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Un-Affordable Housing

Cities keep low- and middle-income families from home ownership

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Executive Summary

Many North Carolina cities use affordable-housing policies to provide housing to low-income citizens. No doubt started with the best intentions, those policies ignore fundamental economic realities. This *Regional Brief* demonstrates that, in most cases, affordable-housing policies produce the opposite effect than was intended. In American cities that have implemented mandatory affordable-housing policies:

- Home prices have risen dramatically. This effect has made houses even more unaffordable for low- and moderate-income residents.
- Homebuilders must sell a percentage of the homes they build below the fair market value. This effect means an economic loss for people who would build homes.
- Homebuilders, at the urging of city governments, have transferred private property to unaccountable land trusts in order to avoid administrative burden and extra cost. These trusts offer residents an illusion of homeownership.
- City councils have passed price-fixing schemes for homes that seem to violate a North Carolina law that prohibits rent control.

To make matters even worse:

- In some cities, past city councils have created the "housing cri-

sis" that affordable housing must solve by imposing restrictive land-use policies ("smart growth"). Now local governments do not consider their culpability. Instead, they want homebuilders and homebuyers to pay for the consequences of their mistakes.

- The Triangle has a significant amount of affordable housing as a metropolitan region. This eliminates the need for Triangle cities to pass coercive affordable-housing policies

Introduction

Affordable-housing policies are based on a simple premise: since home prices are high, the local government should lower them. To do so, cities use (voluntary) affordable-housing policies and (legally-mandated) inclusionary zoning to set "affordable" prices — below the fair market value — based on the median income of area residents. Homebuilders must then designate a percentage, most often 10 to 15 percent, of their new construction as "affordable" and sell those homes to low-income individuals and families for a government-set price. This price ignores construction costs to the builder and value to the consumer (i.e., the amount a buyer is willing to pay).

For example, suppose that Smith Construction Company wanted to build 40 homes in a North Carolina city that had an inclusionary-zoning ordinance. Smith must build six of the homes (15 percent) as "affordable" units. The cost to construct regular and affordable homes would be similar because most ordinances allow no outward distinctions between them, but their prices would be very different. Smith would sell the affordable homes at a price determined by a government formula. This ordinance would result in a loss for the builder: if homes were worth $100,000 on the market, but Smith was forced to sell them for $60,000 each, there would be a $40,000 loss in revenue.

As a result of this policy, homebuilders and homebuyers both lose. Construction projects in municipalities that have inclusionary zoning become less profitable. As a result, builders take on smaller projects, build in neighboring communities without those restrictions, or both. The effect is the artificial reduction in housing supply in a town and, as a result, the artificial increase in housing prices because the same (or increasing) amount of homebuyers are competing for a smaller amount of non-restricted homes. Price is driven up on market-rate homes — often far above the amount they were sold for before the policies took effect. Middle-class buyers are particularly affected, because they have too much money to qualify for affordable housing but too little to compete in the "new" housing market.

A 2004 Reason Foundation study of California's housing market found that approximately 20 percent of Californian cities have inclusionary-zoning ordinances. The study found that, one year after the adoption of inclusionary-zoning ordinances, new home construction fell by 31 percent on average. Prices of market-rate homes skyrocketed, up $22,000 to $44,000 in median cities and by more than $100,000 in high-value markets. The total cost of forcing builders to sell at below-market prices averaged $45 million per jurisdiction. To make matters even worse, fewer affordable units were produced; the average city added fewer than 15 each year.[1]

What are affordable-housing initiatives?

Many cities begin with voluntary affordable-housing policies that offer incentives to builders. Density bonuses are a common form. These bonuses allow homebuilders to construct more homes per acre of land than is permissible under existing regulation — so long as the builder provides a set number of affordable units. This incentive is supposed to allow the builder to recover some of the losses he will incur when he sells the affordable homes at below-market prices.

There are two problems with this policy. First, bonuses may not offset all the losses imposed on the homebuilder. In fact, some builders may choose not to utilize them if they are ill-suited for their project. Second, these incentives illustrate the arbitrary nature of the original planning restrictions. If density restrictions allowed a builder to place 200 homes on 100 acres, but the restriction was changed to 300 homes on 100 acres if the builder complied with a new government policy, then the original restriction was strictly arbitrary. Therefore, rather than create complicated incentive schemes, the city could increase the allowed density and increase its housing supply. This, in turn, would reduce prices overall.

In addition, "voluntary" affordable-housing policy can often become government coercion. In Carrboro, builders who propose developments of five or more homes need a special use permit or a conditional use permit from the Board of Aldermen. The aldermen use this requirement as leverage to force homebuilders to meet the town's "policy goal" of 15 percent affordable units. Builders may choose to construct that 15 percent, pay a fee, or set aside lots to sell to the town. Those who refuse these options must meet with the Board for an "Affordable Housing Review Meeting."[2] This leaves little room for a builder to avoid compliance with a "voluntary" policy.

In Chapel Hill, it is the Town Council's "expectation" that rezoning applicants include affordable units in any "residential component." As advertised on the town website, "a zoning change is a legislative decision and as such is a discretionary decision."[3] In order to increase its leverage on builders, the Council attempted to downzone most property "around town" to R-1, currently one-third acre per home. Had this been successful, builders would have had to apply for rezoning in almost all cases and thus would have been forced to include affordable housing in their plans.[4] (As it happened, public opinion quickly ended the change.)

Table 1: Income definitions based on Area Median Income (AMI)

AMI Level	*Income Definition*
Less than 30% AMI	Extremely Low Income
30% AMI to 50% AMI	Very Low Income
50% AMI to 80% AMI	Low Income
80% AMI to 100% AMI	Moderate Income

What is inclusionary zoning?

Two North Carolina towns — Manteo and Davidson — have moved beyond "voluntary" affordable-housing policies and adopted coercive inclusionary zoning. Inclusionary zoning makes mandatory the goals and processes of voluntary affordable-housing initiatives. By law, homebuilders must sell a percentage of their construction at a price set by the town government. Builders must also guarantee the affordability of these units for a time period that can range from 15 years to perpetuity.

Homebuilders are sometimes permitted to avoid the requirement by paying a fee. The fees most commonly go to a town fund earmarked for affordable housing. This is typically used to subsidize even more affordable housing in the town. But town governments have consistently expressed their preference for homebuilders to construct affordable units. Therefore, it is the most common result.

Determining the price of affordable housing

Local governments set the price of affordable units based on federal calculations. Each year, the U.S. Department of Housing and Urban Development (HUD) publishes the area median income (AMI) for each section of the country. To qualify for affordable housing at the local level, a household's income must be in a certain AMI percentage range. Because this classification scheme is based on percentages, rather than dollar amounts, it can identify "low-income households" in a community completely composed of multimillionaires.

Table 2: Difference between federal and local income figures

Percentage AMI	*Median Income (Durham MSA)**	*Median Income (Chapel Hill)*	*Difference*
100%	$61,700	$92,106	$30,406
80%	$57,050	$73,685	$16,635
50%	$35,650	$46,053	$10,403
30%	$21,400	$27,632	$6,232

* HUD adjusted the income limits at different AMI percentages for the Durham MSA.

Individual ordinances specify the ranges that correspond to income levels (i.e. what percentage of AMI constitutes a low-income household), so there is variation among municipalities. However, the breakdown shown in Table 1 is the most common.

A maximum price range is then calculated for each level of AMI. The range is usually found with a multiplier. For example, Chapel Hill's Planning Department assumes a household may pay 2.5 to 2.75 times its annual income for housing in its published reports of the town's housing market.[5] (This report also uses that standard.)

But this acceptable price range is often based on numbers that inaccurately reflect reality. HUD determines the AMI for regions known as metropolitan statistical areas (MSAs). MSAs are broad geographic regions, so the AMI can over- or underestimate the income of a specific town. For example, Chapel Hill is in the Durham MSA, which contains Durham, Orange, Person, and Chatham Counties. The Durham MSA has a 2006 median family income of $61,700,[6] but the Chapel Hill Planning Department estimates that the town's actual median family income is $92,106[7] (see Table 2).

Despite the disparity between federal calculations and local reality, areas use federal figures to study their housing market. This is misleading at best and deceptive at worst. Using HUD data distorts a town's need for affordable-housing policies. The table below (Table 3) shows the price ranges of homes affordable to Chapel Hill residents based on the federal MSA and local median income calculations. Once more, the disparity between the numbers is striking.

What are the issues with inclusionary zoning?

The legality of inclusionary zoning is questionable: it could be a form of illegal rent control.

The legality of inclusionary zoning in North Carolina is uncertain for two reasons. First, few local governments have been given specific authorization for inclusionary zoning by the North Carolina General Assembly. The two towns that have passed inclusionary-zoning ordinances have not been challenged in court — although it is a possibility.

Second, many municipalities are particularly wary of the state's strict ban on rent control. As statute 42 14.1 reads: "No county or city…may enact, maintain, or enforce any

Table 3: Difference between affordability based on federal and local figures

Percentage AMI	*Housing Price Range (Federal MSA)*	*Housing Price Range (Chapel Hill)*	*Average Difference*
100%	$154,250 to $169,675	$230,265 to $253,292	$79,816
80%	$142,625 to $156,888	$184,212 to $202,633	$43,666
50%	$89,125 to $98,038	$115,133 to $126,646	$27,808
30%	$53,500 to $58,850	$69,080 to $75,987	$16,359

ordinance or regulation which regulates the amount of rent to be charged for privately owned, single-family, or multiple-unit residential or commercial rental property."[8]

For these reasons Chapel Hill has been slow to adopt an inclusionary-zoning ordinance. Its first-draft ordinance was shelved in 2001, due in part to the opinion of the Town Attorney.[9] Aware of being a likely "test case," the town has attempted to justify the ordinance by linking it to local government's powers to protect the public health, safety, and general welfare.[10] To support this effort, it has accumulated reports on its housing market (using federal income figures). It will most likely also include a lengthy preamble in the eventual ordinance that defends its necessity.

This is all an attempt to preempt a legal challenge. Chapel Hill hopes to demonstrate first that providing housing is a legitimate government objective, and second that residents face a lack of affordable homes. However, local governments should not orchestrate an end-run around state legislation that bars price-fixing simply because they favor a project.

Inclusionary-zoning policies provide low-income people with an illusion of homeownership.

Homes made affordable through voluntary affordable-housing initiatives or inclusionary zoning most often have a set period of affordability. For example, in Carrboro, homebuilders must ensure affordability for 100 years. This means the builder is responsible for "including provisions to ensure such continued affordability in legally binding agreements" (e.g., a deed restriction) as well as "arrangements to ensure that … [the] unit is made available for sale or rent only to" a household that does not exceed 80% AMI.[11] This is a daunting task — especially since it is 100 years' work. Many homebuilders do not want such an administrative burden. Thus, they sell homes to government-approved affordable-housing providers.

In the Triangle area — and Orange County in particular — these providers are predominantly land trusts. Of these trusts, the most prominent is the Orange County Housing and Land Trust (OCHLT), which is heavily dependent on money it receives from Chapel Hill, Carrboro, and Hillsborough. OCHLT obtains homes through purchase or, more commonly, through transfer from a homebuilder who does not want to spend resources in meeting government regulation.

The problem is that land trusts give a false promise of home ownership to home "buyers." The trusts guarantee permanent affordability because they permanently own the property. They sell 99-year ground leases (though the period can vary) to qualifying tenants. These leases give the purchaser a 99-year right to do anything except outright own the property or sell it without OCHLT oversight (and for an OCHLT-calculated price). The resident has claim to the physical home structure; the land trust has the deed.

The workings of the OCHLT illustrate the peculiarities of this model. OCHLT selects buyers after they fill out an application. Pursuant with current policy, only people who have lived or worked in Orange County for at least one year are eligible. Buyers pay property taxes and obtain a mortgage from a bank. They pay a nominal fee to the land trust for lease of the land. The terms of the agreement, though, dictate that the buyer will only receive a limited amount of the home's appreciation.

The "homeowner" is then granted 1.5 percent annual appreciation in home value by OCHLT, regardless of local market conditions. If he wants to sell, he must compute the sale price with an OCHLT formula; even then, he will receive only a portion of that amount. (OCHLT estimates that owners receive "20 to 39 percent of the [total] appreciation in the home" in a sale.[12])

Moreover, although the home is theoretically the homeowner's, OCHLT will collect a "stewardship fee" from him. This money will be used for structural repair and improvement: "replacement of HVAC, hot water heater, roof and flooring, plus exterior painting."

In this system, the "owner" is essentially a long-term renter. The entire affordable-housing system transfers property from the private market to permanent quasi-public ownership. The land trust is the owner, and the so-called homebuyer is the permanent dependent client. This is where the rent-control law begins: by government ordinance, land trusts are offering a long-term rent (though by another name) to citizens.

A crisis in housing prices is largely a self-inflicted wound.

City officials in Chapel Hill and Carrboro are quick to decry housing prices that spiral ever upward, but they ignore their responsibility in causing those high prices. Their restrictive land-use policies have decreased the amount of available land and, as a result, caused a dramatic increase in home prices. A recent study determined that restrictive land-use regulations cause 90 percent of the difference between construction costs and home prices.[13] So it is unlikely that more government regulation is the solution for problems created by existing regulation.

In the Triangle, Chapel Hill and Carrboro in particular have demonstrated that they are not serious about allowing builders to build low-cost (and low-priced) homes. Instead, they burden homebuilders with regulations, tree-protection ordinances, open-space requirements, and architectural standards that require builders to build "aesthetically pleasing" buildings. These restrictions and requirements add to the price of homes and make them less affordable.

The factor that contributes most to unaffordable housing is the rural buffer. Chapel Hill and Carrboro are cushioned by a 37,436-acre rural buffer managed by the town governments and Orange County. This land area — described as a "greenbelt" — has a two-acre minimum lot size. After five homes have been placed in a development, the buffer is mandated to increase to five acres. The rural buffer has a tremendous effect on the housing market. As town centers are built out (a major issue in Chapel Hill), property values inside and outside the rural buffer soar.

Affordable-housing policies in dynamic metropolitan areas like the Triangle are not needed.

Dynamic metropolitan areas such as the Triangle automatically produce affordable housing without forcing builders to build it. As the incomes in an area rise, people buy larger, higher-priced homes leaving behind homes that sell at affordable prices. (Just as "affordable automobiles" are often found in the used-car market, affordable housing is typically found in the "used home" market.) Restrictive land-use policies, like those adopted by Chapel Hill and Carrboro, break down this process. Their regulations increase the cost of all homes, not just newly constructed ones.

Even so, a February 12, 2008 search of Realtor.com, a national real-estate listing website, showed a plethora of affordable homes in and around Chapel Hill (see Table 4). The search included Chapel Hill and its neighbors Apex, Carrboro, Durham, and Hillsborough. Homes were 3+/bedrooms and 1+/bathrooms. This is because the standard AMI figures — which use multipliers based on family size (e.g., 30 percent AMI for a one-person and a four-person household are different) — are for families of four.

Chapel Hill is not an isolated community. It does not need affordable homes within its boundaries for low- and moderate-income citizens to have a place to live. The narrow vision adopted by town governments is both harmful and expensive — especially since most of the affordability problems were caused by town regulation at the start.

What is the solution?

Affordable-housing advocates are pursuing policies that produce the opposite of what

Table 4: Available homes in Chapel Hill, according to AMI levels

Using the federal median income of $60,100, these are the homes currently available on the market at each level of AMI:

Percentage AMI	*Housing Price Range*	*Realtor.com Price Range*	*No. Units*
100%	$154,250 to $169,675	$0 to $150,000	573
80%	$142,625 to $156,888	$0 to $125,000	350
50%	$89,125 to $98,038	$0 to $75,000	120
30%	$53,500 to $58,850	$0 to $50,000	44

Then using the Chapel Hill median income of $92,106, these are the homes currently available on the market at each level of AMI:

Percentage AMI	*Housing Price Range*	*Realtor.com Price Range*	*No. Units*
100%	$230,265 to $253,292	$0 to $225,000	1,194
80%	$184,212 to $202,633	$0 to $175,000	823
50%	$115,133 to $126,646	$0 to $125,000	350
30%	$69,080 to $75,987	$0 to $70,000	105

they intend. Those policies increase the price of all housing, making the entire housing stock less affordable. The process is endlessly self-perpetuating. The more regulations governments implement, the higher prices rise, and the higher prices rise, the more regulations governments implement. The result is a dysfunctional market in which both homebuilders and homebuyers lose.

The solution to a high-priced housing market cannot be more government regulation. It is less. Local governments must examine their own role in creating the problem — and then change it. Chapel Hill and Carrboro have kept the rural buffer (37,000 acres) at extremely low densities in the name of preserving local character, but town leaders have not considered increasing housing density in the buffer as a serious affordable-housing policy solution. Nor have they considered less restrictive land-use policies, which would enable homebuilders to build more homes and to sell them at lower prices.

More importantly, local governments should soberly question the necessity of their policies. Even in the Triangle's highest-priced towns — Chapel Hill, for example — there are still affordable homes in neighboring communities. Local governments should not make policy as if their municipalities were separate from all others. Even though there are housing "hot spots" in the Triangle, the region as a whole can offer homes affordable to low- and moderate-income families. Rethinking government regulation in those areas will help.

If Triangle town governments continue restrictive policies, they should not complain that home prices are beyond the reach of low- and moderate-income households. They caused the problem. They must recognize economic realities — not force homebuilders and homebuyers to pay higher prices to assuage governmental guilt.

Other cities in North Carolina must learn this lesson. If city leaders are truly concerned about the welfare of all citizens, then they should avoid policies that increase prices and make housing unaffordable. If they want to help low-income people buy their own home, they should assist them in finding an affordable home not just in their community but wherever they are located.

End Notes

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2. Carrboro Land Use Ordinance, Section 15-54.1, www.ci.carrboro.nc.us/PZI/PDFs/LUO/Art iv.pdf.

3. "Town of Chapel Hill – Affordable Housing Overview," Chapel Hill Planning Department, July 2006, townofchapelhill.org/index.asp?NID=1163.

4. "Summary Minutes of an Affordable Housing Work Session of the Chapel Hill Town Council," Chapel Hill Town Council, April 27, 2005.

5. "Housing," 2007 Chapel Hill Data Book, Chapel Hill Planning Department, p. 4.7.

6. "North Carolina FY 2006 Federal Income Limits," U.S. Department of Housing and Urban Development, www.huduser.org/Datasets/IL/IL06/nc_fy2006.pdf.

7. "Demographics," 2007 Chapel Hill Data Book, Chapel Hill Planning Department, p. 3.9.

8. North Carolina General Statute § 42-14.1, www.ncga.state.nc.us/EnactedLegislation/Statutes/HTML/BySection/Chapter_42/GS_42 14.1.html.

9. W. Calvin Horton, Town Manager, to the Mayor and Town Council of Chapel Hill, "Review of the Comprehensive Plan Affordable Housing Strategies," April 27, 2005.

10. "Summary Minutes of an Affordable Housing Work Session of the Chapel Hill Town Council," Chapel Hill Town Council, April 27, 2005. Such a report was referred to as a "document that would pass legal muster to show the court if necessary that the ordinance we had passed had a rational relation to the statute that gave us the broad authority to regulate the Town" (p. 17).

11. Carrboro Land Use Ordinance, Section 15-182.4, www.ci.carrboro.nc.us/PZI/PDFs/LUO/Art xii.pdf.

12. "Finding a Home," Orange County Housing and Land Trust, www.ochlt.org/findingahome.shtml.

13. Benjamin Powell, Ph.D. and Edward Stringham, Ph.D., "Housing Supply and Affordability: Do Affordable Housing Mandates Work?", Reason Foundation *Policy Study* 318, April 2004, www.reason.org/ps318.pdf, p33.