



Affordable Housing – What’s the Answer?

Everyone agrees that housing needs to be more affordable. The question is what is the best thing the City can do to help? There are many alternatives. Unfortunately, a majority of the City Council seems convinced that the only answer is one that will raise the price of housing for the majority of San José residents, do little to produce homes for low-income individuals, and make San Jose an less desirable place for new families to want to call home.

On June 17th the San José City Council narrowly voted to move forward with a plan to require home builders to set-aside a portion of every new housing development at below-market, subsidized prices. This requirement, known as inclusionary zoning, is likely to increase the cost of buying or renting a home for most San Jose residents. The City Council will likely consider implementing inclusionary zoning citywide this fall. State law already requires inclusionary zoning in neighborhoods that cities have designated as *Redevelopment Project Areas*, in order to spend redevelopment funds on community improvements.

Through the *Strong Neighborhood’s Initiative* and other redevelopment efforts the City of San José has already designated a large percentage of the city as a Redevelopment Project Area. Since this designation carries with it the requirement of inclusionary zoning, the City has already built tens of thousands of housing units that sell or rent at rates far below fair market value. For example, all of downtown San José is designated as a Redevelopment Project Area and therefore requires home builders to sell or rent up to 20% of the units at rates far below what the other 80% of the owners or renters pay. Often times, those paying “market rate” pay a little extra to ensure that the other 20% can be sold or rented at a discount.

The downside of inclusionary zoning is that home builders are forced to raise the price on market-rate units or rely on public subsidies in order to defray the costs of the affordable restrictions and make their projects pencil out. To better illustrate this point consider the following example: A home builder is building a project with 100 units and needs to charge \$700,000 on each home to make the project pencil out, but because of inclusionary zoning is required to sell 20 homes to at \$400,000 to those who meet certain income qualifications. He then has to charge \$775,000 on the remaining homes in order to make up the difference and in effect, artificially raise the median price of all homes in the area. The 80 market-rate homes shoulder the burden of the affordable restrictions. In

the current housing market the additional \$75,000 could mean the difference between a family qualifying for a mortgage and not qualifying. Is it right that for the City to require a home-builder to provide homes for a small number of individuals if it means that the rest of the homes in the area will be less affordable?

Traditionally, San José home builders have either chosen to specialize in market-rate housing and avoid building in Redevelopment Project Areas or they have developed the expertise to get public subsidies. Most builders who build homes with affordable restrictions also build market-rate homes in order to diversify their portfolios, but most market-rate builders have little or no experience building or managing the complexities of housing units that must be set-aside at below market rates. These builders are likely to avoid building in San José if a citywide inclusionary zoning ordinance is passed, further limiting the number of homes built in San José every year.

Anyone who has studied even basic economics understands that the law of supply and demand has the greatest effect on a product's cost. Limiting the number of market-rate homes that are built in San José will drive up the costs of the homes that are built. Furthermore, public funding for housing at all income levels is scarce as the City, State and Federal governments are all dealing with ballooning record deficits. This will leave builders with no other alternative but to charge more for market-rate homes or not build at all. When governments regulate the market with price controls the results are usually the opposite of what was intended. Production declines, but the demand remains constant. The result is higher prices for the majority.

This conundrum is not unique to San José. In fact, cities around the country are dealing with how to provide housing that is affordable to everyone. Recent studies of cities with citywide inclusionary zoning ordinances show that inclusionary zoning results in higher overall prices for homes and apartments while doing little to improve affordability for most residents.

What's the alternative? San José needs to work with home builders to leverage our limited public funds in ways that benefit the greatest number of people, such as low-interest mortgages for first-time home-buyers, security deposit assistance for renters, identifying land for affordable housing, and builder incentive programs that expedite the approval process for projects that are reserved for below market rate renters and buyers.

Councilmember Pete Constant will be hosting a round table discussion this fall with home builders, community leaders and affordable housing advocates called, *Alternatives to Inclusionary Zoning: Making Housing Affordable for Everyone*. This discussion will help to develop reasonable recommendations for addressing the City's need for housing that is affordable, without inadvertently raising the cost of housing for the majority of San José residents.