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Planning & Urban Development Department

TO: Councilor Duson, Chair
Members of the Housing Committee

FROM: Victoria Volent, Housing Program Manager

DATED: January 16, 2018

SUBJECT: Developer Feedback on the Inclusionary Zoning Ordinance

BACKGROUND

In response to the request from the members of the 2017 Housing Committee, staff has collected feedback from developers of ten or more units of residential housing that have received Planning Board approval since the adoption of the Inclusionary Zoning Ordinance. Twelve projects have been subject to Planning Board review on the condition they comply with the requirements set forth in Division 30, Section 14-487.

Of the twelve projects, two projects are currently for sale, three projects have not moved beyond their purchase and sale agreement, two projects have not applied for building permits, and one project partnered with Community Housing of Maine (CHOM) to build two off-site units which are currently leased to two moderate-income households.

Developers were asked:

We would appreciate comments on your experience during the approval process as it relates the IZ provisions, and your thoughts on the regulations that further define the IZ Ordinance (attached is a copy of the regulations for your review).

Developers that paid the fee-in-lieu were further asked:

Specifically, we would like to know why you chose to pay the fee-in-lieu instead of building the inclusionary units.

Four developers responded to our request for feedback

(1) Project: 221 Congress Street. Approved 4/6/2017. Developer: Caleb Johnson

"At present it is our plan to pay the in-lieu of fee because it makes our project more financially viable. This will need to be evaluated again soon to make sure that is still the case.

After a quick review of your document I can see that it would take me a substantiation amount of time to manage the process of understanding and implementing the

construction of workforce housing within a market rate development and that I would lose control of a certain portion of our investment in the project.

To put it simply at first glance it seems like a more predictable approach to pay a set fee than to get into the process of building a single work force unit controlled by the city.

As a disclaimer I have not personally studied this issue in depth and support the idea of encouraging Economic diversity within our city and I have not formed an opinion about whether the IZ ordinance seems positive."

(2) Project: 443 Congress Street. Amended Conditional Use Application November 14, 2017. Developer: Joshua Benthien of Northland Enterprises.

"We are writing to voice our concerns about the current Inclusionary Zoning ("IZ") ordinance. We recognize that Portland needs a variety of housing types to thrive as a city, and we know that the best way to create a range of housing options is for the City to foster a regulatory climate that is conducive to development.

The Inclusionary Zoning ordinance in its current form is a strong disincentive for developers to build multifamily housing projects that have more than nine units. We are unaware of any onsite rental IZ units created in the City to date. The program is failing at creating affordable units in Portland because it poses many impractical restrictions on developers.

We present the following observations and recommendations regarding the IZ, in hopes of improving the existing policy and fostering the development of badly-needed modern rental housing stock:

Tenant Selection; the most glaring shortcoming of the current IZ policy is the City's involvement with tenant screening. The Agreement requires that prospective IZ tenants be approved by the City. That means a property owner cannot lease a unit to an IZ tenant without City staff reviewing the application and retaining the right apply their own screening methods to verify the prospective tenant's income. Practically speaking, this provision is unworkable for the property owner, as few prospective tenants will be willing to wait for the City to approve their application. After much back-and-forth with the City planning staff, we negotiated a 5-day turnaround time for City approval of tenants, and we believe that timeframe would still lead to tenants finding housing elsewhere before signing a lease with us. Further, the City staff are not equipped to screen tenants or determine income eligibility. That is a specialized task best left to experienced property managers.

Additionally, the IZ has no provision that would eliminate the IZ requirements in the event that the City reorganizes its operations, experiences staff layoffs, or simply chooses

to not direct adequate attention to the IZ tenant screening. Also, the IZ provides no legal protection or indemnification to the property owner should the City's screening method be discriminatory or otherwise impermissible by law. We recommend that property owners should have the option to be solely responsible for screening tenants in compliance with the IZ guidelines, with the income eligibility portions of tenant files being available to the City for review with reasonable notice. This would be consistent with the Maine Housing regulations that owners would adhere to under a Low-Income Housing Tax Credit ('LIHTC') project. Those projects are not subject to the IZ, so it seems that the LIHTC screening methods are deemed to be appropriate (i.e. the city doesn't want to double check the AVESTA or Szanton Company screening). This would allow larger, more sophisticated developers and landlords to utilize the screening software that we already have paid for, while still allowing smaller landlords to have the City do the screening if they would rather not take the risk or invest in the income screening protocols.

Duration of Affordability Requirements; The current regulations require IZ units to remain affordable for terms ranging from 10 years, if 100% of a project's units meet IZ affordability, to 99 years if 10% of a project's units meet IZ affordability. As a practical matter, 10% is the most IZ units that most projects can afford to have, so the IZ units are required to remain affordable for 99 years. There is no telling what the City's housing needs will be 10 years from now, let alone a century into the future, and the City is under no obligation to fund the employment of staff to actually oversee the IZ program now or in the future. We recommend that the IZ affordability term be capped at 10 years, with the provision that property owners be required to allow IZ tenants to remain in their units at the IZ rent levels until such time as that tenant vacates. Thus, no tenant would lose their housing as a result of their unit coming out of the IZ compliance period. In the case of LIHTC development, the developers do agree to 99-year deed restrictions, but that is because a large portion of the development costs are being funded by the tax credit investor. They're willing to give up the ability to raise rents beyond AMI increases for 99 years, because MSHA is providing the majority of the funding for the project. In the case of the IZ, the city is providing no such funding or benefit to the development in exchange for the 99-year deed restriction. It is important to also note that in the case of LIHTC deals, the permanent debt is required to be non-recourse to the developer. Meaning the developer is not signing their life's work away to secure the debt. The situation is often quite different in market rate development, where developers are personally guaranteeing the loans; therefore, the risk is much higher for market rate development. The prospect of agreeing to a multigenerational deed restriction becomes a very real risk to the long- term viability of the project. The current IZ deed restriction structure feels like a penalty on the developer, rather than a partnership to provide the affordable units. When a developer considers a 99 years of having the city screen the IZ tenants every year and the resulting increase in vacancy and headache, it is often enough to justify payment of the fee in lieu.

Future Payment-In-Lieu; Given the long affordability terms mentioned above, IZ would potentially be more palatable to developers if it included the option of removing IZ units via the fee-in-lieu at a future date. For example, say a 10-unit apartment building has 1 IZ unit that must remain affordable for 99 years. The developer should have the option to operate the IZ unit and pay the fee-in-lieu at any time in the future, removing the affordability restrictions on that unit once the current tenant terminated their lease; the owner would not be able to suddenly charge market rate for the existing tenant, but would have to wait until they leave before paying the fee and repositioning the unit as a market rate unit. The flexibility to buy out of the IZ requirement in the future will help alleviate the risk that a property will be less valuable to prospective purchasers in the future.

Interior Standards for Workforce Units; The current Workforce Rental Housing Agreement includes many specific requirements for IZ units, right down to bathroom fixtures and linear feet of kitchen counter space. These requirements are too specific, particularly given that the affordability requirements will be in place for many decades. We don't know what design standards and technology will hold in the future. A better approach would be to simply require that the IZ units feature a level of fit and finish comparable to the building's market rate units."

(3) Project: 161 York Street. Approved March 28, 2017. Developer: Michael Cianchette

"The biggest reason we chose the fee-in-lieu was due to parking. As everyone knows, land in Portland is expensive and growing even more so, driving up the cost of existing buildings, new construction, etc. In an effort to increase density (a good thing), the City has loosened the requirements surrounding parking. However, that has driven more and more vehicles onto city streets for their parking needs. As we've seen over the last week, this becomes even more problematic when we have significant snow events forcing parking bans.

Since land costs are high, residential development requires higher sales prices to recoup the initial investment. Those individuals willing to pay higher prices generally do not want to fight parking battles on the streets (to the extent they can avoid it). That meant we needed to incorporate parking into the site to differentiate ourselves in the market (as an aside, the challenges with the planning process led to us missing the market condition we saw available, and our project is currently listed for sale; a different developer is probably willing to decrease the level of quality we wanted to provide in order to make the project economically viable). Once we decided to incorporate parking (and fight the Planning Board to let us do so), the marginal cost of the fee-in-lieu would be more than made up in price point associated with unit sales incorporating parking.

It is a sticky challenge. However, the city needs to come up with a well-thought out parking strategy for both commercial and residential development. That is especially

true with the WEX HQ coming downtown. There will be a day in the future when personally-owned motor vehicles are not a necessity; that day is not today nor will it come in the medium-term future."

(4) Project: 62 India Street (62 Mason Block). Approved May 24, 2016. Developer Joe Dasco

"In short, the reason that we choose to pay the fee-in-lieu is based entirely a financial decision. Given the cost of land and the increasing cost of construction, it costs us less to pay the fee vs. the loss that we would take on building the required units and selling them at a price that meets the IZ ordinance. When I say 'loss' I am not referring to a decrease in profitability. Our cost of construction to build a one- or two-bedroom unit is at least $100,000 more than the mandated price that we would have to sell that unit for to meet the IZ.

In my personal opinion, Portland, like most municipalities, is taking the "Stick" approach vs. the "Carrot" approach. Rather than saddling the developers with the cost to supplement the affordable housing, the city should be using a TIF to encourage more building in general. This may seem counter intuitive during a building boom, however the building boom will come to an end or at least will slow down at some point. If some sort of TIF was used, the city could allocate a percentage of the increased tax base of the property being developed to help fund the affordable housing. For example, take our Mason Block project that is currently under construction in the India Street Neighborhood (our smallest project to date). The IZ fee is $290,000. The increased tax base of this property will be approximately $16,000,000 when it is complete. That equates to approx. $336,000 annually in additional property taxes generated. If the city allocated 20% of the increased tax base to the housing fund, this would equate to $67,200 per year to go towards the affordable housing. Over a 20 year period this project would contribute $1,344,000 to the housing fund vs. the one time contribution of $290,000. This would also reduce the burden to developers which could lead to the creation of more housing units and more money towards the affordable housing."