

The Potential Effects of Inclusionary Zoning in Canada



AltusClayton

The Potential Effects of Inclusionary Zoning in Canada

Prepared for:

Canadian Home Builders' Association

Prepared by:

Altus Clayton
Division of Altus Group Limited

1580 Kingston Road Toronto Ontario M1N 1S2

Phone: (416) 699-5645 Fax: (416) 699-2252

info@altusclayton.com

www.altusclayton.com

May, 2008

EXECUTIVE SUMMARY

Inclusionary zoning policies, common in a number of U.S. municipalities, are emerging in some Canadian cities in recent years. “Inclusionary zoning” refers to municipal policies that require provision of ‘affordable housing’ as part of a larger residential development¹.

The Canadian Home Builders’ Association (CHBA) has approached Altus Clayton to prepare an analysis of inclusionary zoning that assesses the ramifications of such a policy.

Some Canadian municipalities are considering inclusionary zoning policies, similar to those found in municipalities in the United States, as a means of increasing the supply of ‘affordable housing’. However, most research based on the U.S. experience suggests that inclusionary zoning is an ineffective and inefficient policy, compared to other options:

- Inclusionary zoning does not produce a high volume of ‘affordable housing’ – typically, only 3-7 percent of the net new housing produced annually in inclusionary zoning jurisdictions;
- In most cases, it is necessary to provide incentives or compensation to developers to ensure that housing projects are financially feasible;
- There are significant direct and indirect costs connected with inclusionary zoning policies;
- Inclusionary zoning can cause the average price of new homes across the market in certain jurisdictions to increase;
- Higher housing prices in certain U.S. metropolitan areas, such as San Francisco and Boston, are due mainly to land-use restrictions. As a form of zoning restriction, inclusionary zoning ultimately worsens housing affordability; and
- Inclusionary zoning asks homebuyers and land owners to bear the cost of a social subsidy, which is unfair.

Building on these findings from the U.S. experience, this paper assesses the potential effects of inclusionary zoning in Canadian municipalities.

- Inclusionary zoning policy is tantamount to the provision of subsidized housing;

¹ Inclusionary zoning refers to a wide array of policies mandating private-sector contributions toward subsidized housing. The mandated ‘contributions’ can be land, housing units and/or cash-in-lieu, depending on the design of the policy.

-
- Typically, 'subsidized' housing refers to housing, supplied by the public or non-profit sectors, that is supported by government funds. In the case of inclusionary zoning, the "subsidy" is the responsibility of the private sector developer who is building the new housing. Based on development economics, the cost of this subsidy will reduce the economic return on a new housing development to the extent that it would be unlikely to proceed, unless the developer is able to:
 - 1) Pass the cost along to the buyers of market units within the development; or
 - 2) Receive compensation from government in the form of cash grants and/or other concessions such as height or density bonuses.
 - In the first instance (passing on the cost to homebuyers):
 - This option is unlikely to be effective as the price of the housing units would become unaffordable and sales would be more difficult, potentially leading to the entire project failing and not going forward;
 - If the project does not go forward, then, of course, the subsidized units won't be built;
 - In addition, if the market units are not built, this leads to reduced supply in the market, and ultimately to higher housing prices for everyone; and
 - Even if the costs can be passed on and the homebuyers (or renters) absorb these costs, the policy is inequitable as a narrow segment of society bears the cost of a social initiative that ought to be supported by the general tax payer.
 - In the second instance (receiving compensation from government):
 - If grants are used to support subsidized housing in market developments, it is not clear that this is an efficient use of public funds. Findings in this study suggest that the cost to the municipality could be between \$70,000 and \$130,000 per subsidized unit – monies which could be used more effectively to help those in housing need;
 - If other concessions such as height or density bonuses are used to "compensate" the developer for the subsidy costs, other problems can arise:
 - Depending on market conditions and the location of the development, a developer is not always able to

improve the economic returns from a development through higher density; and

- The use of density (or height) as a “currency” to compensate developers is problematic as it assumes that allowing greater densities on site will not have adverse effect on other neighbouring landowners or on the planned function of the neighbourhood. However, if this assumption is correct, then it is questionable why a municipality would have density restrictions in the first place.

Making matters somewhat more complicated, some inclusionary zoning jurisdictions allow (or require under some circumstances) developers to provide their inclusionary zoning obligations in the form of cash-in-lieu (sometimes called a “linkage fee”). This scheme, of course, is tantamount to an additional housing tax levied by the municipality and would have all the same market distorting effects as schemes requiring the provision of subsidized units, as outlined above.

There are also a number of unintended or indirect long-term economic and policy consequences arising from inclusionary zoning. These include:

- **Housing provision** – If inclusionary zoning policies without adequate compensation are introduced, threatening the feasibility of new housing developments, then, ultimately, housing shortages across the municipality or urban area will emerge.
- **Housing affordability** – Affordability among all households is important in order to support economic development and prosperity within the municipality. When new home buyers have to bear the cost of a subsidy, this has negative repercussions on housing affordability.
- **Density** – If the policy makes bringing large higher-density projects to market less feasible, then the municipality may find an emerging shortage of higher-density housing in the long term. This outcome would be particularly harmful to municipalities that are promoting housing intensification and/or downtown revitalization.
- **Subsidized housing** – If a municipality relies on inclusionary zoning to provide the array of housing required for households in core housing need and/or persons requiring supportive/transitional housing, then the policy may fail to deliver an adequate supply of these units.

TABLE OF CONTENTS

	Page
EXECUTIVE SUMMARY.....	i
1 INTRODUCTION.....	1
2 LITERATURE REVIEW.....	1
3 INCLUSIONARY ZONING: FEASIBILITY CASE STUDY.....	5
4 INCLUSIONARY ZONING: LONG-TERM EFFECTS.....	14
5 CONCLUSION.....	16
APPENDIX ANNOTATED BIBLIOGRAPHY OF MAJOR INCLUSIONARY ZONING STUDIES	

1 INTRODUCTION

The Canadian Home Builders' Association (CHBA) has approached Altus Clayton to prepare an analysis of the ramifications of inclusionary zoning. This report sets out these effects.

Inclusionary zoning policies, common in some U.S. municipalities², are emerging in some Canadian cities – for example, recently, Toronto's new *Official Plan* includes inclusionary zoning policies and Edmonton is considering similar policies. Vancouver and some other B.C. municipalities also have inclusionary zoning policies.

Inclusionary zoning refers to municipal policies that require 'affordable housing' to be provided as part of larger residential developments³. The mandated 'contributions' can be in the form of land, housing units and/or cash-in-lieu, depending on the design of the policy. In practice, inclusionary zoning policies focus on placing requirements on certain developments to provide units deemed to be affordable for lower income households.

2 LITERATURE REVIEW

This section provides a brief literature review of academic research on inclusionary zoning and its effects, many of which draw from case studies in U.S. cities.

A large volume of research exists on inclusionary zoning, primarily on the outcomes of policies in U.S. municipalities. A number of U.S. municipalities – mainly in California (because of state legislation) and New Jersey (because of the litigation over "fair share" housing)⁴ – have adopted inclusionary zoning policies in the past 20 years or so. This section provides a brief review of several key studies that evaluate the effectiveness of these policies. The detailed information about the studies included in this report can be found at Appendix A.

² About 1/3 of California municipalities are said to have some form of inclusionary zoning policy in place. These policies are also found in municipalities in New Jersey and Massachusetts. Beyond these states the presence of mandatory inclusionary zoning policies are less common.

³ The term 'affordable housing' is not clearly defined in the literature, and the definition varies considerably from one municipality to the other. This paper will refer to housing units that are the subject of inclusionary zoning policies as 'subsidized units' or 'subsidized housing' for clarity.

⁴ Kerry D. Vandell, *Inclusionary Zoning: Myths and Realities*, Nov. 2003.

Studies on inclusionary zoning are conducted by various organizations including government agencies, non-profit organizations, industry associations, academics, etc. They reveal a wide array of conclusions with strong correlations between the conclusion and the organization's wider policy perspective.

In 2007, the California Coalition for Rural Housing and the Non-Profit Housing Association of Northern California conducted a survey on inclusionary housing programs within the State.⁵ Some important conclusions from the survey are:

- Since 1999, inclusionary zoning programs have created an estimated 29,281 subsidized housing units state-wide, a majority of which are integrated with market units within larger mixed use developments; and
- Nearly three-quarters of the housing produced through inclusionary zoning programs is affordable to people with some of the lowest incomes.

Other studies, such as *Inclusionary Housing in California: 30 years of Innovation*⁶, *Expanding Affordable Housing through Inclusionary Zoning: Lessons from the Washington Metropolitan Area*⁷, and *Boston's Policy Gives Developers Choice*, present similar findings.

The "positive" findings in the above studies seem to reflect the methodology employed by the authors. The primary determinant of success is the *number* of subsidized units built under the policy (i.e., if any number of units is produced then the policy is said to be a success), rather than the *impact* of the subsidized units produced (i.e., did the policy produce enough to meet needs? What is the scale of production relative to the size of the housing market?). Moreover, these studies tend not to assess the costs of the policy. They also ignore the cost of inclusionary zoning policies relative to other housing measures.

Most research based on the U.S. experience suggests that inclusionary zoning is an ineffective and inefficient practice compared with other options.

⁵ The California Coalition for Rural Housing and Non-Profit Housing Association of Northern California, *Affordable by Choice: Trends in California Inclusionary Housing Programs*, Aug. 2007.

⁶ The California Coalition for Rural Housing and Non-Profit Housing Association of Northern California, *Inclusionary Housing in California: 30 Years of Innovation*, 2003.

⁷ Karen Destorel Brown, *Expanding Affordable housing through Inclusionary Zoning: Lessons from the Washington Metropolitan Area*, Oct. 2001.

A study conducted by the Center for Urban Land Economics Research at the University of Wisconsin clarifies the effects of inclusionary zoning and its effectiveness.⁸ It concludes that:

- Inclusionary zoning does not produce a high volume of subsidized housing – typically, only 3-7 percent of the net new stock produced annually represents ‘affordable housing’ in inclusionary zoning jurisdictions;
- There is no distinct evidence that inclusionary zoning will serve low-income households;
- In most cases, it is necessary to provide incentives to developers to ensure that housing projects are financially feasible;
- Inclusionary zoning has only a minor effect on integrating neighbourhoods by income and race; and
- Inclusionary zoning asks homebuyers and land owners to bear the cost of a social subsidy, which is unfair.

A similar study, based on data collected from more than 100 municipalities in Massachusetts, estimated that during the 1990-1997 period only some 5 percent of subsidized housing units were built in local inclusionary zoning areas⁹.

A study released by the Reason Public Policy Institute in 2004 concluded that inclusionary zoning policies have had negative effects on housing affordability within the 50 San Francisco Bay Area cities where it is implemented.¹⁰ Its results include:

- During a 30-year period (1973-2003), fewer than 7,000 affordable units have been produced under the policy within the Bay Area;
- The cost for all inclusionary zoning units in the Bay Area is \$2.2 billion due to lost revenues from the subsidized units;
- The price of new homes increased by \$22,000 to \$44,000 per unit due to inclusionary zoning policies (net of any change in price for other reasons);
- Some 10,662 fewer homes were produced during the seven years after the adoption of inclusionary zoning policy; and

⁸ Kerry D. Vandell, *Inclusionary Zoning: Myths and Realities*, Nov. 2003.

⁹ Philip B. Herr, *Zoning for Affordability in Massachusetts: An Overview*, Jan. 2002.

¹⁰ Benjamin Powell and Edward Stringham, *Housing Supply and Affordability: Do Affordable Housing Mandates Work?* Apr. 2004.

- Bay Area local governments lost an estimated \$553 million in tax revenues, such as property taxes and housing transfer taxes, due to their inclusionary zoning policies.

2.1.1 Canadian Experience

In Canada, municipalities in British Columbia were among the first in adopting versions of inclusionary zoning policies. Recently, a policy review by the Metro Vancouver Policy and Planning Department examined the effectiveness of these policies¹¹:

- Since 1988, Vancouver has required 20 percent of the units in major residential projects to be designated for publicly subsidized housing. Under this policy, developers are required to contribute either land or air rights “priced at a value that is affordable to the provision of non-market housing through senior government subsidy programs”. While the policy created a capacity for 2,280 units, only 1,250 were actually built. The remaining 1,130 units were not built, according to the staff review, because they were unfunded by senior government programs.
- A policy in Burnaby requires 20 percent non-market housing on publicly-owned large development sites. It has produced almost 400 subsidized rental housing units in larger housing projects, also with developers supplying land to sponsoring social housing groups at a controlled price.

Even though Vancouver introduced its Inclusionary zoning policy almost 20 years ago, there have only been 1,250 subsidized housing units actually built, amounting to less than one percent of all housing constructed in Vancouver over the same period. Recent City modifications to this policy have attempted to address these limited results, but are likely to run into many of the same challenges to be found in the U.S., as discussed elsewhere in this report.

Some other municipalities in British Columbia – notably Langford and Richmond – have also adopted versions of inclusionary zoning policies in recent years. In these cases, the track record of such initiatives is too short to permit them to be properly assessed.

¹¹ Metro Vancouver Policy and Planning Department, *Overview of Inclusionary Zoning Policies for Affordable Housing*, 2007.

2.1.2 Lessons from the Inclusionary Zoning Literature

There are, generally, a number of key findings and core lessons that emerge from the bulk of the inclusionary zoning research papers reviewed as part of this study. Key findings include¹²:

- Inclusionary zoning policies have been ineffective (relatively few subsidized housing units); and
- Inclusionary zoning policies have worked only with generous public sector subsidies or other bonuses, while having a substantial cost to the broader community through lost revenues, lower housing production level, lost local tax revenues, and weaker housing affordability.

The core lessons from the research are:

- It is ineffective at producing subsidized housing units;
- It introduces uncertainties, causing distortions in the housing market which can limit future housing supply;
- It can be costly to both private (lost revenues from sales of subsidized units) and public (lost tax revenues) sectors; and
- There are more effective and efficient ways to achieve the same objectives.

A recent Harvard Institute of Economic Research study concludes that zoning and other land use controls play the dominant role in making housing expensive in certain U.S. metropolitan areas.¹³ The land use restriction introduced by inclusionary zoning policy can harm housing affordability. The study suggests that the 'affordable housing' debate should be broadened to encompass zoning reform, especially reducing zoning restrictions, not just public or subsidized construction programs.

3 INCLUSIONARY ZONING: FEASIBILITY CASE STUDY

This analysis investigates the economic impact of inclusionary zoning on a housing development, using pro formas from representative condominium projects from Toronto and Edmonton as examples.

Inclusionary zoning policy is equivalent to the provision of subsidized housing, where the subsidy is borne by the developer (and ultimately the

¹² For a complete list of studies reviewed, please see the annotated bibliography in the Appendix.

¹³ Edward L. Glaeser and Joseph Gyourko, *The Impact of Zoning on Housing Affordability*, Mar. 2002.

homebuyer or renter) who may or may not be compensated by the government. Depending on the design of the policy, the “subsidy” may be borne solely by the developer/homebuyer or by the municipality (or partner public sector agencies) or a combination.

In the U.S. experience, a variety of inclusionary zoning policy models exist. These include, at one end of the spectrum, strict requirements to provide the subsidized units with no compensation. At the other end of the spectrum, developers are fully compensated under inclusionary zoning policies by grants and or other monetary concessions.

In between these two extremes, policies provide height and/or density bonuses in exchange or partial exchange for the provision of subsidized units. This is done on the assumption that with higher densities, a developer can improve the economic return to a development, thus offsetting the cost of providing the subsidized units. In the case of the City of Toronto, for example, inclusionary zoning requirements are being considered for certain housing developments that may be eligible for height and/or density bonuses.

To illustrate the economic cost of inclusionary zoning policies within a development, this paper works through a case study to determine the size and impact of the ‘subsidy’ from developers (or homebuyers) to the subsidized units, using the proposed inclusionary zoning policies, and the respective definitions of ‘affordable housing’ in Toronto and Edmonton as examples¹⁴.

¹⁴ The definition of ‘affordable housing’ in the new City of Toronto Official Plan is: “Affordable rental housing and affordable rents means housing where the total monthly shelter cost (gross monthly rent including utilities – heat, hydro and hot water – but excluding parking and cable television charges) is at or below one times the average City of Toronto rent, by unit type (number of bedrooms), as reported annually by the Canada Mortgage and Housing Corporation.” and “Affordable ownership housing is housing which is priced at or below an amount where the total monthly shelter cost (mortgage principal and interest – based on a 25-year amortization, 10 per cent down payment and chartered bank administered mortgage rate for a conventional 5-year mortgage as reported by the Bank of Canada at the time of application – plus property taxes calculated on a monthly basis) equals the average City of Toronto rent, by unit type, as reported annually by the Canada Mortgage and Housing Corporation. Affordable ownership price includes GST and any other mandatory costs associated with purchasing the unit.” The proposed definition of affordable housing in the City’s *Inclusionary Policy Framework and Implementation Mechanisms* is: “Rental or ownership housing provided to households (individuals and families) who have an affordability problem (pay in excess of 30% of their income on housing) and earn 80% or less of the median income and who are capable of independent living, without a need for support services.”

3.1.1 Unit Cost and Revenue Analysis

We have employed a cost model to estimate the general unit costs of construction, including:

- Construction “hard costs”, which cover labour, raw material and other construction related costs; and
- “Soft costs”, which contain design, sales and marketing, finance, DCs, administration and other back-office costs.

Generally, in the last two years, Edmonton has experienced higher unit construction costs than Toronto. This is due partially to the labour shortage in the province, resulting in higher wages for construction workers and other employees (Figure 1).

On the revenue side, value-per-square-foot data are derived from market transaction data to estimate the unit revenue for condominium apartment units. On average, condominium units in Edmonton have a higher price than the ones in Toronto, due to the strong demand that Edmonton has experienced in the last two years.

In both cases, in order to comply with the ‘affordable housing’ definitions, the subsidized units would be sold at a substantial discount compared to the market-rate units – ranging from just under 30 percent discount up to 42 percent in Toronto, and 40 percent in Edmonton¹⁵.

¹⁵ In Edmonton, the proposed inclusionary zoning framework recommended by consultants to the City called for the City to buy 5 percent of the finished housing units in a multi-family development at 60 percent of their appraised market value. No final decision on the structure of the policy has been made by City Council at the time this study is being prepared, although City staff is considering using 80 percent rather than 60 percent. For the purposes of this illustration, the scheme proposed by the consultants is used, as set out in: Gary Gordon and Associates, *Affordable Housing: Inclusionary Policy Framework and Implementation Mechanisms*, Prepared for the City of Edmonton, July 2007.

Figure 1

Unit Cost and Revenue Analysis, Example Condominium Developments, Toronto and Edmonton

	Toronto		Edmonton	
	Without IZ ¹	Under IZ ⁵	Without IZ	Under IZ
Construction Hard Cost ²			<i>\$/sq.ft</i>	
	174	174	188	188
Soft Cost ³			<i>\$/sq.ft</i>	
	52	52	56	56
Apartment Size			<i>sq.ft</i>	
Bachelor	500	500	500	500
1 Bedroom	650	650	650	650
2 Bedrooms	850	850	850	850
3+ Bedrooms	1,100	1,100	1,100	1,100
High-Rise Value ⁴			<i>\$/sq.ft</i>	
	285		310	
Revenue/Unit			<i>\$ per unit</i>	
Bachelor	142,500	104,572	155,000	93,000
1 Bedroom	185,250	128,051	201,500	120,900
2 Bedrooms	242,250	152,681	263,500	158,100
3+ Bedrooms	313,500	182,209	341,000	204,600

¹ Inclusionary Zoning.

² Altus Helyar (Upper limit of Medium Quality), 2006.

³ It is estimated at about 30% of hard cost.

⁴ Toronto is from the RealNet's Nov. 2006 New Home Price-High Rise in GTA and Edmonton is from Essex Appraisal Group's Edmonton Condominium Market Study 2006.

⁵ Unit revenue under IZ is based on municipality reports.

Source: Altus Clayton based on data from Altus Helyar, RealNet and Essex Appraisal Group

3.1.2 Condominium Project Economic Return under Inclusionary Zoning Policy, Toronto and Edmonton

Based on the unit cost and revenue estimates, the feasibility of a typical 200-unit condominium project (in each city) is assessed. The residential unit mix assumed in this feasibility study is built in part upon the unit mix among a number of comparable recent projects in the respective local markets (Figure 2).

Figure 2 Distribution of Apartment Units by Size, Example Condominium Developments, Toronto and Edmonton

Building Units	Toronto				Edmonton			
	Without IZ ¹	Under IZ		Total	Without IZ	Under IZ		Total
		Market-rate Units	Subsidized Units*			Market-rate Units	Subsidized Units**	
Bachelor	4	3	1	4	4	3	1	4
1 Bedroom	119	95	24	119	119	113	6	119
2 Bedrooms	72	58	14	72	72	69	3	72
3+ Bedrooms	5	4	1	5	5	4	1	5
Total	200	160	40	200	200	190	10	200
Total GFA (sq. ft.)	146,050	116,950	29,100	146,050	146,050	138,000	8,050	146,050

1. Inclusionary Zoning

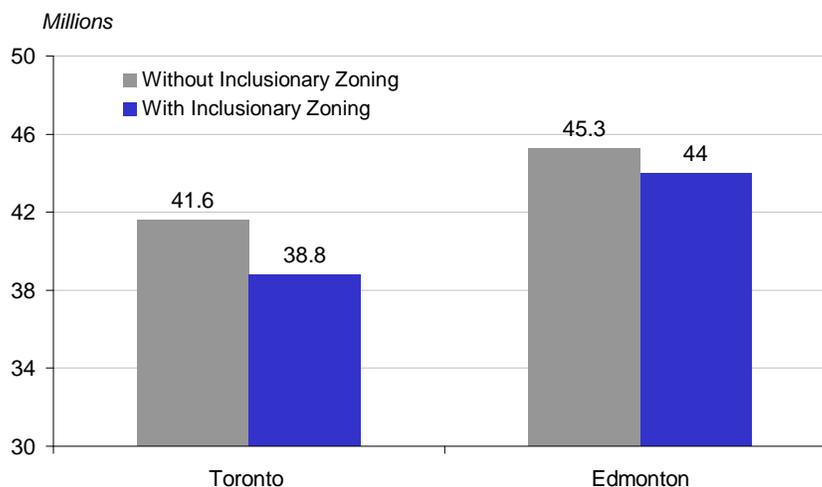
* Under Toronto's policy, 20% of all units should be 'affordable'.

** Under Edmonton's Proposed policy framework, 5% of all units are to be subsidized with 2/3 for single person and 1/3 for family households.

Source: Altus Clayton

Figure 3

Revenue from the Condominium Project, Toronto and Edmonton



Source: Altus Clayton based on data from Altus Helyar, RealNet and Essex Appraisal Group

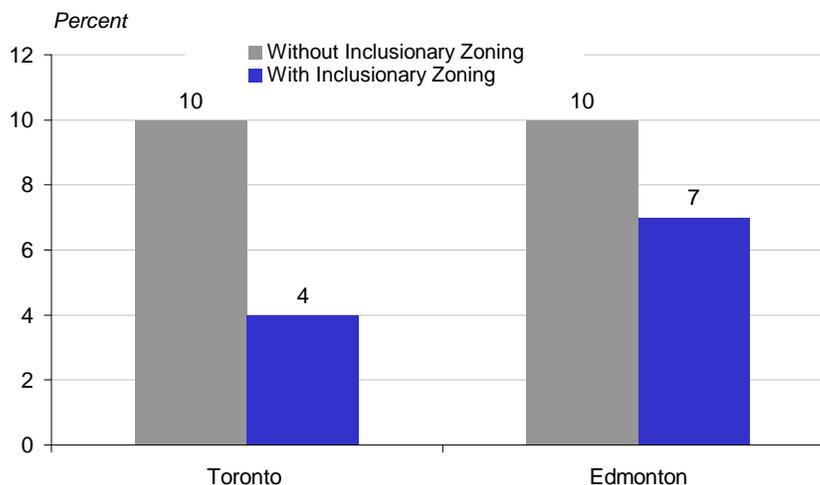
Since the total construction square feet is the same with or without inclusionary zoning policies, the total construction cost including hard cost, soft cost and land value is about \$37.5 million for Toronto's project and \$40.7 million for Edmonton's.

However, because prices of subsidized units are much lower than the remainder of the units, there is a significant difference between the total project revenue with the policy and the one without it (Figure 3).

As development costs are the same between the two scenarios, in the case of a development subject to inclusionary zoning policy, the margin of economic returns would decrease – declined to 4 percent in Toronto and to 7 percent in Edmonton (Figure 4).

Figure 4

Margin of Economic Return from the Condominium Project, Toronto and Edmonton



Source: Altus Clayton based on data from Altus Helyar, RealNet and Essex Appraisal Group

Residential projects involve a wide array of risks ranging from economic risks, such as uncertainties surrounding unit sale prices and construction costs, to political risks. As a result, feasible projects require a minimum level of economic return to compensate for the inherent risks and to attract investment. The business community will not invest in a housing project unless the project is expected to produce an appropriate economic return.

The typical margin of economic return sought in a Canadian residential project is about 10 percent. Since under the policy, the margin of economic return falls below this minimum requirement in both cases, developers, in the absence of offsetting compensation, will likely abandon these condominium projects.

3.1.3 Market Effects

Over the long term, the policy will likely cause a restriction in supply across the overall market, and supply restrictions will ultimately lead to increased average house prices. This is exactly what has happened in inclusionary zoning jurisdictions in the U.S:

- A study of the 33 cities in California's Bay Area concludes that about 10,662 fewer homes were produced during the seven years after the adoption of the inclusionary zoning policy, and the policy caused the price of new homes to increase by \$22,000 to \$44,000¹⁶; and
- A recent study by the Furman Institute for Real Estate & Urban Policy at New York University finds that in suburban Boston municipalities, inclusionary zoning policies have resulted in reduced production and increased prices of single-family homes¹⁷.

These examples show that in a competitive market, where housing projects are generally brought to market at or very close to the minimum economic return, a policy which reduces the achievable income on certain units within the project will lower overall economic return and threaten to make the project unviable. A development might proceed if:

- A developer is able to increase the project revenue sufficiently to improve the economic return by increasing the price of the market units (pass on the subsidy cost); or
- The developer is compensated for the lost revenue by the municipality either through grants or by other concessions such as an allowance for additional density on the site.

The first option is unlikely to be a realistic outcome. A single developer is unlikely to be able to command a price for the housing unit which is higher than what the market is offering, all other things being equal. Ultimately, of course, the market price for housing will rise across the entire market under inclusionary zoning, because of the supply restrictions which occur once developments, like the ones illustrated in these examples, fail to come to market. In the second option, the municipality may be able to offset the potential supply constraints by providing compensation for the lost revenue to the developer. This type of compensation is common in U.S. inclusionary

¹⁶ Powell, Benjamin, et. al., *Housing Supply and Affordability: Do Affordable Housing Mandates Work?*, Apr. 2004.

¹⁷ Schuetz, Jenny, et. al., *The Effects of Inclusionary Zoning on Local Housing Markets: Lessons from the San Francisco, Washington DC and Suburban Boston areas*. Nov. 2007.

zoning jurisdictions.¹⁸ These approaches, however, are inefficient and, in many cases, inequitable.

3.1.4 Government Compensation is No Solution

Returning to the two condominium projects (in Toronto and Edmonton) as an example, the municipality has the option of improving the feasibility of the projects through direct compensation (either grants, or development charge waivers), or providing other concessions that might have an effect on the economic return, such as density bonuses. In the case of the Toronto example, if the City provided cash compensation, the value would have to be some \$2.8 million to keep the project feasible, representing about \$70,000 per subsidized unit. Similarly, the City of Edmonton would have to pay the developer \$1.3 million, which represents some \$130,000 per subsidized unit.

Ultimately, the question is whether this approach is the best use of City funds. Costs of between \$70,000 and \$130,000 per unit are very high and could be employed via other means to assist people in need.

Another common form of municipal compensation is the use of density bonuses. Density bonuses are very common in U.S. inclusionary zoning jurisdictions, being a feature in some 94 percent of all inclusionary zoning projects¹⁹. Density bonuses are very popular with politicians, and are often sold as a “win-win” solution – the developer is able to build higher or denser projects than allowed by zoning regulation (which is good on the assumption that denser projects can provide a higher economic return), and municipalities are able to compensate with a “currency” that doesn’t actually cost any money.

There are, however, a number of problems with relying on density bonuses to fund the provision of ‘affordable housing’.

To build at higher density than is allowed by zoning regulation assumes that development land within a municipality currently has density or height restrictions. This is a reasonable assumption, because most municipalities in Canada strictly control density and height through zoning regulation. But there is considerable debate around what ideal or optimal densities ought to

¹⁸ See for example: Vandell, Kerry D., *Inclusionary Zoning: Myths and Realities*, Nov. 2003 and Rosen, David, *Inclusionary Housing and its Impact on Housing and Land Markets*, Feb. 2004.

¹⁹ The California Coalition for Rural Housing, et. al., *Inclusionary Housing in California: 30 Years of Innovation*, 2003.

be within urban regions. It is not always clear that current densities for any given lands are set at optimal points.

Assuming that zoned densities are 'optimal' for a given development site that is the subject of an inclusionary zoning scheme, then by definition, any bonus given to the development by the municipality will not be 'cost free' but will lead to 'higher than optimal' densities, which would have negative repercussions on neighbouring land uses, potentially, or other aspects of the planned environment.

On the other hand, the zoned densities for a given development site may well be lower than 'optimal', and therefore the density bonus would improve the planned function of the neighbourhood²⁰. This suggests that the original zoning for the site was unfairly restrictive, and that the municipality ought to be considering revising the density restrictions as a means of improving the welfare the population and the efficiency of the housing market – regardless of whether the developer is asked to provide subsidized units or not.

Ironically, the Center for Urban Policy Research suggests that one of the "benefits" of inclusionary zoning with density bonuses is that it promotes intensification and fights 'urban sprawl'²¹. Yet the authors fail to point out that if intensification is a desirable policy, municipalities ought to be pursuing it by liberalizing density restrictions in the first place, not just as a by-product of a subsidized housing policy.

More troubling is the potential that in jurisdictions that trade off density bonuses in order to achieve concessions from developers (like subsidized housing in the case of inclusionary zoning, or other types of concessions in the case of Section 37 under the *Ontario Planning Act*), there is an incentive for municipalities to bring in zoning regulations that are sub-optimal and punitively restrictive, in order that the municipality has ample 'currency' to 'buy' concessions from developers. This type of scheming is not only unfair and inequitable, but promotes an inefficient development process.

²⁰ See, for example, Mills, E., *Why Do We Have Urban Density Controls?* Real Estate Economics, 2005 V33 3: pp. 571-585, who argues that almost all municipalities zone densities lower than would occur in a competitive equilibrium.

²¹ Robert W Burchell and Catherine C. Galley, the Center for Urban Policy Research at Rutgers University, *Inclusionary Zoning: Pros and Cons*, published in **The New Century Housing**, Oct. 2000.

3.1.5 *Payment-in-Lieu is Tantamount to a Housing Tax*

Finally, making matters somewhat more complicated, some inclusionary zoning jurisdictions allow (or require under some circumstances) developers to provide their inclusionary zoning obligations in the form of cash-in-lieu (sometimes called a “linkage fee”). This scheme, of course, is tantamount to an additional housing tax levied by the municipality and would have all the same market distorting effects as schemes requiring the provision of subsidized units. In most provinces, legislation prevents municipalities from compensating developers for cash-in-lieu contributions with density bonuses or other concessions. Thus cash-in-lieu schemes unequivocally increase the cost for developers and ultimately homebuyers.

Government taxes on any product will have the effect of increasing the cost to consumers and ultimately reducing the amount of the product sold in the marketplace. “Sin taxes”, such as those imposed on items such as cigarettes and alcoholic beverages, are specifically focused on items where policy makers want to discourage consumption. Housing, of course, is not such an item.

4 INCLUSIONARY ZONING: LONG-TERM EFFECTS

This section explores the long-term effects of inclusionary zoning policies. As with many policies, there can be intended effects (e.g. increasing provision of subsidized homes) and other, unintended, side-effects.

4.1.1 *Housing Provision and Affordability*

Certain municipalities apply the policy only to larger developments; for example, the policy is in effect on residential projects of 5 hectares and above in Toronto. If the policy makes bringing larger or higher-density projects to market less feasible, then the municipality may find an emerging shortage of larger housing developments in the long term.

Large scale residential projects have various benefits, including:

- Housing mix: Typically, in a larger housing development, there is a greater mix of housing types than in smaller ones; providing homes for families in different income ranges, creating a diverse community; and

- Brownfield development: Many cities have brownfield lands in older industrial areas. Larger-scale residential developments can help to develop those vacant lands.

Inclusionary zoning policies have the potential to discourage larger housing developments, denying those benefits and delaying developments of vacant brownfields.

Moreover, by eroding the viability of some new projects, inclusionary zoning policies lead to reduced supply of new housing across the market. This can ultimately have negative effects on prices, affordability and economic development.

In the marketplace, inclusionary zoning policies will tend to upset the supply and demand balance, leading to fewer new housing units being built. The supply of new housing units will be restricted, as illustrated by example in the last section, as certain residential projects fail to meet viability criteria and ultimately fail to come to market.

Supply shortages ultimately push up the average new home price and rents for new rental units. These higher market prices can be viewed as a 'subsidy' from developers (or home buyers) to support the subsidized units. Bearing the cost of this subsidy means that home prices and rents for market units are higher relative to what they would be without inclusionary zoning. Higher market prices for homes means reduced affordability across the entire housing market.

4.1.2 Density

Many municipalities (and in some cases provincial governments) encourage higher-density development. Market distortion and/or financially punitive inclusionary zoning policies may force residential developers to forego various larger, higher-density housing projects in favour of smaller, lower-density developments which are not the target of inclusionary zoning policies, or are located in suburban or rural municipalities that do not have inclusionary zoning requirements. Ultimately, this effect will reduce density across the metropolitan area.

This outcome would be particularly harmful to municipalities that are promoting housing intensification and/or downtown revitalization.

4.1.3 Supply of Subsidized Housing

If a municipality relies on inclusionary zoning to provide the array of housing required for households in core housing need and/or persons requiring supportive/transitional housing, then the policy will likely fail to deliver an adequate and appropriate supply of these units.

Experience both in the U.S. and in British Columbia suggests that the number of subsidized units that are ultimately created through inclusionary zoning policies tends to be relatively small.

5 CONCLUSION

Inclusionary zoning policies, common in a number of U.S. municipalities, have been emerging in some Canadian cities in recent years. "Inclusionary zoning" is a term referring to municipal policies that require the provision of 'affordable housing' as part of larger residential developments.

The literature from the U.S. overwhelmingly suggests that inclusionary zoning is a relatively ineffective and inefficient approach.

While inclusionary zoning may result in the provision of some subsidized housing, it is unlikely to deliver an adequate supply to meet a municipality's social housing needs. Moreover, there are also a large number of unintended and/or indirect long-term consequences from these policies. These include an inadequate housing supply and reduced overall affordability in the community.

Appendix
**Annotated Bibliography of Major Inclusionary
Zoning Studies**

Effectiveness of the Inclusionary Zoning Policy

Source	Authors/Methodology	City/When	Study Result
<i>The Effects of Inclusionary Zoning on Local Housing Markets: Lessons from the San Francisco, Washington DC and Suburban Boston areas. Nov. 2007</i>	Jenny Schuetz, Rachel Meltzer, Vicky Been: Furman Center for Real Estate and Urban Policy, New York University. Financial support from the Center for Housing Policy	San Francisco, Washington DC and Boston Mass.	<ul style="list-style-type: none"> • Jurisdictions are more likely to adopt an IZ program when they: are larger and more affluent; have more neighbouring jurisdictions that have IZ; or have adopted other land use regulations (specifically cluster zoning or growth management). • The longer IZ programs have been in place, the more affordable units they have produced. In the Washington D.C. area, IZ programs have produced a total of 15,252 affordable units. In suburban Boston, 43% of jurisdictions with IZ had not produced any affordable units. In the San Francisco area, the median annual production across all programs is 9 affordable units/year. Programs with density bonuses and exemptions for smaller projects have produced more affordable units. In suburban Boston IZ resulted in decreases in production and increases in the prices of single-family houses, an effect not evident in San Francisco, according to the authors.
<i>Affordable by Choice: Trends in California Inclusionary Housing Programs, Aug. 2007</i>	The California Coalition for Rural Housing and the Non-Profit Housing Association of Northern California/Survey	Similar to the 2002 Survey, the new study was launched to determine the growth in inclusionary programs in California, and provide a detailed snapshot of the housing that is being produced by these programs.	<ul style="list-style-type: none"> • One-third of California jurisdictions (about 170 jurisdictions) now have inclusionary programs. • Since 1999, IZ programs have created an estimated 29,281 affordable units state wide. • Most inclusionary housing is integrated within market-rate developments. • Nearly three-quarters of the housing produced through IZ programs is affordable to people with some of the lowest incomes. • When market-rate developers work with affordable housing developers to meet their IZ requirement, the units are more likely to serve low-income households.
<i>Overview of Inclusionary Zoning Policies for Affordable Housing, Aug. 2007</i>	<i>Metro Vancouver Policy and Planning Department/Data survey</i>	It is a policy overview about inclusionary zoning practice with emphasis on past experience in British Columbia.	<ul style="list-style-type: none"> • In Vancouver, the City has required 20% of the units in major residential projects to be designated for social housing since 1988. This policy has created capacity for 2,280 units, with 1,250 being built and 1,130 units being unfunded. • In Burnaby, the City has required 20% non-market housing on publicly owned large development sites since 1988. Since then, several large projects, on public sector lands, have created almost 400 non-market rental housing units.
<i>Why Do We Have Urban Density Controls?, 2005</i>	<i>Edwin S. Mills, Kellogg School of Management, published in Real Estate Economics/Economic theoretical study</i>	By using an economic model, the paper presents the effects of density controls. The City of Chicago is used as an example.	This article analyzes restrictions on residential densities in a conventional model of density-distance functions. Density controls force development to extend farther than in competitive equilibrium, thus increasing commuting distance and dwelling costs. Theoretical and numerical analyses presented in the paper conclude that density controls reduce residents' welfare, and the level of the welfare reduction depends on the degree of density controls.

Effectiveness of the Inclusionary Zoning Policy (continued)

Source	Authors/Methodology	City/When	Study Result
<i>Housing Supply and Affordability: Do Affordable Housing Mandates Work?</i> , Apr. 2004	Benjamin Powell and Edward Stringham, <i>The Reason Public Policy Institute</i> /Empirical study	The study is based on data collected from 50 San Francisco Bay Area cities between 1973 and 2003.	<ul style="list-style-type: none"> •IZ produces few units: In total, fewer than 7,000 affordable units have been produced under the policy within the Bay Area. After passing an ordinance, the average city produces fewer than 15 affordable units per year. •IZ has high costs: The cost of IZ in the average jurisdiction is \$45 million due to lost revenues from below market-priced units, bringing the total cost for all IZ units in the Bay Area to date to \$2.2 billion. •IZ makes market-priced homes more expensive: The study estimates that IZ causes the price of new homes in the median city to increase by \$22,000 to \$44,000. •IZ restricts the supply of new homes: In the 33 cities with data for seven years prior and seven years following IZ, 10,662 fewer homes were produced during the seven years after the adoption of IZ. •IZ costs government revenue: The total present value of lost government tax revenue due to the Bay Area IZ ordinances is upwards of \$553 million. •IZ doesn't address the cause of the affordability problem: The real problem is the shortage of housing supply.
<i>Inclusionary Housing and its Impact on Housing and Land Markets</i> , Feb. 2004	David Rosen, <i>David Paul Rosen & Associates</i> , published in <i>NHC Affordable Housing Policy Review</i> /Empirical study	The author has compiled data on annual housing starts for 28 California cities with and without inclusionary housing programs between 1981 and 2001.	<ul style="list-style-type: none"> •Adoption of an inclusionary housing program is not associated with a negative effect on housing production. Instead, other economic indicators such as the prime rate, the 30-year mortgage rate, the unemployment rate and the median home price have greater influence on housing starts. •Developers' costs to comply with IZ can be offset by economic incentives and alternative compliance options.
<i>Economics & Land Use Planning</i> , 2004	Alan W. Evans, <i>Centre for Spatial and Real Estate Economics, University of Reading</i> , published by Blackwell Publishing/Economic theoretical study	The book is a collection of articles written by the author and others on the economics of land use planning, as well as describing economic and other methods of assessing and evaluating planning proposals and controls.	In Chapter 4 of the Book, "Controlling the Density of Development", the author argues that density controls are only needed when an area is developed by a number of firms in a piecemeal and competitive fashion. In this situation, each firm develops a fraction of the area. An increase in density on one site remains an externality for all the others, and the density of development will be too great. Thus, a maximum density should be imposed. However, when the area is developed under the control of a single developer, the density of development will be close to the optimal level. Then, there is no need for any density control.
<i>Inclusionary Zoning: Myths and Realities</i> , Nov. 2003	Kerry D. Vandell, <i>Centre for Urban Land Economics Research-University of Wisconsin</i> /Analysis of other studies	It is a contribution to the public discussion of the adoption of an inclusionary zoning ordinance for the City of Madison	<ul style="list-style-type: none"> •IZ does not produce a high volume of affordable housing. Typically, only 3-7% of the net new stock produced annually represents affordable housing in IZ jurisdictions. •There is not any distinct evidence that IZ will serve low-income households •IZ does not reduce the market values of housing near affordable units. •IZ does not have any effects on the development density. •It is necessary to provide economic incentives to developers to ensure that housing projects are feasible. •IZ only has a minor effect on the integrating neighbourhoods by income and race.

Effectiveness of the Inclusionary Zoning Policy (continued)

Source	Authors/Methodology	City/When	Study Result
<i>Inclusionary Housing in California: 30 Years of Innovation</i> , 2003	The California Coalition for Rural Housing and the Non-Profit Housing Association of Northern California/Survey	CCRH and NPH sent out a questionnaire to all planning agencies listed in the California Planners' Information Network in early April 2002.	<ul style="list-style-type: none"> •As of March 2003, 107 California jurisdictions use local IZ to provide affordable housing. •About one-third of known IZ jurisdictions reported production numbers accounting for over 34,000 units of affordable housing. •In addition, 80% of all respondents believe that their IZ program has stimulated the production of affordable housing that would not have been built otherwise. •For those jurisdictions that did not find IZ helpful, they generally agree that the principal barriers have been market stagnation or infrastructure limitation.
<i>The Impact of Zoning on Housing Affordability</i> , March, 2002	Glaeser, Edward L. and Gyourko, Joseph, <i>Harvard Institute of Economic Research</i> , Harvard University	By using an economic model, the authors explain the cause of high housing prices in certain U.S. areas.	The paper argues that in much of America the price of housing is quite close to the marginal, physical costs of new construction. The price of housing is significantly higher than construction costs only in limited number of areas, such as California and some eastern cities. In those areas, the authors argue that high prices have little to do with conventional models with a free market for land. Instead, the evidence suggests that zoning and other land use controls play the dominant role in making housing expensive.
<i>Zoning for Affordability in Massachusetts: An Overview</i> , Jan. 2002	Philip B. Herr, <i>Philip B. Herr & Associates</i> , published in <i>NHC Affordable Housing Policy Review/Data survey</i>	The author has collected the housing data between 1990 and 1997 in Massachusetts.	<ul style="list-style-type: none"> •There are more than 100 municipalities that had some form of IZ or other zoning provisions explicitly promoting affordable housing in Massachusetts. • Between 1990 and 1997, about 20,000 publicly-subsidized housing units were built in Massachusetts and the author estimates that during the same period, only a little more than 1,000 units were provided through inclusionary zoning or similar schemes.
<i>Boston's Policy Gives Developers Choice</i> , Jan. 2002	Meg Kiely, <i>Community Development & Housing at the Boston Redevelopment Authority</i> , published in <i>NHC Affordable Housing Policy Review/Data survey</i>	Housing data compiled between 2000 and 2002 in Boston.	<ul style="list-style-type: none"> •In Feb. 2000, Boston implemented an IZ development policy. • Between 2000 and 2002, under the policy, developers have contracted to contribute over \$4 million for affordable housing construction and 72 affordable units have been constructed.

Effectiveness of the Inclusionary Zoning Policy (continued)

Source	Authors/Methodology	City/When	Study Result
<i>Expanding Affordable Housing Through Inclusionary Zoning: Lessons from the Washington Metropolitan Area</i> , Oct. 2001	Karen Destorel Brown, <i>The Brookings Institution Center on Urban and Metropolitan Policy/Data survey</i>	Data compiled on various inclusionary zoning programs within the Washington Metropolitan Area between 1974 and 1999.	<ul style="list-style-type: none"> •Between 1997 and 1999, Montgomery County's IZ policy created about 10,572 affordable units. •Between 1990 and 1999, about 582 affordable units were built under Fairfax County's IZ. •During the 1993-1999 period, around 208 affordable units were produced under Loudoun County's IZ. •Households from varied racial, ethnic, and economic backgrounds have benefited from IZ programs. •Affordable housing units have been well distributed throughout the counties. •The number of affordable units created through IZ will decline if residential construction declines.
<i>Inclusionary Zoning: Pros and Cons</i> , Oct. 2000	Robert W Burchell and Catherine C. Galley, <i>the Center for Urban Policy Research</i> at Rutgers University, published in <i>The New Century Housing/Analysis</i> of other studies based on economic theories	This article analyzes other studies on IZ policy.	<ul style="list-style-type: none"> •The provision of affordable housing at little or no financial cost to local governments: most economic incentives to developers are through density bonuses, fee waivers and/or local tax abatements, does not require upfront capital investment from local governments. •The creation of income-integrated communities: the affordable housing created by IZ is not produced as an island of the poor, but rather an income-mixed community •Less urban sprawl: density bonuses often encourage a mixed housing types residential development, to be built more densely than those of primarily single-family zones. •The shift of cost of providing affordable housing to other groups in society. •More developments or induced growth: The density bonus under IZ policy can contribute too many housing projects in non-centre areas surrounding an urban centre.
<i>Inclusionary Housing in California and New Jersey: A Comparative Analysis</i> , 1997	Nico Calavita (San Diego State University), Kenneth Grimes (Wiltshire Community Council) and Alan Mallach (City of Trenton, New Jersey), published in <i>The Housing Policy Debate/Analysis</i> of other studies	This article analyzes studies on California and New Jersey IZ practices.	<ul style="list-style-type: none"> •The 1994 California Coalition for Rural Housing Project survey found that 64 jurisdictions had adopted IZ programs that had produced a total 22,572 units, with 2,439 units approved or in the pipeline. •An informal survey conducted by New Jersey Council on Affordable Housing found that near 7,000 low- and moderate- income units in inclusionary developments had been completed and occupied by 1992.

Source: Altus Clayton based on various articles