

## Workforce Housing: New Tools for Solving the Affordable Housing Dilemma

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### **The Dilemma**

One of the major dilemmas of US cities is providing affordable workforce housing in close proximity to available jobs. Housing cost typically bears an inverse relationship to job proximity. This relationship of housing price to employment makes simple economic sense in that greater housing demand near employment centers drives housing prices higher than in areas lacking employment. As a result, lower income families, who can least afford long commutes, are the ones most often making long commutes from affordable housing to their jobs.

Originally, zoning and land use laws were based upon the concept that the segregation of jobs and housing was desirable to avoid conditions created by jobs such as traffic noise, odors and vibrations that would disturb nearby residents. The rise of the auto industry and cheap oil and gas gave urban planners an ability to segregate homes and jobs to reduce, if not completely avoid, these use conflicts. Families obtained peace and quiet in suburban housing far removed from their central city jobs.

It now seems fairly obvious to planners, if not to average homeowners, that to avoid long commutes, jobs should be dispersed in larger metropolitan areas to create a good balance between jobs and housing. Today mixed-use, high density housing is favored by officials who have grown to understand that long distance commuting is cost prohibitive when all costs are factored in, such as the capital cost for vehicles, the cost of lost family time, the cost to mental and physical health, road construction and maintenance costs and, last but not least, the cost of global warming.

The tendency of residents to seek cheaper, low density housing away from jobs will continually subvert any efforts to solve the workforce housing problem by balancing jobs and housing throughout a metropolitan area. If one moves jobs out into the suburbs, then lower-income homebuyers will keep moving farther out for cheaper housing in a kind of endless cycle of jobs chasing the workforce and driving up prices, which then causes the next round of outward suburban and ex-urban sprawl. If a growth boundary is imposed around a metropolitan area to stop the sprawl, then the small villages and towns near the metropolitan area will likely become fast-growing satellite cities of relatively inexpensive housing producing even longer distance commuting. What has become apparent to urban planners is that avoiding sprawl requires a way to avoid having nearby jobs drive up the price of the housing stock to unaffordable levels and a means of helping homeowners consider the true costs of commuting when making housing decisions. Merely integrating housing and jobs will not stop suburban sprawl. The trick to reversing sprawl is integrating permanently affordable housing with the jobs.

### **User Fees and Affordable Housing**

So, how can planners best help people consider all the costs of the proximity of their housing and jobs? While educational programs help, charging user fees that recover the true public costs of commuting will have the most impact. Government should stop subsidizing commuting by adopting user fees that directly impose on commuters the costs of the infrastructure systems serving the commuters and the costs of counteracting their vehicular greenhouse gases. Fortunately, the technological means of imposing commuter user fees based upon their vehicular mileage driven already exists and has been tested in an Oregon pilot project. The beauty of such user fees is the inherent fairness of making commuters pay their true commuting costs rather than taxing everyone to subsidize their commuting. So, what does this have to do with affordable housing? A sizable vehicular mileage fee makes housing near jobs *relatively* more affordable by offsetting the lower cost of remote housing by increasing commuting costs through the mileage fee. The *relative* affordability of mixed-use workforce housing will be increased in direct proportion to the degree to which commuting costs are charged directly to commuters instead of being paid by the public's general tax funds.

### **Inclusionary Zoning**

The affordable housing problem is connected to land use planning and community growth management. Some states, like New Jersey, have required by law that homebuilders include a fair share of low-income housing in new developments. Over 100 cities around the country have similar inclusionary zoning on their books. Oregon is the only state, however, that has adopted a ban on inclusionary zoning<sup>1</sup>.

Some Oregon cities have tried to mitigate this prohibition by tying annexation of new land to the landowner's agreement to provide a fair share of affordable housing on the newly annexed land. The legal ban on inclusionary zoning does not extend to such voluntary annexation

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<sup>1</sup> Oregon Revised Statutes §197.309

agreements. Such inclusion of affordable housing on newly annexed land can only add affordable housing at the edge of the urban area and inherently cannot remedy the lack of affordable workforce housing near existing jobs in already urbanized Oregon areas resulting from the lack of inclusionary zoning.

Since the stick of inclusionary zoning is unavailable in Oregon, cities need to modify their plans to create incentives for developers to include affordable housing in redevelopment of the existing urban housing stock. Since increased density is generally needed inside cities, the inclusion of affordable housing should be rewarded with density bonuses, transferable development rights, waivers of system development charges and similar tools. It is a simple financial value proposition for developers, and if incentives are worth more than the cost of the affordable housing then developers will build it.

### **Funding Affordable Housing**

Just as we need to stop subsidizing long distance commuting, we need to subsidize workforce housing near existing jobs in already urbanized areas, because of the high land costs in such locations. Unfortunately, existing federal, state and local resources are inadequate to provide such subsidies. Portland affordable housing advocates have advocated subsidizing affordable housing by using Portland Development Commission urban renewal funds that traditionally have been used for economic development.

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Economic development advocates argued that the creation of the jobs allows residents to afford more expensive housing, rather than sacrificing jobs to pay for more affordable housing needed due to resulting unemployment. As the economy has entered a severe recession, economic development has understandably become the top priority in Portland and other cities around Oregon, and affordable housing subsidies will have to come from other funding sources.

For years, affordable housing advocates have tried to get the legislature to provide greater support for affordable housing, including repeal of the inclusionary zoning ban and a permanent funding source, such as a transfer tax or real estate document recording fee dedicated to affordable housing. But the lobbyists of the Oregon Association of Realtors and the Oregon Homebuilders Association, among other real estate trade groups, have always been able to defeat such efforts. With the sweeping change to Democratic of control of the Oregon legislature in November, these real estate industry opponents may need to be more cooperative with affordable housing advocates. Similar to the cities, Governor Kulongoski sees economic development as a higher priority than affordable housing due to the recession and has excluded any new affordable housing funding in his 2009 budget.

### **Dealing with Gentrification**

Even if a city develops a stock of affordable housing, successful economic development leads to the loss of the existing affordable housing by gentrification of many residential neighborhoods. The recent boom in condominium conversions is a prime example of this process by which more affordable rental housing becomes less affordable owned housing. Long before the latest condominium conversion boom, the city of Ashland attacked this problem by requiring

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condominium projects to contain a percentage of affordable units. This problem is more severe in a city like Ashland where its economic development success has been based largely upon tourism creating many relatively lower-paying jobs in the center of the city, where the property values are the highest. Ashland apparently believes its ordinance avoids the inclusionary zoning ban in ORS 197.309 because the restriction is not a part of Ashland's land use regulations.

The Ashland condominium ordinance defines affordability based upon a percentage of the median income for the city and allows the units to be either sold or rented. The ordinance only requires that the units remain affordable for a period of 20 years, so typically the units are rented in order to preserve the prospect of a sale at full fair market value once the price restriction is no longer in effect. The ordinance also uses the incentive of a waiver of the system development charges to obtain longer-term affordability restrictions on the condominium units. The affordability restrictions are recorded in Jackson County real estate records and are enforceable by the city.

One of the strengths of the Ashland approach is that it integrates low-income housing and market-rate housing in the very same project. Experience has taught city planners that segregated affordable housing projects are more likely to become crime-ridden and blighted, whereas integrated affordable housing tends to succeed. The problem of income-segregated housing is not limited to city-subsidized low-income rental projects. Mid-Multnomah County is an example of how neighborhoods can become seriously blighted over the years when there is too little housing ownership. Trying to overcome this economic segregation and the resulting blight will take many years and much more effort at urban renewal than the effort that would have been required at the outset to properly plan this area to balance housing types and create economically integrated and sustainable neighborhoods over the long term

### **Urban Land Cost**

A problem of the Ashland approach is that its affordable housing program is solely limited to condominium projects. A large proportion of families with children want to live in single-family detached (SFD) housing. It is axiomatic that the cost of land will increase if the population is growing faster than the available land supply. As our cities grow, land scarcity will continue to drive up land values for residential development particularly in the more highly populated western half of the state. That means it is unlikely to ever be less expensive to acquire urban Oregon land to provide affordable SFD housing for families with children.

Because the rising value of Oregon urban land is one of the chief impediments to the development of more affordable urban housing, it is incumbent upon local governments to acquire and retain ownership of as much urban land as is possible especially near employers. PSU Professor Will Macht made a similar point in Section 7 (From Zoning to Mixing, page 12)<sup>2</sup> of his article in the last edition of this publication, noting that the current recession will provide an opportunity for Oregon local governments to dedicate to affordable housing land that is foreclosed and escheats to the city for failure to pay property taxes, rather than selling it

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<sup>2</sup> <http://www.pdx.edu/realestate/research.html> Professor Macht wrote: "The enormous increase in housing foreclosures will help to decimate neighborhoods. Those single-use suburbs that are too distant and without a mixture of services will suffer sharp declines in values. This is an obvious problem for former homeowners and struggling lenders. But communities can use the housing crisis as an opportunity to transform the underlying problem. Foreclosures will result in tax delinquencies that put cities in ownership of large numbers of properties. Cities should aggregate those properties into a land and housing bank that can be planned for more intensive mixed uses. Cities can retain ownership of the land and sell the houses much in the manner of the Community Land Trusts. Cities can reduce sales prices to increase affordability but be repaid by inclusion of shared equity provisions upon later resale of the houses when the market recovers."

as surplus land. Portland metropolitan local governments have been doing this for years by donating such foreclosed land to the local community land trusts (the CLTs) and other non-profit housing agencies for a permanently affordable housing stock.

In many cases such surplus land is used by the housing agency to develop attached rental housing projects, and in such cases it is important to avoid large projects exclusively consisting of low-income residents that may, over time, become blighted and adversely affect entire neighborhoods. Income-integrated rental projects not only avoid most blight, but the higher income units will provide additional revenue to the housing agency that may be used as a subsidy that can leverage scarce affordable housing funds. The housing agency retains full ownership of such rental projects, which are typically subject to permanent restrictive covenants that assure the local government that the land will always be dedicated to the provision of affordable housing.

### **Community Land Trusts [CLTs]**

The more interesting and complex use of such surplus land is for the permanent provision of affordable housing through the Community Land Trust (CLT) model that is focused on helping low-income families obtain affordable homeownership and overcome their low incomes, in part, by gaining the equity benefit of amortization of their home loans as well as appreciation in the value of their homes (collectively their equity). While it is true that the equity in affordable rental projects can be used to leverage the development of more affordable rental housing, the CLT advocates argue persuasively that there is a higher social value in helping low-income families participate in the American dream of homeownership by using their home equity to obtain more desirable housing, pay for a college education for their children and help pay for a more comfortable retirement.

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The CLT model has traditionally been based upon the construction of SFD homes on the land acquired by tax foreclosure and donated to the CLT by the local government. The CLT typically partners with the lowest-cost local homebuilder available, which is often Habitat for Humanity, because it uses volunteer labor, donated materials and contributions from the public to subsidize the cost of construction. One of the keys to the success of Habitat for Humanity projects is the requirement that the ultimate purchasers of the home contribute a required number of hours of their own labor to the construction of the home and that they pay a down payment and monthly mortgage payments for the affordable price of their home. The subsidy equals the fair market value of the land, plus the fair market value of the improvements, less the actual price paid by the purchaser. Any net income achieved by Habitat for Humanity on a particular home sale is reinvested in more affordable housing.

### **Community Land Trust [CLT] Ground Leases**

The price of a CLT home does not include the value of the land. Traditionally, the CLT retains ownership of the land and ground leases it to the home purchaser for 99 years. By this means, the land is retained for the permanent provision of affordable housing. Implicit in this CLT

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method is that the ground rent is nominal, as opposed to typical ground rent being set at a fair market rate of return on the value of the land.

Implicit in the nominal ground rent and 99-year term is the fact that the CLT ground lease is in many respects more like a trust deed or mortgage than a true lease. Leases have remedies for a rent default that are far more summary in nature than for a trust deed foreclosure on the purchase of a market-rate house. At the risk of slightly oversimplifying, a tenant can be evicted in about 30 days for nonpayment of rent without any right of reinstatement by paying the past due rent, whereas a normal homeowner can be evicted only after a foreclosure that takes six months and gives the owners the opportunity to reinstate their home loan at any time prior to the foreclosure by paying the past due loan payments. For this reason, the courts have evolved a doctrine that leases that are more like mortgages or trust deeds must be foreclosed judicially before the tenant can be evicted. Another way of putting it is that there would be a fair amount of irony if a charitable organization like a CLT could summarily evict one of its low-income home purchasers who the CLT is trying to help achieve the American dream of homeownership.

If you think about it, the nominal ground rent and 99-year term means that the CLT is really only trying to protect the permanent nature of the subsidy in the affordable house. The real default any CLT (and the local government which donated the land) is worried about avoiding is an attempt by the homeowner to sell the house and retain more than its share of the affordable price upon resale. The heart of the CLT ground lease is the long section defining the amount the low-income seller is entitled to retain from any sale and the requirement that the sale price be permanently affordable. The amount the seller may retain (again at the risk of some minor oversimplification) is equal to the equity (paid amortization of the mortgage and a defined percentage of the appreciation in the value of the improvements). This means that the nature of the ground lease is more similar to a restrictive covenant regarding the amount and sharing of the resale price than a true ground lease. The reason CLTs have traditionally used ground leases is that the law is unclear in many states as to whether such restrictions on affordable housing will be permanently enforced by the courts.

### **Affordable Housing Covenants [AHCs]**

Because of concerns about the possibility that the CLT ground lease might be re-characterized by Oregon courts as a disguised mortgage, and the possibility that result might avoid the permanent enforcement of the restrictions protecting the affordable housing, affordable housing advocates persuaded the 2007 legislature to pass a new statute validating affordable housing covenants (an AHC). This law has been codified at Oregon Revised Statutes 456.270 to .295. The author of this article participated in the drafting of one of the first AHCs under this new law.

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Because the AHC is long and complex, a master AHC is recorded once, much like a condominium declaration, to be applicable to a multi-unit project and then referenced in each conveyance deed as an encumbrance affecting the title to the residence. The individual homeowners are automatically subject to the covenant without signing it, because it runs with ownership of their home as a recorded encumbrance.

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The parties to the AHC are the developer of the housing, the grantor of the subsidy, such as the Portland Development Commission, and the holder of the covenant, such as the Portland Community Land Trust (PCLT). The AHC will recite specifically the nature of the subsidy being provided that will be protected by the affordability covenants. The exact amount of the subsidy will be stated in the conveyance deed for each home, since the subsidy may vary from one house to another, even within the same project. The grantor of the subsidy may retain enforcement rights under the AHC, even though not the primary holder of the covenant, in order to be assured that the subsidy will not be lost through any failure of the AHC holder. In fact, the grantor may want to provide that it will become the holder in the event the original AHC holder is ever dissolved or wants to assign the AHC

Because the AHC is complex and the homebuyers are relatively unsophisticated, the grantor of the subsidy and the AHC holder should require that a knowledgeable attorney advise the homebuyer. The PCLT form of AHC requires the buyer to submit a letter confirming that the buyer is being advised by qualified legal counsel as to the meaning of the AHC. Typically the AHC will be perpetual and will require the owner occupy the house as its primary residence.

### **AHC Maintenance, Taxes and Insurance**

In a sense, the holder of the covenant must act in some respects like a landlord to protect the interest of the holder of the AHC in the property. Like a lease, the AHC used by PCLT has provisions regarding payment of taxes and insurance premiums to protect the subsidy from being lost either through destruction of the property or property tax foreclosure, which would wipe out the AHC. Similarly, construction activities are restricted to avoid construction liens that in Oregon have a superior priority over the AHC, among other interests. The foreclosure of a construction lien would terminate the AHC and could result in a total loss of the subsidy. The AHC holder may want to require reserves to avoid the lack of budgeting skills in the homeowner exposing the holder to loss of the AHC. Similarly, if the housing is converted to cash due to an insured loss, or due to condemnation, then the proceeds must be divided between the owner and the holder of the AHC as their interests appear in the AHC.

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An important aspect of the AHC is the proper maintenance and operation of the affordable housing to avoid blighted conditions that would degrade the value of the housing. The AHC used by PCLT requires maintenance of the house in compliance with both HUD and City of Portland housing maintenance requirements. The concept is that the subsidy can be lost just as much through depreciation of the property as well as by a resale of the property for its full fair market value, rather than for the lower price that factors out the subsidy of the property.

Essentially the CLT acts like a homeowners' association would in a higher-income neighborhood. Like a typical homeowners' association, a certain number of CLT homeowners are elected to the CLT board to have a voice in the enforcement of the restrictions affecting them. The majority control of the CLT will, however, be in the hands of board members elected from the non-homeowners, typically being affordable housing advocates from local governments and private sector real estate related occupations. Because of the ongoing active

role of the AHC holder, the PCLT charges the homeowner a small monthly administrative fee that helps defray the costs of inspecting the property and enforcing the AHC requirements.

### **AHC Priorities and Remedies**

Another danger to the perpetual nature of an AHC is the loss of the property subsidy through foreclosure of the home loan used to finance the purchase of the improvements. The unfortunate reality for holders of AHCs is that the home loan sources will not provide loans unless they have priority over the AHC. That means the AHC must have provisions similar to those in a home equity loan allowing the AHC holder to receive a notice of default on the home loan and the ability to protect its interest by paying off the home loan and foreclosing on the homeowner acting in the shoes of the home loan holder.

The problem that PCLT and other AHC holders have had is that lenders do not recognize and treat the AHC the same as they would the holder of a junior mortgage or trust deed on the property. In order to assure notice and an opportunity to protect the subsidy, the PCLT and most other holders record a junior trust deed against the property as a belt and suspenders approach to protecting against home loan foreclosures. The subsidy is essentially the indebtedness that is secured by such a junior lien on the property.

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The heart of the AHC is the section on sale or other disposition of the property by the homeowner. This is the section that requires that the sale or other disposition be approved by the holder of the AHC to assure an affordable price to the purchaser of the home, and assure that the seller is not obtaining more from the sale or other disposition than the agreed upon share of the sale proceeds. In the PCLT AHC, the owners are limited to obtaining the amount of the principal balance of their home loan that they have paid plus 25% of the appreciation in the improvements during their ownership. They obtain no part of the appreciation in the land value because their original purchase price did not include the value of the land.

If the homeowner defaults on the AHC, then the holder may specifically enforce requirements such as maintenance and repair, or recover damages equal to any funds the homeowner has obtained that represent the subsidy or the share of sale proceeds that were allocated to the holder by the terms of the AHC. The PCLT also includes the remedy of purchasing the property for the purpose of reselling it to another low-income party who will comply with the AHC requirements. Even though the AHC is recorded in the real estate records, it is not unheard of for escrow officers, brokers and other real estate professionals to fail to understand that the homeowner is restricted on the price it may charge and the amount of the proceeds it may retain from any sale. The ancillary trust deed is as much for the education of these parties involved in the sales process as for protection relative to the first priority home loan holder.

If there is any dispute between the parties, then the PCLT AHC provides for alternative dispute resolution by mediation and arbitration, rather than resorting to the courts. That is much more cost efficient and less adversarial. Experience shows that there are rarely disputes that require such resolution, and typically the failure of an AHC will result in the abandonment of the property, rather than an actual contest over the requirements of the AHC.

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### **Space Leases as Affordable Condominium Alternative**

In some circumstances, a long-term PCLT type of lease might be desirable and appropriate, together with an AHC, because the lease is a less expensive means of dividing up multi-unit developments into separate residential unit ownership. On larger multi-unit projects, the Oregon Condominium Act is typically used to create the separate dwelling units and the cost of the condominium document preparation (typically at least \$20,000) is relatively small when spread over a large number of units. However, when a duplex, triplex or fourplex is developed, the small number of units makes the condominium cost a real impediment to keeping the housing units affordable. To avoid this cost, the author assisted the PCLT in modifying its traditional ground lease to convert it into a virtually permanent space lease. In the interest of affordability, both the lender and the title insurance company approved the combination of the PCLT ground lease and a multi-unit space lease addendum in lieu of the more costly condominium documents.

The space lease addendum is relatively short and gives exclusive use of one of the dwelling units to each of the lessees and allocates to each lessee his or her share of the operating costs like utilities, maintenance, insurance and property taxes. The addendum also allocates the repair and maintenance responsibilities between the PCLT and the lessee, as would be typical of a space lease such that the exterior and structural elements are the PCLT responsibility and the interior dwelling unit improvements are the lessee's responsibility. The addendum also allocates the use of the yard, so that each lessee will have exclusive use of his or her portion of the yard. Essentially, all the same issues covered in a condominium declaration are covered in the addendum, but the expense of a survey plat, bylaws, disclosure statement and the extensive application forms for review and approval by the Oregon Real Estate Agency are all avoided, greatly reducing costs.

### **Affordable Assessments**

In mixed-income projects, the homeowner assessments must be restricted to avoid exceeding the ability of low-income residents to pay the assessments. This is a balancing act between affordability and providing sufficient funds to avoid project blight. The unresolved issue is how associations resolve a dispute between the low-income and higher-income owners. One has the danger of some class warfare in homeowner association politics. Traditionally, the courts have provided protection against majority oppression of the minority, but the idea of having the courts involved in homeowner disputes about replacing roofs or siding is not very practical or appealing especially to judges. This is the kind of issue that might best be solved by a creative arbitration and mediation provision in the homeowner documents.

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The tendency even in market-rate condominium projects is for condominium associations to want to cut corners financially and pay as they go for capital repairs and replacements, rather than to build up reserves for future expenses, as required by the Oregon Condominium Act. The City of Ashland considered requiring the market-rate units to subsidize the assessments of the affordable units, but the Oregon Real Estate Agency objected to this approach. The City then modified its ordinance to provide that the affordability of units under its program must take into account not only the usual items like the monthly principal, interest, taxes and insurance, but also the estimated monthly condominium assessment, including the reserve

assessment. This simply requires an even lower price to make the units affordable and increases the tendency for developers to rent, rather than sell.

**Promoting Pride of Ownership**

Related to the issue of affordable assessments is the issue of the optimal balance of renters to homeowners. Based upon experience, secondary mortgage market lenders will not finance projects unless over 50 percent are owner-occupied. As in cities, when individual condominium projects get out of balance in the proportion between owners and renters, experience tends to show that the projects will more likely become blighted, similar to the situation in neighborhoods of primarily rental housing.

In the aftermath of the severe housing recession, we face a danger that decreased levels of homeownership will encourage affordable housing advocates to give up on the goal of increasing homeownership in lieu of rental housing for low-income families. Why is the reduced homeownership and increased rental housing a danger? Because long experience has shown that pride of ownership is a most powerful tool in avoiding urban blight. Alternative non-governmental organizations like community land trusts and Habitat for Humanity have the advantage of a sense of mission and single-minded focus on affordable homeownership, which may be contrary to that of governments and other affordable housing advocates who too often fail to fully appreciate the inherent connection between urban blight and rental housing.

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Already some major cities are suing subprime lenders for predatory lending practices leading to foreclosures, in turn leading to increased blight in their cities. These local government leaders are angry and frustrated that the American dream of homeownership has been crushed for so many of their residents by greedy lenders who made predatory loans the borrowers never had the ability to repay.

Hopefully, these governmental leaders, and the victims of predatory lending they represent, will not give up on homeownership. The community land trust model of affordable homeownership, with standard fixed-payment, fully amortizing home loans, can help to sustain the American dream of homeownership for everyone who has the desire, ability and willingness to work towards it.

It is incumbent upon responsible local officials, developers, lenders, realtors and others in the development community to work towards a system of sustainable homeownership, rather than lose it simply because the deregulation of the lending industry led to such widespread abuse that essentially defrauded borrowers and cities in the name of affordable homeownership.