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MEMO

DATE: February 9, 2018

TO: Susan Anderson, Director, Bureau of Planning and Sustainability
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FROM: Tyler Bump, Senior Economic Planner

CC: Planning and Sustainability Commission

SUBJECT: One Review of Inclusionary Housing Zoning Code and Program

DRAFT
February 9, 2018

After the adoption of the Inclusionary Housing (IH) requirements, there has been significant speculation about the impact on the economics of real estate development and the production of new housing. This memo provides an analysis of one year of development permit activity under the new Inclusionary Housing Zoning Code and Program regulations.

The analysis shows that Pre-IH vested applications continue to work their way through the development review process at a rate that is consistent with recent development trends. However, between February 1, 2017 and February 1, 2018, the rate of filing new applications is significantly slower compared to other years, both pre- and post-recession. This reduction in development application activity was anticipated as the market absorbed pre-IH vested projects. However, permit activity was expected to increase as pre-IH projects are delivered to the market.

This slow down coincides with new IH requirements and market factors including - higher construction costs, tighter lending standards and stabilizing rents - all of which affect development feasibility.

Key Findings

- There are approximately 10,000 units in 81 projects of 20 or more units remaining in the current development pipeline. 5,000 of these units are currently under permit review or approved to issue.
- This current development pipeline represents around 18-24 months of additional development projects that could be delivered to the market.
- Between February 1, 2017 and February 1, 2018, new building permits were filed for 17 projects subject to IH requirements. Twelve of these projects are privately financed and include 565 market rate units and 89 affordable units. The other five projects were affordable housing with public financing.



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Progress of Pre-IH Vested Projects Through the Development Pipeline

For the purposes of this analysis, two types of permits were used to measure new development activity. These are active Land Use Review and Building Permit applications. Of all these permits, only applications for projects subject to IH requirements – those with more than 20 units – were included. This represented 74% of all residential units permitted in 2017.

After the Oregon State Legislature passed Senate Bill 1533 in March 2016, the Bureau of Development Services (BDS) saw a significant increase in building permit and land use review applications. By the time the City of Portland IH program went into effect in February 1, 2017, staff estimated there were approximately 19,000 unbuilt but vested units in the development review pipeline.

By February 1, 2018¹, there were approximately 10,000 units in 81 projects over 20 units remaining in the pipeline. The reduction is due to permits that were completed or moved out of the pipeline due to being withdrawn by the applicant, expiring before fully vested, or being deemed incomplete. Approximately 5,500 units were issued building permits last year in buildings with 20 or more units.

Permit Pipeline as of 2/1/2018

	Projects	Units
Building Permit		
Under Review/Applied	57	4,998
Land Use Review		
Vested but not submitted for building permit	24	5,019
Total Pipeline not Final/Under Inspection	81	10,017

Post Inclusionary Housing Permit Activity

Between February 1, 2017 and February 1, 2018, permits were filed for a total of 17 development projects that were subject to mandatory IH requirements. Projects that have complied with the IH requirements are outside the Central City, relatively smaller in scale compared to recent development trends and do not require land use review. BDS staff continue to track and analyze post-IH land use review and building permit applications.

Twelve of these projects were privately financed. Five were affordable housing projects receiving some level of assistance from the Portland Housing Bureau.

The twelve privately financed projects included 565 market-rate residential units and 89 affordable units. Of the 89 affordable units, 69 units are provided at 80% MFI and 20 units are provided at 60% MFI.

The five projects that included Portland Housing Bureau financing were 100% affordable housing projects and account for 353 units of affordable housing at various income levels between 0% and 80% MFI.

¹ This review of LUR records includes all Type II, Type IIX, and Type III Design Review, Design Review with Modifications, and Historic Resources Review for the analysis period.



Mandatory IH Projects in Permit Pipeline

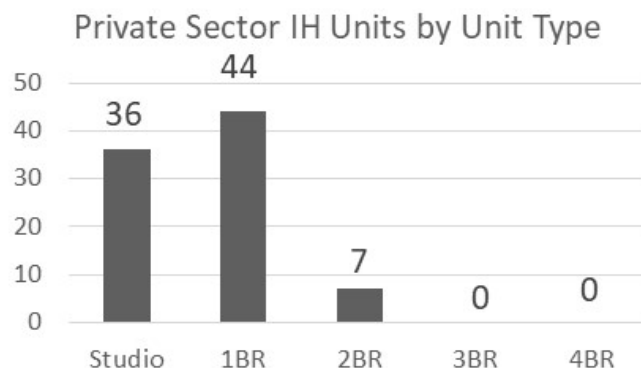
	Projects	Total Units	IH Units
Private Sector Projects Subject to IH	12	654	89
PHB Projects Subject to IH	5	353	28
Total Projects Subject to IH	17	1,007	117

*Two voluntary projects provided units on site, three projects will pay the fee in-lieu to access additional FAR

Three additional smaller (less than 20 units) projects have voluntarily opted into the Inclusionary Housing Program to access additional FAR beyond the base zoning allowances. Two of these projects dedicated three on-site affordable units at 80% AMI. One project has paid a fee-in-lieu to access 2,135 square feet of additional FAR.

Private sector development projects that complied with the IH requirement met the obligations in a variety of ways. Seven projects pursued the 80% AMI option, three projects pursued the 60% AMI option, and one project pursued the off-site dedication option. One recently submitted project is still working with PHB staff to identify which option they will use.

Most private sector projects that complied with IH requirements consisted of smaller units and satisfied their obligation by setting aside studio and one bedroom units within a project. The chart below shows the distribution on unit type for all projects that met the IH requirement by providing units on-site.



Post-IH Early Assistance Review Activity

Many projects come in for an Early Assistance (EA) appointment before a Land Use Review or Building Permit is filed. EAs can give a sense of future development permit activity.

Between February 1, 2017 and February 1, 2018 there were 52 EA appointments for projects that would comply with the IH program. It is anticipated that a number of these projects will move forward through the permitting processes. BDS staff note that projects can take upwards of one-year following the EA appointment to submit for a land use review or building permit due to the time necessary to obtain financing, acquire property and/or complete building design.



Feedback on Post-IH Activity from Focus Groups and Interviews

In January 2018, BPS staff conducted focus groups and interviews with people working in development in Portland to get their feedback on how the market is responding to the IH regulations. The following summarizes some of their observations:

- There was significant discussion that construction cost escalations, stabilizing rents, high land values and tighter lending standards along with recent implementation of IH is creating a perfect storm of slowing development activity.
- Participants who work in centers and corridors outside the Central City identified the gap between the IH requirements and the financial incentives as the biggest impact to development feasibility in those areas. The suggested solutions were to increase the incentives and/or reduce the inclusion rate.
- Those working in the Central City acknowledged that the tax exemption on all residential units in an IH building offered in the Central City significantly helps offset the cost of complying with the regulations.
- However, these same participants expressed significant concern about the uncertainty of what happens after the ten-year tax exemption expires and the project is assessed when it comes on the tax rolls in year eleven.
- All participants, both those active inside and outside the Central City, remarked on the difficulty of evaluating the financial impact of the 99-year duration of the affordability requirements in combination with financial incentives and ongoing operations and maintenance costs.
- Almost all participants discussed the difficulty of attracting capital to a project with the uncertainty of the tax rate after the ten year tax exemption, the 99-year affordability term, and the perception of an aggressive inclusion rate. There was significant discussion about the type of project financing e.g.; institutional capital, large banks, local banks, local investors and differences in perceived risk of IH uncertainty for different finance and lending sources.

Conclusion

During the post-recession development cycle (2013-2018) there have been 3,000 to 7,000 new residential permits issued per year in Portland. The current development pipeline of approximately 10,000 units represents around 18-24 months of supply if all these units are delivered.

To maintain housing production and housing supply targets identified in the 2035 Comprehensive Plan, the City of Portland would need to start seeing significant increases in land use review and building permit applications over the next six to twelve months to replace development pipeline units that will be delivered to market over the next 18-24 months.

With the understanding that there are challenges to development feasibility due to broader market fundamentals, BPS and PHB recommend we explore a process to make adjustments or modifications to the Inclusionary Housing Zoning Code and Program requirements.

