M A N N A, I N C .

LEARNING FROM EXPERIENCE: AFFORDABLE HOMEOWNERS IN WASHINGTON, DC

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A special thanks to ADU owners facing long-term restrictions who continue to advocate for themselves and others.

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Summary

This paper is written in response to a recent report by the Coalition for Smarter Growth entitled *Public Land for Public Good,*[1] for review by the Task Force, and in light of the upcoming review by the City Council of the Inclusionary Zoning law. Manna agrees that it is imperative that the District government prioritize affordable housing in public land development, and the report does a fantastic job of laying out the growing need for affordable housing in the District for low and moderate income families, particularly those under 53% of the Area Median Income (AMI).

While the Mayor's Comprehensive Housing Strategy Task Force devises housing priorities for the next eight years, it not only needs to take into account the affordable housing crisis in DC but also the experiences of those who have lived in the affordable housing that has been developed on city surplus land. As an experienced developer of all types of affordable housing along the Continuum,[2] Manna fully and unreservedly supports the redevelopment of public land that includes a set aside of affordable housing units in market-rate buildings as it relates to rental. Manna also supports the use of public land for buildings that are completely affordable, for all types of much needed housing across the Continuum.

The required set aside of affordable units within market-rate buildings and the city policy that regulates it is called Inclusionary Zoning (IZ). Though Manna supports the rental portion of IZ, Manna is greatly concerned about IZ ownership units. This concern is based on Manna's 30 years of experience successfully working with lower income owners, our research on IZ condominium programs in other cities, and the experiences of affordable owners who were integrated into market-rate condo buildings during the 2000s by the Williams and Fenty Administrations. The effect of long-term resale/rental restrictions and/or escalating condo fees on these 30-80% AMI owners are extremely problematic, and officials from the Department of Housing and Community Development (DHCD) have said that IZ policy does not address these issues.

Public Land for Public Good recommends that the DC government continue to prioritize the set aside of "for-sale units, focus[ing] on households earning 50 and 60 percent AMI, and no higher than 80 percent AMI."[3] However, this recommendation and the report overall is silent on the negative experiences of existing affordable homeowners, which is not only extremely problematic for future affordable owners, but also the DC government who will oversee restrictions on these affordable units. As a result of this silence, the report's insistence on a "better community engagement process" and giving preference to the knowledge of affordable housing developers needs to begin now.

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[1] *Public Land for Public Good: Making the Most of City Land to Meet Affordable Housing Needs.* Coalition for Smarter Growth. October 2012. http://www.smartergrowth.net/anx/ass/library/11/pl4pg-final.pdf.

[2] The Continuum of Housing includes affordable housing options from supportive housing for the homeless to traditional homeownership. For more information, see the Continuum of Housing Campaign at http://www.cnhed.org/shared/layouts/singleblock.jsp?_event=view&_id=120130_U127242__194346.

[3] *Public Land for Public Good*, p. 7.

As the Comprehensive Housing Strategy Task Force considers the recommendations of *Public Land for Public Good* in the context of its full report and recommendations to the Mayor, we ask that they carefully consider the experiences of affordable homeowners laid out in this report. We ask that the Task Force separate rental from ownership IZ units and focus solely on rental for permanently and long-term restricted units. Further, we ask that the Task Force consider policies already under consideration in the City Council and elsewhere in the DC government - policies that offer homeownership opportunities to low and moderate income families that allow for socio-economic growth and a recapture and recycle of funds for the City to develop more affordable housing.

Learning from Experience

As mentioned in the report, "through the 2000s, as a matter of policy, the administrations of Mayors Anthony Williams and Adrian Fenty offered surplus city-owned lands for redevelopment with the condition that 20 to 30 percent of residential units be affordable to low and moderate income residents." More specifically, the report highlights the City Vista project at 5th and K Streets NW, in addition to nine parcels of land near the Columbia Heights Metro station. For-profit developers were offered bonus density and tax breaks if they set aside a percentage of units in new market-rate developments for households making between 30 and 80% AMI. These units, termed Affordable Dwelling Units (ADUs), also have long-term resale and rental restrictions attached to them, which are typically either set at fifteen or twenty years, and sometimes longer. IZ policy, which will be covered in detail later in this paper, places permanent restrictions on IZ ownership units.

Long-term Restrictions

Long-term restrictions require ADU owners to sell to someone else in their income category during the restricted period as well as forbid owners to rent their units except in extreme circumstances as determined by the DHCD. These restrictions not only limit the resale value of the unit, which must correspond to a price deemed affordable for another lower-income person, but also limit the equity that can be drawn from the home. This restriction removes one of the most significant incentives to homeownership and is extremely crippling for owners who would benefit immensely from an additional source of revenue in their home equity.

The equity limitations surrounding ADUs primarily concern the owner's short-term financial situation. While traditional homeowners often utilize the accumulated equity in their homes through home equity lines of credit to fund medical emergencies, education expenses and upgrades/repairs to the property, this short-term source of revenue is unavailable to ADU owners. As one ADU owner recently testified at DHCD, "What bothers me is that when we face economic difficulty as others do, our homes that we worked hard to pay for can't work for us as they do for every other homeowner."[4] Long-term resale restrictions also have an effect on owners' long-term financial situation. As homeownership usually allows owners to build wealth through the home's appreciation, purchasing a home is generally regarded as a beneficial investment. However, long-term resale restrictions limit wealth build-up, effectively locking owners into their current economic situation rather than providing them a means to transition out of it.

Long-term resale and rental restrictions do not allow owners any room for changing life circumstances. This has proven extremely burdensome for occupants who need to relocate before the affordability period has elapsed. Such situations like an expanding family, receiving a career transfer out of the District, or merely choosing to size up or down in home size are common occurrences for many homeowners. Growing out of the unit is extremely likely as most ADUs are one and two-bedroom condo units. Yet ADU owners are given very little flexibility, even in these situations. These owners are essentially penalized for failing to foresee various life events and expenses. Though not intentionally created to burden owners, the current structure of the program does just that.

Another issue with long-term resale restrictions is the use of the District's Home Purchase Assistance Program (HPAP) loan,[5] which most ADU owners received. HPAP provides downpayment assistance for first-time, low and moderate income home buyers. Recipients begin paying down their HPAP loan in year six of owning their home, and the loan is ammoritized over a 40 year period. Without this loan, many ADU owners would not have been able to purchase their units and they also will not be able to access this loan again. If ADU owners need to move to a larger unit in DC, where will they move to? The sale of their unit will not give them nearly enough for a downpayment on another home.

Maintaining Affordable Stock vs. Wealth Creation

Proponents of long-term restrictions contend that such terms ensure that the District is able to maintain a stock of permanent affordable housing. This argument partially rests on the assumption that all lower income owners are out for a quick buck and will sell their unit in a short period of time. Yet, when asked, the proponents cannot provide data to support their positions. Moreover, throughout Manna's thirty years of experience in assisting approximately 1,000 lower income buyers purchase homes, this has not been the case. In fact, 80% of Manna buyers have gone against this assumption and remained in their homes. It is unfair to assume that lower income households will treat homeownership as a 'get rich quick' scheme. These households take the necessary steps to qualify for homeownership and choose to purchase for the same reasons that households of other income levels do.

This policy goal of maintaining an affordable housing stock should be weighed against another policy goal: the upward movement of individuals out of dependency and low income

[4] See http://hatdc.org/?p=688.

[5] For more information on HPAP - the Home Purchase Assistance Program - see http://www.gwul.org/programs/housing/hpap.

or low/no wealth status. According to the most recent data available, less than 6% of the affordable housing stock, or housing supported by the Housing Production Trust Fund (HPTF), is classified as traditional homeownership.[6] An overwhelming majority of the stock, or 84%, is rental units while the remaining 10% is divided between emergency shelter, special needs, and limited or no equity types of ownership units. Given that traditional homeownership, which is set apart by the access to equity and the possibility of equity gain, accounts for such a minor fraction of the entire stock, it is illogical and misguided public policy to insist that long-term restrictions must be in place on all types of housing and all types of people and communities in order to preserve the affordable housing stock.

Escalating Homeowner/Condo Fees

Another negative consequence of the District's ADU program has been the cost of living in higher income buildings and areas. Beyond monthly mortgage payments, ADU owners are subject to homeowner or condominium fees, which vary depending on the type of building designs, amount of common area, and accuracy of the original budget. Current owners of ADUs who were integrated into market-rate condo buildings in Northwest DC have seen these fees increase substantially following settlement. The City government has yet to fully address escalating condo fees for ADU owners.[7] Mixed-income buildings such as Kenyon Square, Barcelona and Fedora, located in the Columbia Heights neighborhood, as well as Chase Point in Friendship Heights have undergone increases of around 100% from the original fee at the time of settlement. Specific data regarding the escalating condo fees for these buildings and others is illustrated below.

Condo Project	Location	Original Condo Fees for ADU	Current Condo Fees for ADU	Change
Chase Point	NW- Friendship Heights	$324.00	$700.00	116%
Fedora	NW- Columbia Heights	$166.00	$351.00	111%
Barcelona	NW- Columbia Heights	$169.00	$350.00	107%
Kenyon Square	NW- Columbia Heights	$284.26	$520.16	83%
Verona Parc	NW- Columbia Heights	$214.35	$354.00	65%
Union Row	NW- Columbia Heights	$375.00	$485.00	29%

[6] See DeLorenzo, Maribeth, and Angie Rodgers. *The District's Housing Production Trust Fund Has Developed Thousands of Affordable Units Since 2001*. Rep. Washington, DC: DCFPI, 2007.

[7] For more information on this issue and news coverage, see http://hatdc.org/?page_id=444.

City Vista K and L Buildings	NW- Mount Vernon	$343.00	$378.29	10%
Note: This data was collected from ADU owners living in the condo projects listed above and compiled on January 12, 2012.				

For some ADU owners in the District, these increases have translated into a larger monthly condo fee than the actual mortgage payment, leaving the owners not only burdened with a higher than expected cost of living, but also confused as to why they were not informed of the possibility of such steep increases.

However, the District is not the only jurisdiction where affordable units have become unaffordable as a result of escalating condo fees. Instead, it joins a list of other places, including San Francisco[8] and jurisdictions in Massachusetts,[9] where this issue was unforeseen by policymakers when implementing Inclusionary Zoning programs. Officials have found it difficult to remedy this problem because 1) developers often set initial condo fees very low, 2) homeowner associations have the authority in determining condo fees and often have more expensive priorities than their lower income neighbors, and 3) there are recorded legal documents that provide for condo fees and they cannot be changed without great difficulty. Unless action is taken, these lower income homeowners in the District will increasingly be priced out of their once affordable homes and left poorer economically than when they purchased the ADU. In short, the ADU requirements will have failed their purpose.

Another issue that arises from the escalating homeowner/condo fees is related to the resale of the property. As a component of an ADU owner's covenant, which is similar for Inclusionary Unit owners, when selling the unit, the subsequent buyer must be in the same income category as the current owner. For instance, if an owner of a unit whose income is equivalent to 60% of the Area Median Income (AMI), when the owner decides to sell the property the new buyer must also be in the 60% AMI category. In the case of an owner seeking to sell an ADU because escalating homeowner/condo fees have caused the unit to become unaffordable, the chances of finding a buyer in the same income category and able to pay the burdensome fees is slim to none. While DHCD has the authority, in this type of situation, to lower the resale price in order to maintain the unit's affordability, doing so only benefits the new owner. The original owner, on the other hand, can expect even less appreciation on the unit. The artificially low re-

[8] See Lloyd, Carol. "Owners' dues keep going up." San Francisco Chronicle. 5 August 2007. http://www.sfgate.com/default/article/Owners-dues-keep-going-up-2526988.php, and Lloyd, Carol. "Is inclusionary zoning providing our much needed affordable housing?" San Francisco Chronicle. 25 April 2008 by Carol Lloyd on April 25, 2008. http://www.sfgate.com/entertainment/article/Is-inclusionary-zoning-providing-our-much-needed-2491071.php#page-1.

[9] See "Governor Patrick Signs Legislation...." Marcus Errico Emmer & Brooks. 1 July 2010. http://www.meeb.com/meeb-legal-alerts/governor-patrick-signs-legislation-amending-how-condominium-percentage-interests-are-established-in-condominiums-including-affordable-units/; "Condo Law's Treatment of Affordable Units Clarified." Massachusetts Land Use Report. 30 August 2010. http://www.landusereport.com/post/1039727090/condo-laws-treatment-of-affordable-units-clarified; and Turner, Cleon H. "Bill H.388." 13 January 2011. The 187th General Court of The Commonwealth of Massachusetts. http://www.malegislature.gov/Bills/187/House/H00388.

sale price will make it probable that the owner will need to move to another affordable unit, possibly an affordable rental, if they can find one.

As already discussed, ADUs make up a small percentage of the total units in a market-rate condominium building, no greater than 30% and sometimes less than 5%. While integrating families of diverse economic situations may sound like good policy in theory, in reality lower income homeowners tend to have different priorities than market-rate homeowners. This fact becomes a problem when these diverse interests affect the homeowner/condo fees required of all residents, regardless of particular income situations. As market-rate owners typically outnumber affordable unit owners by a sizable degree, homeowner/condo fees can escalate as a result of a majority opinion in favor of additional amenities to the building that the affordable owners may neither want nor have the fiances to accommodate.[10] In mixed-income situations where the market-rate owners are paying much more in condo fees than their affordable neighbors, this arrangement has fostered resentment and even brought legal challenges from market-rate owners.[11] Examples like these not only place a struggle on lower income owners, but also cause long-term problems in communities.

Difficulty Securing a Lender

For ADU owners who need to sell, they face an issue when it comes to the Federal Housing Administration loan program, which is usually the most likely source of financing for lower income homeowners. Although lower income homebuyers are exactly whom FHA loans are designed for, banks that the FHA works with will not work with buyers of many ADUs because of a provision in the restrictions for these units. This provision requires that the unit's covenant regarding resale restrictions survive foreclosure. The failure to cancel on foreclosure for loans makes condominium loans very difficult to obtain. FHA caps its loans at 50% of a building's total units and requires bi-annual renewals of eligibility, which many condominium associations refuse to participate in. In layman's terms, this means that the resale restrictions are still applicable after the current owner loses the property and the bank acquires it. Banks are extremely apprehensive to do business with this provision in place, as it not only adds a time-consuming layer of bureaucracy to the resale process but also means that if the bank needs to seize foreclose on the property, the unit will be subject to a below market-rate price. In the absence of an FHA mortgage, lower income potential homebuyers are likely to have a difficult time in finding the funding to transition to homeownership, as conventional mortgage lenders generally have much higher down payment requirements and required PMI is very difficult to obtain for low down payment borrowers due to more stringent requirements.

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[10] See Izadi, Elahe. "Condo Fees and the Pitfalls of Preventing Displacement." DCentric. WAMU. 15 December 2011. http://dcentric.wamu.org/2011/12/condo-fees-and-the-pitfalls-of-preventing-displacement/.

[11] See "Conflict among market rate and affordable owners in condo developments." Inclusionary Zoning Administration. HousingPolicy.org. 8 December 2009. http://forum.housingpolicy.org/group/inclusionaryzoning/forum/topics/conflict-among-market-rate-and; and "HOA Fees and Ongoing Affordability of IZ units." Inclusionary Zoning Administration. HousingPolicy.org. 16 December 2008. http://forum.housingpolicy.org/group/inclusionaryzoning/forum/topics/hoa-fees-and-ongoing.

Case Studies

Below are situations of specific ADU owners who live in the previously mentioned buildings. These stories were shared by the owners themselves or Manna at various public hearings throughout 2012. Their experiences shed light on the dire need for change in current DC affordable homeownership policy.

Condo Fees Greater than Mortgage Payment[12]

I am a homeowner of an Affordable Dwelling Unit (ADU) in the Chase Point Condominium, located in the Friendship Heights neighborhood of Ward 3. I was able to purchase there as a result of an agreement between the developer and the DC government; I am one of five affordable owners in a building of 108 units, some worth over $1 million. I am also a single mother of a 14 year old daughter and until recently worked as an Operations Manager. I purchased my home in January 2008, having worked hard to save money and meet the qualifications of becoming a homeowner. As a first-time, lower income homebuyer, I received down payment assistance in the amount of $77,000 through the District's HPAP program and will begin making payments back to the city in the near future. Understanding that owning a home is far more beneficial than renting, I took advantage of HPAP, also realizing that opportunities like this do not come around often. With the help of HPAP, I was able to join the 66% of Americans who call themselves homeowners.

Remembering back to the first time I learned of my new home, I can vividly recall my overwhelming sense of excitement. Elated doesn't even begin to describe my initial reaction, as tears of joy quickly ensued upon hearing the news. I recognized that my life would forever be different and I was optimistic for my future as a homeowner. However, my situation is quite different today, as a direct result of the escalating condo fees that have come to characterize my experience as a homeowner.

My condo fee was originally set at $324. This spiked to over $500 11 months later. Since that time, the condo fees I am required to pay have only risen further. Each increase has been around $100 and I am now burdened with a monthly condo fee of $700. Not only does this represent a 116% increase from the original amount but it is also higher than my monthly mortgage payment of $682. While I do recall some discussion regarding potential projects within the building that might require greater condo fees, I was never informed that such drastic increases would be in the works. Why did the City not plan for this? Never in my wildest dreams did I imagine the possibility of paying a higher amount for condo fees than for my mortgage payment. I stand assured that if this were to be conveyed to me before settlement, I would never have agreed to live in Chase Point.

[12] Testimony given on July 25, 2012 at the DHCD FY 2013 Consolidated Plan Hearing.

The rising condo fees that I have been subjected to have not only affected the way I live on a daily basis, but have significantly affected the way I plan for the future. As a single mother, it is extremely important to me that I provide for my daughter. Unfortunately, my emergency fund, which functions as a safety net for my daughter and I, has been the only place to turn for the additional funds needed to pay these ever-rising condo fees. These arbitrary increases have affected my sense of security and if they continue to escalate, I will face a greater risk of losing my home. Transitioning from being a tenant to a homeowner is one of my greatest accomplishments in life. The journey I made in order to do so was extremely challenging, but one I gladly took so that I wouldn't have to worry about being forced from my home. Without the escalating condo fees, I would be more than capable of meeting my financial obligations.

Trouble Finding a Buyer[13]

This ADU owner at City Vista K Street is an active duty military person; in early 2012, she was being deployed and needed to resell her unit quickly. She was told by DHCD that using a real estate agent would eat up any of the limited equity that she might be entitled to, but not to worry because she wouldn't need one with the overwhelming demand for affordable units. First, she had to market the property on her own. She then had to find times to show the property to interested buyers, which any real estate agent will tell you is more than a full-time job. Then, out of all the potential buyers, she had to make sure each of them met the income eligibility requirements before referring them to DHCD to ensure compliance and in order for the District to determine the appropriate price of the unit. What's more is that despite the resale formula the City has in place, due to her escalated condo fees (and her fees had not increased as high as other buildings), the price had to be further reduced in order to remain 'affordable' for the next owner. Finally, she had to draft a real estate contract on her own and was required to work with potential buyers to make sure they would qualify for a mortgage. Just imagine her surprise when, after all of this work, the assumed buyer, who qualified for a mortgage, couldn't settle on the property because of an FHA guideline that doesn't allow resale restrictions to survive foreclosures. She was forced to restart the process all over again and had to do so three times.

Needing to Rent One's Unit[14]

I live in an Affordable Dwelling Unit in the Kenyon Square condo building in Ward 1, located just north of the Columbia Heights metro stop and across from the Target. I am currently in my late 40s and didn't want to keep paying out rent and losing that money. I saw the

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[13] Testimony given on June 21, 2012 at the City Council Committee of Housing and Economic Development's Homeownership Roundtable.

[14] Testimony given on June 21, 2012 at the City Council Committee of Housing and Economic Development's Homeownership Roundtable.

ADU program as a way to responsibly invest in my future and become a homeowner in such an expensive city. It's funny to be considered so poor in this city. I was just reading in a national magazine that the average income in DC is over $87,000. I feel pretty poor compared to that, and trying to find affordable ownership opportunities made me feel even poorer.

With my job in an international development organization (I work on strengthening public health systems in developing countries), I travel a lot overseas. I may be in a position where I need to go to Africa for a longer period of time; when I was looking at the ADU program, the City couldn't give me a straight answer as to whether I could hold onto and rent out my unit if that happened. DHCD said they would have to consider my request at the time and couldn't give me any sense if it would be considered a legitimate reason to sublet my place. I took a gamble on the program and purchased in 2009, hoping things would change for the better as it was a new program and systems were still being put in place.

The restrictions are a straightjacket on your life. I've ruled out other jobs within my organization. I feel like my whole life has to be in DC, which is fine for now. However, I know that in a few years I'll want to move overseas to work; that's really what I have to do in order to advance my career. One has to put in so many years here in the US and then go abroad and come back. I want to be able to rent out my unit for simply the same costs that I have (mortgage payment, condo fee, taxes). There are many other life circumstances that could put me in a situation where I would need or want to rent) out my condo but still hold on to it. Add situations that could come up with my partner and there are more variables that could present such a circumstance.

Also given that the restrictions for my building don't allow me to sell my unit for market value until a full twenty years after purchase then please at least make the renting rules more flexible so owners can still hold on to their investments even with normal change of life circumstances that arise. Without some flexibility, I and other owners like me, could likely to be stuck as renters the rest of our lives. Regulate the program so that ADU owners who need to rent out their units cannot recoup anything more than basic costs like mortgage payment, condo fees and taxes. As it stands now the equity built up is rather negligible during this twenty-year period and I don't know if I'll be able to hold onto it for that long.

Life Changing Circumstances and No Access to Equity[15]

I love living in Washington D.C. and especially Columbia Heights. I've been living in my neighborhood for over 14 years now. I came before the Metro and the developers. I've always wanted the opportunity to become a home owner in this area and that opportunity presented itself in 2007 when I purchased my condo and Kenyon Square. At that time I couldn't have imagined how much my life would change; taking in an elderly friend, getting married and having a baby.

Because I love the city that I live in and have contributed to, I agreed to the restrictions that come with owning an ADU. I couldn't afford the average cost of condos at that time…at

[15] Testimony given on July 25, 2012 at the DHCD FY 2013 Consolidated Plan Hearing.

least $500,000. I wanted to remain in my neighborhood where I've been active and have friends. In order for me to remain in Columbia Heights after the gentrification train began to move I decided to take advantage of the affordable housing programs that were offered.

I was not given a free home. I had to qualify with credit and finances in order to even be eligible to purchase this unit. I pay the escalating condo fees associated with living here as well as utilities. Currently I rent a parking space because we were not allowed to purchase parking with the ADUs. I chose not to move to PG or Montgomery County and, believe me, it was tempting. I deserve to have the same rights as any other homeowner, but instead we are being punished for remaining in D.C.

The restriction on my unit makes it impossible for me to do a lot of things that would make life easier such as:

- Refinancing - banks do not often view ADU owners as viable candidates for lower rate refinancing because the restrictions make us a liability; I have yet to be able to refinance.
- Renting your apartment during difficult economic times may be impossible due to restrictions
- Access to equity is restricted; it would be helpful to accrue equity faster so that my living situation can grow as my needs grow.

It doesn't bother me that the ADUs don't have upgrades such as granite, hard wood floors or parking. What bothers me is that when we face economic difficulty as others do, our homes that we worked hard to pay for can't work for us as they do for every other homeowner.

Life happens! It's not easy to remain the same for 20 years and if you do, something is wrong. Buying your first home should be a stepping stone, not a road block.

ADU Owner Organizing and Engagement with City Officials

In October 2011, Manna organized ADU owners across the previously mentioned eight market-rate condo buildings; many had been organizing within their buildings, but this was the first time ADU owners were connected with affordable owners from other buildings. These owners have continued to organize within their buildings, sought support from their condo associations, met with City officials and are working through Manna and with Councilmember Michael Brown's office on legislation to address their issues. Draft legislation was introduced on February 21, 2012 and a public hearing is yet to be scheduled. ADU owners have offered edits to the current legislation, which the Councilmember's office is considering.[16]

A meeting was pulled together on October 17, 2012 by Councilmember Brown's office with Manna and officials from DHCD. The purpose of this meeting was to discuss interim solutions for distressed ADU owners that could be put in place before legislation is voted on. Though the covenants for these units reside with the District government, DHCD stated that they could not do anything on their own to change them. Councilmember Brown's office is currently drafting emergency legislation, which would be in place until formal legislation is solidified and voted on.

[16] For more information, see http://hatdc.org/?page_id=444.

Inclusionary Zoning

Inclusionary Zoning was introduced in the District of Columbia through legislation in 2006.[17] With a stated objective to develop diverse mixed-income communities, the program mandates that a certain percentage of new developments be set aside as 'affordable' and specifies targeted incomes that will qualify for these units. While the program applies to both rental and ownership units, the program has resulted in the production of just two ownership units.[18] Both units, which are located on Georgia Avenue, in Northwest DC, have been on the market for over a year. As of December 2011, the DC Office of Planning estimated that 930 IZ units will result from 82 IZ applicable projects in the pipeline, though it is unclear how many of these units are rental and how many are ownership.[19] In any case, a percentage of these future units will be ownership, and will be permanently restricted as far as resale. Due to the permanent affordability restrictions on Inclusionary Units in the District, IZ owners will never be allowed to access the equity in their home and will have great difficulty finding a lender who will refinance their mortgage.

From the District's perspective, lower income potential homebuyers are offered an incredible opportunity through the Inclusionary Zoning program. However, those who qualify for the program see it as quite the opposite, as evidenced by the District's inability to sell either of the two completed IZ units. While the program does offer lower income residents the opportunity to purchase a home at an affordable price in a city with ever rising real estate values, is purchasing an IZ unit really homeownership? Is it worth the stringent process of becoming an owner? When reviewing the permanent resale restrictions that accompany each unit, specifically the maximum resale price component and the required income category of the subsequent purchaser, this question is open to much debate.

Maximum Resale Price

According to Section 2207.3 of Title 14 of the District of Columbia Municipal Regulations, "the maximum purchase price for all subsequent sales of an Inclusionary Unit Owner shall be the Maximum Resale Price determined by the Department of Housing and Community Development".[20] This section gives the DHCD complete authority in determining the price of an Inclusionary Unit upon resale. Laid out in Section 2218 of Title 14, the DHCD provides a

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[17] The District's Inclusionary Zoning program, in its entirety, can be found in Chapter 22, Inclusionary Zoning Implementation, in Title 14 of the D.C. Municipal Regulations. An online copy of the program's regulations can be found at http://www.dcregs.dc.gov/Gateway/ChapterHome.aspx?ChapterNumber=14-22.

[18] Per the 2011 Inclusionary Zoning Annual Report, these ownership units are the only two IZ units that have been produced. Rental units have yet to be produced. See the report at http://dhcd.dc.gov/sites/default/files/dc/sites/dhcd/release_content/attachments/IZ%20Annual%20Report%202011.pdf

[19] Ibid, p. 6.

[20] See http://www.dcregs.dc.gov/Gateway/RuleHome.aspx?RuleNumber=14-2207.

formula for computing this value.[21] This formula, and an explanation of each variable within it, appears below. This algorithm, created by DHCD, is also used for all restricted ownership units in the District and is extremely complicated and confusing to both affordable homeownership providers and buyers.

$$\text{Maximum Resale Price (MRP)} = (P \times F) + V$$

P = the price the owner paid for the Inclusionary Unit

V = the sum of the value of the Eligible Capital Improvements and Eligible Replacement and Repair Costs

F = the sum of the Ten year Compound Annual Growth Rates of the Area Median Income (AMI) from the year of the owner's purchase of the For Sale Inclusionary Unit to the year of the sale of the For Sale Inclusionary Unit by the Inclusionary Unit owner.

The District's Inclusionary Zoning program, with the goal of maintaining a permanent supply of affordable housing, mandates that regardless of the length of ownership, owners are required to adhere to the MRP formula and are prohibited from selling the property at market-rate. By restricting owners to the maximum resale price, the IZ provisions place a cap on the appreciation of the unit. In denying owners the possibility of reasonable market based appreciation gains (which are always uncertain, but assumed to be material over a seven to ten year period), the District's IZ program greatly reduces one of the largest benefits of homeownership. The restrictive nature of the maximum resale price is even more apparent when analyzing the provisions surrounding the owner's investment in the unit.

The component of the maximum resale price formula that accounts for capital investments and/or replacements and repairs made to the property is denoted by the variable 'V'. IZ owners must differentiate between three types of improvements to the property to determine the value of this variable. Set forth in Schedule 1, Provisions Governing Calculation of Maximum Resale Price, the three types of improvements are as follows: eligible capital improvement (100% credit), eligible replacement and repair cost (50% credit), and ineligible costs (no credit).[22] These restrictions create disincentive to maintain the units and, in essence, require lower income owners to finance the upkeep of units that will eventually be returned to the city's affordable housing stock.

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[21] See http://www.dcregs.dc.gov/Gateway/RuleHome.aspx?RuleNumber=14-2218.

[22] See http://dhcd.dc.gov/sites/default/files/dc/sites/dhcd/publication/attachments/Form%20IZ%20Covenant%2004-11-12.pdf, p. 19.

IZ Unit Owner - Individual Case Study

Keeping in mind the current realities and negative effects of similar affordable unit programs in DC and around the country laid out in this paper, below is an individual case study of a future Inclusionary Unit owner. According to Chapter 22 of Title 14 of the District of Columbia Municipal Regulations, owners of Inclusionary Zoning units must follow a number of steps when reselling the unit. These regulations also lay out a number of guidelines that owners must abide by, including the maximum resale price and a provision mandating the unit be sold to a buyer in the same income category as the original owner. This case study examines the economic situation of a particular Inclusionary Unit owner after selling the unit at the resale price determined by the DHCD, in accordance with the maximum resale price formula.

- Buyer in year 2009, with income of $40,000 and household size of 2, qualifies for IZ Unit at 50% AMI (income limit of $41,100)
- Buyer seeks a 2-bedroom condo for under $120,100 (Max. Purchase Price in 2009)
- Buyer fits income category of very low-income household and is eligible for $40,000 in HPAP assistance, a second trust loan that is available to qualified DC residents who are purchasing their first home
- Buyer purchases an Inclusionary Unit for $120,000 and enters into a covenant which includes the following restrictions:
    - Owner must notify the DHCD before moving and must sell unit at a price determined by the DHCD
    - Owner may not access equity in home
    - Upon taking ownership, buyer is responsible for paying condo fees, which may increase as the building association sees fit
- In year 6, or 2015, owner needs to sell unit and must abide by the Inclusionary Zoning regulations as well as the specific terms in covenant to do so

The owner, who purchased the unit for $120,000 in 2009, will be entitled to a resale price that compensates for market changes over the last 6 years. Using the Maximum Resale Price formula and any applicable data available, the price for this unit will be calculated below.

$$MRP = (P \times F) + V, \text{ where:}$$

P = the original price paid by owner, or $120,000,
F = the ten year compound annual growth rate (CAGR) of the area median income,
V = any eligible capital improvements and/or eligible replacement and repair costs

Since the value of *P* is already known, *F* will be calculated next by using an additional formula, which includes the CAGR.

F = (1 + [((AMI Year m / AMI Year m-10) ^ (1/10) -1) +…((AMI Year k / AMI year k-10) ^ (1/10) -1) / n]) ^ n, where:

m = the year in which the unit was purchased by the owner,
k = the year in which the unit is sold by the owner, and
n = the number of years the unit is owned by the owner

Substituting the information from our example into this formula and using the published CAGR values (with an estimated 3% used for the years 2013-2015) to determine the average CAGR of the years 2010-2015, we are able to calculate *F.*

$$F = (1 + 2.51\%)^{6} = 1.16$$

Assuming the owner has not made any improvements to the unit within 6 years of occupancy, therefore equating a value of 0 for the variable *V*, all the variables within the maximum resale price formula have been accounted for and the MRP can be calculated.

$$MRP = (120{,}000 \times 1.16) + 0 = \$139{,}200$$

At first glance, it appears that the owner can expect a profit of $19,200 upon resale. However, we have yet to subtract the closing costs from this number, which can be estimated at approximately 3% of the sales price, or $4,176. Since the IZ program does not credit the owner for these fees, the owner's new profit is reduced to $15,024. Further, as discussed earlier, the owner is discouraged from using a real estate agent to assist in the resale process. Though given the extremely complicated and onerous process of selling a home, what could this owner expect to walk away with if employing a third party? Assuming a 5% commission fee charged by the broker, valued at $6,960, the owner's final profit would be further reduced to $8,064. Do these resulting amounts indicate that the owner made a good investment or would they have been better off to remain in a rental situation?

What's the Benefit of IZ Ownership?

The owner's economic situation after selling the unit must not only be analyzed in respect to the profit realized from the investment, but also to the opportunities available when moving to a new home. As for ADU owners, the assistance of a Housing Purchase Assistance Program (HPAP) loan is extremely beneficial to those who qualify. It increases a buyer's purchase power immensely and allows households to purchase a home with a significant down payment made upfront. Because it is only available once, however, Inclusionary Unit owners must be careful to use it at the right time. The owner from the above case study, who received $40,000 in HPAP assistance when purchasing the unit, is in a vastly different situation when he/she sells his/her IZ unit and looks to purchase another place; at that point, the owner no longer has the option of utilizing an HPAP loan. Given this reality, the owner will likely face fewer options when attempting to move to a new home, especially if looking to purchase a larger or higher valued property. They will likely cycle back into a rental situation, potentially an affordable rental situation subsidized by the District.

Since the eligibility criteria are the same for rental and ownership through IZ, what if the owner had decided to forego ownership and pursue a rental situation through IZ? If this were the case, not only would the $40,000 of HPAP assistance still be available for future use, but the owner could have spent the six years saving for a larger down payment. Because the restrictive equity limitations prevent Inclusionary Unit owners from realizing the benefits of homeownership anyway, this owner would have benefited more from remaining in a rental situation, saving the extra money not spent on condo fees, maintenance, real estate taxes and other costs incurred through homeownership, and purchasing on the open market at a later date with a larger down payment. They could even multiply the money they save renting by putting it into an Individual Development Account (IDA), which matches the funds that potential lower income homebuyers save toward the purchase of a future home.[23] This example illustrates how homeownership through IZ is more burdensome, rather than beneficial, to owners. It has the lower income owner, rather than the city government or the developer, providing the subsidy to keep the unit affordable.

The Future of IZ in the District

In light of IZ's record to date, proponents are quick to point to the number of proposed developments that are subject to IZ regulations and will therefore yield affordable units. Touting the 930 Inclusionary Units in the pipeline as a success, both the Coalition for Smarter Growth's public land report and the DHCD's recently released annual IZ report fail to distinguish between rental and ownership units when hailing the program as a victory for affordable housing. While IZ may accomplish its goal of increasing the affordable housing stock, in terms of rental units, what evidence is there that it will increase its goal of expanding homeownership opportunities and enabling families to move up the economic ladder? It is not a coincidence that the published pieces on IZ fail to distinguish between the two. Rather, it is much easier to paint the program as a success when ignoring the fact that the ownership component of IZ has not even left the ground yet.

Examining the current situation of the IZ units for sale, and in light of the analysis of the restrictions that burden ADU owners, it can be reasonably assumed that this pattern will continue. The program may go above and beyond what its biggest advocates had hoped for in regard to producing units for rent, but how can the ownership portion of the program be regarded as a success when those 'benefiting' from the program remain in the same economic situation or are put in a worse financial situation due to rising condo fees? In addition, while the program is designed to preserve the affordable housing stock and therefore save the city money in the long-run, the disincentive surrounding upkeep of the units, coupled with the un-

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[23] For a few examples of IDA programs, see http://www.mannadc.org/template/page.cfm?id=119 and http://www.mannadc.org/template/page.cfm?id=192/.

foreseen effects of the program, may cause the exact opposite outcome. And then there is the fact of how expensive it will be to continue to administer this kind of program.

Obviously, homeownership is not for everyone, but it should be available to those who qualify and wish to make the transition. The District's Inclusionary Zoning program takes that opportunity away and instead creates a permanent class of residents who are dependent on taxpayer assistance and have no chance of climbing the socio-economic ladder to a more stable and desirable position for themselves and their families. This policy should be carefully examined, and the ownership portion reworked or abandoned.

Affordable Housing East of the River

Manna believes it is important for the city's housing policy to stop treating each and every neighborhood and ward in the city with the same policies and practices. Different wards, communities and neighborhoods have different needs and different priorities. We need to have specific targets in terms of numbers of units to be produced and amounts of funds allocated to each category of housing across the Continuum. We also need to have a system and approach that updates those targets and needs each year. Moreover, we need to have a system and approach that provides incentive for people to purchase in distressed areas, rather than a system that penalizes them.

One of the areas of the city that the Task Force should pay particular attention to are the neighborhoods east of the Anacostia river. *Public Land for Public Good* points out that Ward 8 has historically had a large amount of affordable housing, including many areas where 50 to 90 percent of all the housing is subsidized. The report also states that "the largest share of planned affordable housing from public land deals, especially very low income housing at the 30 percent AMI level, occurs in the eastern parts of the city -- east of the Anacostia River (Wards 7 and 8) and Ward 6."[24] What the report misses is that this is a golden opportunity to promote homeownership and economic growth in an area that stands to see massive development and gentrification in the next ten years.

As commercial and housing development progresses along the Anacostia River and in various areas throughout Wards 7 and 8, District residents in these wards have an amazing opportunity to purchase in Southeast Washington before prices become too great. Neighborhoods East of River have long been thought of as low income and have historically lacked essential neighborhood amenities until recently. For example, in late 1990s, the community got its first shopping center with a chain grocery store, and today, not only has a second chain grocery store located in the area but also has some popular sit-down restaurants like Denny's, Union Town and Rays the Steaks. The point is, development is occurring and much more is in the planning

[24] *Public Land for Public Good*, p. 24.

process now, such as the redevelopment of St. Elizabeth's.[25] East of the River is becoming a more desirable place to live. We have a golden opportunity to help people who have lived there for generations to stay in, benefit and continue contributing to the area before the incoming development prices them out.

The US Department of Commerce reports the country's homeownership rate at 66.3%, with the District coming in at 45%.[26] Compared to the rest of the city, Ward 8 ranks dead last with a homeownership rate of 24% and Ward 7 fairing a little better at 40%, but still holding the second lowest percentage in the city; and there are many distressed neighborhoods in Ward 7 that are much lower than 40%. 70% of the housing stock in Ward 8 is rental, and Ward 8 Councilmember Marion Barry has declared that there be no more rental development until a balance of "affordable homeownership with equity" is produced and achieved.

These numbers clearly illustrate a need to create, support and encourage affordable homeownership. Homeownership is still the biggest asset builder for low and moderate income families, and with the right education and resources, they can be successful homeowners and lift up entire neighborhoods. With interest rates at an all-time low, lower home prices and opportunities East of the River, available downpayment loans, and a window of opportunity to purchase before slated development drives up prices in Wards 7 and 8, now is the time for low and moderate income people to purchase. And with median rents of more than $1250 in these wards, it is often cheaper to own than rent.

Thus, within a 2-year period, our objectives should be to:[27]

- Raise Awareness about the benefits of homeownership and the current ground-level affordability opportunities East of the River through an aggressive marketing and communication strategy.
- Build Relationships with and Mobilize Residents and Organizations to both promote and/or become homeowners East of the River through a broad-based, personalized community organizing homeownership campaign, reaching 10,000 households.
- Provide DC Residents With Technical Assistance through existing government-funded housing agencies, 1or 2 comprehensive homebuyer resource centers and a homebuyers club located East of the River, resulting in a 30 percent homeownership rate increase in Wards 7 and 8.
- Identify for- profit and non-profit producers and developers with the proven capacity to bring targeted units on-line.

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[25] See http://www.stelizabethseast.com/.

[26] Callis, Robert R. and Melissa Kresin. "Residential Vacancies and Homeownership in the Third Quarter 2011." US Department of Commerce. 2 November 2011. http://www.census.gov/hhes/www/housing/hvs/qtr311/files/q311press.pdf.

[27] See *Welcome Home: East of the River Affordable Homeownership Campaign.* Manna. January 2012. http://www.taskforce2012.org/Portals/1/docs/Welcome-Home-Plan-East-of-the-River-Affordable-Ownership-Campaign.pdf.

• Identify publicly and privately-owned properties that can be purchased and held until they can be developed (in other words, land-banking of affordable properties). This has to be done carefully so as not to alert private owners/sellers to driving up prices.

A Better Way Forward

There are policy alternatives to long-term and permanent resale restrictions that ensure funding for the creation of affordable units and allow owners to access equity appreciation. One alternative to permanent resale restrictions is already an option offered by the United States Department of Housing and Urban Development (HUD) when the DHCD and others are using federal dollars for affordable homeownership development.

Similar to the alternative offered and promoted by HUD, the following Recapture and Recycle Model addresses the concerns of long-term resale restriction advocates who fear that lower income homebuyers will "flip" affordable properties and make "windfall profits", thus depleting the stock of affordable housing in the District. The Model recaptures all funds that are considered "subsidy" to the buyer, including what is seen as "the windfall profit," which is the difference in the original sales price to the low income buyer and the higher appraised/market price at that time. This difference would be repaid if and when the lower income buyer resells his/her unit. This allows the "recaptured" funds and any funds considered subsidies to be treated as a loan that gets repaid (with interest) and "recycled" back into additional affordable units for more qualified lower income families.

For example, if a lower income person purchases a unit that is worth $435,000 from a developer for $235,500 (the cost of developing the unit), then the $199,500 "discount" would be considered a subsidy that would be repaid to the city to produce more affordable homeownership opportunities when the homeowner sells or refinances. The homeowner would benefit from being able to fully utilize, like a typical homeowner, any appreciation accumulated above the original $435,000 value after the 5-10 year period. Graphic representations of the above scenario are in Appendix I.

The City Council is already looking at legislation that incorporates the Recapture Recycle Model for affordable units created using a portion of public money. This legislation focuses on what is called the Bifurcated Policy. Below is an explanation of how this legislation came to be and where it resides now.

Following a public hearing on the topic, Councilmember Michael Brown's Committee of Housing and Workforce Development convened a taskforce in August 2010 consisting of 30 affordable housing experts and local government officials to explore long-term affordability restrictions associated with DC-funded affordable homeownership programs. The taskforce met many times over the next two years. After a series of modeling exercises, it was concluded by the majority of the working group that the District had different types of "markets" within the City. For example, one neighborhood like Columbia Heights had a completely different appeal to it than a neighborhood like Ivy City. As a result, a uniform policy would not work for both areas. The group defined areas as "distressed" or "non-distressed" neighborhood.

Defining what a distressed neighborhood is boiled down to the demographics of the neighborhood. Upon examination of the various census tracts, it was found that the majority of tracts that have a 20% poverty level or higher also had a homeownership rate of 42% or lower. This became the definition of what a distressed neighborhood is. A few policy scenarios would separate the resale restrictions by different criteria to apply to areas that were deemed distressed or non-distressed:

Option A. – Distressed Market: 5 Year Resale-restricted period with a permanent Subsidy Recapture and Recycle Provision. - Rewarding homeowner "pioneers" with more asset appreciation in areas that are less developed. This also acknowledges the fact that certain neighborhoods need additional subsidy simply to make new construction feasible and that homeowners will not likely purchase housing units with complex resale restrictions if the price is only nominally lower than other housing units in the same neighborhood that do not have any restrictions associated with them.

Option B. – Non-Distressed Market: Longer-term resale period (15 years) with permanent recapture and recycle provision during the resale period. This approach would prioritize affordability preservation in areas of the city with incredibly high housing costs. However, a meeting is required to discuss the pros and cons of longer restrictions in non-distressed areas.

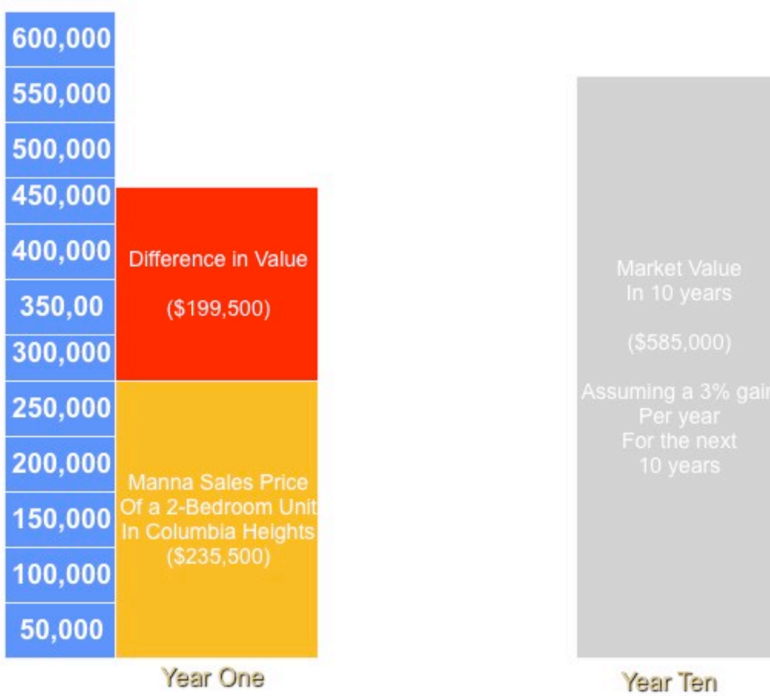
As of July 2012, Councilmember Brown's office indicated that at the request of Former DHCD Director John Hall, the Bifurcated Policy would be routed to the Comprehensive Task Force for closer examination. This policy avoids many of the pitfalls described with long-term restricted units, provides the opportunity for socio-economic growth and independence for families, and provides a way for the City to fund the development of more affordable housing in the District.

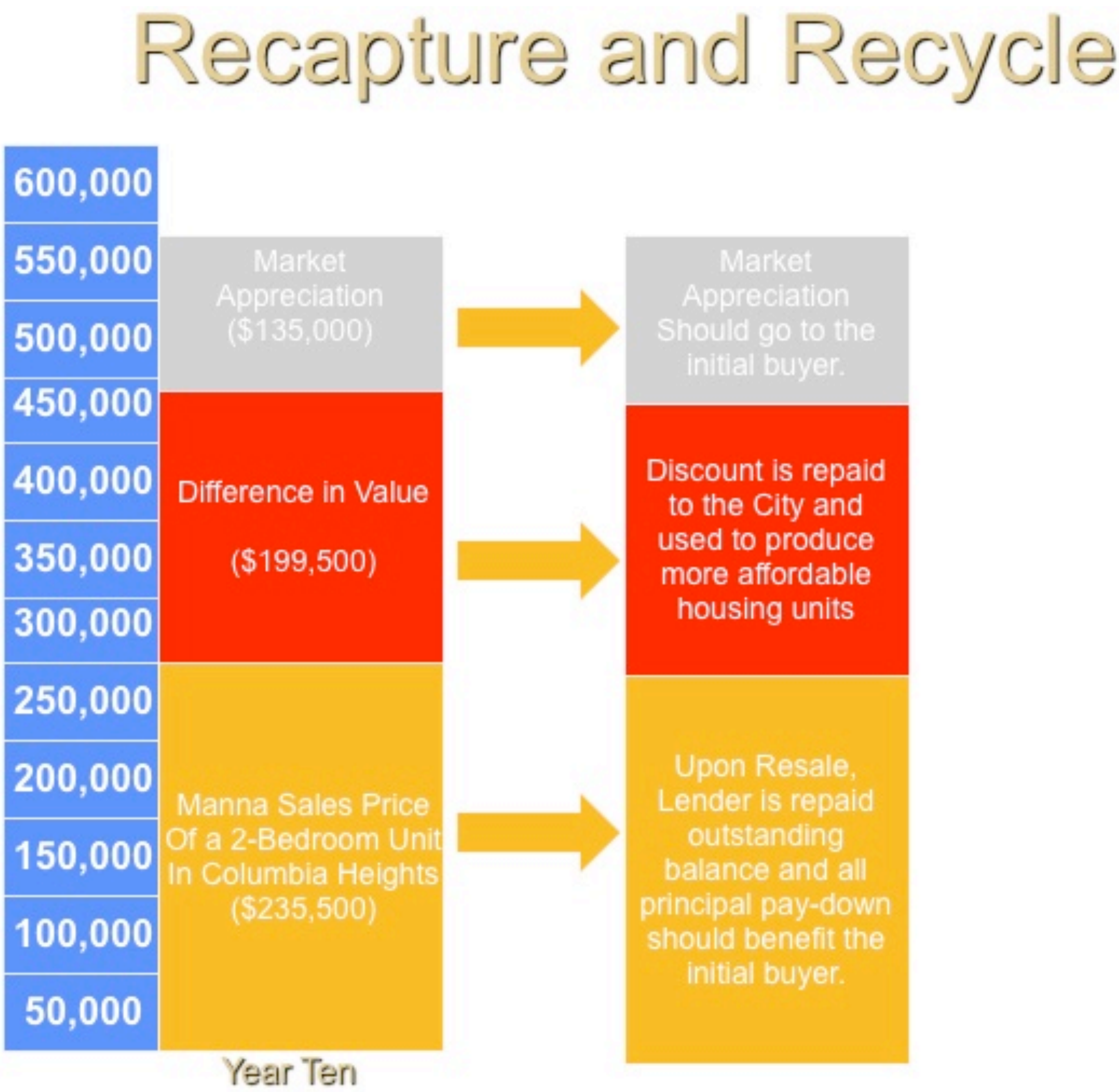
Appendix I

Below is Manna's Recapture Recycle Model, using an actual condominium unit that Manna produced and sold in 2011 at 1343 Clifton St, NW in Columbia Heights.

Difference in Value

10 Year Market Appreciation




Recapture and Recycle
600,000
550,000
500,000
450,000
400,000
350,000
300,000
250,000
200,000
150,000
100,000
50,000
Market Appreciation ($135,000)
Difference in Value
($199,500)
Manna Sales Price Of a 2-Bedroom Unit In Columbia Heights ($235,500)
Year Ten
Market Appreciation Should go to the initial buyer.
Discount is repaid to the City and used to produce more affordable housing units
Upon Resale, Lender is repaid outstanding balance and all principal pay-down should benefit the initial buyer.