Proceedings of the 2011 Land Policy Conference

VALUE CAPTURE and LAND POLICIES

Edited by Gregory K. Ingram and Yu-Hung Hong

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LINCOLN INSTITUTE OF LAND POLICY
CAMBRIDGE, MASSACHUSETTS

Library of Congress Cataloging-in-Publication Data

Value capture and land policies /
edited by Gregory K. Ingram and Yu-Hung Hong.
p. cm.
Includes bibliographical references and index.
ISBN 978-1-55844-227-6
1. Public lands—Valuation. 2. Real estate development—
Finance. 3. Land use, Urban. 4. Public investments.
I. Ingram, Gregory K. II. Hong, Yu-Hung.
HD216.V33 2012
333.10973—dc23 2012008363

Designed by Vern Associates

Composed in Sabon by Achorn International in Bolton, Massachusetts.
Printed and bound by Puritan Press Inc., in Hollis, New Hampshire.
♻ The paper is Rolland Enviro100, an acid-free, 100 percent PCW recycled sheet.

MANUFACTURED IN THE UNITED STATES OF AMERICA

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The Affordability Challenge: Inclusionary Housing and Community Land Trusts in a Federal System

Richard P. Voith and Susan M. Wachter

Inclusionary housing and community land trusts (CLTs)[1] are two mechanisms used to increase the stock of affordable housing.[2] This chapter examines the potential of these mechanisms to provide long-term ("durably") affordable housing in the United States, where there is strong local government and significant competition among local jurisdictions. In particular, it assesses the role of land value capture in enabling these mechanisms to provide for such housing.

The preservation of affordable housing has vexed policy makers, community leaders, developers, and housing economists. Policy makers find themselves torn between two goals: (1) creating as much affordable housing immediately; and

We thank Rachel Bratt and John Davis for their helpful input on an early draft of this chapter. We also thank Yu-Hung Hong for his assistance and support. Any errors that remain are our responsibility. We also acknowledge the assistance of the Research Sponsors Program at the Samuel Zell and Robert Lurie Real Estate Center, Wharton School, University of Pennsylvania.

1. For detailed discussions of community land trusts, see Davis (1994a, 2010).

2. Housing is considered affordable if a household pays no more than 30 percent of its income on it. See the U.S. Department of Housing and Urban Development's definition of *affordable* at http://www.hud.gov/offices/cpd/affordablehousing/index.cfm.

(2) creating housing that remains affordable for a longer period of time. The literature on the expiration of affordability restrictions provides evidence of this dilemma. Recent literature focuses on rental housing constructed with support from the federal low-income housing tax credit (LIHTC) program, where restrictions first expired in 2002.[3] This problem parallels the expiration of affordability restrictions on earlier federal housing projects. In comments on an earlier version of this chapter, Bratt noted that "during the 1980s, the affordability requirements on a number of federal housing programs began to expire, thereby creating enormous problems for tenants facing eviction or substantially higher rents and for local public officials, eager to safeguard the affordable housing in their communities."

As the federal government withdrew its support of affordable housing during the 1980s,[4] local actors, including cities and states, increased their role. The provision of durably affordable housing is, however, difficult and requires significant intervention in the housing market, especially in a federal system of government, where local governments are charged with delivering services and maximizing property values. Although there might be external benefits for sustaining a portfolio of affordable housing in all communities, such intervention is difficult when undertaken on the local level. This is especially true for affordable housing that is designed to be "durable"—that is, permanently available at a reduced cost. One only has to look at the political and economic incentives of the myriad players involved in the demand for and supply of housing, as well as the competition among communities for residents, to understand the challenge of sustaining such a portfolio.

Elected officials, for example, face conflicting demands to ensure affordable housing while at the same time preserving and enhancing home values. Communities have to balance the demand for public services with the resources (frequently property-tax-based) available to fund the production of those services. Low- and moderate-income residents may place high demands on services while providing only modest resources to pay for them, while high-income households may substitute private services for public services. These considerations lead many higher-income communities to adopt low-density fiscal zoning that

3. The program began in 1986 with an initial affordability term of 15 years. The term was later extended to 30 years. For an examination of this program and the issue of the expiration of affordability restrictions, see Meléndez, Schwartz, and de Montrichard (2008). Federal legislation to extend expiration was passed, but proved to be too expensive to implement. By 1997 the program had stopped functioning.

4. For a broader overview of the history of affordable-housing policy in the United States, see Bratt (1989); Erickson (2009); and Schwartz (2010).

effectively prohibits the construction of housing suitable for low- and moderate-income households.[5]

Communities with a substantial stock of affordable housing often do not have sufficient resources to provide quality schools and adequate public services, and they may not attract sufficient capital to sustain the existing affordable stock. Moreover, when private investment is made in housing, values frequently rise beyond levels that are affordable for local residents. Thus, lower-income communities are confronted with the specter of either declining, unattractive, and unsafe communities with poor schools, or gentrification that may or may not deliver economic benefits to current residents.

Developers face a different set of challenges. Responding to housing demand in local communities, developers compete with one another to acquire land needed to produce housing. To successfully bid for land, developers must pursue the most profitable forms of development. In the context of a competitive development industry, excess profits flow to landholders. Thus, developers are constrained to engage in the most profitable forms of development, which usually do not include affordable housing. Moreover, developers often seek to maximize density, which is consistent with the provision of affordable housing, but they are typically thwarted by local zoning laws and approval processes that seek to minimize density, in part to fiscally exclude low-income households (Pollakowski and Wachter 1990).[6]

Families consuming housing services face intertemporal trade-offs with respect to affordable housing. They want to have the benefit of low-cost housing, but they also want to reap the rewards of increasing land values as they help build attractive communities. In addition, more affluent families have an incentive to colocate with other families that have similar or higher incomes (or property values) in order to minimize their share of the fiscal burden of locally funded public goods such as education.

5. Presumably, communities adopt fiscal zoning to preserve property values. Recent research indicates that there are no significant negative spillover effects of affordable housing on adjacent neighborhoods, suggesting that any perceived disamenities associated with affordable housing are not, in fact, evident in the housing market. For a detailed discussion of this topic, see Ellen (2008); Nguyen (2005); and Pollakowski, Ritchay, and Weinrobe (2005). This research does not, however, address the issue of whether municipal costs associated with affordable housing exceed the local tax revenues generated and thereby impose a fiscal burden on other municipal residents. Note that if affordable housing does create an additional fiscal burden, property values of the entire municipality, not just those of the adjacent neighborhoods, will be adversely affected.

6. By limiting the possibilities to develop affordable housing, city managers are responding to the demands of property owners, who aim to protect the value of their real estate investments. This is the "homevoter hypothesis" formalized by Fischel (2001).

Because long-run national growth in real house price appreciation has been small at best, one might be tempted to ignore families' conflicting desires for affordable housing and future growth in housing wealth. This would be a mistake, for three reasons: (1) some relatively long periods of rapid house price appreciation, such as 2000–2006, have had important impacts on affordability and household wealth; (2) given the historically high leverage in the housing market, even small growth in real prices can yield high returns; and (3) average returns may mask significant differences in returns across geography. With respect to the third point, if communities with large supplies of affordable housing are systematically disinvesting in property, it is also true that these properties are poor vehicles for accumulating household wealth.

Attempts to balance the concerns of political leaders, communities, developers, and households have led to a wide variety of approaches toward producing affordable housing that have met modest success at best. These approaches have included publicly produced and managed housing; publicly subsidized housing through down-payment assistance and low-interest mortgages; low-income tax credits and housing vouchers; rent control; and regulatory requirements at the municipal level, such as affordable-housing quotas, inclusionary housing requirements, and project-specific requirements to include affordable housing in market-rate developments. From a private perspective, community land trusts have been established with the specific mission of creating and preserving affordable housing.

For many communities, however, the main efforts with respect to affordable housing have been and continue to be to oppose the provision of housing that low-income or even moderate-income households can afford. Many communities with higher-income households are loath to risk added municipal costs for the residents of low-cost housing, although some wealthy communities have adopted policies encouraging affordable housing (presumably in recognition of potential benefits in terms of lower employment costs for modest-income occupations). Communities with a larger fraction of low-income residents are more open to policies encouraging affordable housing, but in many cases they lack the resources to provide public services for their residents.

The inability of local communities to successfully address the issue of affordable housing is not surprising. In many respects, affordable housing is a classic externality problem that needs to be solved at a government level capable of internalizing the cross-jurisdictional externalities—which suggests a higher level of government than the local municipality.

In this chapter, we look at the economics of affordable housing—in particular, the economics of preserving affordable housing and the role of land value capture in facilitating this—in the context of a federal system of government. We examine affordable-housing policies in New Jersey and Massachusetts over the past 35 years, as well as policies in other selected localities that have adopted inclusionary housing. We also discuss community land trusts in the United States and compare them with their counterpart in the United Kingdom.

The Economics of Affordable Housing in a Federal System of Government

The problem of affordable housing is not so much one of quantity as it is of distribution.[7] There are many communities in the United States where housing is very inexpensive, but these locations often suffer from a lack of economic opportunity, poor public schools, and unsafe environments. In fact, one might argue that the greatest supply of affordable housing in the United States is in communities that have become sufficiently unattractive to drive housing prices low enough for low-income Americans.

The unbalanced distribution of affordable housing that currently characterizes the U.S. housing market may entail significant economic and social costs. Sorting by income and house value is likely to result in long, expensive commutes for modest-income households, insufficient resources to provide public goods in modest-income communities, and a lack of social cohesion within and across communities. Some of these issues, such as commuting costs, might be priced into wages. Others are likely to manifest in less benign ways. In most communities, affordable housing also means house prices that are below replacement costs, so neither residents nor landlords will invest to preserve the affordable-housing stock.

Economists have argued that the affordable-housing problem is a consequence of supply-side regulations (zoning, building codes, regulatory processes, impact fees, prevailing wage rules) and natural constraints on the number of buildable sites that have increased the costs of housing production and human capital deficiencies, whereby some households do not have sufficient marketable skills to generate wages high enough to afford housing. Economists' policy response to this diagnosis is to reduce those regulatory constraints on housing supply that raise the cost of housing and to enhance the marketable skills of low-income households over the long run. The basic assumption behind the policy recommendations is that if all supply constraints were eliminated, the market would efficiently deliver housing at the lowest possible cost, and that distributional issues are best addressed through direct income transfers and human capital investment.

Economists' recommendations with respect to affordable housing have not carried the day, either economically or politically. The reason for this failure lies in three fundamental realities of housing: (1) housing is immobile and durable, but households are mobile; (2) Tiebout competition among communities for mobile households creates a tendency toward homogeneous communities and free

7. In this section, we focus on affordable housing rather than community land trusts (CLTs) because U.S. housing policy has focused more on legislation attempting to increase affordable housing than on creating CLTs, an alternative approach to the issue.

rider problems that result in the underprovision of public goods; and (3) land prices in well-located, desirable communities often increase faster than wages in low- and moderate-wage occupations, creating a need for hedging against future housing price increases. These three aspects of housing create a web of incentives that frequently make it impossible to create a workable political consensus at the local level to effectively address the production and preservation of affordable housing.

IMMOBILE, DURABLE HOUSING AND MOBILE HOUSEHOLDS

Because housing is a long-lived, durable asset, the distribution of affordable housing is largely an artifact of changing development processes over time. The dramatic growth of cities in the first half of the twentieth century was accompanied by the rapid expansion of high-density, modestly scaled housing in central cities. The second half of the twentieth century brought dramatic changes: the rapid decline of many older central cities, the rapid growth of suburban areas, competition among jurisdictions in metropolitan areas for residents and tax bases, and the rapid growth of new, low-density central cities in the South and West. Encouraged by rising incomes and significant housing subsidies (subsidies that increased with income), larger houses on large lots became the norm for development. Fiscal zoning in suburban communities reinforced this trend. The consequence of the shift in development patterns was a concentration of affordable housing in older, declining central cities while employment opportunities were shifting to the suburbs. The concentration of affordable housing in declining central cities gave rise to significant differences in political outcomes between cities and their suburbs. Lower-income city residents were more interested in the provision of city services, which were often redistributive in nature, while residents of suburban communities were focused on preserving homogeneity and property values through fiscal zoning. Thus, cities tended to be more sympathetic to the need for affordable housing, but they could neither fiscally sustain services nor prevent physical decline in their real estate assets.

The underlying forces affecting development patterns are shifting once again. Most of the trends driving the decline of older cities—including the rapid expansion of highway capacity, low suburban development costs, tax policies supporting suburban housing growth, and the decline in urban manufacturing employment—have run their course, and cities are stabilizing or growing once again. This shift poses new problems for housing affordability (Voith and Wachter 2009). Cities that attract significant investment will no longer be viable sources of affordable housing for low-income households, so the housing affordability issue from a metropolitan perspective is likely to become more acute. This worsening phenomenon in central cities is likely to be partially offset by a return to fundamentals in the housing market, which has already lowered prices—but these improvements in affordability may be offset by increased financing costs.

TIEBOUT COMPETITION AMONG COMMUNITIES

Households choose communities when selecting a home. Tiebout-like sorting leads to communities that have relatively homogeneous incomes and correspondingly homogeneous house prices. Some communities specialize in housing for high-income residents, while others specialize in lower-income residents. This can lead to both an underprovision of local public services and, in the context of affordable housing, excessive costs to local residents. In particular:

- Lower-income communities may not have sufficient resources to provide quality education or maintain social cohesion, both of which are likely to have negative consequences that will spill over into neighboring communities.
- Lack of affordable housing in higher-income communities means that workers—police, fire, clerical—in lower-paying jobs will be forced to commute longer distances from other communities, which will ultimately drive up costs for the higher-income community.

The Tiebout sorting process, however, is unlikely to generate the conditions under which the negative consequences of a shortfall in affordable housing can be addressed by local governments. A community that subsidizes affordable housing, for example, is likely to incur the costs of providing affordable housing, while an adjacent community might reap the benefits, as its employees reside in the former community's affordable units. Thus, one community can free ride on the other's investments in affordable housing. Ultimately, the community providing the affordable housing will be less desirable, with lower property values as a consequence of its unilateral policy choice.

Where the negative externalities associated with a lack of affordable housing are large enough, and where the geographic distribution of affordable housing is such that free rider problems are minimized, some local governments in high-income communities have found it beneficial to subsidize affordable housing and/or provide for long-term affordable housing. Presumably, wealthy communities tolerate the introduction of affordable housing because eliminating the negative externalities associated with a lack of affordable housing outweigh the costs and hence should increase the value of existing housing. In that sense, affordable-housing restrictions are a tax or value capture from owners of undeveloped land.

The ability to capture part of the value of undeveloped land is, in fact, a necessary condition for successful inclusionary zoning. Because inclusionary zoning imposes restrictions on developers that are not profit maximizing, developers can pay less for undeveloped land. The implications of this are twofold: (1) the value of undeveloped land will be diminished by the restrictions, and hence part of the value of the land will be captured to support affordable housing; and (2) inclusionary zoning can be effective only where vacant land holds significant value (beyond agricultural use, open space, or option value) that can be captured.

The interrelationship between value capture and inclusionary zoning has important implications for the potential for inclusionary zoning to spur affordable housing in urban and suburban communities. In declining urban communities where the costs of housing production have been greater than the market price of housing, there is virtually no role for inclusionary housing, because land value is essentially negative. Imposition of restrictions will not spur affordable housing and will likely reduce the construction of any market-rate housing.

There is increasing evidence that many formerly declining cities are stabilizing and growing once again (Voith and Wachter 2009). One key aspect of comeback cities appears to be that high density is associated with greater consumption opportunities, as well as the potential for increasing business and social contacts. To the extent that density is becoming more acceptable, and even desirable, there are opportunities to enhance the value of undeveloped land by increasing allowable density, which in turn will increase the potential for inclusionary housing in these cities.

While density appears to be more accepted in revitalizing cities, increasing density is still often vehemently opposed in suburban communities. After all, suburban residents have self-selected into low-density communities, and one would expect them to be predisposed to continued low-density development. Opposition to density means that inclusionary zoning will likely require more land value capture from owners of undeveloped suburban land as compared to communities that allow greater density offsets with affordable housing.

HEDGING AGAINST FUTURE HOUSE PRICE INCREASES AND INCENTIVES FOR INCLUSIONARY HOUSING

Communities that enjoy advantaged locations and constrained land supply have a greater incentive to address housing affordability issues because land (and house) prices may grow more rapidly than labor income. These communities have a motive to hedge the risk that wages paid to low-income workers will not keep up with local or regional land values. Putting aside housing that will be perpetually affordable is therefore a public good externality. The community expects housing to go up; therefore, either employers will have to pay higher wages or the community will have to subsidize housing at ever-higher levels. Communities can offset potentially higher labor costs or higher claims on the public purse tomorrow by putting aside housing today and preserving its affordability far into the future.

Even when communities choose to mandate affordable housing through inclusionary techniques and can do so based on the potential for land value capture, there are at least two serious challenges to the preservation of affordability over time. One concern is whether there is sufficient return on investment to allow owners of inclusionary housing to reinvest in it so as to maintain the quality of that housing over time. If the production cost of housing (excluding land) exceeds the flow of actual or implicit rents, newly created affordable housing will not be physically preserved over time; rather the capital will be consumed.

Another concern is that the cost of achieving a "quantity" goal, such as seeking to ensure that 10 percent of new housing is affordable, could go up over time if land costs go up more than labor costs, because in that region the return to land is higher than the return to human capital. This would require that a larger share of the community's resources be devoted to affordable housing over time.

Attempts to hedge the future costs of housing are difficult in an environment of competitive communities. There is a conflict between short-run maximization of tax revenues, where localities want to see housing sold and resold at the highest possible market rates, and long-run optimization of community wealth, where the community wants to preserve affordable housing in an enduring way, thus offering below-market rates to low-income homeowners. It may be difficult, or even impossible, to achieve this long-run goal in a federal system of government, where localities compete for short-run maximization of tax revenues. For example, workers may live in affordable housing in one locality and work for lower wages in another locality. If cross-jurisdictional externalities are significant, competition among communities may drive out efforts to secure affordable housing.

The next two sections explore local strategies used to create more equitable housing markets: inclusionary housing and community land trusts (CLTs). Both rely on public-private partnerships to provide access to stable housing opportunities for households earning less than the region's median income, but there are important distinctions between them in the long-term preservation of affordable housing.

Inclusionary Housing at the State and Local Levels

This section briefly describes the legislative history of inclusionary housing in New Jersey and Massachusetts, the two states with the longest-standing and most comprehensive affordable-housing laws, as well as in Montgomery County, Maryland, and a few other localities in the United States.[8] The creation of permanently affordable housing is opposed by many communities in these areas, however. For example, many municipalities in New Jersey have taken advantage of regional cooperation agreements (RCAs), which allow wealthy communities to pay other communities to create affordable housing in lieu of providing such housing themselves.

NEW JERSEY

Inclusionary housing was established in New Jersey through a series of decisions made by the New Jersey Supreme Court throughout the 1970s and 1980s. Collectively known as the *Mount Laurel* decisions, they outlawed zoning regulations

8. See Nelson and Wachter (2002) and Schill and Wachter (1995) for a discussion of affordable-housing policy and its interaction with local land use controls in the United States.

that were unfavorable to affordable housing and required all municipalities to provide a reasonable opportunity for such housing. These decisions established a constitutional obligation for the state's 566 municipalities to provide for affordable housing and were expanded by the Fair Housing Act of 1985. The act also created the Council on Affordable Housing (COAH) to oversee the development of affordable units and determine the number of units that each municipality needs to provide. Although each municipality is responsible for satisfying the state's requirement to create a reasonable opportunity for affordable housing, participation in the COAH process is voluntary from the municipality's perspective. As incentive, COAH offers communities benefits such as protection from builder's remedy lawsuits. Historically, roughly half of New Jersey municipalities have participated in COAH. According to recent research, 62,071 COAH units were created through March 2009, with an additional 28,672 in the pipeline (Bratt 2012). Typically, COAH regulations have required affordable housing to remain affordable for 30 years, although COAH regulations also allow communities with high poverty rates to set a duration of only 10 years, presumably in recognition of their need to increase their base of market-rate housing.

The State of New Jersey has also assisted in the creation of affordable housing through its Housing Trust Fund. According to the Fair Housing Act of 1985, affordable housing created with the assistance of this trust fund must remain affordable for 20 years. If the economic feasibility of the development project is in jeopardy, however, the period of required affordability can be shortened.

The *Mount Laurel* decisions and the establishment of COAH have been highly contested. The New Jersey legislature has on occasion attempted to abolish COAH and require instead that a flat percentage of all units built be reserved for affordable housing instead of giving COAH the authority to decide the percentage based on the municipality. In June 2010, the New Jersey legislature passed a bill to end COAH and require that 10 percent of the total housing stock in each town be set aside for affordable housing, essentially copying the Massachusetts approach described in the next section. The governor of New Jersey vetoed the bill, stating that he would approve the bill if the 10 percent rule applied only to new construction. In March 2011, the New Jersey Supreme Court announced that it would revisit the *Mount Laurel* decisions (DeFalco 2011).

MASSACHUSETTS

In Massachusetts the Comprehensive Permit Act, also known as Chapter 40B, was passed in 1969 to address the shortage of affordable-housing units in the state. It requires that 10 percent of all housing within a municipality be affordable for low-income residents.[9] Where this threshold is not met, the statute allows developers to appeal to the state for "density bonuses," which exempt them

9. For a detailed discussion of the Comprehensive Permit Act, see DeGenova et al. (2009), which also presents a series of case studies.

from restrictive zoning if they build housing that sets aside 20 to 25 percent of the units for low-income residents and has long-term affordability restrictions that run at least 30 years. Within a community with less than 10 percent affordable housing, if a development meets these requirements, it can be approved under state-level zoning rules for affordable housing.[10]

This law was originally conceived as a way to combat the kind of fiscal zoning described earlier in the chapter. Through state-level action, developers who propose low-income housing may do so whether or not such housing was desired by the local community. Nevertheless, the majority of affordable housing built in Massachusetts between 1990 and 1997 was constructed outside the Chapter 40B framework. Of the 114,000 units built during that time, approximately 20,000 met state standards to qualify as "subsidized," and only 5,000 units were created under the Comprehensive Permit Act (National Housing Conference 2002). Overall, progress toward the 10 percent goal has been slow. The number of communities meeting this standard increased only from 27 in 2001 to 39 in 2011 (CHPA 2011).

An increasing number of municipalities have adopted zoning provisions that explicitly promote the development of affordable-housing units in an effort to meet the 10 percent threshold and thus insulate themselves from possible state-level appeal. In 1988 only 20 of the 351 municipalities in Massachusetts had their own zoning mandates or provisions for affordable housing. By 1999, 118 cities and towns, more than one-third of all Massachusetts communities, had adopted additional zoning incentives for developers, creating a local zoning framework for affordable housing that lessened the attractiveness of developing under Chapter 40B (National Housing Conference 2002).

The local response, combined with long-standing resentment toward the law, caused the Massachusetts legislature to reconsider and revise the Comprehensive Permit Act. In 2008, in addition to the Massachusetts Department of Housing and Community Development issuing a revision of regulations and guidelines for affordable-housing development, the Massachusetts Supreme Court issued seven decisions in regard to the act. In November 2010, the Massachusetts Comprehensive Permits and Regional Planning Initiative appeared on the ballot as an attempt to repeal Chapter 40B. The debate was contentious, but the public voted to keep the act intact (CHPA 2011).

MONTGOMERY COUNTY, MARYLAND

Local approaches to providing affordable housing can be successful where such housing may result in the provision of cheaper public services as a result of providing housing for key workers. As with all public goods in Tiebout competition, the benefits must be kept from spilling over into other communities. This

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10. Inclusionary zoning can be deemed constitutional because it advances a legitimate state interest and does not deny the owner all economically viable uses.

requires an affluent community centered in a geographically large administrative area. Areas such as Montgomery County, Maryland, satisfy this condition, in part because they are significantly larger than a typical municipality, and hence destructive competition among municipalities is minimized. Local policy makers are able to use zoning to create incentives for local developers to create affordable housing.[11] Through the Montgomery County program, which was instituted in 1974, 12,000 affordable units were built by 2004 (Brunick 2008). The original Montgomery County statute only required a 5-year affordability restriction; this was increased to 10 years in 1981 and currently stands at 30 years for owner-occupied units and 99 years for rental units.[12]

Another Montgomery County initiative, undertaken in 1988 by the Housing Opportunities Commission, the countywide housing authority, appears to be an important rental-based strategy for the successful preservation of long-term affordable housing. As discussed by Bratt (2012), the commission purchases inclusionary units for long-term low- and moderate-income occupancy. Linking affordable-housing production to purchase by public housing authorities or nonprofit organizations may be a good option for regional initiatives.

Bratt (2012) found that in Montgomery County, many more inclusionary rental units than owner-occupied homes remain affordable through this initiative. Only 14 percent of the units built through the Housing Opportunities Commission inclusionary housing program, or about 1,700 units, were placed under public housing ownership and rented out, but they represent 43 percent of the units built through this program that are still affordable. This experience demonstrates that inclusionary housing programs incorporating requirements to produce rental housing might obtain more durable results than those favoring for-sale schemes. This policy direction is discussed in relation to community land trusts later in the chapter.

11. In addition to offering density bonuses in exchange for the provision of affordable units, regions can offer greater flexibility in the type of housing provided, including the possibility of mixing multifamily homes and townhouses. A study of 107 of these programs found that density bonuses were the most common cost offset, appearing in 92 percent of the programs (Bourassa and Hong 2003). Bonuses of up to 35 percent in units per acre were provided.

12. For two-thirds of the units originally built, the affordability restrictions had expired by 1999 (Brown 2001), and they were converted to market rate before Montgomery County got around to amending its original inclusionary zoning ordinance to require longer affordability periods. The failure of the Montgomery County program to provide long-term affordable units prompted the Housing Opportunities Commission in Montgomery County and agencies elsewhere to require longer resale restrictions (Brown 2001). Bratt (2012) notes that the 30-year restriction period can be considerably longer in fact, since the home must be owned by a single owner for 30 years. If the home is sold during that period, the clock resets, and the new owner has to keep it for 30 years before the restriction expires.

ELSEWHERE IN THE UNITED STATES

As in Montgomery County, many local governments have initiated inclusionary housing programs. These programs have arisen in strong housing markets where the lack of affordable housing has become an economic issue. The absence of such housing provides the leverage necessary to raise public support, and developers are willing to keep building because acquisition costs fall as the inclusionary housing requirements are capitalized into the price of land. Starting in the 1970s, municipalities in states such as Colorado and California began implementing such policies without state mandates (National Housing Conference 2004). As of 2004, up to 400 localities across the country had introduced some form of inclusionary housing program.[13] To entice developers to build more affordably, municipalities provide additional zoning flexibility, density bonuses, reductions in parking requirements, waivers of fees or taxes, and other incentives (Brunick 2008).

Overall, advocates for inclusionary housing have been successful in large part because of a local need to provide affordable housing for key workers, a scarcity of public funding, and partnerships (through flexible zoning) with developers. Although all of these programs generate housing units that are more affordable than their market-rate counterparts, many of the units eventually lose their mandated affordability and return to the market rate. Affordability periods required by inclusionary zoning programs vary significantly from one jurisdiction to another, but there has been a recent trend for municipalities to lengthen the period, with 30 years or longer becoming the norm.[14]

In the next section, we turn to community land trusts (CLTs), a potentially useful mechanism for providing affordable housing. When communities have difficulty perpetuating the affordability of housing created by inclusionary programs, CLTs may represent a viable option for preserving that housing (Bourassa 2006; Davis and Jacobus 2008).[15]

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13. Of these, 170 were in California, where state law encourages inclusionary zoning (National Housing Conference 2004).

14. One example is the Vermont Housing and Conservation Board (VHCB), a state-funded housing trust fund. To qualify for VHCB funding, projects must be permanently affordable (Libby 2010).

15. Davis (1994b) points out that CLTs are part of a “third sector,” forming a continuum between public and private ownership, with legal structures more conducive to the preservation of affordability than inclusionary housing programs are. Most like conventional private ownership within this third sector is the concept of the deed-restricted home, in which the occupant privately owns the home, but is limited in the sale price and choice of purchaser when he decides to sell. Most like traditional public housing is nonprofit rental housing. CLTs fall in the middle and may prove to be the best of the third-sector methods for preserving affordability. Others note that CLTs present a viable way of “decommodifying” housing, removing the land component of housing costs from the “speculative” market (Bourassa 2006; Stone 2006).

Community Land Trusts

In the United States, CLTs are intended as a mechanism to provide for the long-term stewardship of affordably priced owner-occupied housing, although the model is also being widely applied to the provision of rental housing and the development of commercial buildings and community facilities.[16] There are, however, several limitations to their potential.

CLTs IN THE UNITED STATES

The number of CLTs in the United States has doubled since 1992, when a federal definition of a community land trust was included in amendments to the National Affordable Housing Act.[17] In 2001 Fannie Mae developed a rider to be used in combination with a CLT ground lease when granting mortgages for resale-restricted CLT homes on leased land. This rider allows Fannie Mae to guarantee financing offered by banks for the purchase of homes in CLTs that otherwise might not be forthcoming (Reese 2008, 34). Even so, few CLT mortgages have been sold on the secondary market thus far.

A key component of the mission of CLTs is to perpetuate affordability, but the potential to achieve this goal may be limited due to the conflicting interests of members and potential members.[18] As members of a CLT, participants agree to provide current and future affordable housing for fellow participants; thus, they agree to the formula set in the ground lease, which is designed to give a “fair return on investment” (Reese 2008, 260). However, as homeowners, they want to be able to sell their property for the maximum price in order to make the most of their investment. From this arises a source of tension between the overall mission and the interests of participants.[19]

As discussed in Bourassa (2006), non-CLT third-sector approaches have weaknesses that can be exploited to end affordability. Deed restrictions generally require third-party enforcement, since cooperative and condominium boards are controlled by residents, who have an incentive to eliminate limited equity provisions. Similarly, mutual housing associations and other forms of nonprofit rental housing do not offer guarantees of long-term affordability.

16. CLTs trace their intellectual roots back to the work of Henry George and the concept of public leaseholds, which can have a similar ground-lease-based structure. For a general overview of public leaseholds, see Bourassa and Hong (2003).

17. According to Jacobus and Abromowitz (2010), in 1992 there were about 200 CLTs operating in 42 states, maintaining about 5,000 housing units. As of January 2012, the National Community Land Trust Network listed 254 CLTs in 45 states and the District of Columbia (National Community Land Trust Network 2012).

18. Part of a CLT’s mission is to achieve a balance between a return on investment for present CLT homeowners and access to affordable units for future CLT home buyers.

19. CLTs in the United States often adopt a ground-lease structure, in which a nonprofit trust owns the land, while the occupant owns the home itself. The lease offers a mechanism for providing affordability through legal restrictions, which typically include limits on rent and

CLTs overcome barriers to affordable home ownership by removing the cost of land from the purchase price and by limiting the future price for which the home can be resold if the homeowner decides to leave the trust. CLTs extend affordability indefinitely in a way that most inclusionary housing programs do not. Typically, CLTs calculate resale prices based on some index, such as changes in the area median income (AMI) or the consumer price index (CPI), or on some percentage of the difference between the appraised value of the home at initial purchase and the appraised value at the time of resale (in both cases, not including land value). This practice allows them to retain all public subsidies and most capital gains, thus lowering the price for subsequent home buyers of modest means. At the same time, resale formulas are designed to provide a fair return for the seller, allowing her to walk away with more wealth than she had when she bought into the CLT.[20]

The most widely used CLT scheme is the appraisal method, which has the advantage of incentivizing maintenance, although it can be subjective (Sungu-Eryilmaz and Greenstein 2007).[21] Other methods have their own advantages and disadvantages. The index method ensures affordability based on the criteria used, but not necessarily for other measures of affordability. Buyer incomes of targeted households, for example, may not increase at the same rate as the index. This method also discourages home improvements. Itemized formulas attempt to provide compensation for home investment, but this process can be difficult to monitor, potentially creating conflicts between home sellers and their CLTs. Mortgage-based formulas for resale values are beneficial in that they guarantee affordability at a given income level, but they discourage maintenance as well (Reese 2008).

CLTs IN THE UNITED STATES VERSUS HOUSING TRUSTS IN THE UNITED KINGDOM

The much older institution of the housing trust (HT) in the United Kingdom has historically dealt with value capture by limiting tenure to renting. While CLTs have been a small part of the solution in the United States, housing trusts account for 8 percent of all owner-occupied housing and 20 percent of all rental housing

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resale pricing (Davis 1994a). The viability of the ground lease as a mechanism for enforcing these restrictions presents one of the primary advantages of the CLT model. Alternative mechanisms, such as deed restrictions, are legally limited by issues of standing, common law, and rules against perpetuities. Restrictions via mortgage liens present an implicit buyout option to the homeowner (Abromowitz 2000).

20. A CLT can define the standard of affordability that it seeks to maintain and that will determine the allowed returns. The key question is whether the market will allow the CLT to generate sufficient investment to maintain the desired affordability standard.

21. In a 2006 survey, 55 percent of CLTs reported using the appraisal method (Sungu-Eryilmaz and Greenstein 2007).

in the United Kingdom. Members are tenants and historically have not benefited from the appreciation of property values upon resale. More recently, shared ownership schemes have been introduced in the United Kingdom, where there is also a growing CLT movement. In both cases, the expectations of households entering the schemes are clear. Information about how to obtain a flat in a housing trust, what participant rights are, and what limits are attached is widely available in the United Kingdom. This supports the system's integrity by generating network externalities. In contrast, more limited information about the rights and limits of CLTs is available in the United States, where regulations vary by state and by CLT.[22]

According to a report prepared for the Madison (Wisconsin) Area Community Land Trust, resale formulas are supposed to keep prices below market level, but they also reward homeowners for making "improvements to their houses because those improvements will likely be reflected in the assessed value of the unit when sold" (Girga et al. 2002, 2). These two objectives are conflicting, as one pushes prices down and the other pushes prices up.[23]

In practice, resale pricing also depends on the state of the market as a benchmark. If the formula is linked to market prices, more affordable markets allow greater equity capture without sacrificing continued affordability, as a more affordable sale, compared to the broader market, is more in line with local conditions. This fact makes it easier for CLTs in more affordable localities to maintain their resale formulas, while owners within CLTs in faster-growing communities experience more temptation to take advantage of the neighboring price appreciation.[24]

Further challenges derive from regulatory settings. In the United States, local government spending is supported by property taxes. CLTs also depend on the local provision of services, supported by property taxes and the valuation of tax ratables. There is, therefore, an underlying tension between the mission of preserving the affordability of CLT housing and the limitations this places on the tax ratables that the CLT provides to the local community (Davis and Jacobus 2008).[25]

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22. It should be noted that part of the reason U.S. municipal governments accept and support CLTs is the lack of standardization of terms and conditions, which allows each community to tailor a program that meets its needs.

23. For a discussion of CLTs that provide a credit for capital improvements that are made by homeowners after purchase, see Temkin, Theodos, and Price (2010) and the performance evaluation of Vermont's Champlain Housing Trust (Davis and Stokes 2009). Although the two objectives of building wealth and preserving affordability are conflicting, CLTs are proving that both can be achieved.

24. Some CLTs have amended their resale formulas, generally following initiatives by homeowners, who control one-third of the votes on CLT boards.

25. In fact, the treatment of property taxes on CLT homes is diverse. Some CLTs pay taxes on the market value of the land (e.g., the Madison Area Community Land Trust). Others pay

Thus, the treatment of value capture lies at the center of three conflicts that challenge the durability of CLTs' affordability. First, homeowners are interested in maximizing the return on their investment. Second, municipalities are interested in maximizing tax ratables. In the United Kingdom, local authorities have no control over the tax base and do not depend on property taxes to finance their expenditures. In contrast, in the United States local fiscal control over the tax base may lead taxpayers to limit schemes like CLTs. Third, lenders are interested in maximizing gains on the sale of properties if the owners default on their mortgages, although a recent study shows that delinquencies and foreclosures were far lower among CLT homeowners than among market-rate homeowners during the real estate market downturn of 2007–2009 (Thaden and Rosenberg 2010).

In addition, homeowners will bear an added burden if the trust does not have substantial funding for maintenance of common spaces and, for homeowners of very low incomes, ongoing maintenance of their homes.[26] Some of these funds can come from the retention of gains on sales, if the CLT collects a transfer fee or stewardship fee at the time a resale-restricted home changes hands. Excess debt is therefore doubly dangerous in putting pressure on CLTs to capture the full appreciation of market prices. In the United Kingdom, this dynamic is muted because gains go to the association in charge of the trust.

The conceptual basis for CLTs' provision of long-term affordable housing is sound. As discussed in the appendix, the higher housing price appreciation is, the less rents are needed to recover required returns in the investment market. The more the potential public good provided by CLTs is needed, the higher the ex ante expected rate of appreciation in housing, and the greater the extent to which this rate of appreciation exceeds the CPI and wage growth for low- to moderate-wage earners. Also, the higher the ex post growth of housing prices is, the greater the potential for CLTs to serve this goal.

Conclusions

As Sinai and Souleles (2005) have shown, home ownership may be risky, but so is renting. Specifically, ownership is a hedge against rent increases in the local market. Sustainable home ownership offers positive externalities for the public's welfare, but it must be durably affordable in hot markets and protected against

taxes based on the price paid by homeowners, but the land is considered to have no value (e.g., the Sawmill Community Land Trust in Albuquerque, New Mexico). In Oregon all CLTs have to pay property taxes based on the market value of the property. The question of the fair assessment of properties owned by CLTs for tax purposes can engender legal disputes, as in Orange County, North Carolina, where a CLT is currently fighting a legal battle with town assessors who argue that both the CLT land and the structures should be taxed at fair market value.

26. This is one reason capital-rich (as opposed to debt-laden) CLTs may be more conducive to permanent affordability.

deferred maintenance and mortgage foreclosure in cold markets. The resale formula that a CLT adopts in pricing the conveyance of its homes from one income-eligible home buyer to another is critical to its success in maintaining affordability. Specifically, if the wrong resale formula is adopted, or if inclusionary housing or CLT housing is eventually allowed to revert to market prices, it has provided no benefit (i.e., subsidy) beyond what the market is offering. To the extent that resale pricing protections fail to keep housing within the financial reach of the low- or moderate-income households for which the program was created, they will have failed in removing this portion of the local housing stock from the market. Unfortunately, in the context of competitive local communities, municipalities may have an incentive to limit their support for CLTs, just as they have incentives to limit the quantity of affordable housing within their borders. The case for inclusionary housing and CLTs can be made more easily in places with a strong land market and few free rider issues.

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APPENDIX

The key role of appreciation in the determination of real estate prices and costs is made clear from the user cost equation which links asset prices to rents. A common approach is to compute the user cost, P^*u, which is defined as

$$P^*u = P^*rf + P^*\rho + P^*tx + P^*d - P^*g,$$

where

P = price in dollars;
P^*rf = forgone interest (at the risk-free rate);
$P^*\rho$ = risk premium for housing;
P^*tx = annual property taxes;
P^*d = annual depreciation; and
P^*g = expected appreciation in housing prices.

With frictionless arbitrage,

$$R = P^*u,$$

where

R = rent in dollars for an asset priced at P, which implies

$$P/R = 1/u = 1/[rf + \rho + tx + d - g].$$

The return on investment, therefore, can be broken down into two portions: appreciation and rents. The higher housing price appreciation is, the less rents are needed to recover required returns in the investment market. Conceptually, an association with the mission of providing affordable *rental* housing will be able to do so more effectively in a strong market with long-term appreciation.[27]

27. For a more detailed example, see Bourassa (2006, 345–348). For a general discussion of the trade-offs, see Jacobus and Lubell (2007).