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January 17, 2018

The Honorable Kymberly Marcos Pine, Chair
and Members
Committee on Zoning and Housing
Honolulu City Council
530 South King Street, Room 202
Honolulu, Hawaii 96813

Dear Chair Pine and Councilmembers:

SUBJECT: Comments on Proposed CD2 Versions of Bill 58 (2017) and Bill 59 (2017)

The Department of Planning and Permitting (DPP) has reviewed the proposed CD2 versions of Bill 58 (2017), relating to an affordable housing requirement (AHR), and Bill 59 (2017), relating to affordable housing incentives, and offers the comments below for your consideration. We appreciate the committee's extensive efforts to meet with stakeholders to refine and improve the bills. All comments are in comparison to the bills as originally introduced.

Given the urgency of our housing affordability crisis, it is time to finalize and adopt these bills, which are based on over three years of stakeholder meetings, research, and technical analysis. The combination of reasonable requirements and financial incentives will help build and maintain a long-term supply of affordable housing – but only if the original income targets and longer affordability period are maintained. We have organized our comments on Bill 58 into critical policy issues and minor technical and administrative issues. The most important requested revisions include:

- **Maintain the original area median income (AMI) limits** for for-sale units at or below 100 percent and 120 percent AMI; eliminate the proposed option to allow affordable units to be targeted to 140 percent AMI, which is close to or below the market.
- **Maintain the original required 30 year affordability period**, without the proposed decrease to a 10 year period after 120 days of marketing (if the unit is not sold).
- **Encourage, but not require, use of a third party** for administration, monitoring, and compliance. This will take time to establish, and should be an administrative decision by the Director of the DPP.

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Bill 59 (2017), Councilmember Pine's Proposed CD2

- The DPP appreciates that the original language has been restored, applying the incentives to all affordable residential units, not just affordable rental units. We also appreciate maintaining the original three expiration dates for real property tax waivers during construction, which would be enforceable since they are tied to the permitting process.

- We understand that the development industry is asking for adoption of Bill 59 only, while deferring (or eliminating) passage of Bill 58. Bill 59 was crafted to provide incentives to help offset the requirements in Bill 58. Any delay in adopting these bills will also delay implementation of the Transit-Oriented Development (TOD) Special District and TOD zoning, in Ordinances 17-54 and 17-56, which were adopted contingent on adoption of Bills 58 and 59. *Recommendation: Bill 59 should be adopted only in conjunction with Bill 58.*

Bill 58 (2017), Councilmember Pine's Proposed CD2

Policy Issues

- The original proposal included a phase-in of the AHR outside of the Ala Moana and Downtown areas to allow time for the market to respond to the requirement (see attached memo from Rick Jacobus dated 12/23/16). *Recommendation: Maintain the proposed phase-in of the AHR.*

- Table -1.4. We have concerns with the proposed higher 140 percent qualifying AMI tier; with how the higher TOD percentage is applied; and with how affordable units in a substantial rehabilitation project are counted. *Recommendation: Revert back to the original language (or similar).*

  - The CD2 modifies the AHR by adding a new qualifying AMI tier that increases the ceiling from 120 to 140 percent on for-sale dwelling units. This would allow 1/3 of the units to be sold to households earning 140 percent and below of the AMI, in return for providing an additional 5 percent of units as affordable.
  - In many areas on Oahu, the median price of homes on the market are close to or below the 140 percent AMI (or even 120 percent) range (*see attached map*). If the affordable units are offered too close to market price, they will not meet the social purpose of the AHR. They will be a drag on marketing, will be expensive to monitor, and may never result in noticeable benefits to anyone. This may set up the AHR for failure. If Council's purpose is to reduce the burden on developers, it would be better to reduce the required AHR percentage, but leave the lower AMI ranges. *Recommendation: Remove the 140 percent option.*

- The CD2 modifies the AHR by creating a new category for TOD that applies a higher percentage only to TOD projects seeking additional height and/or density (rather than applying to all projects in the geographic TOD zones as originally proposed). This modification may also be a disincentive to using height and density bonuses (which are explicitly provided to get more people living near rail stations and using transit). All projects in TOD zones benefit from rail construction, the new mixed use TOD zoning, reduced parking requirements, and significant infrastructure and access investments. *Recommendation: All projects in TOD zones should provide the higher percentage.*
- Footnotes (2) and (3) state that on- and off-site affordable units will count as one-half of a unit. This is appropriate when the principal project is (more expensive) new construction and the affordable units are (much less expensive) substantial rehabilitation. But when the principal project is (less expensive) substantial rehabilitation, the equivalent on-site affordable dwelling units should count as whole units. *Recommendation: Restore original footnote language.*

- <u>Sec. -1.5.(b)(2). Affordability Period</u>. This reduces the required period of affordability from 30 to 10 years after 120 days, if the Declarant is unable to obtain a contract for sale. Since the purpose of the AHR is to build and maintain a long-term supply of affordable housing, reducing the affordability period by 2/3 will not meet that critical purpose.

  - More importantly, there is no evidence that such a reduction would help market units. Only 7 percent of inclusionary housing programs nationwide sell units with restrictions under 30 years. We have not found other national examples of this "reduced period of affordability" approach. The ability to increase the qualifying AMI range if a unit remains unsold or unrented (as provided in Sec. -1.6.) is a more typical fail-safe provision.
  - In a current large project providing affordable units under a unilateral agreement, we have seen many potential buyers simply "wait out" the initial marketing period to take advantage of the reduced requirements.
  - It is not clear whether the intention is that the reduced affordability period in Sec. -1.5.(b)(2) can be combined with the increased qualifying AMI range in Sec. -1.6 after the first 120 days of marketing; it appears that the Declarant might have to choose one or the other option. This should be clarified if both options are included. If this reduction of the affordability period is retained, a definition of "contract" is needed.

    Recommendation: Eliminate the reduced affordability period option. As a potential compromise, if both options are retained, then allow the reduced affordability period only after the end of the second period (240 days).

- Sec. -1.6. Marketing Period. This allows for increasing the qualifying AMI household income level of the purchaser or renter by 20 percent after each 120-day marketing period. This step-up has been shown to be a workable fail-safe in other programs and is preferable to the reduced affordability period described above.
    - We assume that the intent is only to allow this step-up in qualifying AMI range for the initial leasing of each rental unit, but this is not clear. If it is intended to be an ongoing option, this may be a time-consuming administrative task. All affordable rental units should revert back to the original AMI range when they are re-rented.
    - Similar to the affordability period, a definition of "contract" is needed.

      Recommendation: Add language to require proof of good faith marketing efforts to be submitted to the DPP, with approval by the Director of any increase in qualifying AMI range. Require rental units to revert back to original AMI range when re-rented. Clarify whether the step-up is allowed in ongoing rental of affordable units.

Technical and Administrative Issues

- Sec. -1.2. Definitions. In order to qualify for the substantial financial incentives in Bill 59, rehabilitation should be more extensive than "cosmetic and deferred maintenance" improvements to ensure that affordable units will be livable for the 30-year period of affordability. The CD2 definition of "substantial rehabilitation" language is vague and may be difficult to enforce. *Recommendation: Restore the original "50 percent of then-current replacement cost," which is an objective and measurable standard in use by the DPP. Add definition of "contract."*

- Sec. -1.3. Applicability. Sec -1.3.(b)(5) originally proposed not applying the AHR to micro-units. The assumption was that this exemption would apply to projects consisting entirely of micro-units, and that they would be relatively affordable due to size. However, a recent project application for an interim planned development-transit permit proposed claiming this exemption for the micro-unit portion of the project. Another recent Kakaako project is marketing what appear to be luxury micro-units. *Recommendation: Either eliminate the exemption for micro-units, or adjust the definition to language such as "projects consisting entirely of micro-units."*

- Sec. -1.7. Affordable Housing Development Account. The administration is preparing several City-owned properties to be released to private developers via request for proposal for affordable housing development. These projects could provide more affordable units if they can take advantage of these funds for gap financing.

Recommendation: In (b), allow in-lieu fees to be used to support privately developed affordable housing and mixed-income projects on public lands. Allow in-lieu fees to be used for administrative costs by either the City or a third party administrator.

- Sec. -1.9. Procedures. Language should be added to ensure long-term affordability if ownership of the rental or for-sale project is transferred, since "Declarant" appears to apply only to the person who originally executes the affordable housing agreement. *Recommendation: In (b), the phrase "or its successors" (or similar language) should be added after "the Declarant".*

- Sec. -1.11. Administration and Fees. There appears to be a conflict between (b), which specifies that administrative fees will be paid by occupants of rental units, and (c)(3), which specifies that fees will be paid by the owner of rental units. In (c)(3), monitoring by a private compliance monitoring service is required. *Recommendation: A private or third party compliance monitoring program should be encouraged but not required (as described below in Sec. -1.12). Clarify conflicting language about whether owners or renters pay fees.*

- Sec. -1.12. Rules. In (b)(3), an Affordable Housing Compliance Monitoring Program, administered by a third party, is required to be established. Since the Bill's effective date is upon approval, it is not realistic to get a third party program set up in time for required administrative tasks. DPP has been pursuing the third party monitoring approach (and has a consultant contracted to help develop it). We have had several meetings with industry groups and state agencies, exploring potential third party administrative and compliance options, and web-based monitoring and reporting systems, potentially shared with state agencies. For more information on the administrative and compliance options we are exploring, please see related memos from the City's consultant, Rick Jacobus (attached).

    - This should be an administrative decision, since 1) it could take a year or more to set up a third party administrator, and 2) some administrative and compliance functions are appropriate for a third party, while others should be retained by the City.
      Recommendation: Add that the use of a third party administrator is encouraged but shall be at the DPP Director's option.

Thank you for your efforts to address critical affordable housing needs and to improve these bills. We look forward to continuing to work with Council to refine them, and encourage you to adopt them (with our requested changes) as soon as possible.

Should you have any questions, please contact Harrison Rue of our staff, at 768-8294.

Very truly yours,

Kathy K. Sokugawa
Acting Director

Attachments: Rick Jacobus Memo Bill 58 CD2 1/16/18
Rick Jacobus Policy Memo 12/23/16
Map of Median Home List Prices by Zip Code

APPROVED:

Roy K. Amemiya, Jr.
Managing Director

STREET LEVEL

MEMO

To: Kymberly Marcos Pine, Chair, Committee on Zoning and Housing
Honolulu City Council
CC: Harrison Rue, Honolulu Department of Planning and Permitting
From: Rick Jacobus, Street Level Advisors RJ
Re: Affordable Housing Requirements, Bill 58 CD2
Date: January 16, 2018

At the request of the Department of Planning and Permitting, I have reviewed the draft revised Affordable Housing Requirements ordinance (Bill 58 CD2). Overall, I continue to be impressed by the thoughtful approach that Honolulu is taking to this legislation and I think you have a very strong proposal. As you know, I work with many similar programs throughout the United States and, for the most part, what is proposed here is well in line with the established practices of other jurisdictions. However, I want to point out a few details where the proposed ordinance differs significantly from the best practices established in other communities in ways that may cause problems down the road.

Affordability Period

The draft ordinance wisely plans for the risk that affordable homes could sometimes remain unsold for longer periods of time. Relaxing the income limits can help with some common marketing problems and many comparable programs allow this remedy. However the bill also offers to reduce the affordability period, in addition to allowing the higher income limits. This is not a common approach and it seems likely to reduce the impact of the program without solving the most common marketing problems.

Below Market Rate (BMR) homes are almost always in very high demand. New York and San Francisco routinely have thousands of applicants for every available home. However, there are exceptions and it is unfair to require developers to hold units vacant when eligible buyers truly cannot be found.

By a large margin, the most common reason for difficulty selling BMR units is that they were priced and restricted at too *high* an income level. Units that are targeted to lower incomes sell for prices that are more highly discounted below market. It is this large discount that makes it possible to serve buyers who are otherwise priced out of the market. That generally leads to a large pool of interested buyers.

When we increase the income target (say from 100% of Area Median Income to 120% or 140%) we increase the 'affordable' price that these units will sell for. At some point this price approaches the market price. In some cases, we have seen programs impose 'affordable' prices that are above the market price for a comparable unit. When this happens it is not surprising that homes are nearly impossible to sell. This seems to be what happened in Maui where the program required homes affordable to incomes as high as 160% of AMI. The restricted prices of these homes were not far enough below market to reach buyers who were otherwise priced out of the market.

It is important to note that shortening the period of affordability does nothing to solve this most common problem. Buyers who can purchase an unrestricted home can and should choose that option over a restricted home whether the restriction lasts 10 years or 30. A home with restrictions simply can't ethically be sold at a market price to any buyer.

The most effective way to address this problem is to set the pricing and income targeting initially at a level that that results in prices that are comfortably below the market prices in the areas where projects are likely to be built. Some cities address the risk that they might get that initial targeting wrong by requiring developers to always ensure that the BMR units are priced at least 20% below the market value of the unit – though this can significantly increase a developer's cost. Others allow developers who are unable to sell homes after an extended marketing period to instead pay an in-lieu fee. Both approaches avoid creating units that cannot be sold without misleading potential buyers.

Another potential marketing problem relates to financing, There are some situations where no buyers (or very few) in the target income group are able to obtain financing. This is most often a challenge for programs that target buyers earning less than 60% of AMI. In these cases, allowing developers to sell to higher income buyers at the same price after a good faith effort to find lower income buyers, ensures that homes don't sit empty. The draft CD2 is consistent with national best practice in allowing this kind of relaxation of income limits after a period of marketing. Like the bulk of other similar programs it ensures that the price remains set at the initial level which avoids creating an incentive for developers to fail at the initial marketing in order to later receive a higher sale price.

There is sometimes a concern that the price restrictions themselves will make financing difficult to obtain. I have heard it suggested that reducing the affordability period to only 10 years might reduce this risk but I can't see any reason to believe that this would be the case.

I have personally worked in dozens of communities with these programs; I ran a national network that reached hundreds more, and I am not aware of one community that has been unable to find willing lenders for price restricted homes. All but 7% of Inclusionary housing programs impose restrictions that last 30 years or longer – many as long as 99 years. Both Fannie Mae and Freddie Mac are actively seeking to finance restricted homes. While financing a price restricted home may be more challenging than financing a home with no restrictions, the period of restriction will make no difference in this challenge. And in fact, beginning in 2018, the Federal Duty to Serve Rule gives Fannie Mae and Freddie Mac incentives to finance price restricted affordable homes with restrictions that last 30 years or longer. Homes with 10-year restrictions would not be Duty-to-serve eligible.

Income Targeting

While planning for the possibility that some units may be hard to sell is appropriate, it would be better to design the program in a way that avoids those problems in the first place. I am concerned that the higher income targets in the current draft may increase the risk of marketing challenges.

The draft CD2 adds an option that sets the income targeting for the program at the highest conceivable level, well above the norm among comparable cities and above the levels that Honolulu's economic research suggested.

There are over 500 programs in the United States that require new developments to include affordable housing units. The majority target households earning less than the median income (100% of AMI or less). Generally this is where the housing affordability needs are most pressing. But lower income units are more 'expensive' for a developer because their prices are lower. Some cities have chosen policies that target median income or above median income buyers in order to impose less burden on developers. Bill 58 as originally proposed follows this approach by targeting buyers at 100% and 120% of AMI. I understand that the requirement to sell at 80% of AMI (under current unilateral agreements) was not included in Bill 58, to make the requirement less of a burden on developers. These above-median programs can work so long as they are still serving an income group that is not well served by the market. But there is a natural upper limit.

When the affordable price approaches the market price, in addition to the marketing challenges discussed above, there is also a change in the public benefit. The closer to market prices, the more likely the buyers are to be people who would have purchased a market rate unit in any event. These programs are difficult and costly to administer and to monitor over decades. Most cities are only willing to undertake that burden because they hope to make homes affordable to families that would not otherwise be able to purchase them.

It is possible that, even if the homes are close to market initially, over time, if the market rises quickly they could become relatively more affordable. In this case, even if the units provide little immediate benefit, the program creates a stock of homes that are protected from future increases. But, if the program allows a reduction of the term of affordability to only 10 years whenever there is some difficulty in marketing, there is a real risk that just as the market is high enough for units restricted to 140% AMI to really be needed, they will no longer be affordable.

If Council is concerned that the proposed requirements create too high a financial burden on development (a real and appropriate concern), rather than reducing the burden by increasing the income targets, the more common and likely effective alternative is to reduce the *number* of required affordable units. Both approaches reduce the net cost to a project but, somewhat counter intuitively, requiring fewer more deeply affordable units can often generate more public benefit than a greater number of units that are very close to market prices.

Third Party Administration

I am encouraged to see Honolulu pursuing the goal of contracting with an outside third party administrator for ongoing monitoring and support. I have seen many examples where this approach has resulted in a stronger program with better outcomes than when a city manages all aspects of the program internally. However I would caution against requiring this at all times as the current draft CD2 does. I have been meeting with city staff and outside partners over the last year to explore how to improve administration, monitoring, and compliance procedures, including the potential for third party administration.

In every city that has implemented this strategy, city staff retains some key responsibilities and outsources others. The specific mix of roles differs based on the capacities of available outside administrators. And, importantly, this mix changes over time as that capacity changes. Because Honolulu does not currently have an entity playing this kind of role, it may take several years to build partnerships, identify funding, hire staff and develop the systems necessary to successfully monitor these units. In the best case, the city will necessarily have to do some monitoring while this process is occurring. But there is also no guarantee that there will be a third party willing and able to play the necessary role. Even after this start up phase, there may well be points in the future where a change will need to be made. If Council requires a third party administrator at all times, I worry that that will reduce accountability on that third party and make it difficult for staff to ensure that the program remains well run at all times. Instead I would recommend that Council encourage but not require the used of a third party administrator.

Thank you for the opportunity to comment.

MEMO

To: Harrison Rue, Department of Planning and Permitting
From: Rick Jacobus, Street Level Advisors
RE: Policy Options related to Affordable Housing Requirements
Date: December 23, 2016

The City and County of Honolulu is considering adoption of affordable housing requirements (AHR) which would ensure that new residential development includes a portion of homes that would remain affordable to lower and moderate income residents over the long term. The requirements were proposed in the Mayor's Affordable Housing Strategy, as revised in September 2015. The City engaged Street Level Advisors to help refine the AHR strategy and plan for the implementation of such a program. Over the course of a two-day site visit we met with housing developers, housing advocates, state agency partners, and key City staff from several departments in order to better understand the City's needs and current capacity to implement this program. Our discussions focused on two distinct issues:

1. Given the uneven market conditions in communities across the island, should requirements be scaled (different percentages) or phased in over time geographically?

2. How should the City plan for long term monitoring, administration, and stewardship of affordable homes created through the program?

A. Geographic Phasing

There are over 500 communities in the United States that impose affordable housing requirements either on all new residential development or on development that takes advantage of certain planning incentives[1]. For the most part, these programs, which are commonly referred to as "inclusionary housing" or "inclusionary zoning" programs, impose a single requirement across an entire city or county. However, as communities have become more adept at evaluating the economic feasibility of these requirements, there has been a trend toward requirements that recognize the uneven market strength of different neighborhoods within a jurisdiction.

Most communities include neighborhoods where the housing market is very strong as well as neighborhoods where there is far less development pressure. If affordable housing requirements

[1] Achieving Lasting Affordability through Inclusionary Housing, Robert Hickey, Lisa Sturtevant, and Emily Thaden, Lincoln Institute of Land Policy, 2014.

are set too high in an area, they can be perceived as a barrier to new development, and if they are set too low, they produce less affordable housing than they otherwise could.

The City commissioned Strategic Economics to complete an economic feasibility analysis of the potential affordable housing requirements[2]. Strategic Economics followed the national established best practice for these studies. They identified several of the most common local residential development prototypes and evaluated their profitability in several different locations across the city. They found that the rents and condo sales prices were too low in many parts of the island for new housing development to be economically feasible (with or without any affordable housing requirements)[3]. At the same time, they found that in Ala Moana the rents and prices were significantly higher and development would be not only feasible but highly profitable. Table 1 summarizes Strategic Economics' assessment of the financial feasibility of the proposed requirements. In short, they found that, of the four geographic areas they studied, development was only likely to happen in Ala Moana, considering current market conditions. They only studied a few locations, but it is likely that there is similar market strength in Downtown and Kakaako due to similar characteristics. They further found that within Ala Moana, development was profitable enough that the proposed affordable housing requirement, combined with the proposed set of incentives, would reduce profitability but not by enough to deter development. Projects that were profitable without the requirement would still be more than profitable enough to proceed even with the new requirements. In other areas, the requirements would make unprofitable projects even less feasible at this time.

Table 1: Strategic Economics Return on Cost for Condominium Prototypes

		Low-rise, Kapolei	Low-rise, Pearlridge	Mid-rise A, Kapalama	Mid-rise B, Kapalama	High-rise A, Ala Moana	High-rise B, Ala Moana
Baseline (No AHR)		-13%	10%	-7%	5%	1%	25%
On-Site Affordable Housing Requirement	Before Incentives	-16%	5%	-12%	0%	-5%	16%
	With all Incentives	-15%	7%	-10%	2%	-2%	19%
Off-Site Affordable Housing Requirement	Before Incentives	-16%	5%	-12%	0%	-5%	16%
	With all Incentives	-15%	7%	-10%	2%	-2%	19%
In-lieu Fee	Before Incentives	-20%	0%	-13%	-2%	-4%	17%
	With all Incentives	n/a	n/a	n/a	n/a	n/a	n/a

* Projects with greater than 18% return on cost are considered feasible (Shaded green)

While Honolulu's market is extreme in many ways, this pattern is not unusual. Even in the strongest market cities, new development tends to be concentrated in a handful of neighborhoods where rents/prices are high enough to justify the high cost of new construction.

Note that this finding does not mean that a simple islandwide requirement would be problematic. If the market remained as it appears in Strategic Economics analysis, an islandwide requirement would generate significant amounts of affordable housing in Ala Moana with little impact in other areas where development was unlikely even without the requirements. However, the challenge comes from the fact that markets change. Some areas where development is infeasible today are

[2] Affordable Housing Requirements Financial Analysis, Strategic Economics, 2016.

[3] SE's analysis assumed that developers had to pay market rate for land, and did not receive subsidies other than some fee waivers. Therefore, development on public lands, with public subsidies, or by long-term landowners who choose to discount land value is more feasible in softer market areas.

likely to reach a point where development becomes feasible in the near future, and the risk is that affordable housing requirements could delay the point when that transition happens.

This is particularly a concern in communities like Honolulu where transit or other public investment is intended to generate new real estate investment. While unsubsidized larger scale residential development is not currently feasible in most of the planned transit station areas, the history of similar transit investment suggests that higher density development will become feasible in many of these areas as the opening of the rail line approaches in concert with TOD upzoning. The pioneering real estate projects in these emerging areas will be more economically marginal and the risk is that the strong affordable housing requirements that work financially in Ala Moana could be enough to prevent those marginal projects from proceeding and, thus, delay development of those station areas. At the same time, it is important that these station areas develop in a way that is equitable and includes affordable housing. An ideal policy would impose reduced requirements on pioneering projects in emerging areas but increase the requirement as the market was established. Unfortunately, most cities have concluded that timing the market in this way is not entirely practical.

This problem is common and there are a number of different strategies that other cities have used to address it.

1. **Target only high growth areas:** Some cities limit their affordable requirements to only neighborhoods that have strong market conditions at the time that the program is adopted. Both Seattle and New York limit inclusionary requirements to areas zoned for higher density development.
2. **Vary requirements by zone:** Others impose requirements jurisdiction-wide, but vary the level of requirements so that strong market locations provide more affordable housing while other areas face less of a burden. Boston adopted different requirements for three different zones, based on the average market price for new condo units in each area.
3. **Project-by-project underwriting:** Some communities negotiate different requirements for each project in order to ensure that they impose the maximum feasible requirement without over burdening projects. This is, of course, a very staff-intensive process and it can be difficult to get a clear picture of the real economics of every project. Vancouver, BC negotiates the specific requirements for each project independently.
4. **Vary requirements by rents/prices:** Some communities try to achieve the same result in a simpler manner by imposing requirements that vary based on each project's proposed rent or sales price. Projects with higher market rate prices are required to provide more affordable units than projects with more modest prices. Burlington, VT has three tiers of inclusionary requirement with the lowest tier for projects with market rents or prices that are relatively affordable and the highest requirement for projects with luxury units.
5. **Hardship waivers/appeals:** Many programs allow any developer to request a full or partial waiver of requirements if they can show that the requirements would make their project infeasible. It can be very difficult to determine which projects should truly be eligible for this kind of waiver and some communities have had problems drawing a clear enough line. New York, NY provides for an appeals process for

developments that believe the affordable housing requirements render a project financially infeasible. The Board of Standards and Appeals may modify the requirements on a case by case basis.

6. **Vary requirements by project size:** Some communities impose higher requirements on large projects (measured either by land area or number of units). Toronto only requires affordable housing for projects on very large sites.
7. **Scheduled phase in of requirements:** A growing trend has been to phase requirements in over time and to vary the phasing between different areas in order to allow softer market areas more time to adapt to the new requirements. Oakland, CA identified 3 distinct zones based on project financial feasibility and phased requirements in at different rates in each area. In King County, WA, several cities adopted affordable housing requirements that were waived in areas that were targeted for growth until the number of units permitted exceeded a specific threshold.

There are advantages and disadvantages to each of these approaches, and it seems likely that more than one of these approaches could be adapted to meet Honolulu's needs. The last option, phasing in requirements in a geographically targeted way, seems to best meet the city's current needs and administrative capacity. Note that all options will require some degree of additional staff resources, as described in Section B of this memo.

Recommendations:

Zone	Ultimate Requirement	Phase in schedule
Ala Moana and Downtown	Ownership: 20% Rental: 15%	Immediate (on adoption)
Transit Corridor (as defined in Neighborhood TOD Plans)	Ownership: 20% Rental: 15%	5 year phase in (from date of adoption) Year / Ownership / Rental 1 / 0% / 0% 2 / 5% / 3% 3 / 10% / 7% 4 / 15% / 10% 5 / 20% / 15%
Remainder of island	Ownership: 10% Rental: 5%	12 months after adoption

Ala Moana and Downtown

In the strongest market locations, a 20% requirement should take effect immediately after passage of the ordinance establishing the program. Projects in Ala Moana all essentially face this requirement already under the Interim Planned Development – Transit Permit (IPD-T) rules. While Strategic Economics did not analyze projects in Downtown and Kakaako, the economics of development appear similar. We recommend that the City include Downtown in the zone with immediate requirements. We understand that the Hawaii Community Development Authority is considering revising their Reserve Housing Requirements to generally align with similar numbers. It makes sense to keep any requirements in Kakaako parallel with Ala Moana.

Transit Corridor
In the remaining transit station areas, the economic analysis suggests that market conditions are not strong enough to support multi-family development today (unless land is contributed or discounted, or other subsidies provided). Our recommendation is to phase in the requirements so that these areas have strong affordable housing requirements clearly established before the opening of the rail line, but allow a transition period where pioneering projects can benefit from lower requirements. It is important to recognize that it is impossible to predict the exact timing of market changes related to rail. At some point, it is likely that the coming of rail will result in rising rents and prices in many of these station areas, which will prompt new development, but the exact timing will likely differ by area.

One response to this uncertainty would be to exempt the first 100 or 200 units in each station area, as suggested in the draft Affordable Housing Strategy. While this approach is appealing and has been implemented with some success in King County, WA, it adds significant uncertainty for the initial projects. Individual developers in a particular neighborhood will find it difficult to know which project will make it through the building permit application phase first, and whether they can actually count on the exemption. A phasing schedule with specific trigger dates identified clearly in advance allows developers to more readily forecast the impact of the requirements on their project independent of the timing of other projects. It is unlikely that this scheduled phase in will result in exactly the optimal timing in each district, but the additional certainty that it provides may be more important.

For areas where the requirements are scheduled to change, we recommend that the requirement be set at the time that a complete building permit application is submitted, and that a project be allowed a set period of time (say, 3 years) to complete construction without any adjustment in the required percentage. For example, a project in a station area that applied for a permit in year 2 would have a 5% requirement even if they completed construction in year 4 (when any new projects would need to provide 15% affordable units). Projects that took too long would reset to the higher rate.

Remainder of the Island
It appears unlikely that large numbers of other projects would be developed outside of the station areas, but a lower requirement for those that do occur would minimize the risk of the program standing in the way of new investment in underserved areas. Delaying implementation of the requirement in the remaining area for 12 months ensures that any potential developers in these areas have ample warning before new requirements are imposed.

Outside of the transit station areas, the majority of larger scale development projects are likely to require rezoning, which would make these projects subject to the existing Unilateral Agreement (UA) policy. Currently the UA policy requires 30% affordable housing for projects executing UAs. The affordability period for these units is only 10 years. After adoption of an islandwide affordable housing requirements policy it would make sense to update the UA policy to ensure consistent requirements including a 20% requirement and 30-year affordability period.

B. Administration

Successful implementation of an islandwide Affordable Housing Requirement (AHR) policy will require a significant expansion of local administrative capacity. Honolulu has meaningful experience administering this type of program, but the proposed AHR will be more administratively demanding than the current Unilateral Agreements (UA) process.

Currently, the UAs are administered within the City Department of Planning and Permitting by a staff of 4 people, each of whom have significant responsibilities in addition to this program. The current program design relies very heavily on project developers to perform most functions, including all marketing and resident selection and nearly all monitoring and enforcement.

While we did not conduct a formal evaluation of the current program administration, it seems likely, based on our conversations with staff and observations in other cities, that the program is currently understaffed relative to the need. There are a number of practices which are common among similar programs in other states which are not being implemented in Honolulu due to limited staffing capacity. Grounded Solutions Network developed the attached set of ***Stewardship Standards for Affordable Homeownership Programs*** based on detailed feedback from dozens of program administrators and other stakeholders. The Standards, which are designed to protect long-term affordability and ensure fair treatment of homebuyers, include common practices such as providing homebuyer orientations to ensure that buyers understand their restrictions before purchase, and annual monitoring to ensure owner occupancy of affordable homes.

The proposed islandwide AHR policy will require significantly greater local administrative capacity. The AHR will likely involve a higher volume of activity, as a greater number of projects will be expected to provide affordable housing units. At the same time, the AHR will rely on restrictions lasting at least 30 years (ideally even longer if the period of affordability is reset after each sale), while the current UA policy only restricts affordability for 10 years. This change means that the portfolio being monitored will ultimately grow much larger as units added each year will not leave the portfolio.

Longer-term restrictions will also create some additional administrative responsibilities including more directly supporting the resale of affordable ownership units, and more upfront education for homebuyers who will face longer-lasting restrictions. Under the UA program, if the owner of a restricted unit moves within the 10 year affordability period, the project developer is expected to identify a new eligible buyer. This approach is unlikely to work with 30 year restrictions as the initial project developers may no longer be around and/or the city may have no leverage to incentivize them to perform this role so long after the initial sale.

The attached report ***Delivering On The Promise Of Inclusionary Housing Policies: Best Practices In Administration And Monitoring*** provides detailed descriptions of the key administrative functions necessary to successfully implement a program like the proposed AHR.

Key administrative functions include:

Supporting the development process

- Communicating program requirements to developers and property managers
- Reviewing development proposals for compliance with rules
- Negotiating certain requirements to maximize production
- Ensuring that affordable units meet appropriate design and location standards
- Ensuring timely payment of in-lieu fees (if any)
- Planning and implementing reinvestment of fee revenue to produce affordable units

Monitoring Rental Units

- Setting affordable rents
- Working with property managers to ensure fair marketing of units
- Monitoring eligibility screening for new tenants
- Re-certifying annual incomes of tenants
- Enforcing requirements (as necessary)

Stewarding Homeownership Units

- Setting initial prices at an affordable level
- Marketing homes to eligible buyers
- Ensuring that potential buyers receive homebuyer education
- Verifying that applicants understand program requirements and resale restrictions
- Screening applicants against eligibility requirements
- Working with lenders to ensure access to appropriate financing
- Monitoring homes for owner occupancy over time
- Managing resales to future income eligible buyers at formula price
- Enforcing program requirements when necessary

Tracking Results

- Tracking program outcomes
- Refining program design over time

Recommendations:

Expand City Capacity

Whether through a newly created Housing Department or elsewhere, the City will need to add dedicated staff with sole responsibility for oversight of the AHR and UA programs. Even if the City contracts with a nonprofit partner, additional in-house capacity will be necessary to effectively support the development of new projects, including the development of Affordable Housing Agreements, and to manage the contract with the nonprofit partner.

In addition to expanded staffing capacity, the likely volume of new affordable housing units under the proposed AHR policy suggests the need for investment in data systems to manage information about the growing portfolio of restricted units. Both New York and San Francisco have both recently built web-based data systems that allow applicants to apply online. They can also track applicant eligibility and maintain data after a sale to enable ongoing monitoring. Grounded Solutions Network sells a software tool called HomeKeeper (MyHomeKeeper.org) that a number of cities are using to manage inclusionary housing portfolios. A modest initial investment in this kind of infrastructure can greatly reduce the ongoing staffing requirements for a program while simultaneously improving long-term outcomes.

Partner with the State of Hawaii

Both Hawaii Community Development Authority (HCDA) and Hawaii Housing Finance and Development Corporation (HHFDC) have administrative responsibilities for affordable housing units which mirror the City's likely requirements under the proposed AHR. Managing these functions separately in three separate government agencies is inefficient and likely to frustrate both developers and potential residents. There are very significant economies of scale which could be realized through a partnership among these agencies. One agency could provide services to the other two, or all three could partner to contract with a single nonprofit agency to support all three programs, as outlined below.

Explore the feasibility of contracting with a local nonprofit organization for selected administrative functions

A number of cities have invested in the capacity of local nonprofit partner organizations (Particularly Community Land Trusts) to help oversee and support inclusionary housing programs, particularly for affordable homeownership units. This approach provides greater flexibility relative to expanding city staff capacity and offers some additional benefits as well. Homeowners appear to be more willing to reach out to nonprofit partner staff for assistance when they are facing financial difficulty, for example.

The key challenge with this approach is that most cities do not have existing nonprofits with all of the necessary skills and experience. Before relying on a nonprofit partner, Honolulu (ideally together with the State agencies) would need to invest in building the capacity of a local agency.

One approach would be to issue a Request for Qualifications (RFQ) for potential partners. The RFQ would outline the particular set of administrative functions anticipated and provide some sense of the scale of effort and the likely resources over the initial three years. Applicants should be asked to provide background on their organization, including staffing and governance, and detail the extent of their existing capacity to provide services similar to the anticipated services. There are significant advantages to working with a 501(c)3 nonprofit, but there is no reason not to allow for-profit organizations to respond to the RFQ.

Once a potential partner is selected, the first step could be to provide a small planning grant to enable the organization to complete a simple business plan that would outline the roles that they would play in implementing the City and State programs, project likely volume of activity for an initial three year period, identify the staffing levels necessary to succeed, and propose a revenue model to support the necessary staffing and overhead. Two sample business plans for similar nonprofits are attached. The ***Irvine Community Land Trust*** was a startup formed by the City of Irvine, CA to administer their inclusionary units. The ***Workforce Housing Association of Truckee Tahoe*** was an existing nonprofit which the Town of Truckee contracted with to build out entirely new administrative capacity to oversee inclusionary housing units.

Sample division of labor

While the specific roles assigned to any contractor would be determined after considerable discussion and business planning, the matrix below provides a single example of a division of labor that might be appropriate in Honolulu.

Developer	City	Nonprofit
Supporting the development process		
Develop Affordable Housing Agreement	Negotiate and Approve AHA	
	Evaluate alternative options, approve offsite proposals	
	Review design, monitor development	
	Collect Fees	
	Manage investment of in lieu fee revenue	
Monitoring Rental Units		
	Publish table of affordable rents annually	
Market units to tenants	Review and approve developer marketing plans	Maintain central waiting list
Pre-screen tenants for elibibility	Review tenant application material to certify eligibility	
Collect annual income recertification documentation	Review annual income recertification	
Evict/relocate tenants who are no longer eligible		
Stewarding Homeownership Units		
	Publish table of affordable prices annually	
Market homes, refer lower income buyers to nonprofit partner	Review Marketing Plans	Maintain central waiting list
		Provide pre-purchase homebuyer counseling/education
		Provide pre-purchase program orientation
Sell to eligible buyers only.	Certify eligibility	Collect and review homebuyer income eligibility documentation
		Manage lottery or other fair selection process
	Set rules for appropriate financing	Work with Lenders to ensure appropriate financing
		Annually monitor each unit for owner occupancy
	Take any necessary legal action	Refer enforcement to city
	Final approval of each sale	Work with sellers to ensure that homes resell only to eligible buyers
Tracking Results		
		Manage program database
	Receive annual performance reports	Produce annual performance reports
	Refine program rules as needed	

Plan for scalable revenue

While most of the details of ongoing administration can be developed as the AHR program is implemented, the financial aspect should be planned carefully before an AHR ordinance is finalized. The program needs a scalable source of revenue if it is to successfully administer a portfolio of homes that is likely to grow over decades. Many cities have struggled to adequately budget for ongoing administration. The best practice is to rely as much as possible on fee revenue which would increase along with the administrative workload. But any fee structure that the program will impose on developers or homeowners must be clearly identified in the ordinance creating the program and incorporated in any evaluation of the economic burdens of the program. There are two common fee types that Honolulu should consider at this point:

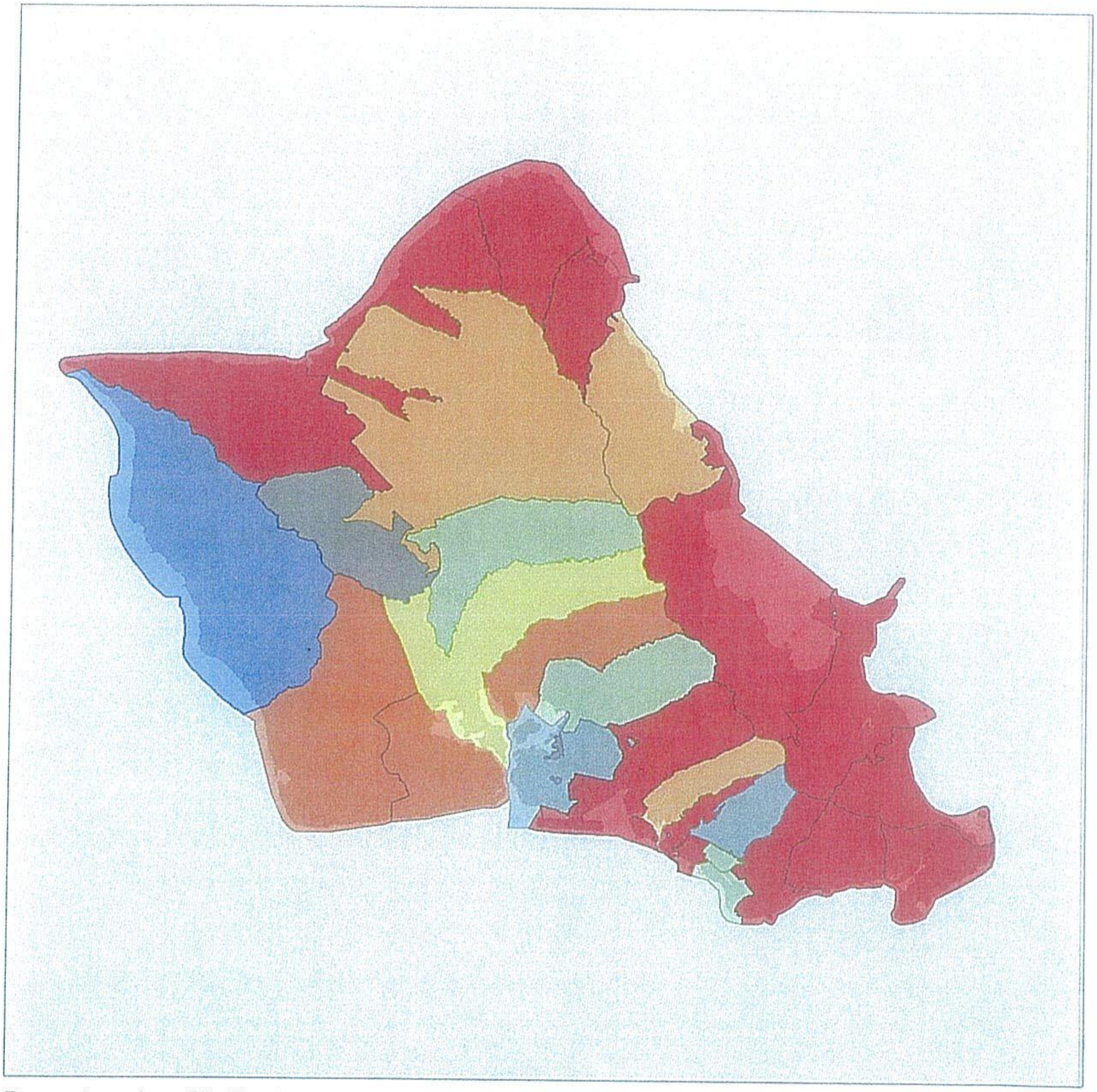
> **Administrative monitoring fees:** Some programs charge administrative fees for each rental or ownership unit each month. For example Honolulu might charge $50 per unit per month. For rental properties, the property owner would pay the fee for all units (likely on an annual basis). For ownership units, each homeowner would pay the fee individually (though often these fees can be included in escrow payments to mortgage lenders). In addition to helping offset the cost of administration, these regular fees help homeowners remember that their home is part of a special program with restrictions on resale. It is important to identify these fees in advance because adding a monthly expense will lower the mortgage amount that a buyer can support. This fee should be included along with other likely housing costs in the formula used to determine the maximum affordable price.
>
> **Resale Fees:** Most programs also charge homeowners a fee at the time that the homeowner sells their affordable home. The level of this fee depends on the level of service provided. In many places, where demand for affordable housing is high, the program maintains a waiting list of eligible buyers, and sellers are able to resell their homes without support from a realtor (or with only limited support). In these areas, the program would manage all aspects of the sale and might charge a resale fee of 2-3% of the restricted sale price of the home. In other areas, where sellers are likely to be paying 5-6% realtor commission, the program would only monitor the sale to ensure that it conforms with program rules and charge a resale fee of .5 – 1% of the price.

Conclusion

Honolulu is well positioned to successfully implement a new AHR program. The economics of development on Oahu are somewhat extreme, but not fundamentally different from high cost markets on the mainland. With careful attention to the market, there is no reason to expect that Honolulu could not successfully require that a significant share of new units be affordable to lower income residents without overburdening development. Existing staff and community partners have a clear understanding of both the potential benefit and the challenges that are likely to be encountered and are likely to be successful in building the additional local capacity that will be necessary to administer the new program.

Attachments

- Stewardship Standards for Affordable Homeownership Programs
- Delivering On The Promise Of Inclusionary Housing Policies: Best Practices In Administration And Monitoring
- City-CLT Partnerships
- Irvine Community Land Trust Business Plan
- WHATT Business Plan



Percentage Area Median Income Represented by Median Home List Price by Zip Code, July 2017

Annual Median Income Level

- Below 90%
- 90% - 100%
- 100% - 110%
- 110% - 120%
- 120% - 130%
- 130% - 140%
- 140% - 150%
- Over 150%

This map shows household AMI levels associated with home prices. For each zip code, it shows the household AMI category that the median listing price would be affordable to.

Sources: Trulia Data, 2017; Strategic Economics, 2018

0 4 8 Miles

STRATEGIC ECONOMICS

- The AMI calculation assumes a 3-person household, 5.25% interest rate and a 5% down payment.
- Not based on actual transaction data. Actual sales prices could be higher or lower than the listed price.
- The 3-person household assumption imay be skewing the results a bit; areas with lrger households may actually be more affordable.
- Waikiki pricing may appear more affordable due to small,older condos, and/or on ground leases.