Montgomery County MD: *Moderately Priced Housing Program*

Montgomery County, a large county of 950,000 directly outside of Washington DC, adopted one of the earliest and probably the single most productive program so far. Despite its success, it cannot be considered a model program, as it continues to take a different approach on key aspects that have not been widely followed by later programs.

INTRODUCTION

Montgomery County is a fast-growing county immediately north of Washington DC. It has a population of 950,000 and large employment base of its own, but it still mainly serves as suburban bedroom community for the nation's capital. The county is well-known for pursuing progressive planning policies.

The idea of adopting inclusionary zoning was first promoted in the early 1970s by housing advocacy groups. The idea most likely came from neighbouring Fairfax County, which passed one of the earliest such programs in 1971. At the time, the county was undergoing rapid growth and development could not keep up with the demand and so concentrated on serving the upper end of the market. Inclusionary zoning was seen as a way of addressing the county's growing shortage of housing for low- and moderate-income households.

The program was unanimously approved by the County Council in October 1973. The County Executive vetoed the legislation, but Council overrode that veto in November 1973. It took effect in January 1974. The first units from the program appeared in 1976.

The provisions are formally set out in Chapter 25A of the Montgomery County Code. They have been changed many times: first in 1981, again substantially in 1989, and most recently in April 2005. There also have been many regulatory changes at other times. These changes have almost always made the provisions more demanding (see following chart).

The state passed legislation explicitly authorizing local jurisdictions to use inclusionary zoning in 2006, but when these provisions were passed, the state legislation made no reference to inclusionary zoning. The provisions were considered permissible because Maryland is one of many home rule states, in which the local governments are seen to have the authority to enact any ordinance not specifically prohibited by the state legislation. The inclusionary provisions have never been challenged in the courts.

Three of the county's neighbours – Fairfax and Loudoun Counties in Virginia and Prince George's County in Maryland – also more recently have enacted programs modelled in

large part on these provisions. Fairfax made its program mandatory after having an unproductive voluntary program for many years.

The program is administered by the Moderately Priced Housing Section of the county's Department of Housing and Community Affairs. The county's public housing agency – the Housing Opportunities Commission (HOC) – also has a significant role through its purchase of some of the inclusionary units for rental purposes.

PROVISIONS

Subject Developments

The requirement to provide inclusionary units now applies to new developments of 20 or more units. The minimum threshold initially was 50 units, and then changed to 30 in the interim.

The requirement applies to all lands to be developed at one location that are owned or controlled by the developer. Developers are not allowed to divide their holdings nor phase the development as a way of circumventing the requirement.

There are two exemptions: housing on lots larger than 1/2 acre (0.2 ha) and subdivisions without public water and sewer systems. Under these exemptions, the large luxury homes that are still being widely built in the county remain free from supporting affordable housing.

Dates of Changes to Some Key Provisions

	1974	1981	1989	2005
set-aside requirement	15%	12.5%	12.5 – 15%	
control period (years)				
-ownership	5	10		30
-rental	5	10	20	99
min. threshold size (units)	50		30	20

Housing Obligation

The required set-aside of inclusionary units ranges from 12.5% to 15% of the total units in the development, according to the permitted density increase:

- Developments using at the base as-of-right density and receiving no density increase are required to provide 12.5%.
- Developments receiving a density increase above the base density are required to provide 0.1% more units for every 1% increase in density, up to the maximum 15% increase in the units for a maximum permitted density increase of 22%.

The basic 12.5% obligation was initially 15%. It was reduced due to pressure from the development industry, but the lower figure still represented a compromise as the developers wanted 10%. Also, initially, developments providing the basic obligation were given a density increase.

Income Targets

The program is directed at providing 'moderately-priced housing'. Although not usefully defined in the legislation, from other various statements and descriptions, this can be taken to mean housing of more modest size, fewer amenities and more compact lots. Furthermore, it is expected that this housing can be built by the private developers, while recovering their costs and even having "a reasonable prospect of realizing a profit".

The program is also said to target households earning a "moderate" income. This is defined as household earning no more than 70% of median income for sales units and 65% for rental, both adjusted for household size. The program initially targeted households earning at or below 60% of the median income, with half of those being at or below 50%.

In practice, these income thresholds are not strictly applied. The project-by-project process used to determine the permitted sales prices often results in prices that exceed what is affordable at the "moderate" income levels.

Cost Offsets

The program does not provide cost offsets to mitigate the costs of the developers in providing the inclusionary units. To the contrary, it aims at giving the developers full cost recovery, and possibly a profit, by allowing them to build less costly forms of housing.

Density bonuses are offered, but only as incentives to provide more affordable housing above the basic12.5% set-aside requirement. Also, these density increases are not automatic. The developers must apply for them, and they must be approved by the planning board after a public review. As a consequence, they are not always fully achieved because of physical constraints on the site or other considerations, as well as pushback from the local residents.

The bonuses are generally are available in all residential zones, except in 'planned unit developments' (PUDs), which are subject to a different approval process.

The only concessions offered the developers are waivers for the regional sanitary sewer charges and the development impact charges specific to the inclusionary units**.**

The owners benefit from lower property tax assessments on the inclusionary units.

Compliance Alternative

The program is directly principally at securing on-site construction of the affordable units, but the regulations also allow for various alternative compliance measures: the provision of land, construction on another site, payments in fees-in-lieu, and a reduction or waiver of the affordable housing obligation.

The granting of these alternatives is at the discretion of various county officials or a special review board. They are generally allowed only under these conditions:

- when the alternative provides a greater benefit than building on site, and it better serves the policy objective of providing a broad range of housing opportunities throughout the count, and/or
- when the development of the affordable units on site is not economically feasible.

The latter condition expressly covers cases where high condo or homeowner association fees make the inclusionary units unaffordable, and the services cannot be eliminated or modified for the inclusionary homeowners.

The fees-in-lieu payments are being reconsidered. For many years, they were determined project-by-project, and probably underestimated the loss to the county of not building the inclusionary units. The county is exploring how best to set a fixed and simple rate that reflects the full value of that loss.

Under the latest ordinance, the fees-in-lieu must be based on the following:

- 10% of the sales price of the market-rate units that were built instead of affordable units in high-rise developments; and
- up to 30% of the sales price for the corresponding units in all other housing developments. (Presumably, the regulations are meant to spell out how “up to 30%” relates to different forms of housing.)

This is said to equal 125% of the estimated land value for each of these units. So, it is unclear how this relates (if at all) to the loss to the county when these units are not built.

The fees must be used in the same planning area as the on-site development.

The payments go to the county’s Housing Initiative Fund, where the money is used to support various lower-income housing needs.

Development Standards

The inclusionary units must be mixed within the market units, and also built at least at the same time and rate as those units.

The inclusionary units can be provided through smaller and different unit types than the market units, but within these limits:

- Only up to 40% of the units in otherwise single-family subdivisions can be attached.
- In single-family developments, all of the affordable units must have three or more bedrooms.
- In multi-family developments, the percentage of studios and one-bedroom units among the affordable units must no higher than their percentage among the market units.

There are also minimum floor space standards for the various types of inclusionary units that are imposed through the pricing system.

The inclusionary units can be provided for sale or rental, but the percentage of affordable rental units out of the inclusionary total must not exceed that for the market-rate rental units out of the total market.

The program supports, but does not actually require, that the inclusionary units look like the market units. The developers typically are strongly in favour of this condition because they feel that reduces sales resistance from the market-unit buyers. The pricing system allows for price adjustments for external up-grades to the inclusionary units that make them look like the others.

Affordability Controls

Legal Agreements

The affordability controls are set out in a covenant registered on the title of the unit. The developers are able to use their own documents, provided they contain the content required by the county.

Control Period

The affordability of ownership units is currently controlled for 30 years and rental for 99 years. This period has been gradually extended over the years. Initially, it was 5 years for both tenures, then10 years, and then 20 for ownership and 30 for rental, before going to the latest limits.

The 30-year period for the ownership is now renewable each time the affordable ownership unit is sold within the control period. The renewal of the controls is a relatively recent change for the program.

Eligibility Criteria

The eligibility criteria are established by regulation. To be eligible for purchasing an inclusionary unit, the buyers must meet these requirements:

- earn less than the maximum income limit, adjusted for household size;
- be first time buyers;
- complete an approved homebuyer course; and
- qualify for and secure their own mortgage financing.

First-time buyers are defined as a buyers who do not currently own a home, nor have owned a home anywhere in the last five years or an inclusionary unit at any time.

First Sales Process

The developers are responsible for selling the new affordable units. The department helps by providing a list of eligible buyers appropriate for the units drawn from its applicants.

The department uses a points system coupled with a random selection process in the developing the list. First, it prioritizes the eligible applicants on its waiting list by giving a point for every year they have been on the waiting list (up to 3 points); and also a point for those living in the county, and a point for those working in the county. Then, for each pool of applicants with the same number of points, the county generates a computer-generated randomly-ordered list. The selling agents are required to offer units according to the order that the names appear on that list.

From the start or the program, HOC has had the first right to purchase or lease up to one-third of the new units produced in each development at the permitted sale or rent . Since 1985, this right has been extended to designated housing development agencies or non-profit corporation, and the ceiling raised to a total of 40% of the units. Currently, 15 providers have that privilege.

First Sales Prices

The permitted first sales prices are determined by constructions costs, and not strictly by targeted income limits. More specifically, under the county's pricing system, the prices are set in a way that allows the developers to recover their full costs and possibly take a profit, without density bonuses or other cost offsets.

To set the sales prices, the county annually (or nearly annually) establishes a base construction cost and a site development cost for a range of basic unit types. These costs are based on modestly-sized houses with an adequate but "no frills" standard of construction and amenities. The basic unit types at the present time are described as detached, semi-detached, townhouse or four-plex, piggyback townhouse, garden condo and highrise.

These base costs are tied to minimum specifications covering a wide range of features, such as appliances, privacy fences, linen closets, sound attenuation and others.

In order to accommodate specific design changes and site conditions, the process also allows for various adjustments to be made to these base costs:

1. The costs for units that are bigger or smaller (but only to a minimum or maximum size) than the base size are adjusted according to a set $/ft^2 for the construction cost.
2. Fixed costs are set for a number of particular changes, like deleting a basement, adding a finished or roughed-in bath, adding a walk-out basement and adding a garage.
3. There is an allowance (up to a 10% increase in the sales price) for modifications to the exterior to make the inclusionary units look more like the market units.

The developers are responsible for using a standard work sheet for showing the various adjustments they propose to use when determining their proposed price. The proposed price changes then must be approved by the county, which typically works to contain or lower the price when the resulting price is too high for the targeted households. To obtain price reductions, the county might in turn push for modifications like leaving some space unfinished, removing a deck, or reducing the standard of the interior finishes.

Resales Process

During the control period, the affordable units can be resold only to the county or to another certified eligible buyer at no more than the maximum permitted resale price.

The county retains the first right to purchase these units upon resale during the control period, but has assigned this right to HOC or one of the designated non-profit agencies to buy the units. If not purchased through this process, the units then must be sold to a certified buyer through a lottery or other approved means.

After the control period has expired, the inclusionary units can be sold on the open market without any price or eligibility limits, but half of the windfall obtained by the seller must be returned to the county. Windfall is defined as the difference between the initial purchase price and the permitted resale price as defined below. At a minimum, the seller is allowed to receive $10,000.

This windfall requirement was introduced during1989, but only came into effect during 1999 after the end of 10-year controls. Before that time, the inclusionary units were sold without any recovery of the windfall.

After the control period has expired, the county still retains a right of first refusal – that is, a right to purchase at a price that matches the best offer on the open market.

Resale Price

During the control period, the inclusionary units can be resold only for a price at or below the maximum resale price set by the county.

The maximum permitted resale price is based upon the purchase price adjusted by the change in the CPI for the period of ownership, and with allowances for the following:

- the fair market value of any capital improvements made to the property;
- any mortgage-related fees added to price;
- some closing costs like transfer taxes and recording charges; and
- the real estate commission (except when the buyer is supplied from the county's waiting list).

Other Restrictions

The buyers must agree to occupy the inclusionary units as their primary residence. If this agreement is not honored, the county has the right to force a sale. The owners are able to apply for a temporary waiver, when conditions can be set on the maximum time and allowable rent. The control period also will be extended to cover the period of absence.

Heirs of the owners can inherit the title of the inclusionary unit, provided they live in the unit during the control period. If not, they must sell the unit under the controls in the agreement.

ADMINISTRATION

The program is administered by the Moderately Priced Housing Section of the county's Department of Housing and Community Affairs. The section has a staff of seven.

Its main on-going responsibilities included these:

- vetting and certifying eligible buyers and renters;
- maintaining a prioritized list of eligible buyers and renters;
- determining the maximum permitted sales and rental rates for new units;
- entering into development agreements and market agreements with the developers;
- overseeing the sales and resales proceedings;
- vetting the sale documents;
- determining the maximum permitted resale prices; and
- enforcing the occupancy and resale controls, and other provisions of the program.

Their experience shows that the sales of these units must be carefully monitored in order to prevent violations like sales to non-eligible buyers and at higher than the permitted price. The section employs roughly 1-1½ people full-time, and a lawyer nearly full-time in another section, in monitoring and enforcement.

The department does not provide financing, financial assistance or rental assistance to the purchasers or renters. It also does not buy any of the units; it assigns its first right of purchase to HOC and others.

HOC, in addition to buying the inclusionary units and maintaining them as permanently affordable rental units, has over the years provided various forms of assistance to the inclusionary and other affordable ownership buyers. It currently has a program to assist long-time renters to buy their homes.

PRODUCTION

The program has produced more than 12,500 affordable housing units through 2007. This amounts to about 6% of the housing stock built in the county since the start of the program. Nearly 9,000 of these units (71%) have been ownership.

The fees-in-lieu generated by this program have amounted to about $20 million through 2008.

Because of how the permitted sales prices are set, somewhere between 1/4 and 1/3 of the new units might not meet the county's affordable income thresholds.

An in-house analysis indicated that roughly 1/3 of the developments were built at the permitted base density (and so are subject to the minimum 12.5% set-aside), while the remainder took advantage of the density bonuses (and so contributed up to 15%). Only half or less of the latter built to the maximum allowed density. No records are kept on how effective the density bonus is in incenting additional units in comparison to mandatory provision under the basic permitted density.

The program has produced on average nearly 400 inclusionary units annually, ranging from a peak of more than 1,200 units in 1984 and a low of less than 100 in 2007.

The production has been steadily declining over the last many years. The prevalent reason offered is that the county has been running out of developable lands accessible to Washington DC.

Up to the present time, HOC has purchased about 1,600 of the inclusionary units and the designated non-profits about another 225. So, together they have bought less than 15% of the available units, or much less than their permitted quota. All of these units are used as rental housing for lower-income households.

Various reasons are given for why HOC has not bought more units, including these:

- The organization has often lacked the necessary funding.
- Some of the available units have been inappropriate or difficult to rent. (The developers are providing a lot of stacked townhouses for the inclusionary units. These are considered unsuitable for families, which represent the larger part of HOC's waiting list.)
- The units have been in areas already having a relatively high percentage of affordable units.
- The condo fees for the units have made them too expensive.

As of 2007, only about 2,600 of the inclusionary units (21% of the total) remained under the restrictive covenants. If the units bought by HOC and non-profits are added to these, this indicates that more than 8,000 (about 65%) have been sold on the open market and lost their affordability due to the lax controls placed on them in the past.

For a number of years, the county has been building fewer inclusionary units every year than it has losing due to the expiring controls. This attrition could continue for some time because the ten-year agreements were used until early 2005, and so the controls on these units could be expiring until early 2015. The rental units are particularly vulnerable because the owners can legally raise the rents immediately after the agreements elapse.

OBSERVATIONS

This program is one of the most important pioneering mandatory inclusionary zoning programs in the US, and also one of the most productive. It is pre-dated by only three earlier programs, and then by a matter of only two to three years. No other program is close to having produced as many inclusionary units.

One notable innovation introduced by this program was authorizing their housing agency to purchase a portion of the units at the affordable price. The agency generally has not been able to buy its full quota due to a lack of funds and other reasons. Nevertheless, this represents an important way of converting some of the inclusionary units from ownership to rental, and serving households at a lower income level.

Despite its historic importance, this program cannot be considered a model program. Although it has been adapted many times over the years, it has not kept up with what might be considered best current practices. The fundamental features that distinguish this program generally have not been replicated. The more recent programs seemed to have looked to the approaches used elsewhere.

One significant difference between this program and virtually all of the others is in how the initial maximum affordable price is set. In this program, it is based upon a price that allows for full cost recovery without cost offsets. This stands in contrast to other programs, which base the price on what is affordable at the targeted incomes, and then generally provide cost offsets to mitigate the cost burden to the developers.

Consistent with this cost-recovery approach, the program also allows the developers to provide smaller, more compact and “no-frills” units for the affordable units (such as, townhouses in otherwise single-family estates) as a way of reducing costs. Most other programs require the developers provide a share of the market units, albeit possibly with some changes to the interior amenities and finishes.

A substantial number of the new units produced under this system have not met the targeted “moderate” income thresholds, and this problem seems to be growing as construction costs are rising faster than incomes.   It is relevant to note that the county has been considering a change to a stricter income-based approach as used elsewhere, and but this is facing strong resistance from the developers who fear that this will squeeze them more than the current system.

The major shortcoming of this program has been its inadequate affordability protections. The program initially imposed only 5-year controls, and then only gradually and recently extended this to 30 years for ownership units. In addition, the program only relatively recently made the control period renewal upon resale, and started recovering some of the windfall gain whenever the units are sold on the open market.

The inadequate protections were considered reasonable early on because the program was seen as mainly serving young first-time buyers, who in time would wish to move out and up.   Furthermore, it was thought the units would retain their lower price because they were relatively small and compact. This thinking failed to foresee the dramatic growth in house prices over the last many years.

The consequence is that county seems to have lost a staggering 65% or so – or more than 8,000 out of 12,500 inclusionary units – through the elapsed controls, without until recently recovering much of the windfall gain.

Although the county has moved to toughen the controls, it has not yet addressed another problem. The program has been producing steadily fewer inclusionary units for the last many years well before the current downtown. The prime reason appears to be that the program was initially designed to harness large single-family subdivisions built on open land. Meanwhile, due to rising land prices and depleting land supply, the development in the county has moved to denser forms of development and redevelopment. There is no indication that the program is being adapted to this new reality.

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