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A Report on Erie County Industrial Development Agency Lower Income Housing Component Proposal

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Erie County Legislature
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Dear Honorable Members:

The Erie County Comptroller's Office has completed a report on the proposal to mandate lower income housing components to every Erie County Industrial Development Agency residential project in the City of Buffalo.

Our objectives were to:

- Understand the purpose of such policies.
- Determine if the objectives of the policies would be met with implementation in the City of Buffalo.

To accomplish these objectives, we examined similar policies across the United States and spoke to developers as to the impact of such policies on redevelopment projects.

As a result of our examination, we have determined that the implementation of such policies may demonstrate results counter to the intentions of the policy.

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INTRODUCTION

At his State of the County speech earlier this year, the County Executive announced a goal of making downtown loft apartments more affordable. In order to achieve this goal, he stated his intent to require future adaptive reuse projects which seek Erie County Industrial Development Agency backing to include components that promote affordable housing. He stated that everyone should be allowed to live where they want, and that monthly rents of $1500 in some units are an impediment to that right. He suggested that up to ten percent of available apartments be subject to an affordable housing policy. The policy seems to be applicable only to housing projects in the City of Buffalo and not in the suburbs.

Policies such as the one proposed have been implemented in other communities in the United States with varying results. The impact of such policies depend in large part on the financial conditions in those communities. Factors to consider include, but are not limited to, housing demand, household income and economic and population trends.

The Erie County Industrial Development Agency adopted an Adaptive Reuse Policy in 2008 and has administered the policy since its inception. Redevelopment Resources, an independent company, was contracted to perform a review of the Adaptive Reuse Policy. In its report issued in June, Redevelopment Resources concluded that the Erie County Industrial Development Agency's Adaptive Reuse Program "is one of the most successful adaptive reuse programs in the country." While lauding its successes, the report stressed further study "[p]rior to considering adjustments or changes to this very successful program."

Since the announcement at the State of the County address, the Comptroller's Office has received a number of inquiries as to how such a proposal would impact housing stock in the City of Buffalo. Concerns included the impact of the policy on redevelopment of existing properties, changes that would have to be made to projects in order to make them still attractive to developers and the potential cost of the policy to taxpayers. This report will examine the potential impact of implementation of such a plan.

INCLUSIONARY ZONING

The Erie County Industrial Development Agency proposal sounds similar to inclusionary zoning requirements implemented in some municipalities in the United States. Unlike zoning, which applies to all projects in the municipality meeting certain thresholds, the present proposal would only apply to projects receiving support from the Erie County Industrial Development Agency. Because the proposal would not be subject to the scrutiny and actions of the legislative process, it would be considered a policy of the Erie County Industrial Development Agency, not a law. However, the effects of the policy would mimic the inclusionary zoning laws implemented in other municipalities. As such, it is fair to compare the conditions of and actions taken by other municipalities with respect to inclusionary zoning to the present proposal.

In an October 2012 report prepared for the Erie County Department of Environment and Planning entitled "Affordable Housing and Zoning Techniques," impediments to fair housing created by zoning, as well as alternative options to promote fair housing, were discussed. The report states that fair housing does not discriminate on the basis of race color, religion, sex, national origin, family status or persons with disability. Although fair housing does not specifically address income, it finds that there is a close relationship between fair housing and affordable housing, due to the overlap between those protected categories and income. As such, affordable housing is a proxy for fair housing.

The report discusses one way that many communities have encouraged affordable housing through incentive zoning, also sometimes referred to as inclusionary zoning. Incentive zoning is more likely to be mandated in areas with high housing costs. The report cites Boston, Massachusetts, the State of California and Washington, DC as areas with mandated incentive zoning. In New York State, incentive zoning is voluntary. A typical requirement for mandatory incentive zoning is to provide low cost housing for 10 – 25% of the units. The units must be affordable to households with moderate incomes, although there may be requirements for low income households as well.

Incentives may include:

- Density bonuses
- Reduced setbacks or design standards
- Increased heights of the building
- Flexibility on open space requirements
- Expedited approval process
- Flexibility in the types of uses for the property
- Reduced parking requirements
- Financial incentives, including reduced permit fees, property tax abatements and other subsidies

The policy proposal for the Erie County Industrial Development Agency, as discussed in the State of the County speech, focusses on the expectations of what a project would provide to the community that would not otherwise be in the developer's ideal proposal, namely, ten percent of the housing units being offered at less than the market rate. It did not discuss what the Erie County Industrial Development Agency would, or even could, provide in return for offering these less than market value housing units.

ECONOMIC CONDITIONS IN BUFFALO

For decades, there has been a continuing discussion regarding flight from the City of Buffalo to suburban areas. One of the common reasons cited for the existence of suburban flight is class and economic considerations. In a nutshell, some individuals are choosing to move from the city to suburbs, because they view the city as poorer and the suburbs as more affluent. This perception seems to be supported by certain economic statistics.

Poverty levels in Buffalo are amongst the highest in the United States. According to a United States Census Bureau report, Buffalo had the 16th highest poverty rate amongst the 589 largest cities in the United States. The federal poverty level in 2016 was defined as a household income below $24,250 for a family of four. Buffalo's median income per family was $63,900.

Due to factors including, but by no means limited to, suburban flight, Buffalo is also a shrinking city. The population of Buffalo has shrunk 1.7% since 2010, from 261,325 to an estimated 256,502. As the decade has progressed, the rate of population decrease has accelerated. A decreasing population without a corresponding decrease in housing stock would lead an individual to intuitively conclude that more housing would be available to the remaining residents of a community. Census data seems to support this conclusion.

The United States Census Bureau American Community Survey (ACS) provides data for many statistical areas, including housing and income. ACS data for the Buffalo-Niagara Falls metro area shows that median monthly gross rent as a fraction of median household income was 16.99% in 2015, the most recent year for which complete data is available. This marks a 0.72% decrease since 2014. Rent is considered affordable when it accounts for 30% or less of a household's income. Reasons for this change include increased income and decreased rental costs. The data also indicate a trend of an increasing number of households renting as a fraction of total Buffalo-Niagara Falls metro area households. Despite this increasing trend in renting instead of owning, the vacancy rate is 7.16%. This is considered a substantial vacancy rate.

Housing is a major factor as to why Forbes magazine routinely names Buffalo as one of its most affordable cities in the United States. For 2017, it cites, among other factors, the fact that 81.8% of homes would be affordable to residents who make the median household income, based on the Housing Opportunity Index from the National Association of Home Builders. Of course, low Income by definition is those households with incomes between 51% and 80% of the area median income. Given a median family income of $63,900, low income would be considered households of four people with a household income between $32,389 and $51,120. The Housing Opportunity Index does not speak directly to the affordability of housing to low income buyers, nor does it speak directly to the affordability of rental properties to low income households or the availability of rental units to low income households. However, it does offer insight as to the overall affordability of housing in the Buffalo metropolitan area.

Further, these numbers do not reflect data solely from the City of Buffalo. As stated, it is the Buffalo-Niagara Falls metro area. Although broader in scope than Buffalo's city boundaries, the data does offer significant insight into economic conditions in the City of Buffalo. That data supports the view that housing in Buffalo is more affordable than most other cities throughout the United States.

According to the Erie County Industrial Development Agency, "[t]he mission of the Erie County IDA is to provide the resources that encourage investment, innovation and international trade, creating a successful business climate that improves the quality of life for the residents of the region." Implementing a requirement that residential projects receiving Erie County Industrial Development Agency support mandate a minimum number of lower income housing units may or may not further the stated mission. If a project proceeds, it would seem that the quality of life for residents who are able to move into the newly refurbished and updated units would undoubtedly be improved. However, that assumes that the project proceeds at all.

EFFECT OF MANDATED HOUSING COMPONENT ON INVESTMENT

The Urban Land Institute conducts an annual study of Emerging Trends in Real Estate. The 2017 study examined markets and their potential for investment opportunity for 78 cities across the United States. It considered real estate areas such as office, retail, industrial, multifamily, hotel and housing. The study ranked Buffalo the lowest – 78 out of 78 – for its real estate market. Particularly low rated were Buffalo's multifamily and housing sectors. The study noted Buffalo's high affordability index, scoring the highest of the 78 markets. Higher affordability can be an indication of lower demand for housing or a higher supply of housing, resulting in a lower potential for profit for housing projects. Buffalo also scores lower than the national average for rent as a percentage of household income. While rent as a percentage of household income is 25.3% across the nation, it is only 21.7% in Buffalo. Buffalo scored significantly lower than any other city in the study for investment prospects in the multifamily sector, including rentals, and tied for second lowest in the housing sector.

In short, of the 78 cities studied, 77 cities were considered better investment opportunities for multifamily properties and only one city was considered worse than Buffalo for housing properties. Given the comparative opportunities across the United States, investment in these sectors in Buffalo could benefit from programs to encourage, rather than discourage, investment.

Unfortunately, requirements mimicking inclusionary zoning may serve to discourage, rather than encourage, investment in some projects. If the project does not proceed, residential units slated to be created by such a project will not be created. The housing stock in the city will not be expanded by that project. Individuals will not be lured back to the city to live in that project. Associated economic gains by attracting residential consumers back to the city will be lost. The opportunity to negotiate less than market cost housing as part of a mutually arrived at agreement will also be lost.

In examining this issue, input from developers who are in the business of developing properties were contacted to evaluate how investment in downtown housing projects might be impacted by a blanket policy mandating that specific percentages of residential units by reserved for less than market cost housing in order to receive Erie County Industrial Development Agency investment support. As could be expected, the individuals who spoke on the issue were opposed to implementation of such a policy. Such comments were expected due to the potential reduction in profitability of a project that decreases the potential rental income to the owners of the property. However, the issue is not whether the developers liked the policy proposal – they did not – but whether the implementation of such a policy would serve to deter investment downtown.

Mandating a set minimum percentage of rental units to be affordable to lower income households would cause developers to earn lower profits on a project. Not only do lower profits affect the bottom line directly for the developer, they also could impact the cost or even availability of financing for the project. A given project is considered riskier if it is anticipated to earn less profit than it otherwise would. Reduced profit margins increase the possibility that unforeseen contingencies could cause the project to lose money, jeopardizing the ultimate satisfaction of lending terms.

For example, a project costing $8,075,000 would typically be funded by the developer, loans and other sources. The developer would invest 25 percent of the project's cost, which would be $2,018,750 in this example. The developer would then seek bank financing, with the gap remaining after developer and bank financing to be funded through public sources, such as tax credits and Industrial Development Agency funding. Without a mandated housing component, a bank would likely be willing to finance $4,441,250. This would leave the developer to seek $1,615,000 in public funding to fill the financing gap and allow the project to proceed.

With a mandated housing component, the profitability of a project decreases. The decreased profitability increases the risk both for the developer and the lending bank. As such, bank financing in this example is reduced to $2,826,250. The need for public funding is doubled to $3,230,000 for the project to proceed and any housing units to be built.

Absent the doubling of public funding under an inclusionary housing mandate, economic models predict that developers would take steps to increase revenue to a level that would make the project attractive again. Developers may choose to increase rent on remaining units not subject to lower income limitations. This strategy is more viable in an area with a high demand and high income housing environment. The increased rent would make housing less affordable for individuals at the income that could otherwise afford the rental units, possibly discouraging those individuals from renting the units at all. Such a concern could cause the developer to abandon the project and develop projects in areas which are not constrained by mandates to provide less than market cost housing. Making matters worse, if new units are not ultimately developed in an area, the laws of supply and demand suggest that housing prices will be generally higher than if the units were ultimately built. The well-intentioned proposal to reduce housing costs would have the opposite effect.

It should be noted that the deleterious effects of policies mimicking inclusionary zoning would not be expected to be as prevalent in "hot" real estate markets. In such markets, the opportunity for profit is higher, in large part because the demand for housing is higher. Higher demand drives up prices. The potential for higher rent makes inclusionary zoning policies a cost of doing business in a still profitable real estate market. Projects with lower potential profit would more likely be negatively affected by less than market cost housing mandates.

Buffalo is not considered "hot" real estate market. As discussed earlier, Buffalo ranked 78th out of 78 cities examined for attractiveness of real estate markets for investment. The Urban Land Institute study noted that Buffalo had recovered the jobs it lost during the recession, but cited a lack of positive momentum. Concerns contributing to the lack of momentum include declining population, slow demographic growth and low residential and retail growth. As such, making projects less attractive to developers could result in less projects being undertaken. This would not only fail to increase the housing stock, it would also cause an opportunity for construction jobs to be lost.

EFFECT OF MANDATED HOUSING COMPONENT ON NEIGHBORHOODS

Of course, residential and retail growth go hand-in-hand. In order to grow retail, you need consumers. One source of consumers is individuals living in close proximity to retail establishments. It follows that increasing residential mass can contribute to retail growth. Further, increasing appropriate retail options in an area is sometimes cited as a factor making it attractive for residential growth. There may be a "hen before the egg" question as to whether residential growth spurs retail, or whether retail spurs residential. They are certainly complementary. However, if a residential project is not built, there is less incentive to develop retail options in an area.

In addition to building communities through retail offerings, advocates also cite creation of access for moderate and low income households to quality schools as a reason for inclusionary zoning. One factor driving housing costs up is access to quality schools. Units with such access tend to cost more than comparable units without such access. Regardless, many educational researchers argue that by giving lower income families access to higher quality schools, the opportunities for success in school and therefore the opportunity to break the cycle of poverty are increased.

RealtyTrac conducted a study in 2015 which concluded that homes were not affordable for average wage earners in 65% of the 1,823 zip codes with good schools. The least affordable zip codes were in San Francisco, New York City and Phoenix. The fifth most affordable zip code with a good school was in Buffalo, New York. Buffalo was commended for having ten zip codes with both affordable homes and a good school. One concern, although not immediate, is that providing a good school would tend to drive up housing costs. That reason should not be a factor to discourage improvement of our schools. There are steps that can be taken to address the issue of rising housing costs due to quality schools, if and when it arises, that do not directly affect housing stock availability.

Certainly, Buffalo provides more opportunities for affordable housing in areas with good schools than most other cities in the United States. This does not mean that improving access to good schools is not desirable or possible. However, the blanket proposal of mandating less than market rate housing in Erie County Industrial Development Agency supported projects does not ensure that housing will be created in areas with good schools. Projects could be built in areas considered lacking a good school. If that occurs, it would have the effect of driving lower income families into housing that, while attractive and modern, provides less than ideal educational opportunities for their children.

CURRENT ERIE COUNTY INDUSTRIAL DEVELOPMENT AGENCY ADAPTIVE REUSE PROGRAM

The Erie County Industrial Development Agency currently operates an Adaptive Reuse Program. The Erie County Industrial Development Agency recently released a study that examined the success of the program as operated. It found that the program leverages $36.10 in benefit to the community for every $1 given in tax breaks. In addition to creating 1,865 permanent and 4,500 construction jobs, fifty-three properties (4 million square feet) were transformed from vacant to in use. More than 1,100 housing units have come on-line due to the program.

By transforming vacant properties into commercial and residential units, the program has lured people back downtown. By offering a variety of housing options, neighborhoods are being transformed from poorer to mixed income communities, which would seem to be one of the goals of the proposal advanced during the State of the County speech.

The State of the County proposal seems to stress the importance of creating mixed income communities by mixing units within buildings, without looking at the composition of the neighborhood as a whole. If investment is stalled due to policies mimicking inclusionary zoning, it could have the unintended effect of slowing the growth of mixed income communities, while promoting vacant properties in poorer neighborhoods to remain vacant.

The study, while lauding the success of the program, stressed caution and further careful study before making changes to the program. It suggested looking at areas, rather than individual parcels, as potential adaptive reuse projects. It suggested consideration of the impact of expiring tax credits on the affordability of debt service for reuse projects. Given these conclusions by Redevelopment Resources, caution should be exercised before changing a currently successful program.

CONCLUSION

Requiring that a minimum percentage of rental units be available in order for a residential project to receive Erie County Industrial Development Agency support and benefits could hinder development downtown. Given the state of the economy, it is widely viewed that Erie County Industrial Development Agency support and benefits are not only desirable, but they are necessary for some projects to proceed at all. The support is necessary for the project to reduce financial risk and be deemed profitable. Profitability is necessary in order to secure financing for projects. It is unlikely that a significant number of projects will proceed on a cash basis, with limited outside financing. As such, without financing, development of these projects is unlikely.

A mandated low income housing component for each residential project also tends to reduce profitability. Given this loss of profitability, developers must be further incentivized in order for a project to proceed. These incentives go beyond tax breaks and other increased direct financial incentives, and include variances as to what otherwise would be allowed for a project. Without increased incentives, a project may not proceed.

Further, mandated less than market cost housing requirements are extremely localized in scope. They look solely at what is included in a given project. They do not look at the presence and availability of low income housing options in the surrounding neighborhood. They do not consider if more low income housing is needed in a particular area. A blanket policy does not incentivize the projects to be built where they are most needed to assist in revitalizing a neighborhood.

The goal of providing affordable housing to a larger segment of the population is admirable. However, mandates such as the one proposed for the Erie County Industrial Development Agency may unintentionally run counter to these goals, by diminishing flexibility to negotiate project details that are beneficial to both the developer of the project and the community as a whole. Discouraging development is not beneficial to the goal of rebuilding and revitalizing downtown Buffalo. Further careful study is needed before implementing any policy which may mandate lower than market cost housing as part of any project receiving Erie County Industrial Development Agency benefits.