George Mason University School of Public Policy
Center for Regional Analysis

Policies and Programs to Preserve Affordable Housing:

A Review of Incentives and Recommendations for Northern Virginia

prepared for

The Alliance for Housing Solutions

by

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HIGHLIGHTS

Purpose of the Study

The Alliance for Housing Solutions (AHS) is embarking on a policy research project to develop recommendations for incentives to maintain and expand the supply of affordable rental housing in Northern Virginia. AHS provided a survey grant to review state, regional, and local policies and programs across the country that are targeted at preserving market-rate affordable units that are at risk of becoming unaffordable. The review and recommendations in this report represent the first phase of AHS's larger project.

The Alliance for Housing Solutions

The Alliance for Housing Solutions (AHS) is a 501 (c) (3) not-for-profit organization working to increase community knowledge and support for affordable housing through research, education and advocacy.

Key Findings

- While it is currently difficult for low- and moderate-income families to find affordable rental housing in Northern Virginia, recent trends in the regional economy indicate that the situation will become much more severe over the next few years.

- If the affordable housing problem in Northern Virginia is not addressed, families will have a harder time staying in the region and potential workers and employers may choose to locate elsewhere.

- The strong housing market has made it difficult, if not impossible for local governments to amass resources sufficient to buy rental properties or even to support non-profit organizations in their acquisition of rental properties to stem a net loss of affordable housing.

- No one set of tools has been implemented in any jurisdiction specifically to stem the loss of market-rate affordable rental housing. However, some incentives that have been tried in other places could be modified to be included in a comprehensive affordable housing strategy for Northern Virginia.

- Four action items are recommended for Northern Virginia jurisdictions:

    1. **Gather Information.** Develop a database of multi-family rental properties that includes rent, occupant, and sales history data, as well as impacts of rising operating costs.

    2. **Engage the Business Community.** Facilitate the creation of a business-led regional housing trust fund.

    3. **Institute a Condominium Conversion Tax.** Assess a conversion tax to slow the pace of condominium conversion and to generate additional revenue for affordable housing efforts.

    4. **Assist Owners with Operating Costs.** Explore the possibility of offering property tax exemptions and maintenance grants or loans to private and non-profit owners of market rate affordable rental properties.

Purpose

The mission of the Alliance for Housing Solutions (AHS) is to "increase the supply of affordable housing in Northern Virginia and especially in Arlington County through research, publication and advocacy." As one step toward that goal, AHS is embarking on a policy research project to develop recommendations for incentives to preserve the supply of affordable rental housing in Northern Virginia. This report provides a review of selected state, regional, and local policies and programs around the country which have been or could be used to *preserve market-rate affordable units that are at risk of becoming unaffordable as a result of strong regional housing demand.* The report concludes with four recommendations for actions by local jurisdictions.

The focus on *preservation* of existing units, rather than creation of new units, is intentional. Rising property values in Northern Virginia has made it very difficult for local jurisdictions to amass sufficient resources to build or acquire new affordable housing. Contributions from private developers, either via contributions to a housing fund or construction of new affordable units, are limited relative to the need. Therefore, an important strategy for local jurisdictions involves developing policies to stop the loss of market rate rental units that are affordable to persons and families with low or moderate incomes.

Included in the scope of this research is a review of financial and other tools designed to encourage owners of multi-family rental properties 1) to keep their units affordable or 2) to sell their property to non-profits or other organizations that will maintain the units as affordable. This report includes a review of some policies and programs that do not address exactly the issues identified by AHS. For example, some states have developed affordable preservation strategies targeted at housing projects with expiring federal subsidies. However, the specific incentives used in other jurisdictions often could be applied more generally to privately-owned, market-rate affordable rental properties in Northern Virginia. This review should be considered a supplement to other recent studies on affordable housing best practices prepared for the Washington DC region and area jurisdictions.[1]

Methodology

For this review of affordable housing preservation strategies, the focus was primarily on states, regions and localities that are well-known for their innovative approaches to affordable housing issues and/or have faced a strong housing market similar to the Washington DC and Northern Virginia housing markets. These jurisdictions include: Virginia, Maryland, California, Oregon, Minnesota; District of Columbia; Arlington and Fairfax counties; Alexandria and Norfolk cities; New York, Boston, San Francisco, San Jose, Chicago, Boston, and Vancouver, British Columbia.

1 For example. ICF Consulting. (2003). *Affordable Housing Case Studies: A Report for Arlington County*. Fairfax, VA: ICF Consulting; The Washington Area Housing Partnership. WOW! Why Don't We Do That in Our Jurisdiction?: The Washington Region's Best Affordable Housing Practices. Washington, D.C.: The Washington Area Housing Partnership; and The Washington Area Housing Partnership. *Toolkit for Affordable Housing Development.* Washington, D.C.: The Washington Area Housing Partnership.

The information reviewed for this report included summary reports and official documents accessed via the Internet. Sites accessed included state, county, city, and regional governing body web sites; sites dedicated to affordable housing policy, such as the Joint Center for Housing Studies, HUD, PolicyLink, and Knowledgeplex; and sites devoted to multi-family rental housing, such as the National Apartment Association, the National Leased Housing Association, and the Urban Land Institute. Interviews were also conducted with housing staff in Arlington County, Fairfax County, Montgomery County, the City of Boston, the City of Chicago, and the City of San Jose, as well as with private and non-profit multi-family property owners in Northern Virginia.

In this report, *market rate affordable rental units* refers to rental units owned by private or non-profit owners that charge rents consistent with conditions of the local housing market. In general, these property owners receive no or very little public assistance. *Subsidized or assisted rental units* refers to units in rental properties that receive federal, state and/or local subsidies or other assistance to keep rents at affordable levels. The recommendations in this report are targeted at market rate affordable rental units; however, the policies and programs in other jurisdictions reviewed for this report often target subsidized rental units. In many cases, these programs could be modified to address the loss of market rate affordable units.

Background

According to reports by the Metropolitan Washington Council of Governments (COG), the Washington DC region experienced a net loss of more than 20,000 subsidized/assisted rental units between 2001 and 2004.[2] Thousands more market-rate units have been lost as property owners renovate their properties to attract higher income residents who can pay higher rents or sell their rental properties to condominium developers.

The Arlington County Department of Housing and Community Development estimates that between 2000 and 2005, approximately 9,900 rental units in Arlington alone have become unaffordable to households with incomes at or below 60 percent of area median income. This represents a loss of 52 percent of the affordable units in the County. Condominium conversion has reduced further the supply of affordable rental housing in Arlington. Since 2004, about 2,300 rental units have been converted to condominiums. Another 500 rental units have been demolished for townhouse construction.[3]

The Urban land Institute (ULI) recently brought to light the impact that disinvestment is having on small rental properties—those under 50 units.[4] Many of these smaller properties are older structures and do not receive any government subsidies. Nevertheless, in many markets, including Northern Virginia, these properties constitute a significant share of lower-cost market rate rental housing. The ULI article concludes: "In spite of the role they play as *de facto* sources of lower-cost shelter, small multi-family properties have not been a major part of the public policy debate on housing."

2 Metropolitan Washington Council of Governments. 2001 and 2004 Housing Data Survey reports. Retrieved July 6, 2006, from http://www.mwcog.org/store/item.asp?PUBLICATION_ID=201.

3 Arlington County Department of Housing and Community Development. (2006). *Issue Brief: Affordable Housing*.

4 Malloy, Cheryl and Doug Moritz. (2006). "Halting the Loss of Rental Units," *Multi-family Trends* May/June.

The most important factors discouraging small property owners from keeping their units affordable are related to increased costs, the strength of the region's housing market, and local regulations. Smaller, 1940s-era properties, which are prevalent in the inner suburbs, have become particularly susceptible to redevelopment because of the level of upkeep needed to maintain their properties. According to a recent Property Owners and Management Survey, individual property owners own about 80 percent of buildings with fewer than 10 rental units nationally. For many, the rental business is a part-time activity to supplement other income;

more than one-third of owners of small buildings report no profit from their rentals.[5] Not surprisingly, then, it often makes sense to sell their properties instead of putting money and time into maintenance and upkeep. The survey reveals it is particularly difficult for very small (<5 unit) property owners to meet maintenance demands.

While it is currently difficult for low- and moderate-income families to find affordable rental housing in Northern Virginia, recent trends in the regional economy indicate that the situation will become even more severe over the next few years. Continued strong job growth in the region will result in increasing demand pressures. While condominium conversions are likely to slow in response to the oversupply and deceleration in condominium prices, rents are forecast to rise faster than they have in recent years in response to the increased demand for rental housing from people who have been priced out of the ownership market. Delta Associates currently forecasts rents in the Washington DC metropolitan area will rise between 6 and 7 percent annually over the next few years, up from 2 to 3 percent in recent years.

Most of the Northern Virginia jurisdictions recognize the problem of a declining supply of market-rate affordable rental properties and have made preserving these units a general goal in their comprehensive plans. However, county and city plans are short on specific preservation policies. A huge part of the challenge is that it seems impossible to rally enough resources to combat the strong housing demand and rapid housing market accelerations. The experiences of other places across the country may give Northern Virginia jurisdictions ideas for new approaches to the problem.

Tools/Policies

The affordable housing preservation tools summarized below can be categorized as follows: 1) new revenue streams and mechanisms to improve county or city efforts to acquire at-risk properties; 2) financial incentives to encourage property owners to keep units affordable; and 3) other tools to increase opportunities for keeping units affordable for current tenants.

1. New Revenue Streams and Mechanisms to Improve County or City Efforts to Acquire At-Risk Properties

If cost were no object, the best way to permanently preserve at-risk properties is to transfer them to non-speculative ownership. Moving projects into the hands of entities whose purpose is providing housing rather than generating profit is more likely to keep tenants in their homes and preserve the property as a future housing resource.[6]

5 Joint Center for Housing Studies of Harvard University. (2006). *America's Rental Housing: Homes for a Diverse Nation.* Cambridge, MA: Harvard University.

6 PolicyLink. Retrieved July 6, 2006, from http://www.policylink.org,

By and large, the affordable housing preservation programs local jurisdictions have developed have been financial strategies designed to generate additional income to purchase rental buildings and/or provide grants and loans to non-profit affordable housing organizations to purchase and manage rental properties. Existing programs supporting the operation, rehabilitation and/or acquisition of affordable housing projects include Low Income Housing Tax

Credit (LIHTC) subsidies, Section 8 Moderate Rehabilitation and New Construction Programs, Section 236 program, tax-exempt bonds, Housing Trust Funds funded through developer contributions and other sources.

Arlington County has a Housing Reserve Fund in place, which is funded primarily through developer contributions, and an Affordable Housing Investment Fund, which is funded by federal HOME funds and local general revenue. But the County has a difficult time competing in this strong housing market with private developers because real estate prices have soared in the region. Arlington already has cultivated strong relationships with non-profit affordable housing developers. There may be opportunities to increase the number of units acquired if additional resources could be made available so that offers to private property owners could be more competitive in the open market.[7] However, it is unlikely that public money alone will be sufficient to facilitate such purchases.

Boston is an example of one city that is attempting to expand its efforts to facilitate the acquisition and rehabilitation of market-rate rental properties with the goal of preserving them as affordable housing. Its strategy involves working with the state to increase funds for affordable housing efforts and collaborating with local lenders to make use of available financing tools, including tax credits and low interest loan programs. The Rental Housing Acquisition Pilot (RHAP) is a initiative begun in 2004 to assist non-profit and private owners to buy existing unregulated housing for the purposes of operating it over the long term as affordable housing. The objectives of the program are to: 1) enable buyers to quickly acquire properties as they come on the market and 2) enable buyers to successfully manage the transition phase from market-rate to affordable housing, including rehabilitation if needed. Complementing this initiative, the City will support tenant-organizing efforts in unregulated housing as a means of encouraging more property owners to participate in this program.

The goal of the RHAP is to convert 300 units of unregulated rental housing into new long-term affordable housing over five years.[8] However, despite increased funding from the state housing trust fund and participation of local lenders, the City is finding it difficult to compete in its hot real estate market. To date, no units have been purchased through the RHAP. Property prices in Boston, as in Northern Virginia, have made it prohibitively expensive for governments and non-profits to buy market-rate properties.

One necessary part of the solution is to increase the amount of resources available for acquisition and rehabilitation.

1.1. Dedicated funds from property tax revenue

Recently, Fairfax County and the City of Alexandria voted to dedicate one penny from the localities' property tax rate to an affordable housing trust fund. Montgomery County, Maryland

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7 However, if a jurisdiction does not know that an owner of an affordable building is considering sale or redevelopment—or if it finds out too late—then it is impossible to make a deal involving a non-profit developer. Policy recommendations related to notification are discussed in section 3 below.

8 City of Boston. (2004). *Leading the Way II: A Report on Boston's Housing Strategy FY2004-FY2007.*

has dedicated 2.5 percent of the County property tax to its Housing Initiative Fund.

In 2004, the **Fairfax County** Board of Supervisors instituted the Affordable Housing Preservation Initiative for Fairfax County. The Affordable Housing Preservation Action Committee ("Action Committee"), along with input from non-profit organizations, citizen groups, business community, real estate industry, and County boards and authorities, developed a

set of tools aimed at increasing the amount of affordable housing that is preserved in the County. They released their recommendations in 2005. The Action Committee's primary recommendation was to dedicate one penny of the real estate tax rate to the preservation of affordable housing.

The revenue generated is expected to total approximately $17.5 million in fiscal year 2006 and is administered through the County's Affordable Housing Partnership Program (AHPP), which also administers the County's Community Development Block Grant (CDBG) funds and Home Investment Partnership Program (HOME) funds. Funds are provided to potential developers through an application process. Projects funded with money from the One Penny for Housing (also called the Housing Flexibility Fund) are required to remain affordable for 20 years in the case of rental units and 15 years in the case of ownership units. Units must be affordable to households at or less than 120 percent of area median income. The type of funding can be a loan, deferred payment loan, and/or grant. The emphasis of projects funded with One Penny for Housing (Housing Flexibility Fund) moneys is on the preservation of existing projects.

The first project funded through the One Penny for Housing (Housing Flexibility Fund) was the Madison Ridge apartment complex in Centreville. Wesley Housing Development Corporation (Wesley) was awarded $2.5 million from the Housing Flexibility Fund to help preserve the 216 market-rate affordable housing at Madison Ridge. Wesley received additional funds from other County housing programs to purchase and redevelop the property. The final acquisition and rehabilitation financing totaled $38.5 million for the 216-unit project. This example indicates the substantial resources necessary to purchase large rental properties in the region.

To date, Fairfax County has facilitated the preservation of 494 affordable units using resources from the One Penny for Housing Fund.

In a move similar to Fairfax County's, the Alexandria City Council recently announced that the City will dedicate one penny for each dollar received from real estate taxes and title recording fees to affordable housing. The action will generate an estimated $2.6 to $3 million in 2006. The City is using a large part of those funds to finance general obligation bonds, thereby greatly increasing the amount of money it will have for affordable housing.

1.2. Condominium Conversion Taxes

In addition to dedicating 2.5 percent of the County property tax revenue to its Housing Initiative Fund, **Montgomery County** assesses developers a condominium conversion tax and various impact taxes, which have all been used to fund affordable housing preservation efforts through its Housing Trust Fund. **Berkeley**, California, **New York** City, and the state of **Hawaii** are among other places that have instituted a condominium conversion tax, though none of them specifically link that money to an affordable housing fund.

1.3 Private Sector/Major Employers

A potential source of funding that has often gone untapped is the non-developer private sector. Regional employers have a vested interest in the available of affordable housing in the community. If workers are not able to afford to live in the region, they may move elsewhere. If companies are trying to attract talent from outside of the region, they may find people rejecting job offers because of the inability to afford housing. If local companies lose workers because of housing affordability problems, they will also lose out on profits and the potential to expand.

In **Santa Clara County,** California, regional businesses have joined with non-profit organizations to increase funds for the development and rehabilitation of affordable housing in the County. The Housing Trust Fund of Santa Clara County was established in 1999 by a task force comprised of the Silicon Valley Manufacturing Group, the Santa County Collaborative on Housing and Homelessness, the County Board of Supervisors, and the Community Foundation Silicon Valley. The Housing Trust Fund raises money from the fifteen cities in Santa Clara County, as well as from County employers, employer foundations, and even local citizens. The Housing Trust Fund's web page has a button to "Donate Now" which allows anyone to contribute $5, $10, $20, or any amount to the Fund. The Housing Trust Fund also engages in public awareness campaigns to help make businesses understand how a lack of affordable housing affects their bottom line. The Housing Trust Fund raised an endowment of $20 million in its first two years. As of June 2006, investments from the Housing Trust have helped create more than $1 billion in affordable housing.

The Housing Trust Fund of Santa Clara has several home buyer and rental programs. The Multi-family Rental Housing Program is specifically designed to promote the development, rehabilitation, and maintenance of affordable multi-family rental projects within Santa Clara County. The fund provides land or property acquisition loans, construction gap loans, predevelopment loans, debt service guaranties, and long term gap/permanent loans. The program has facilitated the development of 1,249 affordable rental units over the period 2002 through 2005.

2. Financial Incentives to Encourage Property Owners to Keep Units Affordable

Rising costs—including utilities, maintenance, property taxes and other costs—make it more difficult for multi-family property owners to keep rents affordable for low-income tenants. The rising costs may make it particularly difficult for owners of small buildings. If local jurisdictions can create financial incentives to reduce the burden of these rising costs on property owners, the owners will be better able to maintain affordable rents.

Data from Urban Land Institute (ULI) *Dollars & Cents of Multifamily Housing* reports indicate that operating expenses for multi-family properties in the Washington DC metropolitan area rose only slightly between 2003 and 2004; however, local property owners indicated that they have experienced much faster cost increases. According to ULI, between 2003 and 2004, the average per unit operating expenses for all multi-family rental properties in the Washington DC metropolitan area rose by 0.6 percent. The biggest cost increases were for insurance, electricity, and maintenance.

The ULI report likely understates the actual increases in operating costs. A report prepared by the New York Rent Guidelines Board also documents annual increases in operating expenses experienced in high-cost areas. The report found that the operating costs for rent stabilized buildings in New York City increased by 5.8 percent between 2004 and 2005. Costs in pre-World War II buildings increased by 6.8 percent and costs in post-war buildings rose by 4.7 percent.[9] The biggest costs increases were associated with a significant rise in fuel oil costs. These costs will increase even further if oil prices continue to rise.

For the *Dollars & Cents of Multifamily Housing* reports, ULI surveyed a small number of properties in the Washington DC area that had fewer than 100 units and found that the operating costs for these properties increased from $4,884 per unit in 2003 to $7,517 per unit in 2004. While the sample is too limited to draw firm conclusions, the finding does support the anecdotal evidence that operating costs for smaller rental properties are escalating rapidly.

According to a large, local residential developer, maintenance/service costs have increased nearly 69 percent over the past four years, or approximately 17 percent annually. The primary drivers of the cost increases included increases in water and sewer costs, property taxes, and salaries and benefits for staff.

Small, non-profit housing organizations have also been hit hard by cost increases. One organization with more than 300 units in Northern Virginia has experienced increases of between 20 and 30 percent in gas and electricity costs in the past year. These utility and other cost increases have forced the postponement of needed property improvements. In addition, maintenance is being done reactively, rather than proactively, which could lead to further deterioration of the properties.

Property tax increases are not an issue in some jurisdictions, such as Fairfax County, where properties owned by non-profits are tax exempt. In other counties and cities, such as Arlington County, property tax increases have a much larger impact on non-profit owners of affordable rental properties.

Private owners of small rental properties also have experienced first-hand the pressures of rising operating and maintenance costs. Many small properties in Northern Virginia are World War II-era buildings that are in need of significant improvements, including windows, wiring, plumbing, and hot water lines. According to one private property owner, property maintenance costs have been the single biggest source of operating costs increases in recent years. Rising property taxes, though an issue, lag behind rising maintenance costs.

Despite these concerns voiced by both non-profit and private property owners, counties and cities generally have not developed tools to help property owners with maintenance and upgrading costs. In general, financial incentives for rental property owners have focused on property tax exemptions and abatements. Only one jurisdiction reviewed for this report—the District of Columbia—offered any type of financial incentive to offset other operating costs.

Tax breaks have also been the focus of federal legislation. The 2002 Millennial Housing Commission report recommended that Congress “commit to the preservation of existing [housing] affordability” by enacting a preservation tax incentive that would encourage sellers to transfer their properties to organizations dedicated to the acquisition and management of affordable housing. Subject to state housing finance agency oversight, an owner who sells a federally-subsidized housing property to a so-called “preservation entity” would be eligible for exit tax relief. The Affordable Housing Preservation Tax Relief Act of 2005 (H.R. 3715) was introduced by Congressmen Jim Ramstad (R-MN) and Benjamin Cardin (D-MD) and is currently stalled in committee.

9 New York City Rent Guidelines Board. (2006). *Housing NYC: Rents, Markets and Trends 2005.*

A federal tax incentive for preserving affordable housing is unlikely to make a difference in areas such as Northern Virginia where so much of the loss of affordable rental housing is due not to the expiration of federal subsidies, but rather as a result of the financial pressures of the private market. Local jurisdictions are challenged to find ways to make it financially attractive (or at least viable) for property owners to maintain their rental units as affordable. Several tax-related policies that have been implemented in Virginia and elsewhere to reduce the tax burden on owners of affordable rental housing include: 1) property tax credits, 2) property tax exemptions/ abatements, and 3) property tax classifications. The following section discusses these policies, as well as the role other offsets and transfer of development rights programs could play in an overall strategy to preserve affordable housing.

2.1. Property tax credits

Although not specifically designed to preserve affordable housing units, a **Commonwealth of Virginia** tax credit that was instituted in the 1990s could be a way to make it more financially feasible for rental property owners to keep at least some of their rental units affordable to a segment of the low-income population in a hot market. Between 1991 and 1999, the Commonwealth provided a tax credit to individual and corporate property owners when they reduced rents to low-income tenants who were over age 62, disabled, or homeless. The rent charged on these units had to be at least 15 percent lower than rents charged to others for comparable units in the same building. The property owner could charge higher rents for other units. The total credit amounted to 50 percent of the total rent reductions provided by the taxpayer. Although this program has expired, it could serve as a guide for a similar program in the future.

2.2. Property tax exemptions and abatements

A number of states and localities have tax exemption/abatement programs. Many of these programs are targeted at individual, single-family property owners. However, several states and localities have instituted property tax exemption/abatement programs for owners of multi-family rental buildings. The exemptions have been offered generally only to non-profit owners. These types of programs could be modified to benefit private property owners, as well. This tax relief can be provided either for leasing units to low-income tenants at prescribed rents and/or for rehabilitating multi-family buildings. The latter programs do not necessarily ensure that the rehabilitated units will be rented to low-income persons or families.

California provides a property-tax exemption to low-income housing properties owned by non-profit organizations or by limited partnerships in which the managing general partner is a qualified non-profit organization. These properties are eligible for a 100 percent property tax exemption if all units are leased to qualified low-income tenants at the prescribed rents. Partial exemptions are available for the portion of the property serving low-income tenants. To qualify for exemption, the property acquisition or rehabilitation must be financed with tax-exempt mortgage revenue bonds, general obligation bonds, or local, state or federal loans or grants; or the property owner must be receiving federal low-income housing tax credits.

The state of **Oregon** offers state property tax exemptions and allows local governments the opportunity to provide property tax exemptions to owners of multi-family rental buildings under certain circumstances. The state offers property tax exemptions for elderly housing provided by private non-profit companies. The rules governing the exemptions are somewhat complicated and are related to the different governing bodies that have taxing authority over the property. In general, the state allows local governments to offer property tax exemptions to owners of low-income rental housing if they can get the cooperation of the other governing bodies that have taxing authority.

The state also allows local governments to adopt legislation to provide property tax exemptions for rehabilitated residential property, including single family and multi-family units that are located in “distressed areas.” Structures must not be in substantial compliance with local codes at the time of application and are subject to a minimum rehabilitation improvement value of 5 percent of the assessed value of land and improvements for properties less than 25 years of age or 50 percent or more of assessed value, regardless of age. There is no stipulation that the rehabilitated units be rented to low-income tenants.

New York City’s J-51 program provides tax exemptions and/or abatements to owners who rehabilitate multi-family buildings. A J-51 tax exemption temporarily exempts the property from an increase in assessed value that would otherwise occur as a result of significant renovation. The exemptions are usually provided for 14 years; the maximum exemption is 34 years. A J-51 tax abatement reduces existing taxes by a percentage of the cost of the rehabilitation work performed. The abatement is generally 8 1/3 percent over 12 years. No limits on rents are established.

The state of **Missouri** also has a tax abatement program to encourage the rehabilitation of distressed multi-family properties. The Missouri program is an economic incentive program designed to encourage new construction or rehabilitation by freezing a project’s property taxes at the pre-development baseline tax assessment level. Under Missouri Chapter 99, 100, and 353 legislation, tax abatement is available for residential, commercial, or industrial uses in blighted areas and with approved development plans. Typically, the local jurisdiction grants ten-year tax abatement for 100 percent of the improvements. However, the local jurisdiction can provide up to 25 years of tax abatement; ten years of 100 percent abatement and fifteen years of 50 percent abatement, under certain conditions.

Other places also offer tax exemptions and abatements for rehabilitation of multi-family properties in distressed areas in order to improve declining neighborhoods (e.g. **District of Columbia; Spokane, Washington; Dallas, Texas**). Because the objective of these programs is neighborhood revitalization, and not affordable housing preservation, there are usually no conditions on rent levels.

The tax exemption and abatement programs implemented in other states and cities could be modified to address the specific affordable housing concerns in Northern Virginia. Specifically, the programs could be expanded to include both private and non-profit property owners. Requirements regarding income limits of tenants could also be specified explicitly.

2.3. Property tax re-classification

The **Minnesota** state legislature created a new rental property tax rate classification and reduced the state property rate from 2.3 percent to 1 percent for these properties. In order to be eligible for this classification, the property rents must be no higher than 30 percent of 60 percent of the area or statewide median income and must be occupied by tenants with incomes less than 60 percent of area or statewide median income.

2.4. Other offsets

As part of its Distressed Properties Improvement Program, the **District of Columbia** offers deferral or forgiveness of not only property taxes, but also water charges and other public debts owned on rental properties as an incentive for owners to rehabilitate previously vacant residential buildings. The financial incentive is conditioned on 15 percent of the completed units being made available to low- and moderate-income renters.

2.5. Transfer of development rights

A brief mention should be made about how a transfer of development rights (TDR) program could be part of a larger strategy to preserve affordable housing byeasing financial burdens on small property owners. TDR programs generally allow landowners to transfer development rights from one property to another landowner who wants to develop his land at higher densities. The goal is usually to preserve undeveloped land and has been used most frequently acorss the country to preserve farmland. TDR programs can give more flexibility to local governments to control development while also compensating landowners for restrictions on the potential development of their properties.

TDR programs can be one tool in preserving market rate affordable housing in Northern Virginia. Owners of small rental properties may have "unused" density on their parcel. A TDR program could allow these property owners to transfer their right to develop their property to another landowner in another part of the jurisdiction where higher density development is being encouraged. Rental property owners, therefore, would receive financial compensation for not redeveloping their properties at higher densities. One rental property owner in Northern Virginia noted that a program that allowed him to sell the development rights to part of his property would be a strong incentive to maintain his property as affordable. This compensation could be tied to an agreement that property owners keep their units affordable for a certain period of time.

No jurisdiction has been identified as using TDR programs in this way to preserve affordable housing, but TDR programs more generally have been gaining increased attention. Many communities, including **Arlington County** and **Montgomery County**, have allowed the transfer of development rights under certain conditions in their development approval processes. These approaches could be modified to achieve the goal of preserving affordable housing.

3. Other Tools to Increase Opportunities for Keeping Units Affordable for Current Tenants

Several states have initiated programs designed to increase the opportunities for local jurisdictions, as well as tenants, to take action to stop increasing rents and/or condominium conversions. The state of California has been at the forefront of these types of policies, which include 1) notification policies, 2) limits on condominium conversions, 3) statutory leases, and 4) "rights of first refusal" legislation.

3.1. Notification policies

The **California** state legislation in 2001 adopted a law that requires owners of specified federally-assisted projects to provide Notices of Intent to prepay a federally-assisted mortgage, terminate mortgage insurance, or terminate rent subsidies or restrictions at 12 and six months prior to taking action. The notices must be sent to all affected tenants and to affected public agencies, including the City or County where the project is located. The California Department of Housing and Community Development maintains a list of organizations that are interested in purchasing government-subsidized multi-family housing properties (presumably to maintain them as affordable housing). If the owner wants to sell, a notice also must be provided within 12 months of sale date to qualified entities interested in purchasing. Note that this “notice of intent” policy only applied to federally-assisted properties.

3.2. Limits on condominium conversions

A bill in the **California** state legislature (AB 2562 and SB 1676) would require a property owner who intends to convert residential rental property to resident ownership to provide certain notices to the tenants and prospective tenants. Written notification of the intent to convert would be required at least 180 days prior to termination of tenancy due to conversion. The assembly bill (AB 2562) was defeated in June 2006. The senate bill (SB 1676) is currently in committee.

In the city of **San Francisco,** condominium conversions are essentially barred. Rental apartment buildings with more than six units may not be converted to condominiums. This provision has been tested via referendum. Proposition R was put to voters in 2002, which would have allowed conversions equal to 1 percent of the total housing stock each year for 25 years. Proposition R was defeated and the ban on condominium conversions remains in effect.

Several municipalities in **Vancouver, B.C.** also have condominium conversion control policies in effect. In Burnaby and New Westminster, there is a complete prohibition of conversions of multi-unit rental apartment buildings. North Vancouver permits condominium conversions only when the vacancy rate is equal to or greater than 4 percent for a minimum of 12 consecutive months. The city of Vancouver allows conversions only if tenant notification guidelines are followed.

3.3. Statutory leases

Statutory leases are leases for current tenants that are required by law in **Maryland** and **Rhode Island** when a multi-family building is converted into a condominium or a property owner decides to pre-pay a federally-assisted mortgage in order to raise rents. Statutory leases provide a temporary solution to current residents affected by rising rents or conversions. Both statutes provide for one-year renewals for all tenants, and certain classes of tenants, generally the elderly or disabled, are guaranteed two (Rhode Island) or three (Maryland) years of renewals. Maryland allows for good cause evictions during the statutory renewal period, while Rhode Island permits termination only for death or non-payment. Rhode Island’s efforts appear to have been effective, as there have been no prepayments as of the end of 1998. Unfortunately, according to public officials in Maryland, administrative decisions have left the tenant protection statute there almost completely unenforced, and thousands of units have converted to market-rate. A similar statute in **Maine** requires owners to allow tenants to remain for up to six months at rent levels equal to those at conversion, although there is no information on how well this requirement is enforced.

3.4. “Rights of first refusal” legislation

Several states and localities have enacted “Rights of First Refusal” initiatives. These policies are designed to create opportunities for tenants, local governments, and/or non-profit organizations to make an offer to purchase a subsidized or assisted multi-family rental property. Property owners are required to notify a specified group of interested parties when they plan to either sell the property or otherwise terminate the subsidy.

Illinois, Maryland, California, Maine, Texas, Rhode Island, District of Columbia, San Francisco and **Portland, Oregon** all have “rights of first refusal” policies. In all cases, these policies apply only to federally-subsidized and some state-subsidized housing with expiring contracts. Generally, the notification requirement is triggered by the intention to sell or dispose of the property or to take other action that would terminate the subsidy. Notification is required anywhere from 90 days to two years prior to the sale, disposition or other action. The right of first refusal can go to the tenants' association, local or state housing authority, non-profit organizations or some combination of these groups.

Montgomery County has maneuvered through challenging legislative obstacles to change state laws to implement its right of first refusal policy and to use it to try to save specific buildings from conversion. There are two ways in which Montgomery County uses its right of first refusal policy to preserve market-rate affordable rental properties. In both cases, the property owner is required to notify the tenants and the County of the intention to sell the property. The County (or tenants' association) then has the opportunity to match the contract made with a private buyer. This type of purchase involves finding a non-profit developer partner and taking advantage of tax credit financing. The second possibility is that the County negotiates the rental agreement with the potential buyer of the property. Under the negotiated rental agreement, a certain percentage of the units would remain affordable. In some cases, the County requires that rents can only rise at the rate of the Consumer Price Index (CPI).

Hampshire Towers is the largest property that has been subject to Montgomery County's right of first refusal policy. Hampshire Towers is a 400+ unit property in Takoma Park that was recently purchased by the tenants' association, which found a developer partner to which it assigned the property rights. The developer is going to rehabilitate the property, redeveloping one building as an affordable condominium building (with units limited to families with incomes at or below 80 percent of AMI), and maintaining the other building as affordable rental (with rents affordable to families at less than 60 percent of AMI).

Montgomery County has also invested resources working with tenants' groups in smaller buildings to assist them in finding a developer partner, assessing the extent of rehabilitation needed in the building, and navigating the complex financing aspects of affordable housing development.

Recommendations

Cities and counties across the nation are facing the problem of the loss of market-rate affordable rental housing. Northern Virginia is being particularly hard hit because of its desirable location in a fast-growing region and its significant stock of older rental housing. The result of the increased demand for housing has been increases in rents and conversions of rental buildings to condominiums. Thousands of market rate affordable rental units have become unaffordable to low- and moderate-income households over the last 5 years. If the affordable housing problem is not addressed, families will have a harder time staying in Northern Virginia and potential workers may choose jobs in other parts of the country.

Northern Virginia jurisdictions can take a more proactive role in addressing the regional affordable housing problem. Some guidance is available from other jurisdictions across the country. Unfortunately, there is no clear cut set of tools other jurisdictions have adopted to stem the loss of market-rate affordable rental units. However, there are some programs and incentives that have been implemented in other places that could be modified to be included in a comprehensive affordable housing strategy for Northern Virginia.

Policies considered by Northern Virginia jurisdictions need to be evaluated in light of the regulatory environment in the Commonwealth of Virginia. Thus, in general, any policies that limit the rights of property owners—for example, rights of first refusal policies or limits on condominium conversion—would be difficult to implement in Virginia. Policies that involve developing incentive structures for property owners and/or involving non-residential property owners would be more workable.

The results of this analysis imply four recommendations: 1) Gather Information, 2) Engage the Business Community, 3) Institute a Tax on Condominium Conversions, and 4) Develop Programs to Assist Owners with Operating Costs.

1. Gather Information

The first step in setting policies to preserve market-rate affordable rental housing is to develop a database of multifamily rental properties in each County and City in Northern Virginia. This database ideally would include i) the address of the property, ii) the name and address of the property owner, iii) property characteristics (e.g. rents, number of units by size, amenities), iv) property quality (e.g. physical appearance, age of building and major systems), v) sales history, and vi) characteristics of renters, as well as v) an assessment of the impact of rising operating costs.

Some of this information is readily available from a County's or City's Real Estate Assessment Database (READ). Generally, a jurisdiction's READ has information on property address, owner name and address, number of units, sales history, year built, and property class. Data on rents and units by size may be available be merging data from a jurisdiction's annual rent and vacancy survey, if one is conducted. Other information can only be gathered through a survey of multifamily property owners.

A survey of multifamily property owners could gather incredibly valuable information on characteristics and quality of the property and socioeconomic status of the renters (although perhaps only qualitatively). The survey could also elicit information on the property operating costs and expenses, property owners' attitude about County housing policies, and incentives that could help owners keep units affordable.

The city of San Francisco recently surveyed a random sample of owners of multifamily residential rental property owners in the City. In addition to collecting valuable demographic information about owners and renters and characteristics of properties, the City gathered unique information about the reasons owners bought their properties, their expectations for owning the properties into the future, the amount of time they personally spend on maintenance and tenant issues, and their attitudes about government regulations.

A survey like this would be immensely beneficial to Northern Virginia jurisdictions. With address information available from the READ, sending out a short survey to a sample—or even all—multifamily property owners would be relatively straightforward. The resulting data could be used to maintain contact with owners in order to keep abreast of any plans for sale or conversion, to map properties to better understand the geographic location of market-rate affordable rental housing, and to help craft housing policy.

2. Engage the Business Community

The non-developer business community has been largely missing from the affordable housing policy debate in Northern Virginia. The first step in engaging the employer community is to document how a lack of affordable housing limits their opportunities for growth. A regional housing trust fund, modeled after the Housing Trust Fund of Santa Clara County, would be an excellent way to emphasize the role employers can play in preserving affordable housing while also benefiting from private-sector expertise on fundraising. According to the Center for Community Change's Housing Trust Fund Project, five key elements are needed to create a partnership like the trust fund in Santa Clara: i) assemble a group of dedicated leaders from the business community and local governments; ii) have them create a non-profit housing trust, with minimal administrative costs; iii) set ambitious fundraising goals; iv) surpass those goals; and v) spend those funds in such a way that every $1 spent results in $40 worth of affordable housing.[10]

The Northern Virginia region is an ideal place to create a Santa Clara-like, privately-administered housing trust fund. The area is home to hundreds of high tech companies eager for new workers. Many companies have been funded by venture capital, which gives business owners experience with raising capital. Organizations that could collaborate on this initiative include the Greater Washington Board of Trade, Northern Virginia Technology Council, and County and City Chambers of Commerce. The Metropolitan Washington Council of Governments, which already has a subgroup devoted to the discussion of regional affordable housing issues, could be another important resource.

The new money raised through this type of trust can be used to advance local affordable housing development and preservation programs. However, this type of program is not something that can be initiated by one County or City alone. It requires the coordination and cooperation of all Northern Virginia counties and cities—and perhaps all Washington DC metropolitan area jurisdictions—as well as a broad range of business groups.

3. Institute a Tax on Condominium Conversions

Many other high-cost areas, such as New York, California and Hawaii, assess property owners a conversion tax when they turn their rental properties into for-sale properties. This tax has the effect of both slowing the pace of condominium conversion, as well as generating additional revenue for affordable housing efforts.

Northern Virginia jurisdictions may run into a couple of problems with this tool. First, it is a tax on property owners, which will not be greeted warmly by either the property owners themselves or property rights activists in the Commonwealth. Second, the number of condominium conversions in the region has probably peaked, as the supply of new condominiums has soared over the last few years and price appreciation of condominiums has slowed notably. Thus, the amount of revenue generated by a conversion tax will likely be small.

Despite these obstacles, a condominium conversion tax could send an important signal about the jurisdictions' commitment to the preservation of the affordable rental housing stock.

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10 Perrigan, Dana. (2005, August 14). A Trust in Housing: The Pioneering Effort is by Public and Private Sectors. *The Chronicle*.

4. Develop Programs to Assist Owners with Operating Costs

Rising operating and maintenance costs and the necessity for upgrading properties make it difficult for property owners to maintain rents at levels affordable to low- and moderate-income renters. Jurisdictions should explore ways to offset some of these costs for for-profit property owners, including 1) property tax exemptions, 2) loans and grants for maintenance and rehabilitation. and 3) certain operating expenses.

Based on interviews with private and non-profit rental property owners, property tax exemptions are not going to stop the redevelopment of affordable housing into high-rent housing. However, a tax exemption can reduce some of the cost burden to allow property owners to allocate more resources to property improvements. In addition, property tax exemptions are another way a jurisdiction can send a signal about its dedication to preserving market-rate affordable housing and its understanding of the impact a hot real estate market has on property owners. The Commonwealth of Virginia allows localities to assess affordable housing units at lower levels than market-rate units. Northern Virginia counties and cities should verify whether its assessors do take advantage of this state allowance and, if so, whether the reduced assessments are applied to units owned by non-profit owners or both non-profit and for-profit owners. If assessors are not applying the reduced assessments, an effort should be made to find out what needs to be done to facilitate the change. (It may be necessary to first identify the eligible properties, as described in recommendation one above.)

Northern Virginia jurisdictions should also investigate the possibility of providing property tax exemptions to non-profit and for-profit property owners who make upgrades to their properties. Properties would be assessed at the pre-improvement level for a certain number of years, and thus be subject to lower tax. In return, the property owner would be required to keep some or all of the units affordable to renters at or below 60 percent of area median income. These property exemptions have been offered in other places but generally have been made available to non-profit property owners only.

Because maintenance and upkeep are among the biggest expenses faced by property owners, particularly owners of small, older apartment buildings, counties and cities should use affordable housing money to offer grants or loans to property owners to make improvements. The property owner would be required to raise rents by only a pre-determined rate—for example, at the rate of the CPI—for a certain number of years. This type of assistance may encourage small property owners to hold onto their buildings instead of selling them to individuals or groups intent on raising rents or converting units to condominiums.

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