Demographic and Economic Constraints on the Inclusionary Zoning Strategy Utilized for the Production of Low and Moderate Income Housing in New Jersey

A Report Prepared for the
New Jersey State League of Municipalities
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Introduction

This report examines the effectiveness and the limitations of a public policy tool which has been used widely in New Jersey to stimulate the construction of affordable housing for low and moderate income persons. This tool is *"the inclusionary zoning strategy."* Its origins date back several decades to a series of New Jersey Supreme Court cases generally referred to as the *Mount Laurel* rulings.[1]

The New Jersey Supreme Court's 1983 *Mount Laurel* decision established a constitutional obligation that municipalities, in the exercise of their delegated power to zone, "afford [ ] a realistic opportunity for the construction of [their] fair share of the present and prospective regional need for low and moderate income housing." [2] Thereafter, the New Jersey Legislature enacted the Fair Housing Act (FHA) in 1985 codifying the Court's constitutional holding, and setting forth the particular means and strategy by which municipalities were to satisfy this obligation. The FHA created the Council on Affordable Housing (COAH), and directed that agency to implement rules and procedures for the implementation of the Court's policy.[3]

A fundamental strategic tool the Court and Legislature both envisioned that municipalities will utilize to establish a realistic opportunity for the creation of low and moderate income housing is inclusionary zoning. This strategy aims to create significant financial incentives to private developers, in the form of favorable zoning policies which provide density bonuses for development in certain areas of a community. In return, developers agree to use a portion of the profits obtained from the density bonuses to subsidize the construction of a certain number of low and moderate income housing units.

In recent years, inclusionary zoning plans have provided density bonuses to private developers throughout the state, who in return, have set aside up to 20% of the total number of units built for low and moderate income persons.

The primary reliance on private capital, as opposed to public subsidies, is a fundamental element of New Jersey's affordable housing strategy. The FHA specifically noted that nothing in that statute "shall require a municipality to raise or expend municipal revenues in order to provide low and moderate income housing."[4] In its proposed set of Third Round Substantive Rules published in the N.J. Register June 2, 2014, the N.J. Council on Affordable housing affirmed that the "production of affordable housing relies primarily on the private sector …."[5]

The inclusionary zoning strategy is organized around an economic bargain with private developers. The strategy assumes that there is an enormous, untapped demand for new market-rate housing in New Jersey, and a primary barrier to the satisfaction of this demand by the private sector is the artificial constraint on the market represented by restrictive municipal zoning.

[1] *S. Burlington Cnty. NAACP v. Twp of Mount Laurel, 92 N.J. 158, 205 (1983; see also So. Burlington Cty. N.A.A.C.P., et al. v. Mount Laurel Tp., et al., 67 N.J. 151 (1975) (Mount Laurel I), and subsequent decisions, including Hills v. Bernards Township, 103 N.J. 1 (1986), Toll Bros. v. West Windsor Township et al., 173 N.J. 502 (2002).*
[2] *Ibid*
[3] *Fair Housing Act, L. 1985, c 222. N.J.S.A. 52:27D-301*
[4] *FHA 52:27D-311.(d)*
[5] *N.J. COAH Proposed Third Round Substantive Rules published June 2, 2014, Section 5:99 1.1 (d)*

Therefore, the strategy presumes that if local governments selectively relax zoning constraints on private developers in certain portions of municipalities by granting developers generous density bonuses to build market rate housing, then New Jersey will experience a substantial boom in the production of market rate housing. This will result in creation of excess profits, which developers will invest back into private subsidies for construction of affordable units, in accordance with the mandates of the inclusionary zoning regulations.

The inclusionary zoning strategy can succeed only to the extent that private developers are willing to invest substantial amounts of capital in the New Jersey housing market. Thus, the production of affordable housing over the next ten years is largely dependent upon the ability of the New Jersey economy to support the production of new market rate housing by private developers in quantities sufficient to subsidize the desired number of affordable units.

The determination of the financial feasibility of inclusionary zoning plans is a fundamental element of the legislative intent of the FHA, and this concept has been affirmed by the courts. The FHA mandates that COAH, in establishing standards for substantive certification of municipal inclusionary zoning plans, consider whether the proposed percentage of units to be reserved for low and moderate income persons in such zoning plans is "based on economic feasibility with consideration for the proposed density of development."[6] The FHA further directs municipalities to consider that "[r]ezoning for densities [should] assure the economic viability of any inclusionary developments…."[7]

With the passage of the Fair Housing Act and the establishment of COAH, zoning plans for inclusionary developments were initiated by municipalities throughout the state pursuant to the First Round Certifications issued by COAH in 1988. Thereafter, COAH required municipalities to file annual reports on such plans. These reports were to include the potential number of new units authorized by inclusionary zoning enactments approved by each municipality, and the number of new units actually constructed pursuant to such plans. COAH provides a summary of such reports on its website. The data covers the period from approximately 1990 – 2010.[8]

We tallied a summary of these reports. We found that for the 20-year period 1990 – 2010, municipalities have reportedly incorporated inclusionary zoning provisions in their respective land use plans authorizing a total of 35,910 units of low and moderate income housing units to be built. Of this number, 16,870 affordable units (approximately 47% of the total authorized by zoning) have actually been constructed statewide over this 20-year reporting period.

This report is divided into five sections.

Section 1 summarizes the state-wide need for low and moderate income housing over the next ten years in New Jersey as projected by two recent expert assessments. The first assessment is made in a series of recent reports prepared by David N. Kinsey, Ph.D. on behalf of the Fair Share Housing Center (FSHC). The reports in the FSHC assessment are identified in footnotes 10 and 11. The second assessment was

[6] *52:27D-307(e)*
[7] *52:27D-311(a)(1)*
[8] *www.nj.gov/dca/services/lps/hss/archive.html. See "COAH Status and Information," and then "COAH Jurisdiction," and then "Proposed and Completed Affordable Units." The data is based upon municipal reports as of 3/1/2011, for years 1990 through 2010. Time periods covered by these reports have been confirmed with senior COAH officials.*

prepared for the N.J. Council on Affordable Housing (COAH) in a report with appendices, prepared by Rutgers University Center for Urban Policy Research, Edward J. Bloustein School of Planning and Public Policy under the direction of Robert W. Burchell, Ph.D. The report is identified in footnote 9.

Our report provides a summary of these assessments of need for affordable housing for background purposes only. This report will not evaluate the methodologies or findings of these assessments of need. Rather, the focus of this report is *to evaluate the effectiveness of the inclusionary zoning strategy as a delivery mechanism of affordable housing*, without regard to the statistical extent of that need.

Section 2 examines the historical levels of new housing production in New Jersey over the past twenty-five years. This section also examines the relationships between new housing production historically and several fundamental macroeconomic and demographic factors which commonly are used to assess the health of the New Jersey housing market, including the rate of new household formation, employment growth, population changes, and growth in Gross State Product. The purpose of this section is to provide the analytical basis for a realistic forecast of the performance of the New Jersey housing market over the next ten years.

Section 3 examines the recent shift in the location of new housing development in New Jersey, away from rural and suburban municipalities, back into the state's older, more densely-populated towns. This shift has been significant. The trend has enormous implications for the effectiveness of the inclusionary zoning strategy, because, assuming the trend continues, it will result in a growing percentage of all new housing units developed over the next ten years being located in towns which, as a matter of state policy, have no affordable housing obligations under the *Mount Laurel* mandate. This will mean that a significant portion of the total production of new housing will be outside the reach of the inclusionary zoning strategy, thus diminishing the effectiveness of the strategy in meeting affordable housing goals.

Section 4 analyzes a structural limitation on the ability of the inclusionary zoning strategy to meet the needs of more than a quarter of the low and moderate income households in New Jersey. The limitation arises from the fact that the judicial and legislative definitions of those who are deemed to be "low and moderate income" persons includes persons who are extremely poor, and thus unable to afford even a low-income unit produced by private developers under the rules of the inclusionary zoning strategy.

Section 5 provides our findings and conclusions. We will assess the likelihood that the New Jersey economy is capable of producing a sufficient volume of new market-rate housing over the next ten years, such that, in tandem with the inclusionary zoning strategy, the state can succeed in achieving the ambitious goals for affordable housing set by advocates and public policymakers.

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Section 1: Projected Need for Affordable Housing in New Jersey: 2015 – 2025

Two authoritative studies of the future need for affordable housing in New Jersey were recently published. The first was produced under the sponsorship of the New Jersey Council on Affordable Housing (COAH) as part of COAH's proposed Third Round Substantive Rules in 2014. This study was prepared by Rutgers University Center for Urban Policy Research, under the direction of Principal Consultants Robert W. Burchell, Ph.D.; William Dolphin, M.A.; and Jinwoo Kwon, M.R.P. The study, dated April 27, 2014, was included as a series of Technical Appendices to the proposed Third Round Substantive Rules of COAH.[9] This study is referred to herein as the "Rutgers-Burchell Study."

The second study was produced under the sponsorship of the Fair Share Housing Center, with offices in Cherry Hill, NJ, and was prepared by David N. Kinsey, Ph.D., FAICP, PP. This study was dated April 16, 2015.[10] This study was updated on July 17, 2015 with a number of technical revisions and corrections, focusing primarily on adjustments to the fair share needs of several municipalities as set forth in the April 16, 2015 study. The April 16, 2015 study as modified by the July 17, 2015 revisions are together referred to herein as the "FSHC-Kinsey Study." The FSHC-Kinsey Study followed an earlier analysis of New Jersey low and moderate income housing needs prepared by Dr. Kinsey in cooperation with Art Bernard, PP, for the Fair Share Housing Center, dated July, 2014.[11]

These two separate assessments of need use statistical methodologies and demographic analysis which have much in common. However, the conclusions of the two reports are dramatically different.

The Rutgers-Burchell Study concludes that the prospective need for affordable housing for the period 2014 – 2024 is 30,633 new units; in addition, another 21,558 units are needed as a result of the "unanswered obligations" mandated by COAH for the period 1987 – 2014, but which were not produced, for a total projected need over the period 2014 – 2024 of 52,191 units. This Study also identified an additional 62,859 units needed as "Rehabilitation Share," for a total need of approximately 115,000 units.

The FSHC-Kinsey Study examined the prospective need for new units for a similar ten-year period (2015 – 2025) and also took into account the unanswered obligations from past years (1999-2014). After making adjustments for such factors as filtering, demolitions, and conversions, the FSHC-Kinsey Study concluded that the total prospective need for the period 2015 – 2025 is 201,382 affordable units. When this Study included unfulfilled past obligations and the rehabilitation share for existing housing, the Study need totaled nearly 350,000 units.

The aggregate need determined by the FSHC-Kinsey Study therefore is more than three times the need determined by the Rutgers-Burchell Study.

As noted earlier, an analysis of the data, methodologies and assumptions used by these two experts in preparing their respective forecasts, is beyond the scope of this report. Both reports confirm that the level of need for more affordable housing in New Jersey is substantial. Quantifying the exact number of new units needed will undoubtedly be the subject of vigorous debate among experts over the next several years.

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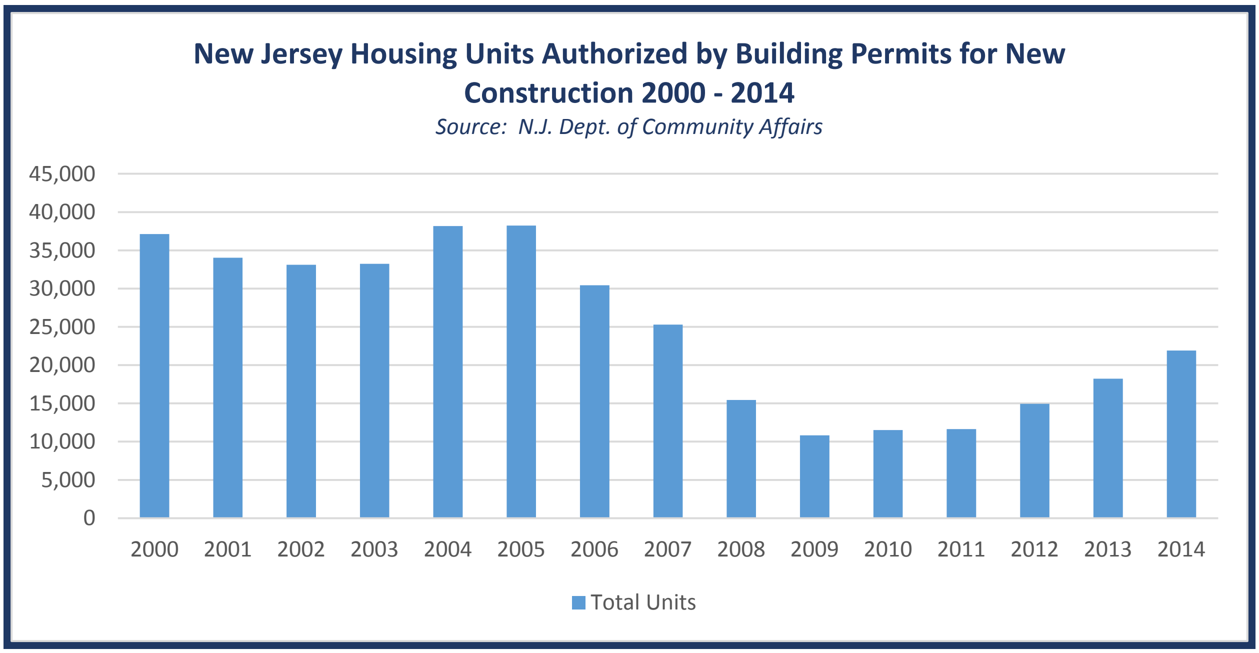
[9] *Municipal Determination of Rehabilitation Share, Fair Share, and Unanswered Prior Obligation – to 2024; Appendices A, B, C, D and E, for New Jersey Council on Affordable Housing, Third Round Substantive Rules, Technical Appendices, Prepared by Rutgers University Center for Urban Policy Research, New Brunswick, NJ, Principal Consultants Robert W. Burchell, Ph.D., William Dolphin, M.A. and Jinwoo Kwon, M.R.P., dated April 27, 2014.*
[10] *FSHC Report dated April 16, 2015 entitled "New Jersey Low and Moderate Income Housing Obligations for 1999-2025, Calculated Using the NJ COAH Prior Round (1987-1999) Methodology," prepared by David Kinsey, Ph.D., PAICP, PP.*
[11] *FSHC Report dated July, 2014, entitled "New Jersey Low and Moderate Income Housing – Prospective Need for 1999-2024, Using the NJ COAH Prior Round (1987-1999) Methodology," prepared by David N. Kinsey, Ph.D., PAICP, PP and Art Bernard, PP.*

The focus of this report, on the other hand, is to examine *the effectiveness of one method of delivery* of *affordable units, namely the inclusionary zoning strategy*, in whatever quantity policymakers agree is the correct number.

Section 2: Housing Production in New Jersey: The Key Demographic and Economic Factors that Drive the Housing Market

In 1990, according to the NJ Department of Community Affairs, a total of 17,527 building permits were issued for the construction of new homes in New Jersey, This figure (and the building permit figures for new housing which follow here) include one-and two-family units, multi-family units such as garden apartment complexes, and new residential units as part of mixed-use projects.[12]

During the most recent 15-year period (2000 – 2014), as the following chart illustrates, new housing permits fluctuated from a high of 38,000 permits in 2005 to a low of 10,800 in 2009.



During this most recent 15-year period, despite cyclical ups and downs, the trend in new housing production in New Jersey is headed gradually downward.

Thus, for the past *15-year period (2000 – 2014)*, the average number of new residential permits issued each year was 24,942.

[12] Note that, while the number of permits issued for new housing construction year to year provides a reliable indicator of the health of the housing market, less than 100% of such permits issued result in actual certificates of occupancy for such new homes for a variety of reasons.

However, for the most recent *10-year period (2005 – 2014)*, the average dropped to 19,845 permits per year.

For the most recent *5-year period (2010-2014)*, marked in many other states as a period of robust recovery from the recession, average new housing production in New Jersey dropped even further, to 15,646 permits per year.

Historical Trends
New Jersey New Housing Permits Issued
2000 – 2014
Source: New Jersey Department of Community Affairs

Time Period	Average Number New Housing Permits Issued Annually
2000 – 2014 (past 15 years)	**24,942**
2005 – 2014 (past 10 years)	**19,845**
2010 – 2014 (past 5 years)	**15,646**

<u>Factors Driving Demand for New Housing</u>

It is widely accepted among economists that "[N]et household growth is the largest single driver of demand for new housing units" [13] Thus, in assessing the future direction of the New Jersey housing market, one focuses on the extent to which the number of households in the state is likely to grow.

The demographic measurement of households in a state first requires calculation of what is known as the "headship rate," which is the probability that a person in the population is a head of a household. Headship rates vary by age group, so that persons under age 18 will have a low headship rate, and the rate increases with each age group as persons form households. Demographers project changes in the number of households over time by first projecting the population of various age groups, and then multiplying those population estimates by the headship rates of each age group. Since household growth is a key component of the demand for new housing, forecasters look at the underlying economic factors which impact both headship rates and population, over time.

[13] *George S. Masnick, Daniel McCue and Eric S. Belsky, "Updated 2010-2020 Household and New Home Demand Projections," Joint Center for Housing Studies, Harvard University, September 2010, p. 33.*

Changes in headship rates and thus the pace of household formation have been shown to be driven generally by two factors: demographic changes within the population, and the health of the underlying economy. [14]

Headship rates and thus household formations tend to increase with age, while recessionary forces in the economy tend to reduce household formation, as young people are less willing and able to establish their own households, and continue living with their parents. Slow or negative economic growth also diminishes job prospects, and the recent recession led to a tightening in home mortgage credit, making it more difficult to obtain a mortgage. Such factors have caused more young persons to defer purchasing a home.

The Joint Center for Housing Studies at Harvard University, in its State of the Nation's Housing 2014, noted that "while headship rates across income groups have been relatively constant over the past 10 years (2004 – 2014), growth in each group has not….," and further noted that "difficult economic and housing market conditions … reduced headship rates among the native born" as well as among immigrants. [15]

The Joint Center's most recent report, the State of the Nation's Housing 2015, concluded its outlook for this current year with an emphasis on the importance of continued employment growth as a key element in improving otherwise tepid national housing demand:

> *Despite the slowdown in 2014, the housing market recovery could regain steam in 2015 if continued employment growth helps to lift household incomes. But the lingering effects of the housing crash and Great Recession continue to impede the recovery. Millions of owners still have little or no equity in their homes and/or damaged credit histories, dampening demand in both the first-time buyer and trade up markets. Although members of the millennial generation are starting to find their footing in the job market and helping to propel rental demand, many of these young adults are saddled with rent burdens and student loan payments that will slow their transition to homeownership.* [16]

A recent report from the respected Pew Research Center, which focuses on social and demographic trends in the U.S. noted that one of the nation's most rapidly-growing demographic groups, the "Millennials," appear to be forming households today at a slower pace than was the case before the recent great recession. The Pew Report noted that "the nation's 18- to 34-year olds are less likely to be living independently of their families and establishing their own households today than they were in the depths of the Great Recession." [17]

The Pew research report went on to note that the declining rate of household formation among millennials has very negative implications for the growth of the housing market in the years ahead:

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[14] "Household Formation and the Great Recession," Timothy Dunne, Data Analysis, Economy, Think Tank, August 23, 2012 [www.ritholtz.com/blog/2012/08/household-formation-and-the-great-recession].
[15] Joint Center for Housing Studies, Harvard University, State of the Nation's Housing 2014, pp. 12 – 13.
[16] Joint Center for Housing Studies of Harvard University, The State of the Nation's Housing 2015, p. 6
[17] "More Millennials Living with Family Despite Improved Job Market," by Richard Fry, Pew Research Center, July 29, 2015, http://www.pewsocialtrends.org/category/publications/. Page 1.

> *The decline in the rate at which young adults are forming households from 2007 to 2015 has had a negative impact on the demand for the nation's housing and, in turn, residential construction. Because of the recession, there are substantially fewer households than would have been predicted based on population growth; using CPS (Current Population Survey) data through 2011 an economist estimated that the shortfall in the number of young adult households accounted for almost three-quarters of the total 2.6 million shortfall in households throughout the economy. In other words, young adults have been a key demographic in the nation's housing bust. Four years later, the rate at which they are forming households is no higher than it was in 2011.*[18]

Moving from projections for the U.S. economy to New Jersey, headship rates and therefore growth in number of households in this state are also expected to be flat over the next 10 years. As discussed below, this forecast is based on projected below-average economic growth in New Jersey, and below-average increases in employment and population.

In the FSHC-Kinsey Study, Dr. Kinsey acknowledged that his methodology

> *takes a conservative approach to headship rates, adopting the actual headship rates observed from the 2000 Census through the current, most recent available headship rate, from the 2013 American Community Survey one-year data, and constant, flat headship rates from the present through 2015, consistent with the JCHS [Joint Center for Housing Studies] projection.*[19]

The Rutgers-Burchell Study utilized similarly conservative projections of headship rates in New Jersey, and therefore, conservative projections for the growth of households from 2014 – 2024:

> *Household sizes in New Jersey have increased slightly over the last two decade; conversely, headship rates have slightly decreased….. Headship rates are determined by age group and county in New Jersey and extended into the future at five year intervals at one-half the rate of change observed from 1990 to 2010."* [20]

Thus, with respect to the primary driver of demand for new residential construction, namely the growth in number of households in New Jersey over the next ten years, there is little evidence to support a projection for a robust increase in housing production in New Jersey over the next decade. This finding must dampen expectations about the ability of the inclusionary zoning strategy to fuel the production of affordable housing.

Demographic trends are not the only indicators of a slow housing market for New Jersey in the next decade. The state's economy has been struggling to recover from the deep recession of 2008 – 2010, and key indicators point to a very disappointing economic performance for New Jersey over the next ten years.

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[18] *Ibid, page 9; the economist referred to in the text is Timothy Dunne, "Household Formation and the Great Recession," Federal Reserve Bank of Cleveland Economic Commentary, Aug. 23, 2012.*
[19] *FSHC-Kinsey Report April 16, 2015, p. 17.*
[20] *Rutgers-Burchell Report, 2014, Technical Appendix p. 10*

The Rutgers Economic Advisory Service (R/ECON) is part of the Center for Urban Policy Research at the Edward J. Bloustein School of Planning and Public Policy at Rutgers University. R/ECON's Forecast of the New Jersey Economy in January, 2015 was entitled "New Jersey: The Recovery Continues at a Slow Pace." [21] The key economic indicators forecasted for the state's economy which could have created momentum for the housing market are lagging.

Particularly troubling in this forecast is the employment picture. The forecast shows growth in employment of only 0.3% in 2014 (an addition of only about 10,000 new jobs), after a growth of 1.2 percent (about 44,800 jobs) in 2013. The report noted that:

> *At these rates the job base will return to the peak level reached in the first quarter of 2008 in mid-2017. By the end of the forecast period in 2024 the employment base will be about 200,000 jobs greater than its level at the peak (2008).*[22]

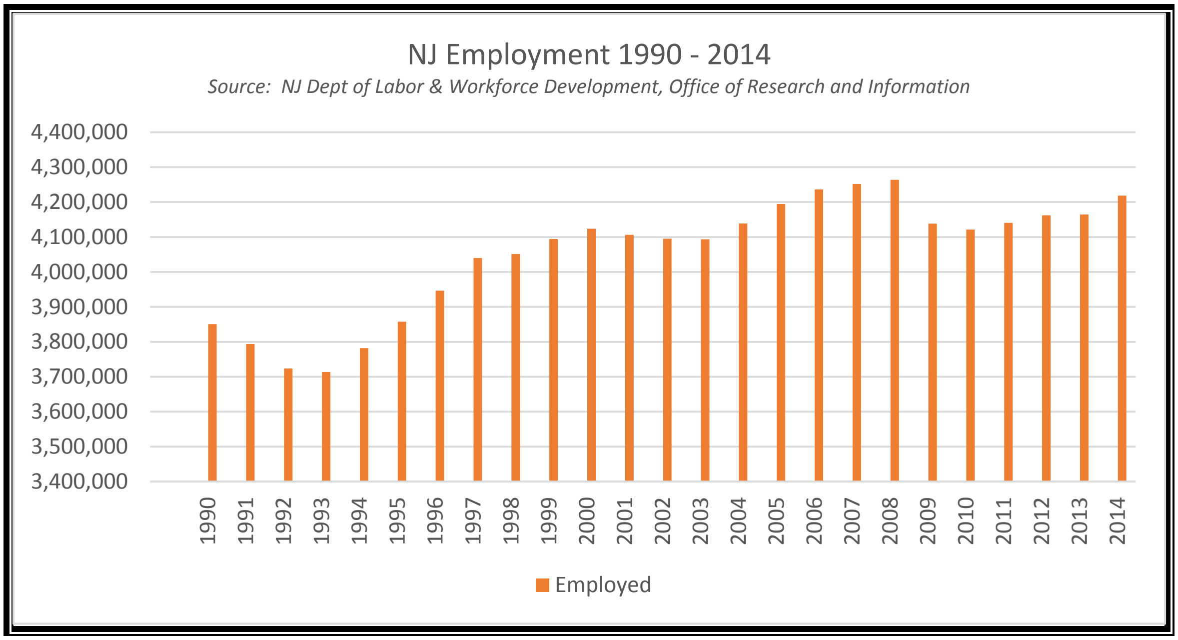
SUMMARY OF NEW JERSEY ECONOMIC FORECAST

	2013	2014	2015	2015 to 2024
Annual Percentage Change				
Nonagricultural Employment	1.2%	0.3%	1.4%	0.8%
Real Gross State Product	1.1%	1.0%	2.9%	2.1%
Personal Income	2.3%	3.1%	4.9%	4.4%
Population	0.4%	0.4%	0.6%	0.7%
Consumer Prices	1.4%	1.4%	0.5%	2.4%
Percentage Unemployment Rate (Average)	8.2%	6.7%	5.9%	5.4%

Source: R/ECON, January 2015

[21] "*Forecast of January, 2015 – New Jersey: The Recovery Continues at a Slow Pace,*" *Nancy H. Mantell, Ph.D. and Michael L. Lahr, Ph.D., Rutgers Economic Advisory Service; the report reflects preliminary employment data for November, 2014 released in December 2014 by the N.J. Dept. of Labor as well as income data for the first 3 quarters of 2014 released in December, 2014 by the U.S. Bureau of Economic Analysis. It also takes into account the preliminary gross domestic product data for 2013 released by the U.S. Bureau of Economic Analysis in June 2014. U.S. forecast information in the report come from the IHS Economics forecast of December 2014.*

[22] *R/ECON Forecast of January 2015 New Jersey*



The report goes on to note that as of May, 2014, the jobs recovery in the U.S. was complete, with employment gains making up for more than all of the 8.7 million jobs lost in the recession.

But the outlook in New Jersey is not as bright. *"Given its slower recovery and rate of expansion, New Jersey's share of the nation's job base will decline from its current 2.83 percent to 2.81 percent in 2024."*[23]

New Jersey has had one of the most disappointing records of recovery from the recent recession of any of the 50 states. In an assessment of the recovery rates of the states as of 2012, a recent Rutgers Regional Report found that by 2012, all but 12 of the 50 states had returned to a level of "real private-sector GDP" equal to 2007 levels. New Jersey was among the 12 laggards, having recovered only 98.8% of its 2007 real GDP, placing New Jersey 43rd among the 50 states in the recovery.[24]

The same analysis indicated that our neighboring states have fared much better in recovery, with New York State recovering 103.3% of its 2007 GDP (and ranking 23rd among the states), and Pennsylvania recovering 103.2% of 2007 GDP, and ranking 24th. [25]

The broader outlook for New Jersey's economic output for the next decade is not bright. In a release accompanying the R/ECON 2015 Forecast, Rutgers economist Nancy H. Mantell noted that in terms of real output (as measured by real gross state product), the state's economy will grow at an average rate of 2.2 percent per year between 2012 and 2033, about 15 percent slower than the average rate expected nationwide.

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[23] *Ibid.*
[24] *"Employment, Recession and Recovery in the 50 States: A Further Update," Joseph J. Seneca and Will Irving, Rutgers Regional Report Number 36, July, 2013, Rutgers Edward J. Bloustein School of Planning and Public Policy, page 7; GDP data from U.S. Bureau of Economic Analysis.*
[25] *Ibid*

> *Dr. Mantell cited the relatively high cost of living and doing business in New Jersey, the state's lower proportion of working-age people and the shift in industrial composition ever more heavily into the service economy, all as contributors to lower real gross state product. Dr. Mantell also called a projected slower average annual increase in population growth in New Jersey throughout the forecast period – 0.6 percent compared with a 0.7 percent national average – as a contributor to the lower real gross state product.*[26]

Section 3: The Shifting Location of New Housing in New Jersey: Implications for the Inclusionary Zoning Strategy

New Jersey's challenging demographics and lagging economy are not the only obstacles to the successful use of inclusionary zoning as a tool for the production of affordable housing. Another obstacle – this one involving shifting patterns of development in the state - presents a different and equally-formidable challenge.

A consensus among recent forecasts for the New Jersey and U.S. housing markets is that, to the extent the market for new housing in the next economic cycle will have any vitality, demand is likely to focus most sharply on rental housing, and on locations which are close to public transportation and employment centers.

In an April, 2012 Regional Report entitled "Demographics, Economics and Housing Demand," Dr. James W. Hughes and Dr. Joseph J. Seneca reported that:

> *Demography is destiny! And, just as forecast, the long-anticipated demographic paradigm of the twenty-first century has unfolded almost exactly on schedule…. As a result, the intersection of demography and the new global economic realities has fundamental implications for residential demand and construction that differ somewhat from the prevailing forecasts of the recent past. Consequently, a new economically constrained demography has emerged, with shifting spatial ramifications….*
>
> *Demographic dynamics now in force … have led to new non-suburban-centric patterns of spatial shelter demand. This is a sharp change from the second half of the twentieth century, when baby boom-driven suburban New Jersey reigned supreme. However, this does not portend the "Death of the American Dream House," nor the demise of suburban New Jersey, although both will never recover their once-vaunted dominant twentieth-century status.*[27]

Writing about the trend away from suburban development, Professors Hughes and Seneca, in a November, 2012 Issue Paper "The Evolving Rental Housing Market in New Jersey" observed that during the period 2000-2009, the underlying dynamics of New Jersey's rental market experienced a marked shift:

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[26] *News Release: Rutgers Forecast: New Jersey Economy Remains in Recovery Mode but Pace Trails Nation's in Several Key Indicators, December 11, 2013.*
[27] *"Demographics, Economics and Housing Demand," James W. Hughes and Joseph J. Seneca, Rutgers Regional Report Issue Paper Number 29, April, 2012, Rutgers Edward J. Bloustein School of Planning and Public Policy, p. 1.*

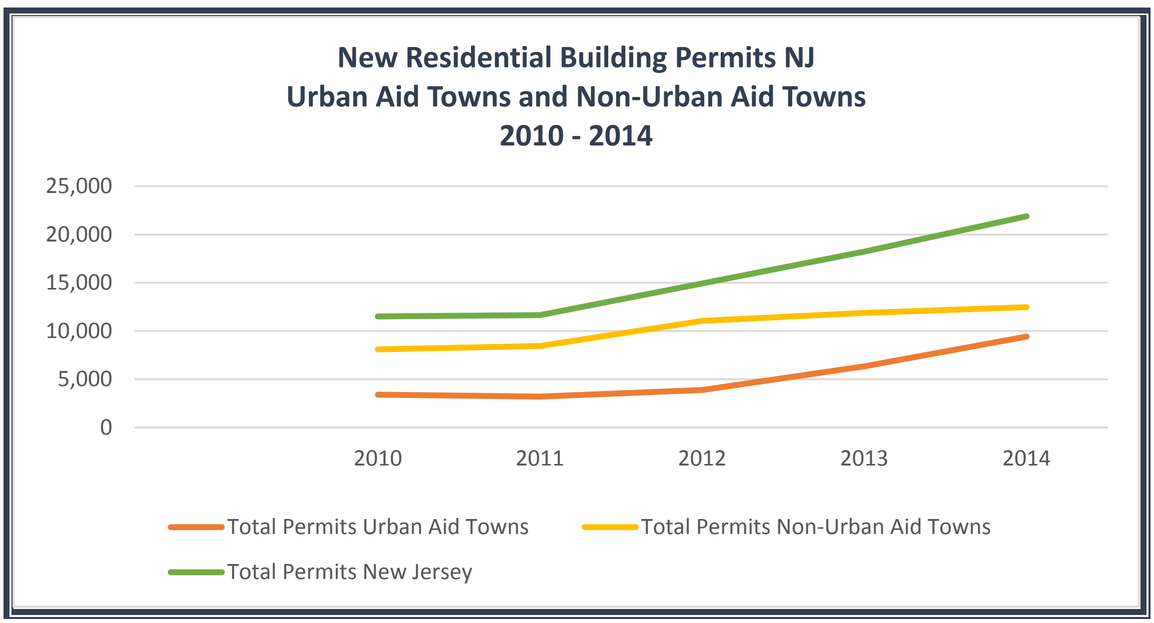
> *Suburban areas were no longer the new economic frontiers, and the proliferation of office sprawl slowed from its previous frantic pace. While suburban restrictive-growth policies intensified, young households began to retreat from suburban lifestyles. As the baby-boom echo, born between 1976 and 1994, began to enter the housing market, a more urban focus emerged. The new generation was far less suburban-centric than its parents. This change will be one of the key rental contours of the decade now unfolding.*[28]

Indeed, the data on New Jersey's recovery from the recent recession confirms that this shift in the locational preferences for new housing from rural and suburban communities, back to urban areas, is now underway.

This trend back to urban areas may be welcome news to smart growth advocates, who have long decried New Jersey's historical pattern of suburban sprawl.

But the shift of new housing back to New Jersey's older cities is moving an increasing share of the growth in housing to places which are outside the regulatory reach of the inclusionary zoning strategy.

During the past five years (2010 – 2014), 78,228 building permits were issued statewide in New Jersey for new residential construction. Of this number, 26,263 (34% of the permits) were issued for units located just in the 56 municipalities which receive state urban aid pursuant to the provisions of N.J.S.A. 52:27D-178. See following table, and Appendix A attached here.



Most of these "urban aid" municipalities are among New Jersey's older, more densely-populated communities, and more likely to be served by public transportation than their suburban and rural counterparts. Many of these towns are undergoing substantial redevelopment with the construction of

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[28] *"The Evolving Rental Housing Market in New Jersey," James W. Hughes and Joseph J. Seneca, Rutgers Regional Report Issue Paper Number 32, November, 2012, Rutgers Edward J. Bloustein School of Planning and Public Policy, p. 5.*

large mixed-use projects funded by private capital. The surge in residential redevelopment in many of these 56 towns has also been accompanied (and likely fueled) by growth in employment in new downtown corporate offices and expansion of employment in nearby higher education and health care institutions.

The concentration of new residential development in urban aid municipalities has enormous implications for the effectiveness of the inclusionary zoning strategy. The reason is that these municipalities are exempt from any fair share housing obligations under *Mount Laurel* mandates.

The policy excluding "urban aid" municipalities from obligations of prospective need dates back to the adoption of COAH's First Round Rules in 1986, wherein COAH noted that

> *The Council determined that it would be inappropriate to distribute reallocated present need and prospective need to urban areas that were in special need of aid. It was determined that such areas have historically housed a disproportionate share of New Jersey's low and moderate income households and have special problems associated with poverty. The urban aid cities were the only general class of cities to meet these criteria.*[29]

The policy was affirmed in COAH's most recent proposed Technical Appendices to Third Round Substantive Rules for the period 2014 – 2024 published in June, 2014:

> *Urban aid cities do not receive projected need and this need is distributed to all communities in the state according to a combined allocation factor that uses the four allocation factors (land capacity, relative income, non-residential job growth/residential unit growth on a statewide basis.) Each non-urban aid community is adjusted by this additional need. This need is taken from Urban Aid Cities and distributed to all other municipalities.*[30]

Thus, the growing volume of new construction of market rate housing in these urban aid towns over the next decade will produce little, if any, increase in the supply of low and moderate income housing, because such new housing developments will be beyond the reach of the inclusionary zoning strategy. This shift in the location of new housing in the state will significantly handicap the effectiveness of the inclusionary zoning strategy as a delivery mechanism for affordable housing over the next ten years.

Section 4: The Inability of the Inclusionary Zoning Strategy to Address the Housing Needs of the Extremely Poor

The financial model which forms the basis of inclusionary zoning presumes that all persons with "moderate incomes" and "low incomes," as those two levels of household incomes are defined, should have a reasonable opportunity for affordable housing.

Regulations adopted by the N.J. Department of Community Affairs to implement the Fair Housing Act generally define housing created by the inclusionary zoning strategy to be "affordable" for a household

[29] *18 N.J.R. 1529, comments on First Round Rules, August 4, 1986.*
[30] *COAH Third Round Substantive Rules, Technical Appendices, p. 59, published New Jersey Register June 2, 2014.*

qualifying as "low" or "moderate" income if such household does not have to spend more than 30% of gross income on housing costs.[31]

COAH publishes guidelines which define "moderate" and "low" income persons, differentiated among six geographic regions within the state

, and scaled according to the number of persons in the household.

"Moderate Income" is defined as 80% of median income in a region. "Low" income is a single point equal to 50% of median income. "Very low" income is exactly 30% of median income. See *Appendix B* which sets forth the 2014 COAH Affordable Housing Regional Income Limits. These income brackets are used by developers and local officials in setting the pricing for affordable units developed under the inclusionary zoning strategy. [32] Pursuant to the provisions of UHAC noted earlier, the allowable pricing for such owned or rented units is calculated such that generally no more than 30% of an eligible household's total monthly income should be devoted to housing costs.[33]

For purposes of illustration, as set forth in Appendix B, a 2-person household in Region 1 (Bergen, Hudson, Passaic, Sussex) would be classified as "very low" income if its annual income did not exceed $20,261 (which is 30% of the median income for a 2-person household in that region in 2014 of $67,538). That 2-person household would be eligible to occupy an affordable housing unit with an annual housing cost of approximately 30% of that "very low" annual income, or $6,078. If that "very low income" unit were a rental apartment, the monthly rent and related housing expenses as defined by COAH would be set at $506.53.

A similar calculation would apply to a "very low income" for sale unit, taking into account costs of a mortgage loan, taxes, insurance and maintenance, the sum of which would also be approximately $506.53. The COAH rules permit landlords or sellers of such affordable units to require credit and background checks on prospective tenants or buyers, to establish the financial ability of the household to make the required housing payments.

This set of financial guidelines can work reasonably well in assisting households with incomes between 30% - 80% of median income in qualifying for "affordable" units built under the inclusionary zoning program.

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[31] *Uniform Housing Affordability Controls ("UHAC"), N.J.A.C. 5:80-26.6 (b) (price restrictions for ownership units) and 5:80-26.12 (a) (price restrictions for rental units). Note that the formula set forth in the UHAC regulations for calculating the allowable "costs" of owning an affordable unit are somewhat complex. The percentage of monthly income of a qualifying household that can be devoted to such costs of ownership is capped at 28%. The formula for calculating the allowable "costs" of renting an affordable unit include utility charges paid by tenant plus the landlord's rent charge. The regulations provide that such "rental costs" should not exceed 30% of the monthly income of the eligible household. We have used the somewhat higher cap of 30% of income in our analysis here for all affordable units, whether owned or rented. UHAC is a set of regulations adopted in 2001 and amended in 2004 by the N.J. Department of Community Affairs to implement the N.J. Fair Housing Act.*

[32] *N.J.A.C. 5:80-26.4(a)*

[33] *Note that this housing cost to allowable income standard is not a "sliding scale." That is, the allowable housing cost for a moderate income household is fixed at 30% of exactly 80% of median income for such household in a region, even though a moderate income household can be so designated if it has annual income as low as 51% of median or as high as 80% of median. Thus, households in the lower end of an affordable income bracket may have to pay more than 30% of actual annual income for housing costs in an affordable unit.*

The strategy, however, fails to address the needs of households whose incomes are significantly below 30% of median. *The pricing of the least expensive ("very low income") affordable units is significantly above the ability to pay for those households with incomes 20% or less than median.*

To illustrate this structural limitation in the inclusionary zoning strategy, we recalculated the 2014 N.J. COAH income limits by region and household size, focusing only on those households *with annual incomes of 20% of median or less*. We labeled this group of households as "*extremely low income*" as distinguished from the "*very low income*" households with incomes of at least 30% of median income.

Region	Annual Income 20% of Median ("Extremely Low Income")	*Household* 1 Person	*Size* 2	3	4	5	6	7	8
1	Bergen, Hudson, Passaic, Sussex	$11,819	13,508	15,196	16,884	18,235	19,586	20,937	22,288
2	Essex, Morris, Union, Warren	12,686	14,498	16,311	18,123	19,573	21,022	22,472	23,922
3	Hunterdon, Middlesex, Somerset	14,700	16,800	18,900	21,000	22,680	24,360	26,040	27,720
4	Mercer, Monmouth, Ocean	12,966	14,818	16,670	18,523	20,005	21,486	22,968	24,450
5	Burlington, Camden, Gloucester	11,410	13,040	14,670	16,300	17,604	18,908	20,212	21,516
6	Atlantic, Cape May, Cumberland, Salem	10,217	11,677	13,136	14,596	15,764	16,931	18,099	19,266

These *"extremely low income"* households seeking affordable housing created under the inclusionary zoning strategy would need to pay housing costs associated with units priced for *"very low income"* households, whose incomes are 50% or more higher than the "extremely low income" households (i.e., 30% of median vs. 20% or less of median).

As the following tables illustrate, these "extremely low income" households would need to pay approximately 45% or more of total income for housing expenses (rent or ownership costs) in a "very low income" unit. Such a housing cost burden is contrary to UHAC guidelines, because it would place an unmanageable financial burden on such households.

	COAH Allowable Housing Expense @ 30% of "Low Income" Level								
		Household	***Size***						
Region		**1 Person**	**2**	**3**	**4**	**5**	**6**	**7**	**8**
1	Bergen, Hudson, Passaic, Sussex	$5,319	$6,078	$6,838	$7,598	$8,206	$8,814	$9,422	$10,029
2	Essex, Morris, Union, Warren	5,709	6,524	7,340	8,155	8,808	9,460	10,113	10,765
3	Hunterdon, Middlesex, Somerset	6,615	7,824	8,802	9,780	10,562	11,345	12,127	12,910
4	Mercer, Monmouth, Ocean	6,130	7,006	7,882	8,758	9,458	10,159	10,859	11,560
5	Burlington, Camden, Gloucester	5,135	5,868	6,602	7,335	7,922	8,509	9,095	9,682
6	Atlantic, Cape May, Cumberland, Salem	4,598	5,255	5,911	6,568	7,094	7,619	8,144	8,670

	Allowable Housing Expense for "Very Low Income" Units as Percentage of "Extremely Low Income" (20% of Median)	***Household***	***Size***						
Region		**1 Person**	**2**	**3**	**4**	**5**	**6**	**7**	**8**
1	Bergen, Hudson, Passaic, Sussex	45%	45%	45%	45%	45%	45%	45%	45%
2	Essex, Morris, Union, Warren	45%	45%	45%	45%	45%	45%	45%	45%
3	Hunterdon, Middlesex, Somerset	45%	47%	47%	47%	47%	47%	47%	47%
4	Mercer, Monmouth, Ocean	47%	47%	47%	47%	47%	47%	47%	47%
5	Burlington, Camden, Gloucester	45%	45%	45%	45%	45%	45%	45%	45%
6	Atlantic, Cape May, Cumberland, Salem	45%	45%	45%	45%	45%	45%	45%	45%

How many households are impacted by this structural limitation built into the inclusionary zoning strategy?

To determine this, we first examined the projected number of affordable housing units needed by _*all low and moderate income households*_ in New Jersey (i.e., households with incomes between 0% - 80% of median) for the period 1999 – 2025 as calculated by the FSHC-Kinsey Study *(Appendix C: Table 3-A attached).* That total is 284,345 units.

Second, we calculated that same total prospective need to 2025 using the FSHC-Kinsey Study, *but excluded households below 20% of median income ("extremely low income") (Appendix C: Table 3-B attached).* That number is 208,606 units.

We then calculated the difference between the two numbers *(Appendix C: Table 3-C).*

The result is that, based upon the methodology used in the FSHC-Kinsey Study, 75,739 affordable units is the total number of prospective need in New Jersey through 2025 just by households whose incomes are 20% of median or less. [34]

This subset of households, which we have classified as "extremely low income households," represents approximately 27% of all those persons identified in the FSHC-Kinsey Study designated as "low and moderate income households."

As shown in the table above, in order for the housing needs of these 75,739 "extremely low income" households to be satisfied by the inclusionary zoning strategy, such households would be required to pay 45% or more of household income for housing costs. Such a result is contrary to state affordable housing policy as set forth in the UHAC rules.

Our conclusion therefore is that more than one-quarter of all "low and moderate income households" statewide do not have sufficient incomes to afford even a "low income" housing unit built under the inclusionary development strategy.

Therefore, the inclusionary development strategy, by reason of its financial structure, *and without regard to the total volume of low and moderate income units produced over the next ten years,* is incapable of meeting the housing needs of more than one-quarter of the households targeted for assistance by the strategy.

This finding has significant implications for the reasonableness of government affordable housing mandates which assign numerical goals to municipalities pursuant to the *Mount Laurel* doctrine. Assuming such regulatory mandates include affordable housing goals for "extremely low income" persons, and further assuming towns achieve 100% compliance in satisfying the mandates, the affordable housing thus produced cannot meet the needs of more than 25% of the targeted population.

Thus, that portion of the future need mandate should not be included in the affordable housing goals for municipalities.

Section 5: Summary and Conclusions

The purpose of this report has been to analyze the factors that determine how effective the inclusionary zoning strategy is likely to be in delivering privately-financed affordable housing units in New Jersey over the next ten years.

Our findings and conclusions may be summarized as follows.

1) All key demographic and economic indicators point to a New Jersey economy that has been, and will continue to be, sluggish, slow-growing, and substantially underperforming the U.S. economy (and the economies of our neighboring Mid-Atlantic states). These key indicators describe a New Jersey economy likely to continue to struggle over the next ten years to achieve a level of growth needed to fuel a robust housing market.

[34] *Please refer to Appendix C: Tables 1-A, 1-B, 1-C, 2-A, 2-B, 2-C and 3-A, 3-B and 3-C.*

2) The inclusionary zoning strategy faces a significant obstacle in its ability to produce affordable housing, under any realistic future market conditions, as a result of the recent shift in the locational preferences of the housing market away from suburban and rural communities, and now noticeably towards the state's urban areas. New Jersey's "urban aid" municipalities are likely to attract a growing share of the state's new housing production in the coming decade. Because these municipalities are exempt from the "set aside" rules of the inclusionary zoning strategy, this trend will significantly diminish the effectiveness of the inclusionary zoning strategy in meeting affordable housing goals.

3) The inclusionary zoning strategy is designed to address the housing needs of households with incomes of at least 30% of median income. However, approximately 76,000 households in New Jersey have significantly lower incomes (20% of median or below). These "extremely low income" households will not be able to afford even the "very low" income units that may be produced over the next 10 years by the inclusionary zoning strategy. In our opinion, there is no credible financial basis to assign mandates to municipalities to create affordable housing for households with incomes of 20% of median or less, utilizing the inclusionary zoning strategy.

4) With respect to the macro-economic outlook for housing production in the state, we find no credible evidence to support the conclusion that New Jersey's economy will be able to increase its historic level of housing production to a level that will allow the inclusionary zoning strategy to come close to achieving the aspirational goals of affordable housing advocates.

We are mindful that prediction of economic and demographic trends into the future is a risky business, and is not an exact science. The many factors and variables that combine to produce such results may change unexpectedly over a ten year period. With those qualifications in mind, and taking into account the multiple challenges to the effectiveness of the inclusionary zoning strategy discussed herein, we have prepared three alternative forecasts for new affordable housing production in New Jersey for the next ten years, which are summarized in the table below**.**

The three alternative projections are based on the following assumptions:

(i) an average of 20% of all new housing in New Jersey over the next 10 years will be located in "urban aid" towns (and thus beyond the jurisdiction of the inclusionary zoning strategy)[35];

(ii) 60% of all new housing projected to be built statewide over the next ten years (excluding the urban aid municipalities) will be part of an inclusionary development project; and

(iii) Within this group of 60% of new housing subject to inclusionary development agreements, all such new developments will abide by a <u>20% "set aside"</u> for low and moderate income households.

[35] *This is a conservative assumption, considering that for the 5-year period 2010-2014, 34% of all new housing in the state was built in these urban aid towns. See Section 3 of this report and Appendix A.*

Based upon these assumptions, and taking into account the economic and demographic analysis of the New Jersey housing market presented in Section 2 of this report, we have projected three alternative forecasts for affordable housing production for the next decade, as set forth in the following table.

Alternative Projections for Affordable Housing Production in New Jersey
2015 – 2025
Utilizing the Inclusionary Zoning Strategy

1	2	3	4	5	6	7
Alternative Growth Assumptions	**2015-2025 New Market Rate Units Average Per Year**	**Aggregate 10-Year Total New Units 2015-2025**	**Adjusted 10-Year Totals Excluding 20% in Urban Aid Towns [36]**	**New Units 2015-2025 Subject to Inclusionary Development Plan (Assume 60% of Row 4)**	**Average Set-Aside For Affordable Units In all Inclusionary Developments 2015-2025 (Column 5) [37]**	**Projected Total New Affordable Units 2015-2025**
Very Aggressive	**40,000**	**400,000**	**320,000**	**192,000**	**20%**	**38,400**
Optimistic	**25,000**	**250,000**	**200,000**	**120,000**	**20%**	**24,000**
Achievable	**18,000**	**180,000**	**144,000**	**86,400**	**20%**	**17,280**

The first growth assumption, labeled "Very Aggressive," is shown for purposes of illustration only. It assumes that New Jersey will produce an average of 40,000 new housing units per year during the next ten years (column 2). In our opinion, there is no credible economic or demographic evidence that supports this forecast. The state has not achieved that level of housing production in many decades, even during the recent housing bubble. Considering the numerous economic and demographic impediments to growth which New Jersey is carrying forward into the next decade, such a prediction has little basis in reality.

The reason we include the "Very Aggressive" growth assumptions is illustrate the enormous structural limitation of the inclusionary growth strategy as a delivery mechanism for producing affordable housing over the next ten years.

[36] *This column reduces projected new housing permits statewide by 20%, to account for the likelihood that at least 20% of these new units will be built in "urban aid" towns which are exempt from inclusionary zoning mandates. The 20% downward adjustment is a conservative assumption; as noted in Appendix A, 34% of all new housing permits statewide were in "urban aid" towns between 2010-2014.*
[37] *Reliable historical data are not available on the aggregate percentage of all new housing units built in New Jersey which were part of an inclusionary zoning agreement. For projection purposes here, we have assumed that over the next 10 years, 60% of all new units statewide will be subject to an inclusionary zoning agreement, and that, for such agreements, the average "set aside" will be 20% of the total. This formula thus equates to an average of a 12% "affordable housing set aside" for all new units projected statewide outside the urban aid towns (i.e., 60% of total units times 20% set aside = 12% of total units set aside).*

The “Very Aggressive” assumption illustrates that, even if the state’s housing market were to perform at such an unprecedented level of production (40,000 units per year for 10 years), the likely result would be the production of only about 38,400 units of affordable housing over the entire ten-year period.

That production figure is approximately 19% of the 10-year need projected by the FSHC-Kinsey Study, and approximately 74% of the 10-year need projected by the Rutgers-Burchell Study.

We have included two less ambitious (and more realistic) forecasts for future housing production. We have labeled these projections “Optimistic” and “Achievable.” We find substantial, credible evidence in current economic and demographic trends in New Jersey to support projections of housing production which are bracketed by these two scenarios.

Therefore, we project the production of all new housing units in New Jersey over the next ten years in the range of 18,000 units per year (“Achievable”) up to 25,000 units per year (“Optimistic”), for an aggregate total production over the next decade of between 180,000 to 250,000 new housing units.

Based on these projections, with the adjustments and assumptions set forth in the table above, we estimate that the inclusionary zoning strategy is capable of delivering a total of between 17,000 to 24,000 new units of low and moderate income housing during the next ten years.

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September 22, 2015

APPENDICES

APPENDIX A:	NJ Building Permits for New Housing in Urban Aid Towns and Statewide 2010-2014
APPENDIX B:	NJ COAH 2014 Affordable Housing Regional Income Limits
APPENDIX C:	Set of data Tables outlining the steps in calculating Projected Number of Low and Moderate Income Households in New Jersey to 2025 with ***incomes below 20% of median***, utilizing income data from the FSHC-Kinsey Study