



TO: Mayor William Peduto

Pittsburgh City Council  
Councilman Rev. Ricky Burgess  
Councilman Dan Gilman  
Councilwoman Deborah Gross  
Councilwoman Darlene Harris  
Councilwoman Theresa Kail-Smith  
Councilman Bruce Kraus  
Councilman R. Daniel Lavelle  
Councilman Corey O'Connor  
Councilwoman Natalia Rudiak

CC: Chief Kevin Acklin

FROM: Raymond Gastil, City Planning

DATE: November 22, 2017

SUBJECT: Inclusionary Zoning Report

The Inclusionary Housing and Incentive Zoning Exploratory Committee, established by Mayor Peduto's executive order earlier this year, has worked to establish a framework of recommendations for moving forward with an Inclusionary and Incentive program to increase the production of housing affordable for Pittsburghers. It builds on the work of the Affordable Housing Task Force and its recommendations, and also on the ongoing work by elected officials, departments, authorities, to develop a sound housing policy for the City of Pittsburgh.

The committee, developed according to the executive order and representing a broad range of stakeholders in housing, worked diligently with the key advisory organization, Grounded Solutions, to develop a report and recommendations.

The attached memo, prepared by Grounded Solutions to reflect the work of the committee, identifies broad areas of consensus, as well as Grounded Solutions' perspective from their work in Pittsburgh and their national leadership and experience in developing affordable housing policy.

As you review the attached memo, I would like to underscore key points for your review. The memo includes both recommendations and alternatives, to insure that it documents not only consensus but also areas for further discussion and deliberation. In the points below, I would like to identify the areas of greatest consensus and steps toward an Inclusionary Zoning program in Pittsburgh.

*Pittsburgh should move forward with an Inclusionary Zoning Program, as part of a broader Inclusionary Housing Policy.*

- The Committee is confident that a feasible, successful Inclusionary Zoning Program is achievable for Pittsburgh.
- It has set a baseline goal for the city of 10% affordable housing, at 50% of Area Median Income, for new construction or adaptive reuse housing developments that are 20 or more units.
- The Inclusionary Zoning Program approach in this memo should be understood as one element of a larger Inclusionary Housing Policy for the City of Pittsburgh, which overall will endeavor to achieve higher levels of new and preserved affordable units at a range of incomes.

*Housing developed with public resources should include affordable housing, with benchmarks.*

- The Committee agrees if a developer receives public resources for a residential project, they should be required to include affordable housing. The definition of public resources includes tax abatements, direct grants, and up-zoning (such as levels increased density and height).
- In today's Pittsburgh market, including affordable units in a market-based project continues to necessitate public resources.
- The potentially most effective public resource is the LERTA tax abatement, potentially offering the strongest opportunity to provide affordable units.

*The report models for feasibility, recognizing that there will be ongoing work to review public resource alternatives to move to an implementation plan.*

- The Committee developed a robust, sophisticated model to determine the minimum feasible Internal Rate of Return (14%) while achieve 10% or greater percentage of affordable units.
- As noted in detail in the report, the most successful modeling requires a full LERTA tax abatement, and also a consistent abatement across the full LERTA period, which provides a greater resource than the program as currently structured.
- This version of LERTA was modeled here to demonstrate the abatement policy's great potential to support an Inclusionary Zoning program.
- It is recognizes that the committee and report cannot assume that this will be the future taxing policy of the LERTA providers, City, State, and School District. For this reason partial and no LERTA abatements are modeled, and an estimate of LERTA equivalent value is provided.
- We will continue to work to insure that this robust model includes further refinements re expense and income and public resources in an evolving market and policy environment.
- Additionally, the report notes that there may be opportunities to establish pilot affordable housing overlay zones, potentially higher than 10% in some areas. These will continue to be tested for feasibility (the final review the mapping of the strongest market areas--identified as Appendix II in the attached memo--is being completed and will be provided next week).



*Moving forward towards consideration, inclusionary zoning code proposals, and an implementation in the context of Inclusionary Housing program.*

- Thanks to the leadership of its residents and elected officials, Pittsburgh is moving to address its inclusionary housing in several areas. To note several crucial initiatives: the ongoing development discussion of a longtime owner occupant protection (LOOP) program to protect long-time owners from steep tax increases, the Incentive Zoning proposed in the Uptown Public Realm which incentivizes affordable housing through height bonuses, the Housing Opportunity Fund, and the preservation of existing income-restricted units.
- This report focuses on combining clear objectives and guidelines with a critical aspect of this overall task—the restructuring of the tax abatement programs. Restructuring the abatements so that an enhanced program promotes inclusion of affordable housing units, provides a foundation for addressing the broad program of Inclusionary Housing.
- The committee members have worked diligently to develop this report, and while the foundational task of their service is the completion of it, there is strong support for continuing to provide expertise and experience to assist the City to move towards proposed code and ultimately implementation.
- We look forward to responding to your questions, including formal sessions such as a post-agenda, meetings, and a program for further deliberation.



## Memorandum

**Date:** October 30, 2017

**To:** Ray Gastil, Director of City Planning; Kyle Chintalapalli, Deputy Chief Development Officer, Office of Mayor William Peduto; Tom Cummings, Director of Housing, Urban Redevelopment Authority

**From:** Sasha Hauswald, Grounded Solutions Network

**Re:** Inclusionary Housing and Incentive Zoning Exploratory Committee Recommendations

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### Introduction

In February 2015, a City Council resolution created the Pittsburgh Affordable Housing Task Force (AHTF), composed of housing advocates, community development organizations, affordable housing lenders and developers, and community organizers and stakeholders. Throughout 2015 and 2016, the Task Force met together and in committees to craft “recommendations and solutions designed to capitalize on the moment we have to expand and preserve affordability within our marketplace.” The final Task Force report was released in May 2016 and contained recommendations concerning four core policy tools: (a) a Housing Opportunity Fund, (b) increased utilization of the federal 4% Low-Income Housing Tax Credit (LIHTC), (c) preservation of housing and protection of residents, and (d) inclusionary housing. In February 2017, Mayor Peduto issued five executive orders intended to advance the recommendations of the Affordable Housing Task Force. One order directed the Department of City Planning to convene an Exploratory Committee, from a broad base of stakeholders, to further research and develop recommendations focused on incentive zoning and inclusionary housing policies for review and consideration by the City Council and Administration.

Grounded Solutions Network (Grounded Solutions) has been asked to support the Department of City Planning in this effort by providing facilitation and technical support to the Exploratory Committee. Since February, we have led the Exploratory Committee through eight structured meetings about key design choices for an effective and implementable Inclusionary housing or incentive zoning program. Grounded Solutions has also provided the Exploratory Committee with examples from other cities and a national perspective on trends and best practices. We have worked closely with the Department of City Planning and the Urban Redevelopment Authority to compile local data on market conditions and development activity in Pittsburgh, and we have used this information to inform Exploratory Committee discussions.

Grounded Solutions also has helped respond to Exploratory Committee comments about the Peninger Consulting Inclusionary Housing Feasibility Study, a report that examines “how much” an inclusionary housing policy could require of market-rate developers without deterring new market-rate real estate

investments. We partnered with Street Level Advisors, a strategy and innovation firm focused on equitable urban development, for the financial feasibility work. With Street Level Advisors, we solicited critical feedback on the Peninger Study findings by using an interactive online pro forma – the Inclusionary Housing Calculator – to display and improve the pro forma models constructed by Peninger Consulting. We received feedback on these models from city staff, residential developers, and a subcommittee of the full Exploratory Committee called the Calculator Working Group. The resulting analysis of “how much” affordability an inclusionary policy could require, and how to offset the cost of these requirements, begins on page 20, with Appendix I of this memo.

This summary memorandum contains a series of recommendations for an inclusionary housing program tailored to Pittsburgh’s housing goals and market conditions. The recommendations are informed, first and foremost, by Exploratory Committee members. National best practices; current Pittsburgh policies; data on market conditions; and feedback from City Planning, the Urban Redevelopment Authority, the Office of Mayor Peduto, and the Law Department were also considered in determining the policy framework described herein.

In many cases, the design of an inclusionary housing policy does not involve any single “right answer.” Instead, inclusionary housing policies must be tailored to meet the specific housing goals held by policymakers and community members. In Pittsburgh’s case, Exploratory Committee members arrived at consensus on many issues, while retaining different priorities and perspectives on others. In this memo, we endeavor to represent diversity of thought on the committee by suggesting Alternative Proposals that could also be considered by the City Council and Administration. In addition, we have included some alternatives that were not explicitly supported by any committee members, but were recommendations of the Pittsburgh Affordable Housing Task Force or alternatives that have arisen with city staff and merited further explanation.

In describing the goals and design of Pittsburgh’s inclusionary housing policy, it will be useful to contextualize the program within Pittsburgh’s evolving policy landscape. Inclusionary housing is one tool in the toolkit. It is not a panacea for all housing concerns, and it must be complemented by a suite of other local policies. The City of Pittsburgh is working on numerous fronts to catalyze economic vitality, equitable growth and a balanced housing supply. The Exploratory Committee process has occurred in parallel to other efforts, including efforts to reduce barriers to development, increase mixed-income housing through the use of 4% tax credits, deploy the Housing Opportunity Fund, create higher-density overlay zones in targeted neighborhoods, preserve existing affordable housing developments, implement a Choice Neighborhoods Grant and planning process, and many others. We invite policymakers to consider the proposed program within this rich policy context.

## Summary of Recommended Program

The summary that follows is an outline of principal program components that are later explained and discussed in more detail:

- Because substantial evidence nationwide shows that voluntary inclusionary zoning programs tend to produce fewer units, a minimum of 10% affordable units<sup>1</sup> will be required of all new residential development projects at least 20 units in size, including rental and for-sale units. This also will apply to the conversion/reuse of existing structures.
- In stronger market areas, new developments will be required to include 15% affordable units on site or off-site.
- To offset the reduced revenue from affordable rents or sales prices, all new projects will be eligible for a pre-determined level of by-right Local Economic Revitalization Tax Assistance (LERTA) tax abatements. These tax abatements are conferred by three taxing entities: the city, the county and the school district. If one or more of these entities is unable or unwilling to grant the LERTA abatement, then a developer will be granted a reduction in, or exemption to, the requirement.
- If all three taxing entities offer recommended tax abatements to the project, a developer may nevertheless choose to turn down any part of the by-right tax abatement benefits, but may not choose to opt-out of stipulated affordability expectations. Only in special circumstances, such as developing sites under historic preservation or requiring significant remediation, may a developer seek special consideration through the Zoning Board of Adjustment process.
- To qualify for initial occupancy in an inclusionary housing unit, a household must earn no more than 80% of Area Median Income (AMI) to purchase an ownership unit, and no more than 50% of AMI to qualify for a rental unit. Allowable pricing in inclusionary homes and apartments will be set at 30% of 80% AMI for ownership and 30% of 50% AMI for rental.
- Rental projects will be required to accept tenant-based Section 8 vouchers for affordable units from otherwise qualified tenants.
- Rental and ownership units will remain affordable for a minimum of 35 years.
- Developers will be offered the option to build their required affordable housing units offsite on a different parcel. The location and overall development plan of off-site projects will meet specified criteria to ensure alignment with fair housing goals.
- The policy will not allow for in-lieu fee payment, land dedication or preservation activities as alternatives to constructing a mixed-income building.
- On-site inclusionary units will be integrated within each building (not segregated) and equivalent to market-rate units in all ways. Core amenities must be 100% shared. Off-site developments should follow design standards established by appropriate city agencies and authorities.

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<sup>1</sup> Affordability is defined in the section below that is entitled Income Qualifications and Pricing.

## Detailed Inclusionary Housing Program Recommendations

The following 16 subsections offer recommendations and alternative proposals for a Pittsburgh-specific inclusionary housing program. Many of these core program components will ultimately be specified in authorizing legislation. We have also noted areas where further discussions and decisions will be necessary for a complete policies and procedures manual for the program.

### 1. Incentivized Mandatory Framework

- *A minimum of 10-15% affordable units<sup>2</sup> will be required of all new residential development projects, including rental and for-sale, at least 20 units in size.*
- *To offset the reduced revenue from affordable rents or sales prices, all new projects will receive a pre-determined level of by-right Local Economic Revitalization Tax Assistance (LERTA) tax abatements. These tax abatements are conferred by three taxing entities: the city, the county and the school district. If one or more of these entities is unable or unwilling to grant the LERTA abatement, then a developer will be granted a reduction in the requirement.*
- *If all three taxing entities offer recommended tax abatements to the project, a developer may nevertheless choose to turn down any part of the by-right tax abatement benefits, but may not choose to opt-out of stipulated affordability expectations. Only in special circumstances, such as developing sites under historic preservation or requiring significant remediation, may a developer seek special consideration through the Zoning Board of Adjustment process.*

#### Explanation

The suggested overarching program design is an incentivized mandatory inclusionary housing program.

Nationally, mandatory programs are more productive than voluntary programs. There are two likely reasons for this fact.

- 1) To produce units under a purely voluntary program, the net financial effect of the incentive package, combined with reduced revenue from affordable units, must result in a project that is, on balance, *more* profitable than it would be otherwise. If incentives simply balance the costs of the inclusionary units, then only mission-driven developers opt-in. Thus, it can be difficult, with limited local funding, to identify sufficient monetary, zoning and procedural incentives to attract a majority of local developers into the program.
- 2) Developers unfamiliar with building and managing mixed-income developments, or who are resistant for other reasons, will opt-out of the program even if it is structured to be a profitable trade on a purely economic basis.

An incentivized mandatory program ensures financial feasibility of new development by offsetting at least a portion of the lost revenue from affordably priced units. (However, these programs are not necessarily structured to make projects more profitable than they “need” to be to attract investor capital.) Incentivized mandatory programs also set a standard, predictable expectation of all developers.

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<sup>2</sup> Affordability is defined in the section below that is entitled Income Qualifications and Pricing.

Transparent up-front expectations can have the effect of “leveling the playing field,” allowing developers to negotiate more effectively for land prices, and meeting community needs *without* a protracted negotiation processes. Simplicity, transparency, predictability and fairness are hallmarks of productive inclusionary housing programs.

Given the ongoing process of revising the city LERTA legislation and uncertainty about the availability of comparable programs that reduce school district and county tax assessments, local developers are understandably nervous about policy proposals that ‘mandate’ affordable units. They generally prefer a voluntary approach where the affordable units are only available if a project elects to apply for the tax abatement.

The middle-ground approach that is recommended here requires affordable units in all projects, but waives the requirement in the event that expected incentives are not available or compliance would otherwise make the project financially infeasible.

Because the Local Economic Revitalization Tax Assistance (LERTA) tax abatements are a central component of core of the recommended policy design, discussions between the three taxing bodies will be a crucial next step toward implementation. The County and School District contribute to these policies and did not have representatives on the Exploratory Committee to provide direct feedback.

#### Alternative Proposals

- A voluntary program that requires affordability upon request and receipt of tax benefits or other forms of financial support.
  - In Pittsburgh’s current development climate, nearly all new residential buildings receive LERTA tax abatement benefits and/or some other form of support, such as TIF. An alternative to the incentivized mandatory framework would be to require affordability when developers request such benefits. For instance, such a policy could require affordability (10-15%) as a condition of receiving LERTA and Act 42, as part of the reauthorization of those tax abatement programs.
  - Feedback from local developers indicates that typical developments in Pittsburgh today would opt into a voluntary framework since tax abatements or other financial subsidies are critically necessary for the baseline feasibility of many purely market-rate projects. Thus, a program that requires affordability in exchange for tax benefits could potentially reap a similar level affordable housing production in the near term.
  - Committee members expressed serious concerns that an incentivized mandatory program, given current market conditions in Pittsburgh, may be too aggressive and could deter new residential development.
  - A voluntary program tied to receipt of city benefits could be structured to apply to construction and renovations of all sizes.
  - As noted above, there may be a risk that more profitable developments, such as those located in the highest-cost neighborhoods, would not require tax abatements for baseline project feasibility and would opt-out of the program.

- An incentivized mandatory planning overlay district covering only select pilot areas.
  - A pilot overlay zone would provide an opportunity to test the effectiveness of an incentivized mandatory framework while implementing a voluntary framework in other areas of the city.
  - A pilot overlay zone could be evaluated over a defined period of time (e.g. 2-3 years) with potential for expansion into a citywide policy.

## 2. By-Right LERTA

- *City, county and school district LERTA will be offered by-right to all developers who comply with their minimum affordable housing requirements.*
- *LERTA levels and other key program elements (such as geographic zones) should be established at inception and revisited for accuracy three years after adoption of the policy, and at least every five years thereafter, to keep pace with market changes while also ensuring a reasonable level of predictability for developers.*

### Explanation

For significant levels of affordability and in most areas of Pittsburgh, tax abatements are needed for new development plans to attract investors. Imposing affordability restrictions without tax benefits could deter new development activity in many neighborhoods. LERTA is available for properties located within certain “deteriorated areas” defined by the Council of the City of Pittsburgh. Currently, the entire city is designated as a deteriorated area, so developments in all neighborhoods are currently LERTA-eligible for exemptions from city property taxes. Under modeled scenarios where new projects receive the LERTA abatement from all three taxing jurisdictions, significant levels of affordable housing set-aside are financially feasible. Although the proposed policy design relies on LERTA, other abatements (Act 42, for example) could be used similarly as cost-offsetting measures for developers providing reduced-price homes and apartments.

Using a conservative model, our analysis suggests that an abatement of at least \$2,300 per unit, per year, for 10 years, would be sufficient to make a 15% affordable housing requirement financially feasible in moderate and strong market areas of the city (see Appendix I for detailed analysis). However, identifying a minimum level of abatement that must be available along with the requirement is challenging, and further financial modeling may be appropriate before finalizing the design of a new abatement program. Necessary LERTA levels should be re-examined and adjusted every three to five years as the market evolves.

Given uncertainty about the future availability of LERTA, it also makes sense to design the affordable housing requirements policy in a way that allows the city to reduce or eliminate the affordable housing requirements in any case where a project is not eligible to receive tax abatements of at least some minimum threshold amount per unit, per year, for 10 years. Ideally, the specific minimum would be identified for each of several types of project and would be different for rental and ownership projects. Over time, this minimum might be adjusted to reflect changing market realities.

## Alternative Proposals

- A modest citywide baseline requirement, such as 5%, in all neighborhood types, without receipt of LERTA.
  - This proposal was discussed in the Exploratory Committee before completion of the calculator financial feasibility modeling exercise. Feedback from the Calculator Working Group and local developers indicated that some level of tax abatement or public support is needed to build even 100% market-rate projects in many neighborhoods. Thus, a 5% requirement without a by-right LERTA allocation could damage feasibility and further reduce development interest in distressed neighborhoods.
  - A 5% citywide requirement could potentially be phased in as a forward-looking policy, which would allow land values to adjust to the policy.
- A 5% minimum requirement without LERTA only in stronger market neighborhoods.
  - A 5% minimum requirement without LERTA may be possible, even with present land values, in specific instances in high-rent neighborhoods. However, it is more desirable to have a higher percentage of affordability in these neighborhoods, even if this requires subsidies in the form of tax abatements to offset costs.
- Require a lower level of affordability (e.g. 5%) while also guaranteeing receipt of full LERTA benefits.
  - Committee members expressed concern that some market-rate rental projects would not be able to support a 10% affordability requirement, even with full LERTA benefits. In this event, there is a risk that residential developments that would have otherwise been built would not move forward.
- Negotiate LERTA benefits on a case-by-case basis.
  - Negotiated benefits could enable the city to be more precise in determining the required level of abatement on a per-project basis.
  - However, predictable LERTA benefits (non-negotiated) are less administratively onerous and more equitable. Negotiated LERTA benefits could delay development plans by requiring extensive analysis, and outcomes could be unfairly more favorable to developers who are well acquainted with the process.

### **3. Citywide Scope with Geographic Variation Only by Market Type**

- *In all parts of the city, developers will be required to offer at least 10% of their residential units at affordable prices.*
- *In stronger markets, as defined by Market Value Analysis (MVA), rent levels and vacancy rates (re-evaluated at specified intervals), new development will have a higher 15% minimum requirement.*

#### Explanation

Much of Pittsburgh's development activity is occurring in neighborhoods with desirable amenities and access to transit. These neighborhoods are becoming increasingly expensive, potentially forcing their lower-income residents into areas of higher poverty, lacking equivalent amenities and transit access. To support Affirmatively Furthering Fair Housing (AFFH) goals, imposing higher percentage affordability

requirements on strong market neighborhoods will encourage economic diversity and inclusion, and will help ensure that the benefits of growth are shared.

In addition to AFFH goals, there are financial reasons to have higher percentage requirements in stronger neighborhoods. There are significant differences in rent levels and land costs citywide, thus significant variation in the ease with which new development can absorb the “cost” of inclusionary housing and still attract investors.

Although raising expectations in strong market neighborhoods has multiple benefits, strictly limiting the geography of the policy to encompass only some parts of the city (*e.g.* currently hot markets) could miss opportunities to build mixed-income housing in newly burgeoning neighborhoods. Neighborhood dynamics shift quickly. Furthermore, public benefits, like LERTA, are an important development incentive in struggling neighborhoods, thereby strengthening distressed communities by encouraging private market investment. For these reasons, the proposed policy establishes a minimum baseline requirement that applies to all areas of the city and serves the dual purpose of incentivizing market-rate development in soft markets while requiring increased affordability in hot markets.

Appendix II shows maps of proposed boundaries for the current “stronger market” delineation, as well as maps of the stronger market areas within that boundary where current zoning allows for multifamily development. With the exception of large-scale, single-family developments of townhomes or detached houses, the large majority of developments subject to the inclusionary requirement will be multifamily projects, thus the policy will primarily be applied in multi-family zoned areas.

#### Alternative Proposals

- Three geographic tiers (soft, moderate, strong) rather than two.
  - This could be difficult to delineate accurately, particularly with data limitations. It would require frequent updating, and complexity may outweigh the benefits.
- No neighborhood variation, but instead a citywide 10% required set-aside, with by-right city LERTA and a 20% set-aside with added school district and school district and county LERTA.
  - This would be simple to understand and administer, and it would not require the complex and controversial process of mapping neighborhood types.
  - It would not be tailored to neighborhood-level feasibility differences, so it could make development in very soft markets more difficult and/or lose opportunities for greater affordability in the strongest markets.
  - Financial modeling indicates that, at this time, residential developments in softer market areas are not able to support a 10% set-aside with the city LERTA only, nor a 20% set-aside with LERTA abatements from all three taxing jurisdictions. This policy may be promising for future consideration under stronger market conditions.
- Provide additional incentives for higher levels of affordability in transit-rich neighborhoods or transit corridors.
  - Transit corridors are likely to see increased development and density over time; building in affordability now will help ensure economic diversity and inclusion for the long run.

- Public investments in transit infrastructure typically drive up the land costs and housing costs near new transit nodes. Inclusionary requirements are a means of “capturing” rising land values and distributing benefits back to the public.
- Transit-rich locations are often excellent affordable housing and mixed-income housing sites when they offer efficient access to jobs and amenities.
- It is still to be explored what incentives the city might be able to offer in exchange for higher affordability in transit corridors.

#### 4. Type and Tenure of Development

- *The proposed policy would apply to new construction, substantial rehabilitation, and conversion/reuse projects, including both homeownership and rental developments of at least 20 units in size.*<sup>3</sup>

##### Explanation

Both rents and home sale prices have been on the rise in Pittsburgh and, in many neighborhoods, have become too expensive for lower-income households. Thus, the city has an unmet need for affordable units in both markets – ownership and rental. One reason to restrict the policy only to ownership or only to rental would be if one tenure type were currently infeasible in the market. However, modeling demonstrates financial feasibility for construction of both tenure types, with some ownership prototypes being particularly profitable.

Pittsburgh’s building stock offers many opportunities for rehabilitation and conversion/reuse of existing structures. In the coming years, the city expects a substantial subset of new housing to be created from renovations of existing structures. While costs vary widely on conversion/reuse projects, they can be amongst the most profitable types of residential development. Thus, exempting such projects from the policy would result in missed opportunity for affordability with no obvious benefit.

##### Alternative Proposal

- Exempt ownership developments from the policy.
  - Currently, there are few condo developments or developments of single-family homes occurring. Although this may change in the future, in the near term, the policy is not likely to create large numbers of affordable ownership opportunities.
  - Committee members expressed concern that pricing for affordable ownership units would be a delicate matter, and it could be challenging to ensure that buyers are not entering into purchase agreements that place them at financial risk.

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##### <sup>3</sup> **Supplementary Note on Substantial Rehabilitation**

“Substantial rehabilitation” will require additional definition from the Department of City Planning. For instance, permits for residential renovations or conversion/reuse projects valued over a specific dollar amount, or exceeding a certain percentage of the current property value, might be used to define substantial rehabilitation.

## 5. Project Threshold Size

- *Projects of at least 20 units in size will be subject to the policy requirements, and residential construction projects with 19 or fewer units will be exempt. Smaller developments will therefore not automatically be subject to the rules and requirements of this inclusionary housing policy. Taxing bodies will have discretion to approve or deny tax abatement benefits to smaller projects if requested by developers, and to negotiate for community benefits in exchange as they see fit.*

### Explanation

Nationally, most inclusionary housing programs have a threshold size of five units or 10 units. However, in the Pittsburgh market, many believe that larger developments are more easily able to defray the costs of affordable units. Furthermore, small landlords may be burdened by the administrative responsibilities of program compliance, such as providing rent-roll information to the city. Given that we do not currently hold data on the financial feasibility or profit levels of small-scale developments, setting a threshold of 20 units is a precautionary measure from a financial feasibility perspective. Using this threshold, any development subject to the requirement will have at least two affordable units.

### Alternative Proposal

- Require an in-lieu fee for small developments, scaled to the size of development.
  - An in-lieu fee scaled to the size of development may be more equitable (all developments contributing toward affordability). It could also help eliminate the desire to build 18- or 19-unit buildings.<sup>4</sup>
  - An in-lieu fee could impose an added challenge to building small developments. A new fee or tax is, in general, viewed as highly undesirable given the challenging development context and existing administrative barriers facing developers.

## 6. Income Qualifications and Pricing

- *To qualify for initial occupancy in an inclusionary housing unit, a household must earn no more than 80% of Area Median Income (AMI) to purchase an ownership unit, and no more than 50% of AMI to qualify for a rental unit.*
- *Allowable pricing in inclusionary homes and apartments would be set at 30% of 80% AMI for ownership and 30% of 50% AMI for rental.*<sup>5</sup>

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<sup>4</sup> Other methods could be considered to remove the incentive to build an 18- or 19-unit building if this is of concern. For instance, the City could lower the threshold size to 10 units, so that 10- to 19-unit buildings would include one or two affordable units, while also including small project size as one of the qualifying criteria for variance eligibility.

### <sup>5</sup> **Supplementary Notes on Income Qualifications and Pricing**

Prices of inclusionary units should be updated annually based upon HUD AMI. Units with equivalent bedroom counts will be priced equally. For unit pricing determinations, the assumed household size per number of

## Explanation

### *Defining Affordable*

According to HUD standards and most city programs, housing is defined as “affordable” if rent and utilities do not exceed 30% of the occupants’ total household income.

### *Targeting Need*

Income targeting in inclusionary housing programs varies widely. Some programs target the lowest income levels (“deep affordability”), while others aim to create “missing middle” housing. There is no right answer, but there are some important target level considerations:

- 1) Does the market already serve households at the chosen target income level? If so, will there be sufficient demand to fill the inclusionary units?
- 2) Will projects and the desired set-aside be feasible if the chosen level of affordability is mandated?<sup>6</sup>

### Rental Need

In 2017, HUD’s established 50% AMI income for a family of three in Pittsburgh was equivalent to \$32,700. According to data in the 2010-2014 American Community Survey (ACS), there were 8,565 renter households earning between 30% and 50% of AMI who were housing cost burdened (paying more than 30% of income on rent).

The \$817/month affordable rent for a three-person household earning 50% of AMI (see above) is significantly below the August 2017 median list price for three-bedroom units in Pittsburgh of \$1,380/month ([www.zillow.com](http://www.zillow.com)). Additionally, most inclusionary units will be in new apartment

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bedrooms should be consistent with other city programs. Typically, programs assume the occupying household will be one person larger than the number of bedrooms (e.g. a three-person household would occupy a two-bedroom apartment). Additionally, many programs have preferences or requirements to ensure that families are right sized for the available units (e.g. no fewer than two persons and no more than five persons for renting a two-bedroom unit).

In many programs, developers are not allowed to charge low-income tenants additional utility expenses, rent for parking spaces, or fees to access amenities when these costs would effectively increase total housing costs for low-income tenants above the allowable rent level. Similarly, most programs incorporate assumptions about HOA dues, utilities, mortgage insurance, *etc.* in determining the annually allowable sales price for affordable ownership units. Details on how pricing should consider these ancillary housing prices (additional to rent and mortgage payments) should be formalized in the program’s policies and procedures.

Policies and procedures should also stipulate whether annual income certification will be required and what will occur if a tenant’s income grows and they become over income for the program. Some programs allow tenants to remain in place up until a certain second income max (e.g. 80% AMI).

<sup>6</sup> Feasibility considerations will change in future years as the market strengthens and market rate prices rise and should be re-examined every 3-5 years.

buildings and in desirable parts of town, meaning that they are generally higher quality than “naturally affordable” housing that is equivalently priced and available in the open market.

Thus, there appears to be a strong need and demand for apartments that would be priced affordably for households that earn 50% of AMI.

The Affordable Housing Task Force recommended pricing inclusionary housing units at 50% of HUD AMI for an additional reason: “Households earning less than 50% AMI are eligible for Housing Choice Voucher payments to supplement their direct rent payments...”

Setting the maximum allowable rental price at 30% of 50% AMI will help ensure that allowable rents in inclusionary units will not exceed the HUD payment standard for the Section 8 Program (which is discussed in greater detail in a dedicated section, below). The payment standard for a landlord who accepts Section 8 is HUD’s annually determined Fair Market Rent (FMR). In 2017, the Pittsburgh two-bedroom FMR was \$822 (three-person household), whereas the allowable rent for a three-person household earning 50% of AMI was \$817.<sup>7</sup> Thus, if the pricing of inclusionary units is set to be higher than 30% of income for a 50% AMI household, then a landlord will earn more by turning away Section 8 voucher holders.

### Ownership Need

In examining the need and demand for homes priced at 80% of AMI, 2010-2014 ACS data show that 3,085 homeowners earning between 50% and 80% of AMI were housing cost burdened (paying more than 30% of income on housing costs) – indicating that households in this income range must sometimes stretch beyond their means to buy the home they want. Home prices have also risen since 2014, so this data may underestimate housing affordability problems in the ownership market. August 2017 data from Zillow state that “Pittsburgh home values have gone up 4.6% over the past year, and Zillow predicts they will rise 3.2% within the next year.”

According to Zillow, the median price of homes listed in August 2017 was \$179,999. A household of three earning 80% of AMI, or about \$52,300, would be able to afford a home price of about \$210,000.<sup>8</sup> Since 80% AMI households can therefore afford the median market price, it appears that the market is better serving homebuyers at 80% AMI than renters at 50% AMI, and the demand for inclusionary ownership units at this price level will depend upon location, size and quality as compared to other homes for sale in the equivalent price range. Committee members confirmed that lower-cost homes on the market require substantial renovations and/or are located in less desirable locations. Nevertheless, the city should monitor marketing and sales of ownership units and consider adjustments to the program if the new homes are not selling.

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<sup>7</sup> The Housing Authority of the City of Pittsburgh (HACP) is currently considering implementation of “Small Area FMRs” which would result in higher FMR payments to landlords in more expensive areas of the city. In the future, it may be that the Section 8 payment standard will be equivalent to, or even higher than, an affordable price for households at 60% AMI in strong market neighborhoods.

<sup>8</sup> **Assumptions:** 30-year fixed-rate mortgage, no additional household debt, 10% down payment, 35% debt to income ratio, \$900/mo principal and interest, \$415/mo property tax, \$77/mo home insurance, \$138/mo mortgage insurance.

### *Financial Feasibility*

The greatest need for affordable housing in Pittsburgh is at lower income levels. ACS data show that 15,905 renter households and 4,420 homeowner households that earn less than 30% of AMI were housing cost burdened. Furthermore, the large majority of these households were severely cost burdened (paying more than 50% of their income on rent).

However, the lower the income level that is served by the affordable units the higher the cost to a project sponsor. All things being equal, deeper affordability reduces the return available to a developer. Consider the following results from the Calculator Working Group's model of a Pittsburgh development:

- A 10% set-aside of affordable units priced for households at 30% AMI would render some projects infeasible, even with the full LERTA to help offset the costs.
- Developments modeled are feasible with a 10% or 15% affordable housing requirement targeting 50% of AMI (when receiving full LERTA tax abatements).

### Alternative Proposal

- Set pricing at 30% of 70% AMI for ownership, while retaining the income cap of 80% AMI.
  - Pricing ownership units below the maximum qualified income creates a "buffer" between allowable prices and allowable income. It offers three benefits:
    - 1) It builds in flexibility for adapting to rising HOA dues, reducing the chance of foreclosure
    - 2) It enlarges the pool of qualified interested owners for rapid sales and lease-up processes
    - 3) Lower-income households can afford to buy without severe cost burden

## **7. Section 8**

- *Require sponsors of projects with on-site affordable units to accept tenant-based Section 8 vouchers for renting these units, from otherwise qualified tenants.*

### Explanation

One way to serve lower-income residents without significantly reducing the financial feasibility of a project is to rely on Section 8 vouchers. The Housing Authority offers vouchers to very low-income households and makes up the difference between what these families can comfortably afford and the Fair Market Rent (FMR) set by the Authority. Although a developer/owner faces compliance, reporting and other costs beyond the reduced rent, the voucher program can allow a project to serve residents earning far less than 50% of AMI without further reducing its rental income.

Our recommendation is to consider requiring sponsors of projects that are required to provide on-site affordable units to accept tenant-based Section 8 vouchers from the prospective tenants in these units. The Housing Authority has unused vouchers due to difficulty that tenants report in finding apartments that will accept the vouchers.

Before adopting this policy, however, it would make sense for the city to more closely explore the administrative burdens imposed on property owners who already accept voucher-holding tenants. There is a risk that this provision could greatly complicate the already challenging task of complying with an affordable housing requirement.

## **8. 4% Low-Income Housing Tax Credit (80/20)**

- *Use of the 4% Tax Credit should be a voluntary additional incentive in exchange for increased affordability, and should not be an offset for the base requirement.*

### Explanation

The city could occasionally rely on the 4% Low-Income Housing Tax Credit (LIHTC) program to provide an additional subsidy that would enable selected projects to serve residents at lower incomes or to increase the number of affordable units. For example, the LIHTC program can be used to subsidize mixed-income projects where 20% of the units are restricted to households earning less than 50% of AMI. With this subsidy, a project that might otherwise struggle to provide 15% of units at 50% of AMI could afford to offer 20% of units at 40% of AMI.

Unfortunately, the complexity of the LIHTC program makes it unsuitable for many of the residential projects that are likely to be built in Pittsburgh. Thus, while it is recommended that the city continue to pursue opportunities to partner with market-rate developers to support the development of LIHTC 80/20 mixed-income projects, we recommend against relying on this program to make a higher affordability requirement feasible for all projects.

## **9. Duration of Affordability Requirements**

- *Rental and ownership units will remain affordable for a minimum of 35 years.*

### Explanation

Nationally, over 80% of inclusionary housing programs have units that remain affordable for at least 30 years, with many programs having affordability terms of 50 years, 99 years or the life of the building. Longer affordability terms add considerable efficiencies to the up-front public and private investments needed to construct affordable housing units. Longer affordability terms also enable the city to “bake-in” a healthy income mix that lasts over time, even as housing prices rise, and to build up a substantial stock of affordable units over time. In Pittsburgh, legal and administrative concerns have led to a recommendation of at least 35 years for all units, which has the added benefit of alignment with other affordable housing programs. The Pennsylvania Housing Finance Agency, for instance, has recently changed the affordability duration required for Low-Income Housing Tax Credit (LIHTC) developments to 35 years.

Procedurally, within the 35-year period, when a tenant moves out, the city will be notified and a new income-qualified tenant will be selected. The city will create program guidelines that allow for tenant incomes to increase somewhat without threat of eviction. The guidelines will also outline the

requirements for marketing units and selecting tenants. The rules for homeownership units will need to consider details such as whether prospective buyers will be allowed to access down-payment loan assistance, and what formula to use in establishing initial and resale prices. These important programmatic details are typically contained in a procedures manual that can be updated administratively, rather than in an ordinance that would require a lengthy amendment process.

### *Financial Feasibility*

The inclusionary calculator that was built by Grounded Solutions, with Exploratory Committee and city input and review, and used to model theoretical developments in Pittsburgh, assumes as a baseline that the affordability of inclusionary units lasts for the duration of the life of the building. Thus, from a feasibility perspective, 30, 35, 50 or 99 years should also work under the current model of feasibility estimates.

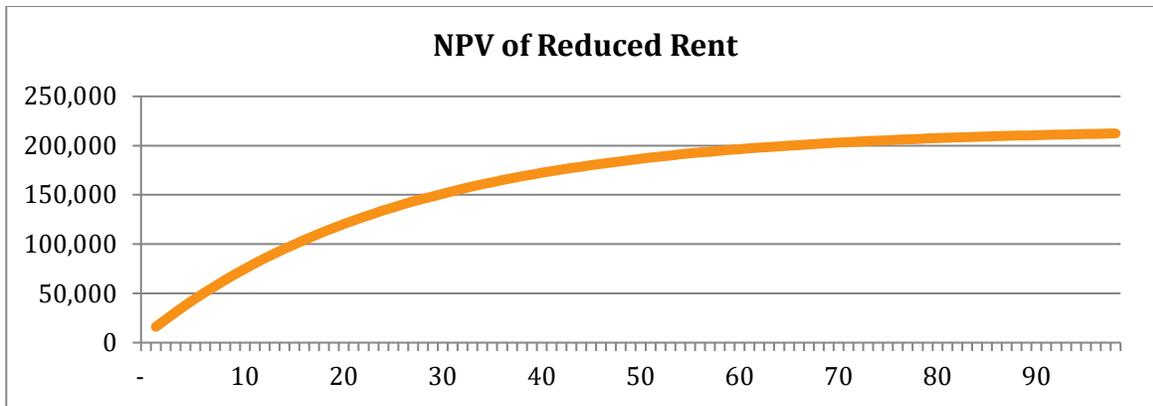
To more closely examine the order of magnitude of financial impact for these varying durations of affordability, we constructed a simple discounted cash flow model. We calculated the annual difference in income between an affordable unit (at 60% of AMI) and a market-rate rental unit adjusting for inflation over a 99-year period. We then calculated the present value of this reduction in rent over different periods of time chosen to represent different potential affordability periods. We assumed a 6% discount rate.

In general, because of the time value of money, reducing the cash flow many decades in the future has less impact on a project's value today than reductions in cash flow in the near term. As a result, the longer the term of affordability the less difference each extra year will make.

For example, increasing the period of affordability from 10 to 20 years doubles the cost of the requirements (the present value of the forgone revenue), but increasing from 50 to 99 years adds only 15% to the cost.

Period of Affordability	Net Present Value (NPV) of Foregone Revenue
10 Years	\$69,356.28
20 Years	\$120,363.24
30 Years	\$151,285.14
35 Years	\$162,818.04
50 Years	\$185,462.32
75 Years	\$205,067.99
99 Years	\$212,380.56

There are practical considerations that this analysis overlooks. Most developers are unlikely to hold a rental project for such a long period. The key question is how a buyer in year five or 10 will treat the remaining length of affordability when they value the property. Institutional investors, who themselves expect to sell within 10 years, may treat any restrictions lasting beyond this period all the same, which would mean that much longer-term affordability might not cost more at all. On the other hand, it is also possible that some potential buyers may be unwilling to buy a property with long-lasting restrictions, while being open instead to properties with shorter-term restrictions.



### Alternative Proposals

- Set a period of affordability to a minimum of 50 years, 99 years or the life of the building (instead of 35 years).
  - Longer terms of affordability (e.g. 99 years) are a prevalent national best practice that maximizes up-front investments and grows the stock of affordable units over time. Many older inclusionary programs began with short terms of affordability (e.g. 15 years) and amended their policies when they began to lose units to market-rate conversions.
  - If a long term of affordability is established initially, the city may wish to revisit how it is working for developers and administrators during the three- to five-year program review. Affordability terms can be shortened (but not lengthened) in deed restrictions and other development agreements.
- Reset the affordability term upon sale if an ownership unit is resold before 35 years of occupancy.
  - This kind of reset creates essentially perpetual affordability and an asset that can serve generations of homeowners.

### **10. Off-Site Performance Option**

- *Developers will be offered the option to build their required affordable housing units on a different parcel.*
- *To ensure that the policy affirmatively furthers fair housing, an off-site development would have to meet one of the two criteria below:*
  - *If the development is located in a strong market, as shown on the maps in Appendix II, then the off-site units must be located no more than .25 miles from the original site.*
  - *If the originating development is not located in a strong market, then the location of the off-site units must satisfy to-be-developed AFFH criteria ensuring that the location and overall development plan achieves fair-housing goals. Detailed criteria for site review will be developed by the relevant city agencies and authorities and included in the program’s formal policies and procedures. Such criteria will ensure that off-site units are located in a no-less desirable location than the original project in terms of environmental quality, public safety, public transportation, job opportunities and other amenities.*

- *Off-site developments will not be allowed on an adjacent parcel without approval by the relevant city agencies and authorities, since this could potentially result in an income-segregated development.*
- *Affordable off-site units must be built prior to or concurrently with the on-site development.*<sup>9</sup>

### Explanation

Offering alternative compliance options to building on site comes with both benefits and drawbacks. Flexibility in the program can attenuate risk that the policy will render new projects infeasible. Economic impacts are reduced if developers are allowed to choose the compliance option that fits best with their individual development plan, preference and business model. However, on-site compliance is the only guarantee of mixed-income development, and programs with strong on-site requirements tend to be more successful at achieving economic inclusion and fair housing goals. The Exploratory Committee was in broad agreement that the goal of the Pittsburgh policy should be to maximize on-site compliance.

The Pittsburgh policy, as recommended, would allow for an off-site development option with strict geographic limitations.

Additionally, the city may wish to consider whether off-site development also would be subject to a slightly higher unit requirement (e.g. the equivalent of 12% or 17% of the units in the originating development). Off-site units can be less expensive to build, and thus a higher requirement would accomplish dual goals of encouraging on-site compliance and ensuring that off-site developments, when created, are of equal or greater value to the public.

### Alternative Proposals

- Allow off-site compliance through partnerships.
  - Some jurisdictions allow market-rate developers to partner with experienced affordable housing developers in order to leverage state and federal programs, such as Low-Income Housing Tax Credits, to construct an affordable project. Such partnerships can facilitate new development of special needs and deeply affordable units.
  - Developers could potentially comply by making a small contribution to another affordable housing development in exchange for a nominal partnership interest. Consequently, the market-rate developers could get “credit” for affordable units that would have been built anyway. It would be difficult to ensure the amount of a developer’s contribution to an off-site development is commensurate with the cost of producing units on site.
- Only allow the off-site option under special circumstances.
  - To maximize the number of developers who provide on-site units and create mixed income buildings, the city could restrict the off-site option to developments facing special circumstances and grant the off-site allowance through a Zoning Board of Adjustment

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#### <sup>9</sup> **Supplementary Note on Off-Site Compliance Option**

For program enforcement reasons, many cities require that the off-site development be complete prior to, or simultaneous with, the originating development. Jurisdictions often choose to deny granting a “certificate of occupancy” to the market-rate development until they have confidence that the developer will meet their obligation.

process (rather than allowing off-site development as an automatically allowable alternative to on-site construction). As described in greater detail below, under item 14, the Department of City Planning and the Urban Redevelopment Authority will create a suggested list of qualifying conditions under which developers could apply for a variance to the inclusionary housing policy, which would be articulated in the program's formal policies and procedures.

## 11. Other Alternative Compliance Options

- *The Pittsburgh policy will not allow for in-lieu fee payment, land dedication or preservation activities as alternatives to constructing a mixed-income building.*<sup>10</sup>

### Explanation

As discussed above, the Exploratory Committee prioritized establishing a policy that will encourage mixed-income development. Offering the in-lieu fee option can work well in places that want to leverage the new local resources with untapped state and federal programs. Unfortunately, the in-lieu fee option also has potential pitfalls. Many programs set in-lieu fees too low (resulting in all or most developers opting to fee out). In Pittsburgh, if the in-lieu fee were set to a relatively high level so that it was attractive only to high-end developments, this would result in relatively more opt-outs in Pittsburgh's most desirable neighborhoods. Such a pattern of opt-outs would be contrary to fair housing goals.

The Exploratory Committee also considered whether developers might be able to meet their inclusionary housing obligations by preserving existing affordable and naturally occurring affordable housing (NOAH). Pittsburgh has significant housing stock in need of reinvestment, but committee members believed that preservation should be tackled as an independent issue, not bundled into the inclusionary policy. They shared concerns that a preservation option would not serve the core integration goals of the policy since many existing regulated affordable projects, as well as naturally occurring affordable buildings, are located in low-income neighborhoods. In addition, the committee members were concerned that it would be difficult to fairly determine which preservation opportunities should qualify as a substitute for constructing on-site units. Some preservation projects require huge capital investments, while others might be very low cost, thus it would be difficult to calibrate the preservation option so that it is equivalent to building on site, both from a financial feasibility perspective and from a public benefit perspective.

Lastly, the Exploratory Committee considered whether to offer developers the option to donate land. This option was disfavored for reasons similar to the in-lieu fee and preservation options. There is

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### <sup>10</sup> **Supplementary Note on In-Lieu Fee Option**

Another consideration for Pittsburgh: If developers are allowed to choose an in-lieu fee option, would they still be eligible for tax abatements? If so, then the in-lieu fee would effectively be returning public money back to the city in a different form.

already a great deal of vacant and underutilized land in the city of Pittsburgh. Therefore, in Pittsburgh, unlike higher density and hotter market cities, land donation would not usually be as valuable of a contribution to the public. The donated land would need to be in an excellent location and equal in value to the production of units on site in order to be a fair “trade” for exemption from on-site development. Since each parcel is unique and carries specific constraints on what could be built, the committee felt that land-dedication could be an inequitably “easier” means of compliance, unlikely to offer the same benefits as actual mixed-income development.

#### Alternative Proposal

- Allow in-lieu fee payment.

Pittsburgh has diverse housing needs – from preservation, to senior housing, to homeless services. In-lieu fee payments into the Housing Opportunity Fund could support such needs. Additionally, some Exploratory Committee members expressed concern that market-rate developers sometimes lack experience managing affordable units and thus, particularly over the long term, inclusionary units may not comply with the program’s rules. It would be incumbent upon the city or a contracted monitoring entity to ensure compliance.

In-lieu fees are a common feature of inclusionary housing programs and can be set in a variety of ways. If pursued, it would be important that the fee option offer a meaningful choice to developers. Under the current policy design, developers opting for an in-lieu fee could pay the LERTA allocation they receive (or a portion thereof) into the Housing Opportunity Fund. For example, a developer could pay \$2,300 per unit, per year, for a 10-year period, in in-lieu fees.

## **12. Design Standards**

- *On-site inclusionary units would be required to be equivalent to market-rate units within the building in all ways, including appliances, finishes and size.*
- *Affordable units in off-site developments should follow design standards established by appropriate city agencies and authorities.*

#### Explanation

All inclusionary housing programs must define minimum quality standards for their affordable units. While in some cities inclusionary units must be completely identical to market-rate units, other cities allow developers to build slightly smaller units or units with different interior finishes, so long as they meet standards. In Pittsburgh, developers who participated in the Exploratory Committee expressed that there would be limited cost savings from flexibility in design standards, including internal finishes, since efficiencies from bulk purchase orders are maximized when all units are identical. Furthermore, more expensive finishes are often more durable.

Allowing quality or aesthetic differences between units could also risk stigmatizing low-income residents, potentially implying that tenants and owners in the inclusionary units do not deserve or appreciate an equivalent level of design and durability.

## Alternative Proposal

- Allow for greater design flexibility in the case of detached affordable for-sale homes and townhomes.
  - Allowing smaller unit sizes or changes to interior finishes may be a more valuable cost-offsetting option in ownership developments than for rental developments. Allowable differences would need careful design and oversight.

### **13. Location and Access for On-site Units**

- *Affordable units must be integrated within each building (not in adjacent buildings) and distributed throughout each building, with the exception that the top floor may be reserved for market-rate units only.*
- *In high-rise buildings with six or more floors of residential units, the planning department has purview to allow not only the upper-most floor, but the top two or three floors, to be reserved for market-rate pricing, depending on project height.*
- *Core amenities, such as a gym, pool or parking space must be 100% shared with no additional charges to low-income residents unless those charges are subtracted from rent or HOA dues.<sup>11</sup>*

#### Explanation

Separate buildings, separate entrances or conspicuous clustering of affordable units would be counter to mixed-income integration goals and risk stigmatization of low-income residents. Furthermore, shared amenities support neighborly interactions and social integration. Owners of mixed-income buildings find that having segregated amenities creates rifts and tensions between occupants, as well as stigmatization of the lower-income residents.

Top floor units often carry a significantly higher market value. Exempting the upper-most floor(s) can allow developers the benefit of additional revenue to support project feasibility without significantly affecting the integrated feeling of a building.

### **14. Variance Process**

- *Currently, a developer can request variances to the zoning code in instances where code requirements would render the project infeasible or impose an excessive burden to the development.*
- *In cases where a developer is offered full LERTA benefits, the Zoning Board of Adjustment will follow a set of written guidelines concerning which requested variances to the inclusionary housing policy to consider, and what evidence must be presented to demonstrate infeasibility.*
- *In cases where a developer does not receive full LERTA tax benefits, the Zoning Board should be able to administratively determine a reduction in the unit obligation.*

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<sup>11</sup> The Department of City Planning will examine whether exceptions to this rule, such as renting a “party room” would be allowable, and will incorporate details into the program policies and procedures manual containing administrative guidelines.

## Explanation

Assuming that it is codified in the zoning code, the inclusionary housing policy will automatically carry the opportunity for a developer to go through a variance process to reduce or eliminate the project's affordable housing requirement, if the developer can demonstrate that compliance is financially infeasible. The variance process provides meaningful protection in the event that mandatory requirements prove overly burdensome. However, it could also create an "uneven playing field" that allows unfair exemption of developers who are better equipped to advocate on behalf of their projects.

To limit the number of variance requests to those projects that truly warrant an exception, we recommend that applications only be considered when coming from developers facing special circumstances, such as historic preservation costs or the environmental conditions of the site. The Department of City Planning and the Urban Redevelopment Authority will create a suggested list of qualifying conditions under which developers could apply for a variance to the inclusionary housing policy, which would be articulated in the program's formal policies and procedures.

We also suggest that the request be subject to a second phase of inquiry, after confirming that the development meets stipulated special circumstances or qualifying conditions. The second phase of review would assess the degree to which a development will face financial hardship for compliance with the inclusionary housing policy.

Detailed guidance for the Zoning Board on considering, reviewing and granting variances to the inclusionary housing policy will be written by the City Planning Department and Urban Redevelopment Authority. Some recommendations for this guidance from the Exploratory Committee include:

- All information supporting a variance request should be made publicly available at the time the application is filed.
- Variance requests with complete documentation demonstrating financial hardship would receive initial review by the Urban Redevelopment Authority (URA), with a recommendation provided to the Zoning Board of Adjustments.
- If a full LERTA is provided, the taxing bodies should have an opportunity to decide whether to participate in the event a variance is granted.
- Variances would allow for reducing the number of on-site or off-site units, but would not allow an in-lieu fee payment, land dedication or other alternatives to building affordable units.

## **15. Other Developer Benefits**

- *Consider requiring additional affordable units (above the citywide 10% or 15% required on site under current policy) in conjunction with any future rezoning or overlay districts that confer new development potential in the form of height and density increases.*
- *As the market strengthens, consider adopting a refined density bonus program which would confer additional project-level height and density in exchange for affordability.*

- *Explore reduced parking requirements and fast track processing in the three- to five-year program review as additions to the inclusionary program “package” of incentives.*

### Explanation

It is clear from our limited research that there are many projects in Pittsburgh for which additional residential density would not add significant financial value to the project. However, there also appear to be some locations where higher density than is currently allowed by zoning would offer additional value, as in the EcoInnovation District Plan for Uptown and West Oakland. In Pittsburgh’s current market, information from the planning department and from developers themselves indicate the number of sites where density increases are of significant value are limited. However, Pittsburgh appears to be experiencing a period of transition, and it is possible (but not yet certain) that in the near future greater density will confer value in more locations.

In recognition of this limitation, we recommend that the initial inclusionary housing policy not assume that increases in density are a reliable means for offsetting the basic cost of providing the required affordable units. However, independently from any basic requirement, the city could consider adopting a forward-looking density bonus program that would confer additional height and density in exchange for providing affordable units beyond the level that would be otherwise required. A voluntary bonus program like this could be available citywide or incorporated as part of the process of rezoning in areas that are likely to experience significant development activity. For instance, the waterfront may soon have a new zoning framework for much of its length. The waterfront rezoning process offers an opportunity to analyze the financial value of added height and density in that particular area, and the potential for requiring additional affordability in exchange for density. Committee members expressed support for a program that would require affordability (e.g. 10%) as a condition of upzoning, specially planned district approval, and height bonuses in those districts where additional height is appropriate.

As with additional density, reduced parking requirements are not consistently valuable to developers in Pittsburgh today, but may become so with increased urban density, walkability and transit-oriented development (TOD).

Fast-tracked processing requires coordination across multiple departments, and the city is engaged in a process to identify how to speed development and construction approvals. At this time, however, there is no clear process by which to provide faster entitlement/approval turnaround to developers in the inclusionary program.

## **16. Program Monitoring and Compliance**

Monitoring is an essential component of any inclusionary program’s success. Staffing is needed to ensure that the inclusionary units are created in alignment with the policy, occupied by qualifying families, and maintained over time.

Most often, the local planning department monitors developments through planning and construction phases to ensure that quality affordable units get built. In Pittsburgh, the Department of City Planning — working with the Department of Permits, Licenses and Inspections — is the logical home for this function. If developers are not compliant, they can be denied planning approvals, building permits or certificates of occupancy. For example, this could be the case if a developer attempts to cluster all affordable units in the basement of the building or fails to comply with requirements for number of bedrooms.

Primary administrative oversight and enforcement would likely transition from the Department of City Planning to another department or to an organization contracted by the city as a development approaches completion. “Contracting for stewardship” can be an efficient means of ensuring compliance with marketing requirements, lottery processes, tenant/owner education, fair selection processes, *etc.* It will be important to consider procedures for unit turnover as well as initial occupancy.

The program may also allow for affordable units to be leased or sold to entities with relevant affordable housing experience. For instance, a developer may be permitted to sell for-sale units to a community land trust that commits to comply with program’s affordability requirements; or a large rental building might master lease required affordable units to an agency that serves extremely low-income households.

Complete responsibilities for oversight and administration of the inclusionary housing program should be detailed in the program’s formal policies and procedures.

## **Appendix I: Summary of Financial Feasibility Exercise**

### **Background and Scope of Analysis**

In 2016 the City of Pittsburgh engaged Peninger Consulting to conduct a study of the economic feasibility of affordable housing requirements and the need for offsetting incentives. The results of this research were included in a report dated May 31, 2016.

Following on this work, Grounded Solutions was asked to provide support to a subcommittee of the working group focused on understanding and ‘reality testing’ the Peninger findings. To facilitate understanding of the results, we loaded Peninger’s proforma models into the Grounded Solutions Inclusionary Housing Calculator. The calculator is available online at <https://inclusionaryhousing.org/wp-content/ih-flash/Pittsburgh%20Beta0.4.5.html>.

### ***Adjusting Income Targets***

The Peninger report used the Pittsburgh median income from the U.S. Census for the purpose of calculating the income limits, rents and prices of affordable homes. Nearly all affordable housing programs instead rely on the area median income (AMI) published by the U.S. Department of Housing and Urban Development (HUD) for this purpose. Because the HUD AMI is based on the incomes from the seven-county region, it is important to understand that the median income in the City of Pittsburgh is significantly lower. However, the U.S. Census median income is calculated very differently and published on a different schedule. Relying on this metric in a housing program would introduce significant administrative challenges. At the direction of the city and Exploratory Committee, we converted Peninger’s calculations to reflect the HUD median instead.

### ***Additional Profitability Measure***

In response to requests from Calculator Working Group participants, we also modified the calculator to present the internal rate of return (IRR) for rental projects and to use this metric for comparison among these projects. Realistically, there is no single metric that can, on its own, determine feasibility. Peninger Consulting and the Grounded Solutions calculator use profit as a percent of development cost as the metric for comparing profitability among projects. This metric provides a rough measure of the size of a developer’s gain on sale relative to the cost of the project. It has the advantage of being appropriate and relevant to both rental and ownership projects, enabling a side-by-side comparison of otherwise very different projects. However, this is not how most rental developers evaluate the feasibility of their projects. Internal rate of return more closely tracks the actual return available to developers and their investors. In order to implement the IRR calculation, however, we had to make additional assumptions about the financing structure and the holding period before a developer would seek to sell a project.

The level of profitability expected by developers and required by investors varies in different places and even from one developer to the next. However, in most cities, local developers can come to agreement on the required IRR or profit as a percent of development cost to use as an average threshold for moving forward with project planning. Based on feedback from committee members, we identified 14% IRR as the threshold below which projects would be considered ‘infeasible.’

The tool now shows both the IRR and profit as a percent of development cost (as well as a third metric, yield on cost) for rental projects and only profit as a percent of development cost for ownership projects.

### ***Committee Examples***

In addition, we worked with committee members and city staff to identify additional real project performance data. Ultimately, we were only able to obtain one additional real project proforma. We loaded this model into the calculator and worked closely with the sponsor of this project to ensure that the resulting calculator model closely matched the economics of this real project. The example project closely resembled the four- to five-story rental project in Peninger's report, but because it involved higher costs, the example project was less profitable and less able to support affordable units.<sup>12</sup>

We presented the new model to the Calculator Working Group and made adjustments based on committee member feedback and discussion. We have not independently verified the accuracy of these assumptions, but members of the committee found them to be reasonable.

We also worked with one member of the working group to develop a realistic project scenario utilizing Low-Income Housing Tax Credit (80/20) financing. This scenario was completed after the final working group meeting, but the results were presented to the larger task force.

In order to facilitate the evaluation of potential policy designs that treated strong market locations differently from softer market locations within the city, we developed one additional project prototype and included it in the final calculator. Both the Peninger models and the committee example assume development in a relatively strong location. The softer market prototype is very similar to the committee example, but it assumes lower land costs and lower rents.

We interviewed city staff in planning and at the Urban Redevelopment Authority, as well as two additional private developers, in order to obtain additional perspective on the current market realities, the extent to which projects require tax abatements in order to be financially feasible, and the value of additional residential density.

### ***Additional Modeling of Incentives***

The Peninger report recommended that the city revise its tax abatement programs and consider other financial incentives to facilitate the creation of affordable units, but it did not closely model the specifics of potential abatements or other incentives or provide detailed recommendations regarding the design of any incentive policy. In order to support the task force and city staff in considering the impact of potential incentives, we modified the Grounded Solutions Inclusionary Housing Calculator to allow the inclusion of several potential incentives.

- **Tax abatements:** Pittsburgh is currently considering broad changes to its tax abatement

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<sup>12</sup> Some developers believe that fewer new rental properties of this scale will be built in the near future and that if the market softens, smaller scale development may become more typical. Such potential changes in the development environment should be assessed in 3-5 years from program adoption.

programs. In order to facilitate maximum flexibility in analysis, we added a number of variables to our calculator. The revised tool allows users to specify the percentage of additional tax that would be abated, the period of the abatement, whether the abatement percentage should be reduced over time, and the cap on the abatement amount. We designed the tool to allow modeling of both LERTA where the abatement is provided as an annual credit and Act 42 style abatements where the abatement reduces the property assessment.

- **Low-Income Housing Tax Credits – 80/20:** We revised the tool to enable modeling of projects that utilize the 4% Low-Income Housing Tax Credit using an 80/20 structure where 80% of units are market rate and 20% are below market rate.
- **Section 8:** We also modified the tool to allow users to assume Section 8 Fair Market Rents in place of the rent levels calculated based on the target income level. This change allows modeling for either project-based or tenant-based Section 8 vouchers.

**Findings**

- **Feasibility of development:**

The example project identified by the Calculator Working Group was a wood-frame rental project with structured parking that was similar in size and amenities to the hypothetical four- to five-story rental project described by Peninger. However, it differed in a number of respects, including differences in construction costs, land price and operating expenses (operating expenses in the table below include property management, real estate taxes, etc.) Key differences are highlighted in Table 1. For comparison, the table also includes the assumptions we used in our softer market prototype.

**Table 1: Key Differences**

	Peninger (4-5 story rental)	Example Project	Softer Market
Number of Units	140	172	172
Average Rent/Foot	\$2.33	\$2.32	\$2.11
Construction Cost/Foot	\$160	\$165	\$165
Land Price/Acre	\$500,000	\$3,000,000	\$1,500,000
Cap Rate	5.8%	6.25%	6.25%
Operating Expenses	30%	37%	37%

<b>Project Cost</b>	\$28,286,544	\$33,259,331	\$32,059,331
<b>Estimated Value</b>	\$34,052,586	\$38,201,226	\$35,728,320
<b>Return (IRR)</b>	18.7% (no LERTA)	16.6% (full LERTA)	15.43% (full LERTA)

Another important difference is that the committee example included commercial space. While the model also included income from the commercial space, the added cost of construction was not offset by the added income. The net result of these differences is that the committee example was far more expensive to build but generated roughly the same annual net income, and thus, the same expected value but a much lower rate of return for investors. The estimated value was calculated by dividing the annual net operating income after stabilized occupancy by the identified cap rates.

In fact, the committee example was only financially feasible because we assumed that it would benefit from very significant tax abatements that were not included in Peninger’s model.

Differing assumptions about the basic project economics make a significant difference in the design of a potential affordable housing requirements policy. Table 2 shows the projected internal rate of return (IRR) for projects with differing levels of requirement with and without the LERTA. “Full LERTA” indicates projects that receive abatements from the city, county and school district. The table has been shaded to highlight combinations where the projected IRR exceeds the identified threshold of 14%.

**Table 2, Summary of Feasibility Results (Internal Rate of Return)**

LERTA	Affordable Units	Peninger	Committee	Softer
No LERTA	0%	18.70%	9.81%	7.75%
Full LERTA	0%	24.37%	16.68%	15.43%
Full LERTA	10% @ 50% AMI	22.68%	15.16%	14.05%
Full LERTA	15% @ 50% AMI	21.82%	14.24%	13.21%

*Brown shading indicates scenarios with IRR above 14%.*

The Peninger model suggests that projects would be profitable and could support some level of affordable housing even without LERTA.

On the other hand, the committee example without LERTA does not achieve the target IRR even with no affordable housing requirement. With the full LERTA, this project can feasibly provide 15% affordable units.

In the soft market scenario, lower rents are partially offset by lower land cost. This project is also not feasible without LERTA, and again, with the full LERTA the project is not only feasible but also can support affordable units. However, the project can support 10% affordable units but not 15%.

Given the uncertainty about the current strength of Pittsburgh’s housing development market, it seems that setting an affordable housing requirement at an initially modest level and accompanying any requirement with a by-right access to meaningful tax abatements would be the safest course of action. Over time as the market strengthens and developers become accustomed to the requirements, it may make sense to revisit the level of the requirement and the accompanying incentives.

- **Tax Abatements:**

The availability of tax abatements appears to be crucial to the financial feasibility of meaningful affordable housing requirements. However, there is significant uncertainty surrounding the ongoing availability of tax abatements from the city, county and school district.

Ideally, the design of any affordable housing requirement will be closely tied to the design of tax abatement programs at all three jurisdictions.

Because Pittsburgh’s LERTA policy is currently being re-evaluated, it is challenging to model the impact that tax abatements could have on feasibility. There are several variables that influence the total value of the tax abatement.

**Percent abatement:** Pittsburgh’s current residential LERTA policy allows a 100% abatement of the tax that would otherwise be due on the increased value of improvements. Even with a 100% abatement, a project would pay property tax on the value of land plus any value attributed to buildings on the property before the site was redeveloped. Reducing the abatement percentage would increase the annual tax bill that projects paid and reduce the ability of those projects to feasibly include affordable units.

**Phase out:** The current residential LERTA policy reduces the abatement percentage in steps every two years over the 10-year period. This drops the percentage of taxes abated from 100% in the first two years to 60% in years nine and 10. This step down significantly reduces the value of the abatement. For example, for the committee project, a 100% LERTA that did not phase out would have a present value of \$2,909,476, while the same LERTA phased out gradually every two years would have a present value of \$2,412,642. This is a big enough difference to noticeably impact the internal rate of return and the level of affordable housing requirements that can be supported.

**Cap:** The existing LERTA programs include caps on the total value of abatement that can be claimed by any single project. Capping the annual abatement has little or no impact on smaller projects, but it limits the amount of abatement available to larger projects. This choice matters for the design of affordable housing requirements. While it may be true to some extent that larger projects are better able to absorb the cost of providing affordable units, capping the LERTA to a specific dollar amount reduces the LERTA per unit for larger projects.

**Table 3: Residential LERTA Caps**

City	\$150,000
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School	\$250,000
County	\$100,000

Currently the school district cap for residential LERTA is much higher than the city and county caps. While the school district tax rate is also higher, the cap is higher proportionally, which means that a larger project would hit the city and county caps well before hitting the school district cap. The city’s Local Economic Stimulus program has a \$250,000 cap.

For a project like the committee example, the caps would not be relevant at project sizes below 180 units. Above that number of units, the city and county caps would limit the amount of additional value from those abatements. The project would not hit the school district cap until it had nearly 250 units.

For the committee example with only 172 units, none of the caps would be reached and the project would receive 100% abatement of the increase in tax on improvements initially. For this project, the combined abatements are worth approximately \$400,000 or \$2,325 per unit in the first year.

**Other taxing jurisdictions:** The level of affordable housing that can be feasibly required depends to a large degree on whether (or at what level) the school district and county also provide tax abatements. The tax paid to the City of Pittsburgh represents only 36% of a typical local property tax bill. The school district receives a larger share of property tax payments.

**Table 4: Pittsburgh Millage Rates (2017)**

City	8.06
School	9.84
County	4.73

Table 5 illustrates the feasibility of each of the three project prototypes under a wider range of assumptions about LERTA and affordability requirements.

Note the table assumes affordability at 50% of HUD AMI and that the LERTAs are all 100% abatements for 10 years, with no phase out over time, and that they are capped at \$400,000 combined value across all three jurisdictions.

**Table 5: Comparison of Project IRRs with Varying LERTA Assumptions**

No LERTA

	Peninger	Committee	Softer
No Affordable Units	18.70%	9.81%	7.75%
5% @ 50% of AMI	17.65%	8.65%	6.64%
10% @ 50% of AMI	16.55%	7.71%	5.77%
15% @ 50% of AMI	15.42%	6.44%	4.56%

City LERTA Only

	Peninger	Committee	Softer
No Affordable Units	21.33%	12.52%	10.82%
5% @ 50% of AMI	20.39%	11.51%	9.87%
10% @ 50% of AMI	19.41%	10.68%	9.12%
15% @ 50% of AMI	18.41%	9.59%	8.09%

Full City, County and School District LERTA

	Peninger	Committee	Softer
No Affordable Units	24.37%	16.68%	15.43%
5% @ 50% of AMI	23.54%	15.82%	14.63%
10% @ 50% of AMI	22.68%	15.16%	14.05%
15% @ 50% of AMI	21.82%	14.24%	13.21%

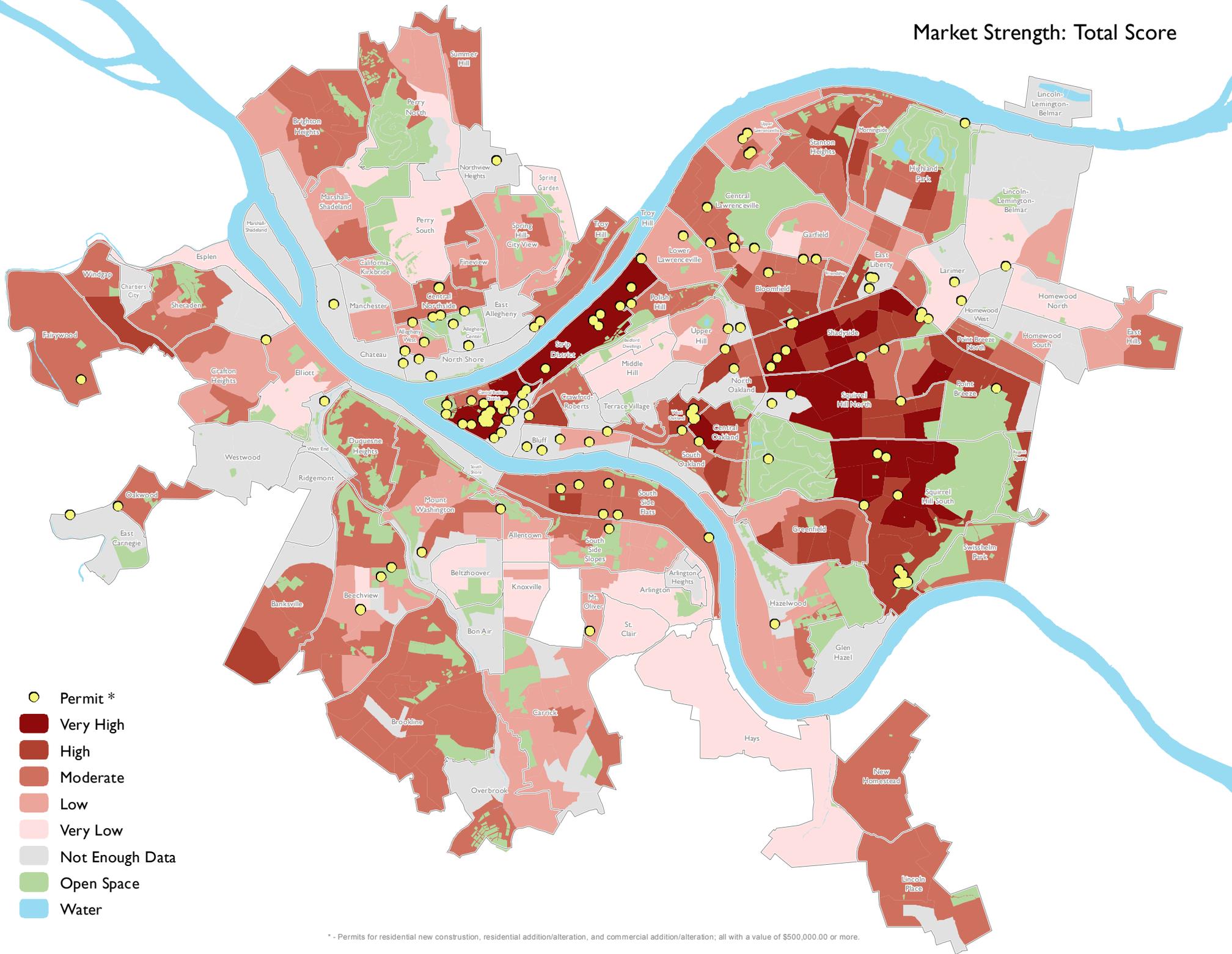
The table shows that while the Peninger four- to five-story rental prototype could support a 15% affordable housing requirement even with no LERTA, the committee example and softer market prototype would not be feasible at all without LERTA from the city and at least one other jurisdiction. However, with LERTA from all three taxing jurisdictions, even the more conservative committee model would be feasible with a 15% affordable housing requirement. The softer market model could also support affordable units with the benefit of all three jurisdictions' LERTA programs, but it could only support 10% not 15%.

- **Minimum Abatement Level:**

Identifying a minimum level of abatement that must be available along with the requirement is challenging; further financial modeling may be appropriate before finalizing the design of a new abatement program. However, our initial analysis suggests that an abatement of at least \$2,300 per unit, per year, for 10 years, in a project would be sufficient to make even the more conservative committee example financially feasible with a 15% affordable housing requirement.

Given the uncertainty about the future availability of LERTA, it may make sense to design the affordable housing requirements policy in a way that allows the city to reduce or eliminate the affordable housing requirements in any case where a project is not eligible to receive tax abatements of at least some minimum threshold amount per unit, per year, for 10 years. Ideally, the specific minimum would be identified for each of several types of project and would be different for rental and ownership projects. Over time, this minimum might be adjusted to reflect changing market realities.

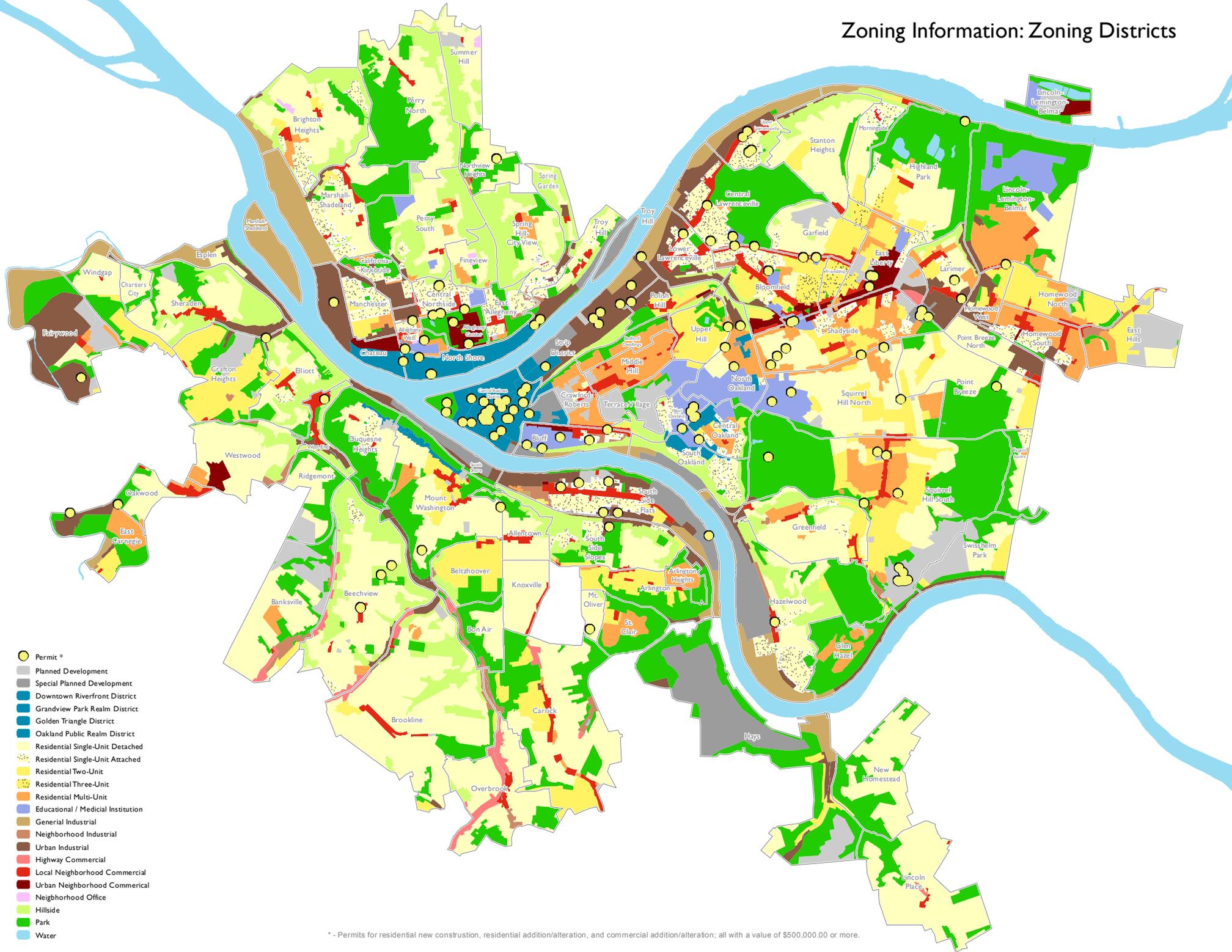
# Market Strength: Total Score



\* - Permits for residential new construction, residential addition/alteration, and commercial addition/alteration; all with a value of \$500,000.00 or more.



# Zoning Information: Zoning Districts



\* - Permits for residential new construction, residential addition/alteration, and commercial addition/alteration; all with a value of \$500,000.00 or more.