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To: Tammie Grossman, Director of Development Customer Services, Village of Oak Park

From: John, Lynch Executive Director, OPEDC

Subject: Inclusionary Housing Ordinance

OPEDC staff appreciates the opportunity to offer thoughts regarding the economics of inclusionary housing policies currently under consideration in Oak Park. In addition to relying on our own experience with this topic, we have consulted with developers and conducted additional research, noting in particular a 2016 report issued by the Urban Land Institute's Terwilliger Center for Housing titled "The Economics of Inclusionary Development," which sought to provide policy makers with advice and guidance regarding inclusionary housing policies. That report was based on a comprehensive review of available research with respect to affordable housing policies nationally, and we find it to be a sound basis for our conclusions. In short, we believe that an Inclusionary Housing Ordinance (IHO) may help to create affordable housing in the community if carefully and conservatively crafted, but we acknowledge significant risks to the development market (and corresponding lack of benefits to affordable housing goals) if potential projects are overly burdened with costs of compliance.

As typically drafted, an IHO adds an additional cost of compliance to any new development subject to the ordinance – either by reduced rental income, lower sales prices, or cash payments in lieu of providing affordable units on-site. Often overlooked, however, is that the vast majority of the cost to comply with an IHO is borne not by the developers, but by property owners as the *sellers* of the underlying land for development. As stated in the ULI report, "[inclusionary housing] policies principally affect land value, especially in the short run."

By way of explanation, it may be understood that land prices in a competitive environment will be bid to the maximum level that allows a developer to pursue a project given the development potential of the land and the developer's minimum risk-adjusted return requirements. Additional project costs, such as those imposed by an IHO, can therefore not be easily borne from projected returns, as that would likely reduce projected returns below those necessary to justify a project's risk. Instead, such additional costs – if reasonably known or anticipated – are built into a project pro forma when valuing the land to be acquired.

So will land owners accept the reductions in redevelopment value brought on by an IHO? There is no single answer to that question, but when considering the terms of the IHO it can be illustrative to think in terms of that question. For example, we understand that the ordinance as currently proposed may require 5-10% of residential units to be affordable, with an option to pay a per unit fee ranging from $50,0000 to $100,000 in lieu of delivering on-site units. Using the in-lieu calculation, the cost of the IHO could range from [5% x (# of units) x $50,000] to [10% x (# of units) x $100,000], or **$2,500 to $10,000 per unit**. We know from experience that land values for multifamily apartment projects currently range from $20,000 to $30,000 per unit in our market, while land values for townhome projects range from $50,000 to perhaps $80,000 per unit depending on location and target sale price. The IHO effectively serves to lower each of these values by $2,500 to $10,000, for a **land value reduction of up to 50%** if implemented at the high end of the proposed range. The question of whether landowners will be willing to absorb the reduction in land value is not insignificant, and would depend on the unique circumstances of the owner and property.

The economics of providing on-site units are typically more challenging still. While affordable units may be delivered at an incrementally lower cost than market units (using more moderate interior finishes, for example), the market value of affordable units is substantially below that of market units. We have estimated that a unit which may be valued at $350,000-$400,000 based on rental cash flow may be worth no more than $200,000 if rent-capped, a price which is well below cost to build. Similarly, a $500,000 market-rate townhome may be limited in sale price to under $120,000, again below construction cost and resulting in nearly $400,0000 in reduced revenue to the developer for each unit provided on-site. Requiring any significant percentage of units to be delivered on-site should therefore be expected to have major ramifications on development feasibility for most projects.

With these economic implications in mind, we support the inclusion of incentives with any IHO adopted, such as bonuses and permit fee reductions, as proposed by Village staff. The success of any IHO hinges on the private sector's interest and ability to build market-rate housing, and incentives may offset some of the cost implications from providing affordable units or in-lieu contributions. We are cautious, however, not to overstate the impact bonuses can have on a project pro forma – particularly in an environment where land prices and construction costs are high, and building height and parking ratios are areas of concern within the community.

We see the in-lieu fee option as likely more impactful than incentives in terms of advancing the overarching goal of adding affordable housing supply in Oak Park. At $50,000 to $100,000 per unit we hope that most projects will remain feasible and thereby add increment to affordable housing program funds. Moreover, because of the organizational capacity that currently exists in Oak Park and recent success using in lieu contributions, Oak Park has proven the ability to leverage funds in ways that are as impactful, or even more so, that on-site units.

The staff at OPEDC appreciates the goal of maintaining affordable housing in Oak Park and commends the Village Board and staff for prioritizing the issue. We also believe that a defined ordinance can offer certainty in application that is not offered with ad-hoc applications. We do offer caution, however, that well-intentioned policies may fall short of their promise if cost implications render new projects infeasible. As stated by ULI in its report, "In many communities, the costs (in reduced land value or economic return) of developing in accordance with the [inclusionary housing] policy outweigh the benefits, so developers do not participate." *If developers do not participate, the benefits of any inclusionary housing program disappear.* It is therefore imperative that restraint be used when setting parameters for the IHO, lest overly onerous requirements render too many projects infeasible and the program therefore ineffective.