AFFORDABLE HOUSING IN MONTGOMERY COUNTY, MARYLAND: INCLUSIONARY ZONING AND BEYOND

Introduction

In 1974, Montgomery County, Maryland became the first municipality in the nation to enact an inclusionary zoning law. At that time, the County's population was 564,000 and most new residential construction consisted of single family houses.

The County's inclusionary zoning law, known as the Moderately Priced Dwelling Unit (MPDU) Law[1], has served the County well by producing 11,700 affordable housing units. But 2006 is not 1974, and the program that once worked so well in producing significant numbers of affordable units, consisting mostly of town house and garden apartments in large acre developments, is no longer working so well. Why? Because of the tremendous growth that has occurred in the County since 1974. The County's population is now 942,000. Residential construction is primarily multi-family housing and a large percentage of that is devoted to luxury high rise buildings. As the population has increased, the land available for residential construction has diminished – large acre tracts are scarce and, absent significant zoning changes, the County will be "built out" in less than 20 years.[2] The result has been a decrease in the number of affordable units built from small lots with expensive high rise construction.

The County has not stood idly by: In response to both the dwindling numbers of affordable units produced each year, and the transitioning of many affordable units to market rate as MPDU covenants expired, the County recently made significant changes to the MPDU Law. While these changes been largely positive, some additional adjustments may be necessary – not only to the MPDU Law but also in the approach the County takes to constructing and retaining affordable housing.

The MPDU Law – Basic Tenets and Not So Basic Difficulties

The MPDU Law is an inclusionary zoning ordinance because it applies to almost all residential zones in the County – the exceptions are the zones with permitted densities of less than 1 house per acre.

MPDUs must be constructed in projects containing 20 or more residential units. Originally, the law applied only to projects with 50 or more units. Within the last three years, this number was reduced to 35 units, and then to 20 units.

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[1] The MPDU Law is located in Chapter 25A of the Montgomery County Code. The Montgomery County Code can be accessed at www.amlegal.com.

[2] 93,000 acres of the County's 317,000 acres is zoned for agriculture and MPDUs are not required in the agricultural zones. In addition, 65,000 of those 93,000 acres are preserved for agricultural use through various types of easements. A change in zoning would not be sufficient to construct MPDUs on those 65,000 acres – the easements would also have to be terminated.

Both rental and for sale MPDUs are protected by covenants recorded in the County's land records.[3] The covenants provide, among other things, the number of years that the unit must be maintained as an MPDU, the requirement that the unit must be occupied as the tenant or owner's primary residence; and, if the MPDU is sold during the covenant period, the sales price must be determined by the County, not the owner.

Developers must construct MPDUs at a rate that is not less than 12.5% of the total number of market rate units in a project. The construction of additional MPDUs above the 12.5 % floor, up to a cap of 15% of the total housing project, results in a bonus density. Developers are given bonus densities based on a sliding scale that ranges from 0 additional market rate units (for 12.5% MPDUs) up to 22% (for 15% MPDUs).[4] In recent years, developers have had an increasingly difficult time realizing bonus density on small lots because development standards (like neighborhood compatibility and environmental requirements) do not always permit the construction of the full bonus density. Last year, in an effort to combat this problem, the County Council adopted some changes to the County's zoning ordinance to increase the permissible building height in certain zones. [5]

Developers are expected to construct the MPDUs without County resources.[6] In large measure, the developers in Montgomery County have willingly participated in the MPDU program because, altruistic motivations aside, a basic tenet of the MPDU program has been that the developer will realize a profit on the overall project.[7] Perhaps that is why Montgomery County has never had to defend a "takings" challenge by a developer. However, a developer's profit margin and MPDU affordability have become important issues in the County.[8]

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[3] Sample MDPU covenants and other helpful information are maintained by the Department of Housing and Community Affairs on the County's website: www.montgomerycountymd.gov\mpdu.

[4] If, for example, the zoning on a project would permit 100 units, a developer who constructed 15 percent (or 15) MPDUs would receive the maximum bonus density of 22 percent, so that the total number of units in the project would be 122: 100 market rate units, 15 MPDUs and a bonus of 7 market rate units.

[5] The County's zoning ordinance is located in Chapter 59 of the Montgomery County Code.

[6] There is some cost to the County because the staff of the County's Department of Housing and Community Affairs (DHCA) is paid at tax payer expense to administer the MPDU program.

[7] The policy declarations in the MPDU law include the following:

> The County Council hereby declares it to be the public policy of the County to:
> (4) Encourage the construction of moderately priced housing by allowing optional increases in density in order to reduce land costs and the costs of optional features that may be built into such moderately priced housing; [and]* * *
> (6) Ensure that private developers constructing moderately priced dwelling units under this Chapter incur no loss or penalty as a result thereof, and have reasonable prospects of realizing a profit on such units by virtue of the MPDU density bonus. . . .

Section 25A-2 of the Montgomery County Code.

[8] The maximum income (or affordability) limits for the MPDU program are set at about 65-70% of the median income for the Washington Metropolitan Area (WMA) adjusted for family size, as determined by

The scarcity of large acre parcels has redirected construction from single family and town house projects to high rise development in central business districts located near the Metro. Because of the proximity to offices and transportation, the land value for these new projects is high. Likewise, the construction material for high rise buildings (anything over 4 floors) is more costly than "stick" construction. If you add a monthly condominium fee to the land and construction costs, fitting the MPDUs into that project can become an economic headache – both for the developer and for the prospective MPDU owner. Presumably, the additional market rate units created by the bonus density help subsidize the MPDUs, but the developer can not always squeeze all of the additional density into the zone. As for the prospective MPDU owner, the subsidy created by the additional market units only offsets the cost of the unit – not the monthly condominium fee she must pay.

Over the years, developers who faced these tight economic situations were provided alternative methods by which to meet their MPDU requirements. These alternative methods included: (1) making a payment on a per unit basis to the County's Housing Initiative Fund (HIF) in lieu of constructing the MPDUs; (2) donating land to the County for affordable housing construction; or (3) constructing the MPDUs in an adjacent (instead of the same) planning area. Two years ago, these "buy out" options became very controversial. The controversy was fueled by several factors: a) the number of MPDUs being built was diminishing, many current MPDUs were at the end of their covenant periods, and there was concern that the buy outs only exacerbated the problem of dwindling MPDUs; b) a perception that the fees collected were, in effect, wind falls to the developers because the fees did not provide sufficient funds to construct the same number of units elsewhere; and c) the perception that, as a result of the buyouts, the MPDUs were not being built in the wealthier sections of the County.[9]

Recent Changes to the MPDU Law

In 2004 and 2005, the County Council passed legislation in an attempt to address these issues. Buyouts are now very difficult to obtain: they must be reviewed by a three person panel, as opposed to only the Director of the Department of Housing and Community Affairs. Payments in lieu of constructing the MPDUs are limited either to situations in which the environmental constraints of the building site render the construction of the MPDUs economically infeasible or an indivisible package of services

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the Department of Housing and Urban Development (HUD). This cap translates, approximately, to a starting teacher's salary in Montgomery County. Currently, the maximum income for eligibility in the MPDU Program for those who wish to purchase an MPDU ranges from $44,000 for an individual to $68,000 for a family of five. The rental incomes range from $40,000 for an individual to $62,000 for a family of five. There is no mandated "floor" for a person to be eligible to either rent or own an MPDU, but that person must demonstrate that she can afford the rent or the mortgage payment.

[9] Although never mentioned by the critics of the buy outs and the MPDU program, MPDU units have always been preserved by the County's housing authority and non-profits. Under the MPDU law, the housing authority and non-profits can acquire up to a total of 40% of the MPDUs constructed in each project. Once they are acquired, the covenants on the MPDUs are usually extended for periods up to 40 years in exchange for favorable acquisition loans provided by the County.

(such as condominium fees in a luxury condominium or retirement community) increases the cost so significantly that the MPDUs are effectively unaffordable. Also, if a developer can make the case that a buyout is appropriate, the amount of the payment to the Housing Initiative Fund is now mandated by the County Code – the payment "must equal or exceed 125% of the imputed cost of the land for each unbuilt MPDU." *Section 25A-5A(b) of the Montgomery County Code.* The imputed land costs "must be calculated as 10% (for high rise units) or up to 30% (for all other housing units) of the actual sale price charged for each unit." If the MPDUs will be rental units, the land costs are imputed using the rent actually charged.

There is some opportunity for a developer of a high rise residential building to provide some or all of the MPDUs at another location if that location is in the same planning area (the MPDU Law used to permit locating MPDUs at an alternative location in an adjacent planning area). *Section 25A-5B of the Montgomery County Code.* The difficulty is that the cost of land (if the developer will construct the MPDUs), or the cost of housing, (if the developer will rehabilitate existing housing for the MPDUs), in the same planning area is likely to be as expensive as the land for the high rise project.

No developer has sought to use a buyout since the effective date of the new law, April 1, 2005. However, several new condominium projects are on the horizon and land costs, as well as the adverse impact of the condominium fees on MPDUs, may force developers to use the new procedure or challenge the new buyout procedure.

Another change to the MPDU law intended to address the diminishing number of MPDU units was to substantially increase in the number of years that a unit must remain an MPDU. Instead of an MPDU being available for sale at a market rate price after a covenant period of 10 years, a new for sale unit is now subject to MPDU covenants for 30 years. Further, the "for sale" covenants will be extended for another 30 years every time the MPDU is sold within the initial 30 year period – rendering the unit, for all intents and purposes, an MPDU in perpetuity. Rental MPDUs used to be subject to MPDU covenants for 20 years, but now are covenanted for 99 years.

The change in the MPDU covenant period is a dramatic one in Montgomery County because new MPDU owners will no longer benefit from market rate sales at the end of 10 years.[10] Instead, the financial return for an MPDU owner who sells her unit is limited to increases in the Consumer Price Index (CPI) and to credits added to the sales price to compensate the owner for capital improvements made to the unit.

The County's Housing Initiative Fund, or HIF, has benefited from the sale of the MPDUs with expired covenants. An MPDU owner must give the County one-half of the profit realized by the first sale of an MPDU after the expiration of the covenants. The

[10] In Montgomery County, the experience has been that the market units adjacent to the MPDUs have helped to increase the post-covenant sales price for the MPDUs, as opposed to the MPDUs adversely affecting the value of the adjacent market rate units. The value of some MPDUs, such as those at the Avenel, a high-end golf course community, has increased by more than four times the original purchase price.

County's share of the profit is deposited in the HIF (the HIF is discussed below). Because of the tremendous increase in property values over the last several years, many owners sold their MPDUs without notifying the County and without sharing the profit. There were also owners who sold their MPDUs at market rates while the units were still under MPDU covenants. (Apparently, title companies either did not read, or heed, the requirements of the covenants on the land records when completing the sales transactions). As a result, the County has put several procedures in place to ensure that it has advance notice before an MPDU sale goes to closing. It has also taken collection action against all of the errant owners, resulting in hundreds of thousands of dollars being collected for the HIF.

What will the future hold?

There are currently 1,300 MPDU-eligible persons looking for housing in the County. Hopefully, the recent legislative requirements for MPDUs will help enlarge the pool of MPDUs and thereby reduce the size of the waiting list. But even if the MPDU waiting list gets some relief, there are many residents whose income falls either above or below the MDPU eligibility ranges of 60-70% of the area's median income.

Many county workers like nurses, teachers, police and firefighters earn too much to be eligible for the MPDU Program, but market rate housing is beyond their means. In 2004, the median price for a new, single family detached house in the County was over $660,000 and that price has increased. As a consequence, these service providers are moving out of the County.

To address worker flight, Bill 30-05 was introduced in the County Council last fall.[11] The bill's targeted audience is residents earning between 80% and 120% of the area's median income. The fundamentals of the bill are the same as the MPDU program. However, there are few differences: the housing covered by the bill is located in the expensive central business districts (commercial centers close to the Metro) and developers would have both a minimum 12.5% MPDU requirement as well as a 10% work force housing requirement. Unlike the MPDU bonus density, the bonus density for work force housing would be limited increasing the project size to compensate only for the number of units required to construct work force housing units.

After many hours of hearings, including testimony from economists, Bill 30-05 remains in committee. Like the difficulties presented by attempting to fit MPDUs in high rise buildings in these central business districts, it is clear that it will be very difficult to achieve both the MDPUs and the work force housing units without substantial subsidies from either developers or the market rate occupants. Currently, neither prospect appears to be politically tenable in the County. It is possible that the County could agree to fund some of the gap between the cost of constructing the MPDU and work force housing units and the sale or rental price for the units, but that funding may direct money away

[11] http://www.washingtonpost.com/wp-dyn/content/article/2005/10/10/AR2005101001585.html

from housing projects that currently assist residents whose incomes fall below the MPDU eligibility levels.

In addition to funding received from federal and state sources, the HIF is used by the County to provide housing for those whose incomes are less than the MPDU income ranges. Funds from the HIF assist the County's housing authority (the Housing Opportunities Commission) and other non-profit and low-income housing providers in acquiring, constructing and rehabilitating housing. The HIF is funded from a variety of sources including County transfer taxes, a fee levied against units converted into condominiums, an annual appropriation from the County Council and repayments from loans made out of the HIF.

Among other things, the HIF is used for gap financing by providing long term, low interest loans. In exchange for these favorable loans (which are secured by the projects they finance), borrowers agree to provide a certain number of units to persons whose income levels are usually between 40% and 60% of the area's median income for the life of the loan. The requirement to provide these units is recorded among the land records and does not terminate if the loan is repaid prior to the maturity date. Recently, the HIF has also been used to entice owners, through subsidies, to renew their Housing Assistance Program (HAP) contracts with HUD in order to maintain Section 8 housing and to acquire housing for formerly homeless persons.

There is never a shortage of requests for assistance from the HIF and that demand is bound to continue as federal dollars for programs like Section 8 and the Community Development Block Grant (CDBG) are cut. Demand for the HIF dollar may also increase if the County determines that the MPDU and work force housing programs require some subsidies.

Difficult decisions lie ahead as the County determines where to allocate it housing dollars. The County's housing needs now span the spectrum of income levels -- from the homeless to those who make 120% of area median income. What is clear is that the basic underpinnings of the County's inclusionary zoning program are no longer reality. The County must be attentive to the economic difficulties that arise from attempting to use what may now be an outdated housing model to fit new development facts – small lots in expensive central business districts. The County must, necessarily, be more creative and flexible to meet the increased housing needs. Who knows, maybe next year the County will determine that MPDU buy outs are a good vehicle for providing additional funding to the HIF?

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Montgomery County, Maryland
April 2006

* Thank you to the County's Department of Housing and Community Affairs and Christopher J. Anderson, Manager of Single Family Programs, for their assistance with statistical information for this article.