Tool: Incentives to Develop

THE HOUSING AFFORDABILITY TOOLKIT

Developed in Partnership with
HR&A Advisors

Incentives to Develop

Housing development incentives can expand, diversify, and accelerate the production of affordably priced rental housing.

What Are Housing Development Incentives?

Local policies designed to stimulate the development of housing. A local government may employ a variety of mechanisms to incentivize the development of housing, whether by altering regulatory restrictions or by providing direct and indirect forms of support. Whatever the mechanism, these incentives ultimately increase revenue streams or decrease costs for a given development, thus increasing a project's likelihood of being developed.

REGULATORY INCENTIVES

Flexibility around project approvals, development rights, density, parking, and design.

FUNDING INCENTIVES

Direct or indirect funding or financing, to ease development costs or operating expenses.

How Housing Development Incentives Work

Housing development incentives can improve housing affordability in two ways – a direct approach that provides incentives in exchange for lower rents and a supply approach that increases the supply of rental housing to reduce the demand pressure on existing units.

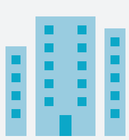
DIRECT APPROACH

A well-run direct incentive program can increase affordability by requiring a reduction in rent in exchange for a commensurate set of incentives. These incentives can be achieved through negotiations between the developer and the municipality or through established government programs.

SUPPLY APPROACH

A supply approach focuses on increasing the overall supply of housing by reducing the costs of development and making more development feasible. An increased supply can stabilize or reduce rents and decrease the likelihood that existing residents are displaced.

Incentive Policies Can Be Designed to:



Expand Production
More housing is built than otherwise feasible

Diversify Production
Incentives strive for an optimal housing mix and depth of affordability

Accelerate Production
Housing is built more quickly than otherwise feasible

Incentives Categories

Housing development incentives vary widely in format and purpose and can be combined to achieve a suite of benefits.

Two Types of Incentives

Regulatory incentives can be relatively inexpensive and straightforward to implement but can be less effective than direct funding in increasing new housing by large amounts. Some incentives include:

- Density Bonuses
- Flexible Design Standards
- Reduced Parking Requirements
- Accelerated Approvals
- By-Right Development

Funding incentives provide money directly or indirectly from public reserves. They can be significant, and even necessary, for project feasibility. Some incentives include:

- Reduced Fees
- Public Land
- Tax Incentives
- Public Funding

All Incentives Should Strive to Be:

MEANINGFUL

To be meaningful to the developer, the incentive should pass the "but for" test: "but for" this incentive, the housing would not have been developed.

To be meaningful for the community, the incentive should be leveraged to **target a locality's specific needs.**

TRANSPARENT, CONSISTENT, AND ACCESSIBLE

Developers and other participants must be able to **understand, anticipate, and access** both the benefits and the associated restrictions and requirements.

MARKET-APPROPRIATE

The incentive must reflect local needs and constraints, such as market demand, political climate, affordability needs, and local cost levels.

Density Bonuses

In markets that can support more units, additional density will increase overall supply and help to bring rents in line with local needs.

Incentive Format

Density bonuses allow more units of housing to be built on a site than would be allowed for under existing zoning regulations in exchange for a developer's provision of affordably priced units or other public goals. The "bonus" can be achieved through an increase in floor area ratio (FAR), a greater building height, decreased minimum unit size, or loosened setback requirements. Density bonuses typically allow for an increase of between 10% and 20% over a zoning code's baseline permitted density. In effect, for every affordable unit in a development, the developer is able to add a determined number of market-rate units to the development.

Density bonuses work as an incentive by increasing a project's overall revenue and decreasing per-unit development costs. Developers are able to build, and eventually operate or sell, more units than otherwise possible. Often, these additional units are market-rate units that serve to offset the lower levels of rental revenue derived from affordably priced units.

Density bonuses are one of the most common incentives offered to developers. The incentive is relatively inexpensive, is straightforward to implement, and effectively advances public and private goals.

Market Impact & Considerations

IMPACT

In appropriate markets, density bonuses can effectively improve affordability through both direct and supply approaches.

Density bonuses can directly incentivize the building of more affordably priced units, if the rent generated by the additional units allowed is sufficient to offset the affordability requirements.

Moreover, by adding more units than otherwise would be the case, the project also contributes more to the overall supply of rental units, which can improve affordability.

CONSIDERATIONS

Is the market strong enough to support the additional units? A density bonus is not helpful if the additional units are left unabsorbed by the market.

Will the additional density alter the type of construction required for the building and, therefore, add exceptional costs? On a project-by-project basis, an increase in the number of units may trigger a need to use different construction materials. The potential increase in costs may nullify the increased revenue.

San Diego, CA's Affordable Homes Bonus Program (AHBP)

San Diego introduced a density bonus program that offers a maximum 50% density increase when at least 15% of units are rent-restricted. The AHBP also allowed developers to receive up to five density bonuses, rather than the three allowed by the state's analogous program. The AHBP received 18 applications within its first three months, marking a 900% increase in average monthly applications over submissions to the state density bonus program.

Flexible Design Standards

Flexible design allows for more housing to be built in places where it is most needed and reduces the cost of development.

Incentive Format

Design flexibility incentives reduce regulatory constraints, allowing for more flexible building designs. These incentives often entail reducing required setbacks, increasing buildable area, allowing for flexible lot consideration, or reducing minimum lot size requirements. Together, these design allowances increase the potential for development on infill sites, making use of a greater portion of urban land to provide housing.

By increasing the effective supply of developable land, flexible design standards work as an incentive by increasing project feasibility and unlocking potential revenues. Developers are able to build on land that would otherwise be unsuitable for housing if baseline design standards were maintained. Moreover, more challenging parcels of land that warrant design flexibility are often small infill sites in densely developed areas, where there is likely greater demand for housing. Flexibility incentives provide resident households the option to live in highly sought-after areas where there may be superior employment opportunity, public education, or transportation connectivity.

Market Impact & Considerations

IMPACT

Flexible design standards can contribute to affordability through both a direct and supply approach. Design flexibility incentives can be used to directly incentivize the addition of more affordably priced units. Moreover, by activating sites that would otherwise be unused, the incentive contributes to the overall supply of rental units, which can improve affordability.

CONSIDERATIONS

Is the market strong enough to support the additional units? In markets where units are not easily absorbed, the risks associated with the potential revenue may not justify the costs of undertaking an exceptional design.

Will the required changes in design lead to prohibitively high costs? On a project-by-project basis, the need for an unconventional design may cause a project to be costlier than is feasible.

A Suite of Design Incentives in Tallahassee, FL

In exchange for requiring 10% of new housing units to be affordable, the City of Tallahassee provides housing design flexibility, such as relief from setback requirements and minimum lot size requirements, as well as a 25% density bonus.

Reduced Parking

Relaxed parking requirements can decrease costs and allow more rental units to be developed.

Incentive Format

Reduced parking requirements relax zoning standards to allow for less required on-site parking, in return for the provision of more housing units.

Reduced parking requirements reduce costs and can potentially increase revenues. Structured parking is expensive to build, and surface lot parking is space-intensive. The flexibility to build only the parking space the market demands can amount to a significant reduction in construction costs and/or land costs. Moreover, it may be possible and market-supportable to use the saved space to build additional housing units, thus further increasing project revenues.

Market Impact & Considerations

IMPACT

Reduced parking requirements can contribute to affordability through both a direct and supply approach.

By requiring that projects provide a certain number or percentage of affordably priced units to qualify for the cost savings of reduced parking, the city may directly encourage an increase in affordably priced units. The lower costs of development can lower the necessary rent levels.

In addition, simply being able to build more housing units on space that would have otherwise been used for parking increases the overall supply of housing, thus easing rents through a supply approach.

CONSIDERATIONS

Are the levels of parking required reflective of market demand? A reduction in parking requirements should meet local demand for parking, amending what may be excessive requirements. As transportation options, such as ride-sharing, expand in some markets, local demand for parking spaces may meaningfully decrease.

How much costs do parking requirements add to development? The costs vary from market to market and by parking type but are significant in most areas.

Eased Downtown Parking Requirements for Seattle, WA

Seattle passed a bill in 2018 to reduce parking requirements for affordable housing projects, requiring one parking space per six units instead of three. In areas where “frequent transit” is available, no parking is required for any residential units. This measure will significantly ease rents in what is currently an expensive place to build – according to a 2015 report, one parking space per affordable housing unit increases rent by 12.5% in King County.

Accelerated Approvals

Saving time during pre-development and construction reduces both development costs and risks.

Incentive Format

Accelerated approvals move projects through key regulatory phases more quickly than usual. This may entail moving a project more quickly through initial land use approvals and post-entitlement planning or more expediently performing late-stage building code and construction inspections prior to delivery. Municipal staff may negotiate a timeline with the developer and may choose to prioritize projects and scale the approval timelines by each project's number of affordably priced units or depth of affordability.

Accelerated approvals work as an incentive by decreasing both the direct and opportunity costs associated with time and risk. By sticking to an expedited schedule, developers can avoid cost overruns and unnecessary delays, begin leasing units earlier, and obtain rental income sooner. Moreover, the resulting decrease in risk for a project may help developers access additional, or more favorable, sources of financing, decreasing necessary rents.

Market Impact & Considerations

IMPACT

Accelerated approvals contribute to affordability by directly reducing the cost of development, which allows for lower rents. Many cities promise to expedite reviews for projects that directly contribute to the city's stock of affordably priced units. The incentive is generally most effective in securing affordably priced units if provided alongside additional incentives.

CONSIDERATIONS

Is the incentive adequate on its own? Accelerated approvals alone are unlikely to "move the needle" on housing development. However, the incentive is relatively inexpensive and straightforward to provide, and when effectively delivered it models a general good practice for efficient government. The incentive can be especially effective in certain markets where risks are high or for certain projects or developers particularly sensitive to delays.

Accelerated Permitting in Santa Fe, NM

The City of Santa Fe, New Mexico accelerates the permitting process for projects that include at least 25 percent affordable housing. This policy is coupled with a number of other ordinances, including permit fee waivers, impact fee waivers, and a reduced utility expansion charge for affordably priced housing properties.

By-Right Development

Housing supply can grow in response to demand, helping to bring rents and housing options more in line with community needs.

Incentive Format

A by-right development approval process uses uniform, codified, and consistent zoning and development regulation to streamline and enable new housing developments. In contrast, "discretionary" zoning allows disparate groups to prioritize individual interests in ways that can be severely disruptive to the addition of housing supply and affordability.

By-right development works as an incentive by reducing softs costs and land costs and by mitigating project risk. An efficient and predictable entitlement process reduces carrying costs, consulting fees, and other costs associated with approval processes when compared to a lengthy discretionary review process. Land costs are reduced when the zoning premium on multifamily land is rendered obsolete, as by-right policies increase the number of parcels with few zoning restrictions, reducing competition and associated land costs.

Market Impact & Considerations

IMPACT

By-right development lowers the cost and increases the supply of rental housing in areas where there is the greatest demand, thereby reducing the competitive pressures that drive up rents. By decreasing the costs associated with permitting and entitlement, developments require less financing and lower rents to achieve viability. By-right development protocols also encourage a greater volume of new development, as developers can anticipate a transparent and efficient process.

CONSIDERATIONS

Does the market need more units? By-right development allows supply to be more responsive to demand or actual need.

Is there political will to adopt by-right development? By-right development requires political consensus, which can be difficult to achieve in many jurisdictions.

How does the building review process differ geographically? Areas where discretionary review is more stringent, and where communities are more well-organized, tend to be wealthier and more well-established communities where affordably priced housing is most needed.

"The Anti-Snob Law" – Massachusetts Chapter 40B

Once achieved, a statewide approach to by-right development both reflects and can act upon broad coalitions of support for more housing. The state of Massachusetts passed Chapter 40B in 1969, which allows affordable housing to be developed in towns where less than 10% of housing is affordable, regardless of local zoning ordinances. The policy has reduced local zoning and permitting barriers. 90% of qualifying projects submitted to local Zoning Boards of Appeals have been approved.

Reduced Fees

Waivers or reimbursements decrease costs dollar-for-dollar, while deferrals reduce risk.

Incentive Format

Fee reductions waive, reimburse, or defer a variety of fees typically incurred throughout a project's lifespan. These fees include those associated with building permitting, planning, and development, such as zoning fees, subdivision fees, site plan fees, building plan review-permit-inspection fees, and impact fees.

The extent of the fee reduction can be scaled depending on the type of housing units in question. For example, fees may be reimbursed to different percentages depending on the depth of affordability. Another policy option is to defer fees for market-rate units, such that the fee is to be paid when those units reach a certain level of occupancy.

Fee reductions work as an incentive by directly decreasing project costs (or project risk, in the case of fee deferrals). Fixed cost savings are especially valuable for smaller developments, and per-unit cost savings can be significant for larger developments with many housing units.

Market Impact & Considerations

IMPACT

Reduced fees contribute to affordability primarily through direct cost reduction.

Fee reductions cover development soft costs and, therefore, help to lower the rents that a project requires to be feasible and profitable.

In some markets, a large fee reduction may be adequate to instigate a greater volume of housing development, but the incentive does not often contribute to a significant growth in supply.

CONSIDERATIONS

How meaningful are fee reductions in a market? Fee reductions would be most impactful in markets where developers are already eager to build but where development costs are high enough for a waived fee to be significant.

How important are these fees to the property and community? Some fees, such as impact fees, would contribute to surrounding infrastructure and improvements. Foregoing this capital to incentivize affordability forces a tradeoff between important public goods.

Impact Fee Waivers in Polk County, FL

Polk County waives and reduces impact fees for newly developed for-sale and rental units provided to low-income households. Developers pay full impact fees up front when applying for a permit, but fees are reimbursed as housing units are occupied by low-income households. The county sets a maximum waiver cap of $250,000 per year across the city, to limit the program’s impact on the city budget.

Public Land

Public land sold at a below-market price in exchange for affordability lowers the cost of development and allows for lower rents.

Incentive Format

A public land policy establishes criteria by which local governments select and sell parcels of publicly controlled land at below-market prices (often free) to improve affordability. Effective policies draw from a broad portfolio of land parcels and work to maximize the value of that land – such as by allowing for dense and mixed-income developments. The policy should employ a well-defined selection process and expedient regulatory approvals.

Public land acts as an incentive by decreasing development costs. The reduction in land price mitigates a very significant development cost, allowing for lower rents and greater affordability.

Public land disposition can operate effectively and create community benefits in strong and weak markets alike. Disposition creates opportunities in strong markets and catalyzes reinvestment in weaker ones.

Market Impact & Considerations

IMPACT

Public land incentives can contribute to affordability through both direct and supply approaches. By minimizing a significant cost to development, public land incentives directly allow for the creation of more affordably priced units. And depending on the market need, public land can be provided as an incentive for a spectrum of housing types, to contribute to the overall supply of rental units, which can improve affordability.

CONSIDERATIONS

What is the size and strength of a municipality's public land portfolio? The impact of this incentive is directly tied to quantity and quality of land made available. More and better-quality parcels have a greater impact on affordability.

Is the incentive complemented by other policies? Public land incentives typically are not effective on their own. Even with a significant portfolio, a standalone land policy will produce fewer than 100 units annually.

High Density Transit-Oriented Workforce Housing in Atlanta, GA

Atlanta's public land disposition guidelines are complemented by zoning relief for project modifications, as well as higher density uses and reduced parking requirements. These offerings helped the Metropolitan Atlanta Rapid Transit Authority (MARTA) recruit developers for station-area transit-oriented development (TOD) contracts that include workforce units. The program, introduced in Q3 2018, is coupled with a $15 million fund that will provide below-market, low-rate financing to support development of workforce housing.

Tax Incentives

Property tax incentives improve affordability by lowering the cost to operate rental housing.

Incentive Format

Property tax incentives are state or local policies that reduce the tax burden on properties that support a public policy goal. The specific mechanisms vary but fall under three broad categories: tax abatements, tax rebates, or tax exemptions. These incentives can be strategically enacted in different geographies and for different project types, to encourage development for which the city has the greatest need. For example, tax incentives can be provided for both new development and for capital improvements on existing buildings.

These tax incentives work by reducing property taxes, lowering operating costs. For a designated period of time, tax reductions amount to a direct discount on a property's operating costs. As operating costs rise in many areas, this cost savings can be very meaningful for project budgets.

Market Impact & Considerations

IMPACT

Tax incentives can effectively contribute to affordability through both a direct and supply approach. By lowering operating expenses, tax incentives directly allow for projects to incur lower rents, as is often required. And in markets where the promise of tax incentives is enough to encourage more development overall, the incentive contributes to affordability by increasing housing supply.

CONSIDERATIONS

Can a municipality afford the cost of foregone revenue? A direct approach to improving affordability can work in any market, as long as the city is able to bear the opportunity cost of lower tax revenues.

Would other market conditions prevent the efficacy of tax incentives? Tax incentives would be most effective in markets where rents do not support construction costs, but where land is largely available and developable. If a city's land use and regulatory environment is the primary barrier, tax incentives will not be able to induce new development.

Inducing Development in Philadelphia, PA

Philadelphia's tax incentive policy is designed to induce development of for-sale and rental housing by applying a significant 10-year tax incentive to a market with relatively weak conditions and the fourth-highest construction costs in the country. As a result, development has increased by 367% since the incentive took effect in 2000, while suburban areas without the incentive saw only an 11% increase in building activity. A report by JLL found that every $1 in tax revenue foregone results in $2 of net revenue through the resulting effects of the policy.

Public Funding

Public money can catalyze development that would otherwise be financially infeasible.

Incentive Format

Public funding "closes the gap" for desirable but otherwise infeasible projects. This money can come from federal, state, and local levels, with a multitude of formats and restrictions. Meaningful funding levels typically range from hundreds of thousands to millions of dollars.

Funding can be invested *directly* into project costs (capital or operating). In this case, the incentive works by directly decreasing costs and expenses. Public money often constitutes a critical piece of the capital stack for developers of affordably priced housing.

Funding can also *indirectly* benefit a housing project by covering the costs of surrounding improvements. These amenities include transportation and utilities infrastructure, parks and open space, and investments in economic revitalization. These projects bolster the success and cash flow of not only the project, but also the community and future projects.

The promise of public money serves as an early-stage instigator for new housing projects. Funding can be competitive to secure and tightly budgeted, but – when properly allotted – can be transformational for funding recipients.

Market Impact & Considerations

IMPACT

Public funding contributes to affordability through both a direct and supply approach. Depending on the source, public funding is often competitively awarded to projects that promise to deliver affordably priced units. This is possible because the funding directly reduces development costs and, therefore, the rents necessary for a viable project. Public money and improvements also play an important role in galvanizing new development of all kinds, thus improving affordability by increasing supply overall.

CONSIDERATIONS

What restrictions does the public funding take? Depending on their design, public funds can come with many strings attached, which can affect the project's calculus in direct and indirect ways.

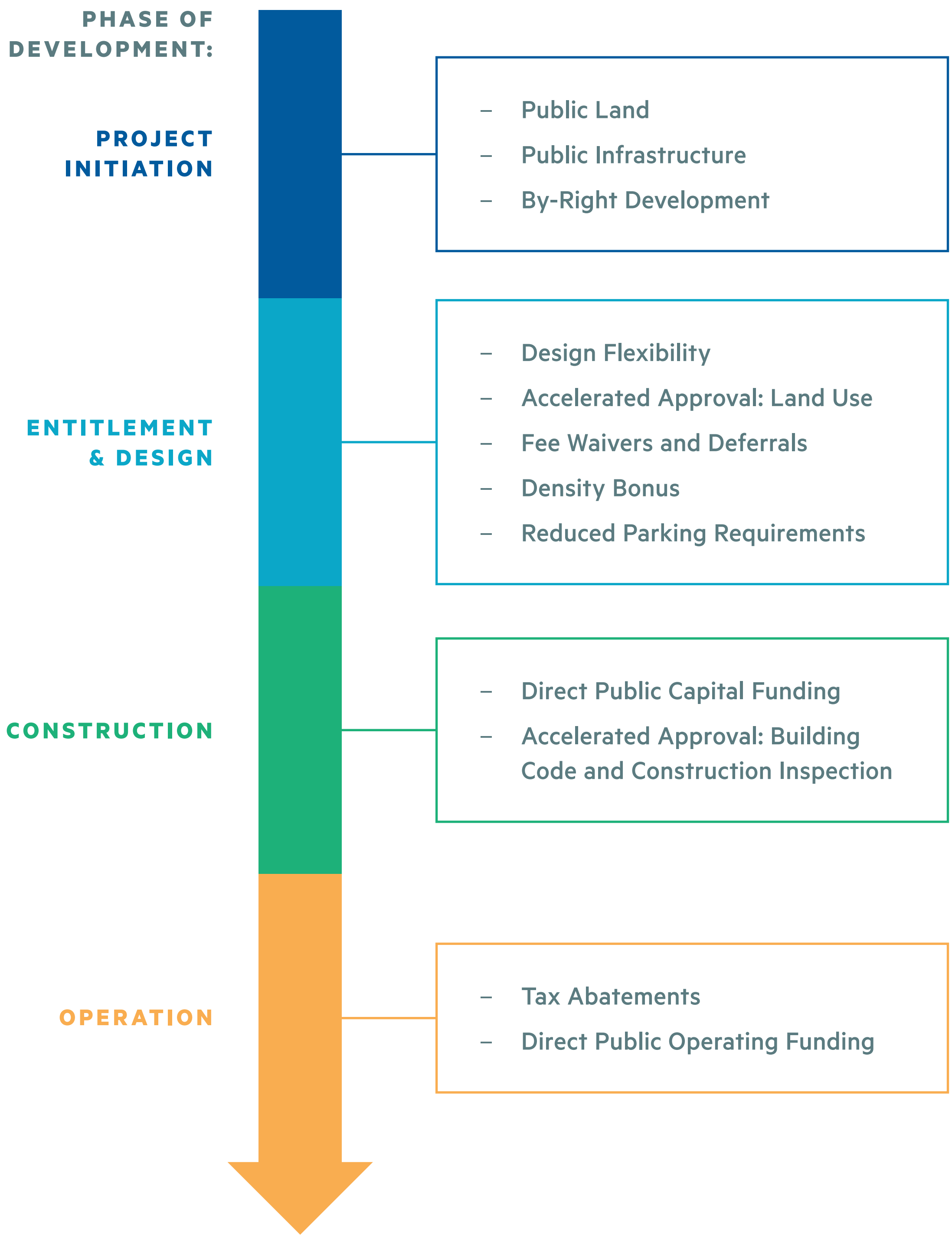
How significant is the financing gap, and will public money be adequate to fill it? In markets where building is expensive and/or rents are weak, a significant level of funding may be necessary – and public reserves may be inadequate.

Housing Production Trust Fund in Washington, D.C.

The HPTF is a special revenue fund in the District of Columbia that produces and preserves affordable housing. Drawing from a 15 percent tax on deed recordation and transfer taxes, the fund currently aims to commit $100 million per year (the second highest in the nation). Every dollar of HPTF funding is matched with $2.50 of private and federal financing, to be used toward qualifying and winning projects that serve a stipulated range of AMIs and housing needs. Between 2001 and 2016, the HPTF produced or preserved nearly 10,000 units of affordable housing.

Phases of Incentives

Housing incentive policies influence project financials and outcomes throughout the development process.

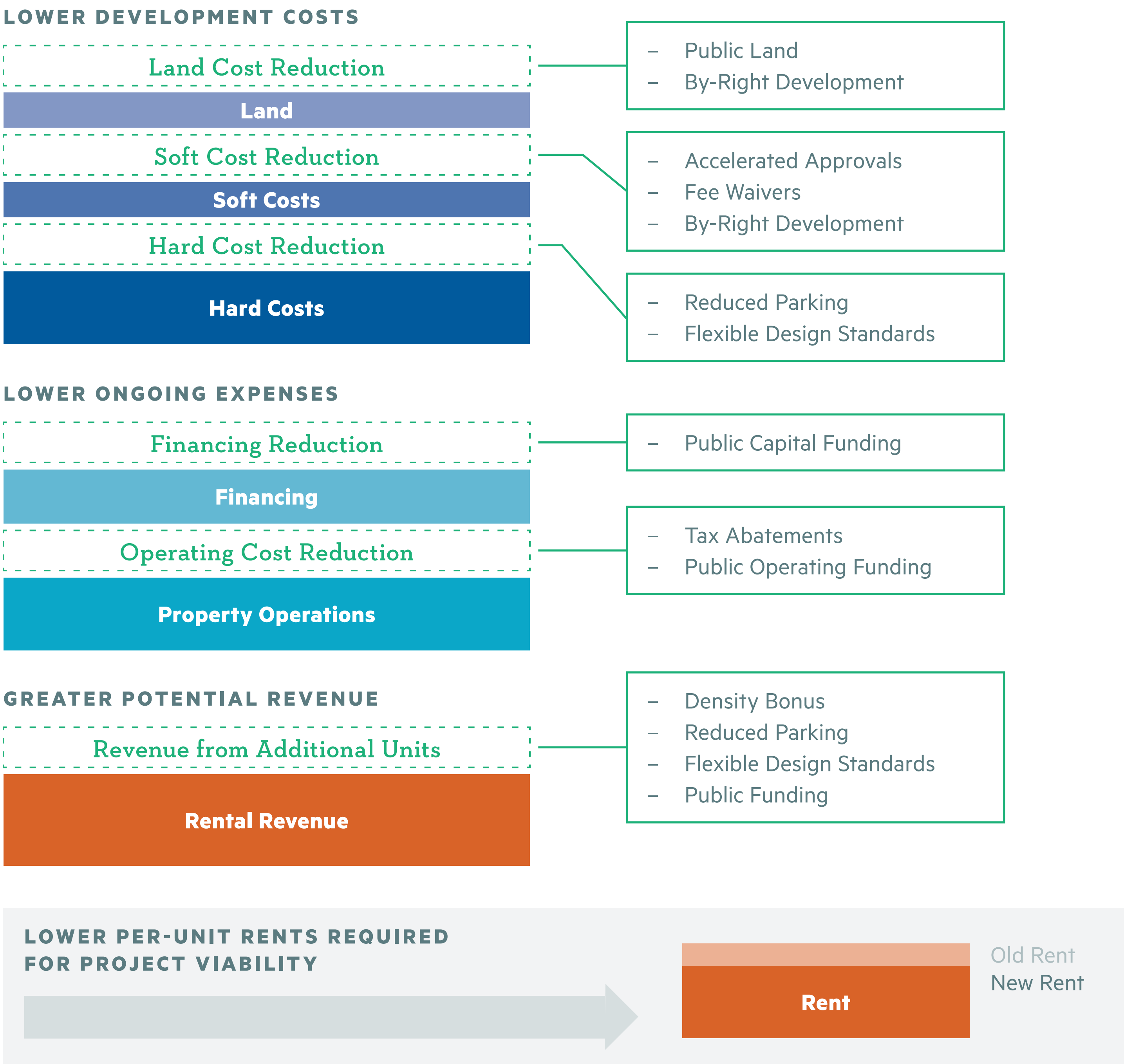


Economics of the Tool

Housing incentive policies can obligate and/or allow for a direct reduction in rents.

Direct Approach:
Reduced Costs and Expenses; Increased Revenue

Housing development incentives reduce costs or increase revenue, thus allowing for a direct decrease in rent for at least a portion of units, while still maintaining project viability.



Economics of the Tool

Housing development incentives can be designed to increase the production of all forms of housing.

Supply Approach: Increasing Overall Production

Housing development incentives can increase the supply of housing and, consequently, improve housing affordability. In particular, **incentives such as by-right development, flexible design standards, public land, public funding, and tax incentives can significantly increase the likelihood of development.**

Currently, the increase in rents of existing affordably priced market-rate housing is one of the largest factors driving the affordability crisis nationwide. The loss of this housing is a direct result of insufficient supply for new renter households. Increasing the supply expands affordability for all households.

The indirect impact of increased supply on lowering rents can be significant. Below is the estimated[1] impact of a 1% increase in housing supply on rents and the number of households who would be able to afford rental housing as a result.

		EFFECT OF 1% INCREASE IN SUPPLY	
	DECREASE IN SHARE OF UNITS <$800 SINCE 2000 (PERCENTAGE POINTS)	REDUCTION IN RENT	INCREASE IN AFFORDABILITY (BY HOUSEHOLDS)
Atlanta	15.7	0.63%	690
Sacramento	19.5	0.98%	720
Minneapolis	15.1	0.95%	780
Denver	20.9	0.98%	1,300
Pittsburgh	21.1	1.19%	730
San Antonio	19.3	0.82%	720
Seattle	14.5	1.02%	1,500
Tampa	26.8	1.00%	580

A **1% increase** in overall supply in Pittsburgh would add **1,200 units** to the market and reduce overall prices by **1.19%**. This would make Pittsburgh affordable to **730** additional households.[2]

1 A 2018 study by the Bay Area Council Economic Institute ("Solving the Housing Affordability Crisis") evaluated the effect of various housing policies based on the number of households for which housing would become affordable as a result of the policy, using a 30% housing-cost-burden assumption. The report evaluated the responsiveness of price to changing the supply through policy. Using a similar method, HR&A evaluated the number of households for which housing would become affordable, given a 1% increase in the overall supply of the eight case-study cities.

2 730 additional households would pass the threshold below 30% for affordability.