC

Edwin Stromberg, Program Manager, Environmental Impacts Research and Demonstration Program, Office of Policy Development and Research, U.S. Department of Housing and Urban Development

Christopher E. Tawa, Senior Managing Director, Agency Bond Credit Enhancement, MMA Financial, LLC

Larry Witte, Director, Standard & Poor’s