

INCLUSIONARY HOUSING PRACTICE NOTE

THE KEY CONSIDERATIONS FOR
INITIALISING AN INCLUSIONARY HOUSING
POLICY AND FEASIBILITY STUDY





LVC
inclusive
cities

The National Land Value Capture Programme in South Africa was initiated by a tripartite partnership between the Development Action Group (DAG), the Lincoln Institute of Land Policy, and the National Treasury's Cities Support Programme (CSP). Launched in March 2020, the programme aims to strengthen the capability of metropolitan governments to efficiently and effectively implement innovative Land Value Capture tools and strategies. Simultaneously, the programme seeks to build capacity in built environment practitioners and civic organisations to influence institutional, regulatory, and other procedural changes required to implement appropriate Land Value Capture tools and strategies. This report is the fourth publication by the LVC Programme on the topic of Inclusionary Housing.

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* Note in executive summary: Cf Permanent Estate and Finance Co Ltd v Johannesburg City Council 1952 (4) SA 249 (W) at 258; Municipality of Stellenbosch v Shelf-line 104 (Pty) Ltd 2012 (1) SA 599 (SCA) para [28]-[29].

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FOREWORD

South African cities continue to face the challenges and opportunities that stem from accelerating urbanisation and population growth. These include the rising price of well-located urban land and property, which consequently weakens the urban poor's ability to access well-located, affordable housing opportunities. Inclusionary housing provision is an important intervention that helps to widen access to these kinds of housing opportunities.

When the most vulnerable members of our society fail to access housing near places of economic activity, the risk of poorer development outcomes, that perpetuate past spatial inequality, increases dramatically. Introducing inclusionary housing requirements is therefore an important aspect of land use planning and development management practice. It is also a relevant and necessary instrument for both metros and large secondary cities that are grappling with gentrification and spatial inequality inherited from the apartheid era. DAG recognises that the ongoing efforts to secure the provision of inclusionary housing units within private-sector-led development projects has proved to be a highly political process and there is a clear need for further work on advocacy, raising awareness and capacity building. As part of the National Land Value Capture Programme, the National Partnership Programme on land value capture supports metros as they develop and envision inclusionary housing policies and more specifically conduct feasibility studies. This publication draws on this experience, and therefore serves as a useful reference for policy makers, development practitioners and civil society organisations. A detailed and clear inclusionary housing practice note is also a key tool for processes such as: negotiations on IH contribution expected from developers in the absence of policy; determining the feasibility of policy parameters, and the review and evaluation of existing policy or practice. DAG and its funding partners are committed to continue contributing towards the ongoing efforts to initiate evidence-based policy and practice. We would like to thank our partners, the Cities Support Programme, and the Lincoln Institute of Land Policy for their support and contributions.

Abbreviations

AR – Additional rights requested or offered
CBD – Central Business District
CC – Construction costs
CoCT – City of Cape Town
DAG – Development Action Group
DP – Developer profit
FS – Feasibility Study
IH – Inclusionary Housing
LVC – Land value capture
RLV – Residual Land Value
RMV – Residential Market value
ToR – Terms of Reference
US – United States of America

INTRODUCTION

The concept of Inclusionary Housing (IH) has the dual potential to promote the construction of affordable housing, while also fostering social and spatial inclusion. The IH concept, as developed in the 1970s in the US, stipulates the creation of affordable units by the private sector, either encouraged through incentives like density bonuses or alternatively based on a mandatory requirement. The IH concept is built on the longstanding belief that increases in land value that result from society's efforts do not belong to the land or property owner. Therefore, the increased value should (at least partly) be captured by the public sector. An equally important premise/precondition for using LVC tools is that market values are increasing due to market forces or induced by public action i.e., granting permissions or investment.

The idea of mobilising Inclusionary Housing as a land use planning tool that advances spatial transformation is not new in South Africa. It emerged from 2004/2005 policy initiatives that responded to a concern that government programmes were not adequately responding to the inherited fragmentation and division of our cities. Inclusionary Housing was therefore proposed as a more direct intervention. Currently, the IH discourse in South Africa is no longer a political statement of commitment to change but an important legal requirement enshrined in the Spatial Planning and Land Use

Management Act (SPLUMA) legislation. This legislation outlines a strong legal obligation to act in a way that ensures that land use planning processes advance spatial justice principles. Chapter 5 on land use management requires municipalities to adopt land use schemes that include provisions to promote the inclusion of affordable housing in residential land development. As a result, several departments across all three spheres of governance (i.e., local, provincial, and national government) as well as individual private sector developers, have already begun taking initiative towards the development of IH units and local IH policies¹.

Against this background, as involved stakeholders consider and plan the development and implementation of an IH policy, a multitude of questions arise:

1. What is the **potential implication** of an inclusionary housing requirement on the financial feasibility of new residential developments? And consequently, the overall market, i.e. will it reduce supply of market units (when they are needed).
2. What is the **rationale/basis** for Inclusionary Housing policy choices?
3. What **policy scenario** will yield the maximum number of units and/or fees?
4. Considering the potential set of incentives available for developers making inclusionary housing provisions, **how many units** within a given development can be set aside as affordable, without hampering the economics of housing delivery processes?



INCLUSIONARY HOUSING FEASIBILITY STUDIES

The purposes of an Inclusionary Housing feasibility study may include:

- Determining the scope or extent of the IH density overlay zone (i.e., the quantum of land use incentives/additional bulk required in exchange for an IH contribution)
- Revising an existing inclusionary housing policy or programme to improve production levels or to achieve deeper levels of affordability

BOX 1

- Determining the impact of mandatory IH requirements on projects' financial feasibility and/or residual land values
- Establishing the extent and scope of cost offsets required to ensure adequate provision of affordable housing
- Establishing the viability of policy options and or targeted income thresholds meant to benefit from an inclusionary housing programme
- Understanding the extent of other concessions and/or financial incentives required to make any given IH policy option viable

-
5. **What size developments** should trigger IH incentives or mandatory requirements?
 6. **For whom is affordability guaranteed?** Which parts of the 'gap-market' are served, and can IH interventions reach lower income brackets? i.e., how and who are units allocated for?
 7. Are the units supposed to be **affordable in perpetuity**? And who is controlling, maintaining, and managing them?

To answer these and further questions, and through them understand the potential impact of an envisaged IH policy, it is highly recommended that one conduct a feasibility study. An Inclusionary Housing feasibility study is done for different purposes/reasons. (See Box 1)

Feasibility studies create an opportunity for diverse stakeholders to engage and reflect on different affordability requirement alternatives and various incentives that can be applied in combination or as stand-alone features. The basis for these reflections and calculations is on the one hand a sound understanding of local realities and on the other hand **a clear determination of the main objective(s) of the envisaged Inclusionary Housing policy.**

It is of the utmost importance that both the local context (including local market conditions) and the policy's main objective(s) are carefully discussed and determined. It is highly advisable to conduct this complex and multisectoral discussion before commissioning a feasibility study. Once these central ideological factors are determined, it becomes possible to assess which approach to IH would best suit the context and objectives of the policy. **These approaches are either incentive-led, volunteer-based, or mandatory-based approaches to Inclusionary Housing (as explained in the next section).**

This practice note provides an overview of the key issues and considerations for municipalities when commissioning a feasibility study. It encourages the relevant stakeholders, including policy makers, to reflect on the main objectives of introducing an IH policy. The practice note also highlights the various assumptions behind the different IH approaches, ranging from incentive to mandatory – or voluntary based (a specificity in South Africa), while placing them into a local South African political, socio-economic, and cultural context.

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SECTION 1

THE DIFFERENT CONTEXTS AND APPROACHES TO INCLUSIONARY HOUSING

There are several different Inclusionary Housing policy contexts, rationales, and statutory requirements that underpin the framing and economic feasibility of any Inclusionary Housing policy. To effectively respond to this wide range of contexts, a variety of different approaches have been developed. These approaches follow two main ideological foundations for Inclusionary Housing programmes, with a third currently emerging.

The first school of thought or ideological position is that of Inclusionary Housing as a land value capture mechanism targeted at unearned land value windfalls associated with increasing market conditions or public action. This ideology tends to set the basis for most *mandatory Inclusionary Housing programmes*, which are primarily applied outside the United States of America².

The second is the notion of cost offsets. This position is based on the conviction that developers must not suffer economic loss through compliance with Inclusionary Housing requirements. This sets the basis for the *incentives-based inclusionary housing programme*. Following this school of thought, developers would provide affordable housing to reduce problematic social or economic conditions and would then be compensated out of considerations of fairness.

A potentially third ideological position is emerging from the current experiences in South Africa and more specifically Cape Town. This position can be defined as a broad-based voluntary approach that is often characterised by retention or maintenance of the same financial yield or profit that could have been obtained in the absence of an IH requirement. Ideally the voluntary-based option can be used as a temporary intervention in the absence or during the development of a clearly defined policy approach (mandatory or incentive-based).

The Inclusionary Housing programmes can be classified into three main groups, a mandatory-based, an incentives-based and a voluntary-based approach. Deciding on the ideological approach is crucial before commissioning a feasibility study. The insights from ongoing IH policy development initiatives in South Africa suggest the existence of different development scenarios necessitating some form of feasibility analysis. These different development scenarios are uniquely different such that there is no single IH feasibility approach that can be universally applied. In other words, an IH feasibility analysis within a context of a voluntary IH policy context/scenario is not necessarily best suited under incentive or mandatory based policy requirements. This is largely because there are different sets of assumptions and rationale underpinning these different policy contexts and it is to these that we now focus on.



BOX 2

Mandatory-based Approach

Purely based on a land value capture principle.

Capture unearned land value windfalls associated with public action.

MANDATORY BASED INCLUSIONARY HOUSING POLICY PROGRAMME/ APPROACH

The mandatory Inclusionary Housing requirement is based on a long-standing practice or policy approach that seeks to recover and reinvest land value increases that result from public investment and government actions. There are several arguments that explain how government actions contribute to increased land value. The first of these is the notion that a well-functioning land use planning system often generates higher social welfare through its constraining effect on socially undesirable uses. As a result of this improved planning higher land values are generated.

An alternative rationale for Inclusionary Housing requirements is based on the notion that housing provision and land use planning are intricately linked. This is primarily because the land use planning system designates the amount of land to be dedicated to housing development and lays out the ground rules for that development. Therefore, the omissions and commissions of the planning system (i.e., reducing or keeping the quantity or densities of residentially designated land uses artificially low) create surpluses or shortages in the supply of land needed to accommodate growth. In so doing, the planning choices can increase the cost of land and hence of housing. Additionally, the rigidity of land use plans in the context of a rapidly changing society may also contribute to a scarcity of land for development and lead to higher housing costs. This fundamental problem, rooted in the land use planning

regime, necessitates the development of Inclusionary Housing policies to secure the delivery of affordable housing units.

Several countries across the world consider Inclusionary Housing an important mechanism for land value capture. Planners and economists across the world have also proven that an Inclusionary Housing requirement results in lower land prices. The cost for the provision of the Inclusionary Housing component is generally offset through leveraging the economic gains from rising real estate values associated with public action in the form of well-functioning land use planning and management practice.

In instances where land value capture is the underlying rationale, the sharing of the windfall is often in the form of: (i) the developer making financial contribution amounting to a given percentage of the total land value windfall or (ii) equity share, or (iii) transfer of affordable housing units (equivalent to a given percentage of the total land value windfall) to a state institution responsible for the management of the units in perpetuity). It is also important to note that the level of importance placed on value capture and how it is reflected in public policy tend to vary between countries or cities. It also depends on how the planning system has evolved especially in terms of capturing land value windfalls linked to public effort.

High level characteristics of a mandatory inclusionary housing approach

Characteristics:

- This approach (partly) recovers and reinvests land value increases that result from public investment and government actions.
- Within this approach, the degree to which IH units stay affordable is dependent on policy decisions. In this approach, the IH requirement is key in determining the residual land value for the redevelopment site.
- This approach is well suited to the South African context where an oversupply of development rights is prevalent. (an oversupply of rights will negatively impact on land value increases)

Result:

- A method of sharing the windfall load is selected and carried out.
- No/limited subsidies are required by the public.
- Reduced residual land value, considering the development potential of a property (i.e., based on a highest and best use) and the cost for providing IH.



BOX 3

Incentives-based Approach

Developers must not suffer economic loss if affordable housing is provided.

Notion of cost offsets.

THE INCENTIVE BASED INCLUSIONARY HOUSING POLICY APPROACH

The incentives-based approach is commonly known as a cost offset instead of a value capture. The key incentives used under this approach are density bonuses (most common approach in the US), tax abatements, parking reductions, a reduction in development charges, fast tracking planning approvals, and reduced regulatory standards. It is important to note that some of these incentives, especially the tax abatement and financial subsidies come at a cost to the public. The land

value capture concept is often implicit and or plays a small part in the incentive based Inclusionary Housing programme. The land value capture concept is partially relevant if the density bonus/ additional development rights form part of the package of incentives being offered.

In most US states, incentive based Inclusionary Housing has proved to be a preferred approach, primarily because the package of incentives tends to defuse local opposition and/or reduce the perceived cost of Inclusionary Housing on project feasibility.

High Level Characteristics of an Incentive Based Inclusionary Housing Policy Approach:

Characteristics:

- Incurred capital costs for the IH units are fully or partially offset by a clearly defined set of incentives offered by the public sector.
- The notion of value capture is implicit, and the use of incentives is to avoid getting embroiled in legal disputes with powerful developers and landowners.
- This approach is likely to receive less resistance from powerful and highly influential developers and landowners.

Result:

- Depending on the nature and scope of incentives used, the affordability of the IH units can be in perpetuity or limited to a defined number of years (US average 30-and 39 years)

The mandatory Inclusionary Housing requirement is based on a long-standing practice or policy approach that seeks to recover and reinvest land value increases that result from public investment and government actions.



BOX 4

Voluntary-based Approach

Developers maintain the same financial yield or profit that could have been obtained if there was no IH requirement.

Temporary intervention in the absence or during the development of a clearly defined policy approach.

VOLUNTARY INCLUSIONARY HOUSING APPROACH:

In a Voluntary Inclusionary Housing scenario, a private sector developer commits to provide Inclusionary Housing with the expectation that it will improve the chances and the speed of the planning application approval.

Under a Voluntary Inclusionary Housing provision, land value capture or the idea of sharing potential land value windfalls does not usually form a key part of the approach. The IH contribution is often based on a reduced unit size, a practice that effectively maintains the same development yield or profit that could have been obtained without an IH component³.

There are several reasons that can explain and justify why land value capture is not a central feature in this scenario. These include but are not limited to the following:

1. The developer successfully argued that the requirement for IH was introduced to them very late into the project planning and they had not factored that into the residual value of land at the time of purchasing the site. Meaning part of the windfall was already acquired by the landowner who sold the site to them. (Or land values increased after the purchase that could be shared)
2. The contingency budget is too small to accommodate the expected % contribution for the IH unit.

3. There is no clear policy in place that outlines the IH policy rationale and context, thus creating room for a broad interpretation of what is reasonable and most practical under the circumstances.

Under a voluntary approach, the key variable that determines the affordability benchmark is the capital costs needed to produce the affordable unit. The affordability is often based on or determined by unit size and in some instances the developer may opt not to sell the affordable housing units but to instead retain them and collect rental income that will be set in a way that ensures that the net present value of the cumulative rental cash flow over a given time period is equal to the amount that the developer would have gained if the unit was sold at the time of project completion. It is important to note that developers may only be willing to manage affordable rental units if their corporate organization already has/ manages rental properties.

High Level Characteristics of a Voluntary Inclusionary Housing Approach

Characteristics:

- The notion of land value capture is neither explicit nor implicit.
- Developers and in most instances, landowners take the full share of the land value windfall. The diminution of such a gain in land value is often argued as a form of indirect tax or subsidy for the public from them.
- The IH contribution is often based on the reduced size of the unit.
- Effectively maintains the same development yield or profit that could have been obtained without an IH component.

Result:

- Smaller affordable housing units with a price per square metre that is almost equal to market rate housing.

Remark:

- The approach is ideally a temporary solution applicable to instances where there is a lack of policy certainty on the required thresholds for the IH contribution.

Right, top: The well-located area of Salt River in Cape Town is experiencing gentrification. Inclusionary Housing is one of the tools that can be used to counter exclusionary outcomes of gentrification.

Right, bottom: Access to economic opportunities are key to unlocking sustainable livelihoods for city residents. In South Africa transport systems are experiencing severe strain, meaning residents living far away from work opportunities struggle to access these.





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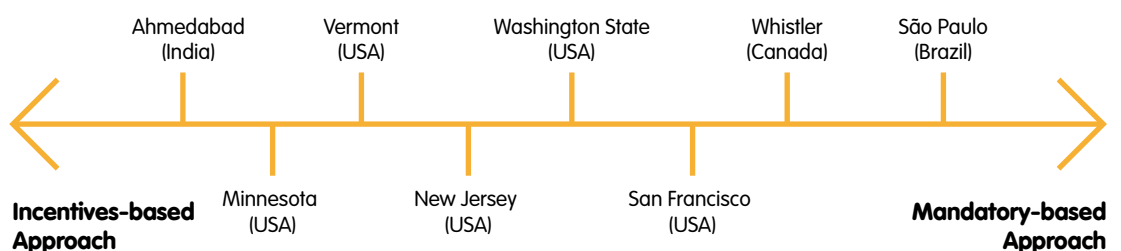
SECTION 2

A CONTINUUM OF INCLUSIONARY HOUSING APPROACHES

The above-described approaches – in particular, the mandatory and the incentive-based approach - can be considered ‘extreme’ scenarios. They both form opposite poles and in between them stretches a continuum. In its pure form, the mandatory approach focuses on a reduction of the residual land value. The incentive-based approach focuses on offsetting additional costs.

The key difference between the incentive-based approach and the mandatory approach is how the issue of cost offset is handled. Under an incentive-based approach the cost offset is explicit while under the mandatory based approach cost offset is not explicitly handled. Instead, there is an implicit assumption that the cost either becomes a factor into the land costs or is absorbed by the market rate houses. In practice, many IH policies incorporate a hybrid form – requesting elements of the mandatory IH approach and offering elements of the incentive-based approach. This hybridity is demonstrated by the Ireland IH policy programme (Calavita and Mallach, 2010).

Below: Minnesota, Ahmedabad, Vermont, New Jersey (all incentive-based); Washington (Middle - both); San Francisco, Whistler and Davis (USA) (mandatory-based).



EXAMPLES OF MANDATORY IH PROGRAMMES:

- In the USA, the San Francisco (1981), and Boston (1986) linkage ordinances required the developers of non-residential facilities, such as office buildings and shopping centres, to contribute towards affordable housing trust funds. The nature and extent of the contribution was based on the need for lower-income housing generated by the jobs created by the new development. The term linkage fee is a form of inclusionary housing contribution, and its legality hinges on how the local authority regulates development exactions or impact fees.
- In Canada, the Whistler Municipality's 1988 Employee Housing Service Charge bylaw introduced a linkage-driven inclusionary programme that required commercial or tourist accommodation developments to either provide affordable housing for employees or contribute to an affordable housing trust fund. There is also IH related legislation for resort areas with very expensive residential housing. The legislation is intended to ensure that there is adequate affordable housing for workers. In some ways it is intended to protect the Economic Development interest and tourism economy of the Province.

EXAMPLES OF INCENTIVE-BASED INCLUSIONARY HOUSING PROGRAMMES:

- **The Minnesota** statute allows the Metropolitan Council to work with municipalities and developers to provide incentives for inclusionary housing developments, such as a waiver of service availability charges or other regulatory incentives that would result in an identifiable cost avoidance or reduction for an inclusionary housing development.
- **In Vermont**, the statute explicitly requires local ordinances to offer "development incentives that contribute to the economic feasibility of providing affordable housing units", such as: density bonuses, reductions, or waivers of minimum lot; dimensional or parking requirements; reductions or waivers of applicable fees; or reductions or waivers of required public or non-public improvements.
- **New Jersey** is one of thirteen US states with statutes or regulations that either expressly authorize inclusionary zoning (using the actual words inclusionary zoning) or clearly imply such authority by granting broad powers to promote affordable housing. The New Jersey incentive-based approach was largely influenced by the 2007 state court judgement on the *Matter of the Adoption of N.J.A.C. 5:94 and 5:95*, 390 N.J. Super. 1, cert. denied 192

N.J. 72. The court held that municipalities must provide developers with "compensating benefits" to mitigate the cost of the affordable housing obligation. As a result, the New Jersey Fair Housing Act makes provision for a requirement of a minimum percentage of housing units in any residential development when a zoning change takes place. The Act also stipulates that these housing units be reserved for occupancy by low- or moderate-income households. The percentage of inclusionary units within the development is determined by the council based on economic feasibility, with a consideration for the proposed density of development. The economic feasibility, focused on proposed density of development, is for the purposes of establishing the scope of land value windfall to offset the cost of IH units linked to any development.

In South Africa, the voluntary IH approach is an important means of phasing in the mandatory approach. It is an appropriate method to overcome potential resistance from developers, as they might argue that the absence of policy certainty means they have missed an opportunity to use IH requirement as a cost factor at the point of land acquisition. Given such a scenario, it might be best to encourage the voluntary approach as part of phased IH practice approach. As the sector develops a clear understanding of the practice and its potential implications on different market segments and development typologies, a detailed policy focused either on the mandatory or incentive approach can then be introduced to standardise a practice that has already evolved. While deciding on whether to develop an incentive-based or mandatory approach, it is important to consider the local context, politics, the existing or to be enabled regulatory environment and the stakeholder framework.

Right, top: Incentive-based Inclusionary Housing in Ahmedabad, Gujarat, India. Credit: Harsh Patel

Right, middle: Incentive-based Inclusionary Housing in Minneapolis, Minnesota, USA. Credit: Akajeff.

Right, bottom: Mandatory-based Inclusionary Housing in San Francisco, California, USA. Credit: Mathieu Le Mauff.



Ahmedabad, Gujarat, India



Minneapolis, Minnesota, USA



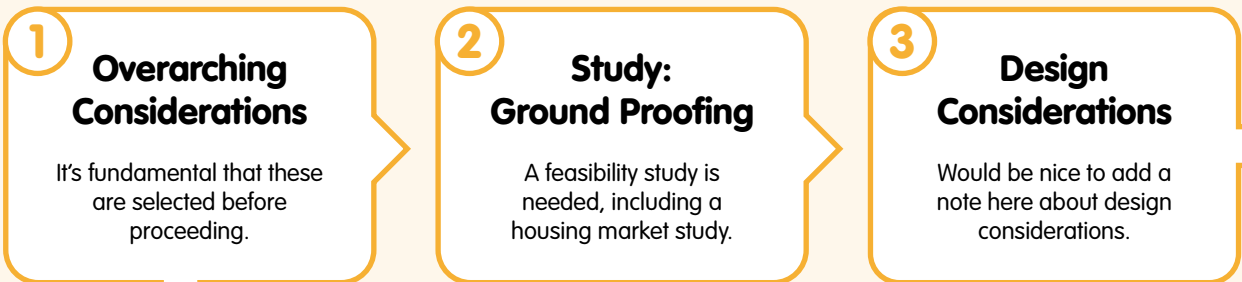
San Francisco, California, USA

SECTION 3

KEY DECISIONS TO BE MADE

There are important considerations that need to be understood and explained to policy makers. These include how a potential IH policy aligns with a particular ideological framework and legal instruments. In most

instances, the ideological position is often implicit but plays an important role in influencing the legal framework that sets the basis for institutionalization of IH programs.



Options for Ideological Framework

- Neoliberalism
- Social Market Economy
- Socialism

Grounds for an IH Policy

- Land-use Planning Requirements
- Statutory Provision
- Constitutional Law
- Case Law

Options for IH Approaches

- Incentive-based

- Voluntary

- Mandatory

OVERARCHING CONSIDERATIONS

The overarching consideration varies depending on context. The ideological framework is something that is often defined at national level and its dictated by the governing party. this is usually the case in situation where there is a top down approach to institutionalization of IH program (i.e., national government influencing the implementation of IH policy).

The opposite is equally true, i.e., the bottom up approach. It is the ideological position that largely influences how the statutory provision, constitutional law provision and ins some instances case law get interpreted.

All these different assumptions and legal interpretation will then dictate/ define the type of IH approach i.e., whether it takes the form of financial incentive, voluntary approach or mandatory.

Options for IH Contribution



- Onsite Contribution
- Offsite Contribution (max. distance)
- In-lieu Fee Payment

Time Horizon



- Land Contribution
- Affordability for a Limited Period
- Affordability in Perpetuity

Target Group



- Percentage of AMI
- Fixed Income Boundaries

Triggering Size

- Number of Units



- Size of building (m²)

Incentives



- Density Bonus
- Fast Approval
- Discounted Public Land
- Fiscale Incentives
- None
- Reduced Parking Requirements

Options for IH Contribution

- Rental Units
- Ownership Units
- Shared Equity Units



DESIGN CONSIDERATIONS

To be considered: How low does the policy want to reach (in terms of the income-level served) and how many units are the target?

- Lower reach within the gap market: possible if one chose the option relating to in-lieu fees and the units are produced off site. If units need to be produced on-site, then less units should be produced and the units should be subsidized accordingly.
- Higher reach within the gap market: produced on site: more units can be produced especially if the target market segment is for the people just below the bank finance market threshold.

Throughout this process it is important to ensure that the overarching and design considerations are well aligned with one another, and that the feasibility study is used to help inform the decision-making process.



SECTION 4

KEY FEATURES & METHODS OF AN INCLUSIONARY HOUSING FEASIBILITY STUDY

There are two main pieces of work that underpin an Inclusionary Housing feasibility analysis, namely (i) a housing market study and (ii) the evaluation of IH policy impact on revenues and costs.

HOUSING MARKET STUDIES:

Understanding supply and demand within a housing market is an important aspect of an Inclusionary Housing feasibility study because it establishes an evidence base for policy makers to define appropriate IH policy parameters.

A housing market demand and supply study is meant to provide insights on the following aspects

1. The geographic areas with a strong and exclusionary property market as well as those with weak markets that might not necessarily require IH related policy interventions.
2. Residential market segments and how they differ in terms of demand and supply. This level of detail is useful for determining the housing market segments that an IH policy programme should be prioritising. Establishing a clear understanding of the submarkets within the policy area is also important for the purposes of fine tuning the policy as well as supporting policy changes over time.

Another equally important reason for conducting a housing market study as part of an Inclusionary Housing feasibility study is to establish a better understanding of the nature and extent to which additional development rights can be used as an incentive for Inclusionary Housing. This involves the review and analysis of past or contemporary land use planning applications linked to the targeted areas for Inclusionary Housing requirements. The key objective is to evaluate various aspects/factors directly linked to the projects which may include (i) the nature and extent of residential market segments for the housing products delivered, (ii) the development typology i.e., whether it's a high-rise, medium size, or low-rise development typology and (iii) whether the projects were built within the recommended consent

Left: Aerial shot capturing new development taking shape in Pretoria's urban landscape.
Credit: Jacek Sopotnicki.

use or whether the developer applied for substantial additional development rights (i.e., development rights which are over and above the recommended consent use as defined by the municipal land use zoning scheme).

Depending on the policy context and objective, it remains possible for an Inclusionary Housing feasibility study to contain a housing market study analysis that is solely focused on either of the above stated reasons or a combination of both.

ANALYSIS OF IH POLICY IMPACT ON REVENUE AND COSTS:

An analysis of an Inclusionary Housing policy's impact on revenues and costs is done for the purposes of establishing an illustration of (i) the revenues and costs of development typologies within a specific geographic area targeted for inclusionary housing, and (ii) the possible impact of each policy option on the residual land value and/or the project feasibility, which is measured based on development yield, internal return on investment and/or developer profit. One of the key outputs from this analysis is a standard pro forma that includes a set of variables to be considered for the purposes of calculating both onsite affordable housing contributions and the fees in-lieu of a contribution.

METHODOLOGICAL APPROACH:

STEPS: These steps are valid for both the mandatory- and incentive-based approach

3. Define the building typologies and/or development context subjected to IH contribution.
4. Understand the impact of the incentive package on the developers profit and cost of land.
5. Determine the thresholds for IH contribution for both the IH programme and the sensitivity analysis on project financials.

STEP 1: Development typologies subjected to IH requirements.

Typology: High Density Tower Block of Flats

- Land area: 2000 – 5000 sqm with Development Net Density of over 400 dwelling units per hectare
- Building height: over 20 storeys
- Development Units: 300-500 units

Typology: Medium Density Mixed Use Block of Flats with lifts and stairs

- Land area: 500 – 2000 sqm with Development Net Density of between 250 to 400 dwelling units per hectare
- Building height: 4-9 storeys
- Development Units: 50-300 units

Typology: Mid Rise Residential Walk-Up Block of Flats

- Land area: 500 – 2000 sqm with Development Net Density ranging between 250 and 400 dwelling units per hectare.
- Building height: 3-4 storeys
- Development Units: 10-100 units

Typology: Single dwelling to low rise residential estate development

- Land area: 10000 – 100000 sqm with Development Net density ranging between 150 and 250 dwelling units per hectare.
- Building height: 1 – 4 storeys
- Development Units: 50-300 units

Step 2: Understanding the impact of the incentive package on the developer's profit and cost of land.

The nature and scope of the incentive package offered tends to vary and the ultimate value usually depends on the following factors:

1. **The geographic area:** the bulk rate/ land values vary greatly between geographic areas (i.e., areas with high/ strong urban land markets vs. areas with low or poor urban land market demand)
2. **The development typology:** Any additional bulk up to a point that requires different building technology implies higher construction costs. (i.e., Typology 1 vs Typology 3 or 4)
3. **The nature and scope of existing development rights:** whether there is already an oversupply of existing development rights vs. Scarce/ insufficient supply of additional rights. It is also important to establish a shared understanding on what additional development rights means. The key decision that must be made is whether additional density refers to the bulk rights that are above the following:
 - Primary land use rights (CoCT: as of right)
 - Secondary land use right (CoCT: consent use rights)
 - More than primary and secondary land use rights
4. **Establishing the base value informants (i.e., price per square metre of land):** Is the municipal rates base a

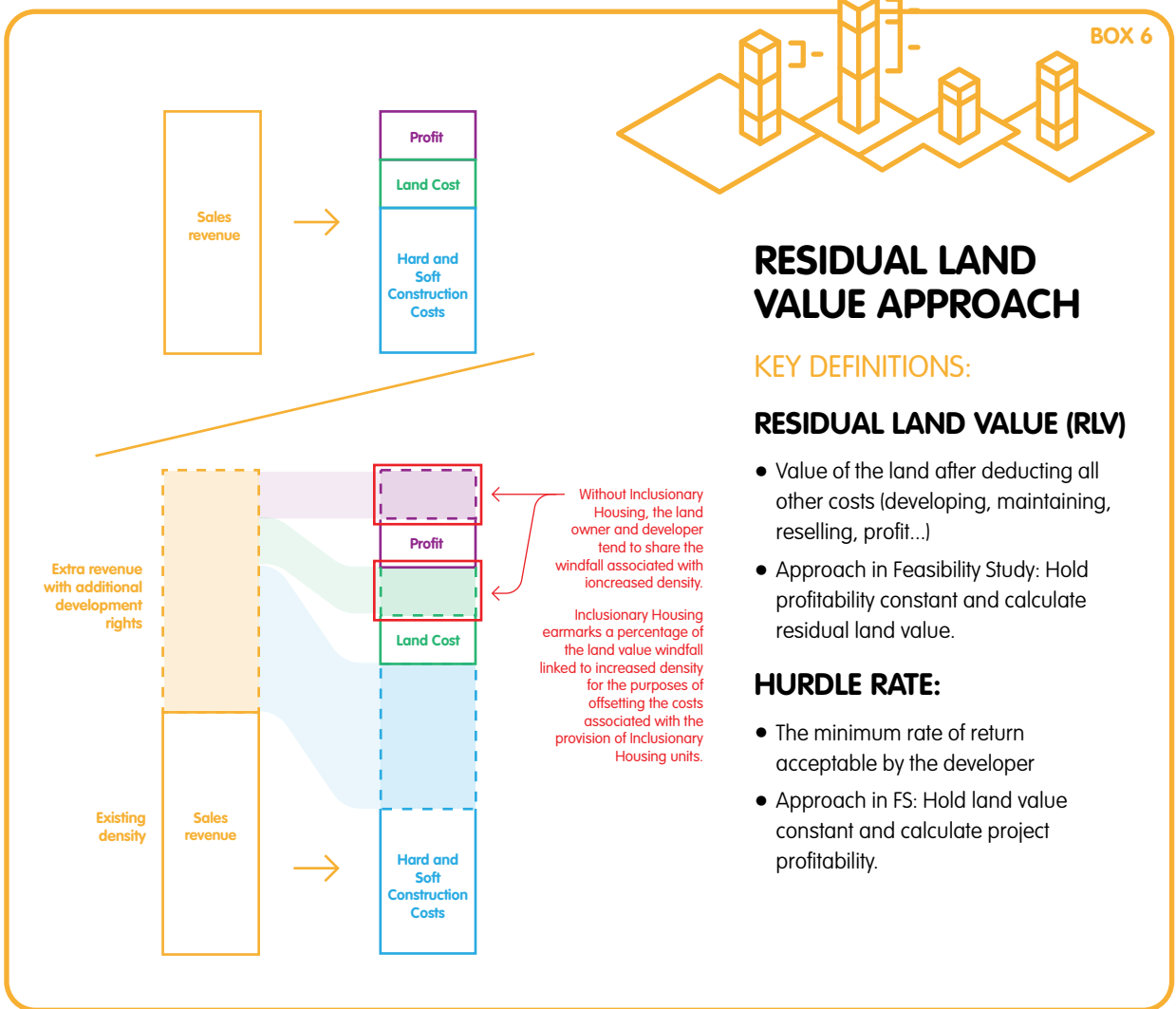
good source of data on the market value of properties or is it best to use the most recent comparable sales data (*The capitalisation approach/ The commercial value approach*) or perhaps a median between the two.

Step 3: Sensitivity analysis on project financials to determine thresholds for IH contribution.

- Identify the key variables affecting the project financials (e.g., cost of finance, sales rate etc.)
- Clearly define policy design considerations:
 - percentage of the total building stock vs. percentage of the additional incentives offered,
- Target beneficiaries (lower end, gap market or combination of both)
- Nature of fee contribution (standardised vs. Negotiated)

Finally, one needs to choose between the residual land value and the hurdle rate as a basis for market sensitivity

analysis. The hurdle rate refers to the minimum rate of return required on a project or investment. It is important to note that the sensitivity analysis based on the hurdle rate is most ideal under the voluntary approach and there is clear evidence that the developer missed an opportunity to use the IH requirement as a key factor in determining the cost of land at the time of land acquisition. The residual land value on the other refers to the total value payable by the developer after deducting development costs and or profit margins from the gross development value. The residual land value is more ideal under mandatory- or incentive-based approach. The major difference between the hurdle rate and residual land value as a basis for sensitivity analysis is that under the hurdle rate the developer profit will be sensitive to the IH requirements and everything else (i.e., cost of land and construction) is fixed/held constant. On the other hand, the residual land value is sensitive to the IH requirements and everything else (i.e., developer profit and construction cost) is fixed/held constant.



APPLIED ANALYSIS

MANDATORY AND INCENTIVE-BASED FEASIBILITY STUDIES

BOX 7

REAL EXAMPLE: ZERO2ONE

Background and context:

- Proposed 137m tall mixed-use development in the centre of Cape Town CBD, including 939 residential units, a business space of 6150m² and 615 parking bays.

- Size of land: 2882m²
- Existing rights: General Business Subzone 7 with equivalent as of right floor factor total bulk of 27755.2m²
- Total Proposed floor space: 42042m²
- Additional rights sought: 14286.8m², 51.5% relative to the entire site.
- Residential space market value for the area: R35 700 m²

INCENTIVE-BASED

The formula:

$$Rmv = Cc + Dp + Rlv + Ar$$

(Rmv: residential market value; Dp: Developer profit; Cc: hard and soft construction costs; Rlv: residual land value; Ar Additional rights requested/ offered)
Key assumptions to establish the land value capture potential for financing inclusionary housing units:

N.B. The R/ m² of residential market value for Cape Town CBD = R35 700/m²

Cc= 60% of Rmv

Dp= 20% of Rmv⁴

Rlv= 20% of Rmv

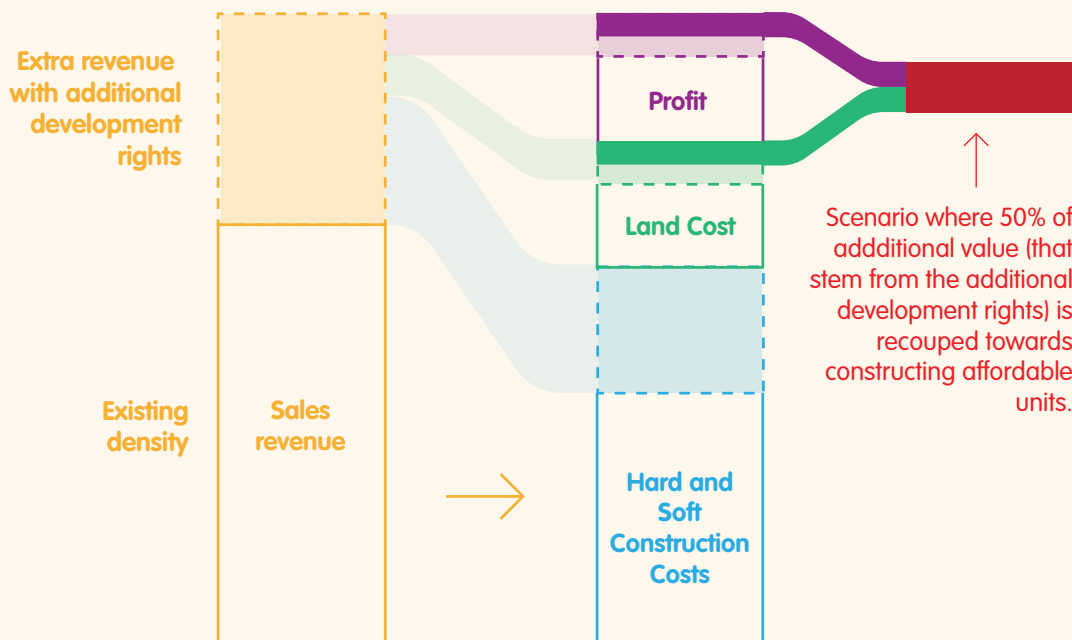
Ar= 50 or more additional bulk rights

The value of the additional rights sought/ offered = 20%⁵ of Rmv x Ar

$$= 20\% \text{ of } (R35\,700/m^2) \times (14286.8m^2)$$

$$= R\,102\,007\,752$$

Assuming the IH policy option is 50% of the additional value this will translate to R51 003 876, if it is 20% of the additional value the contribution will be worth R20 401 550



The mandatory based approach is generally regulatory in nature because it prescribes a percentage of inclusionary housing as part of land use planning scheme. There is no direct financial incentives to offset the cost of IH units.

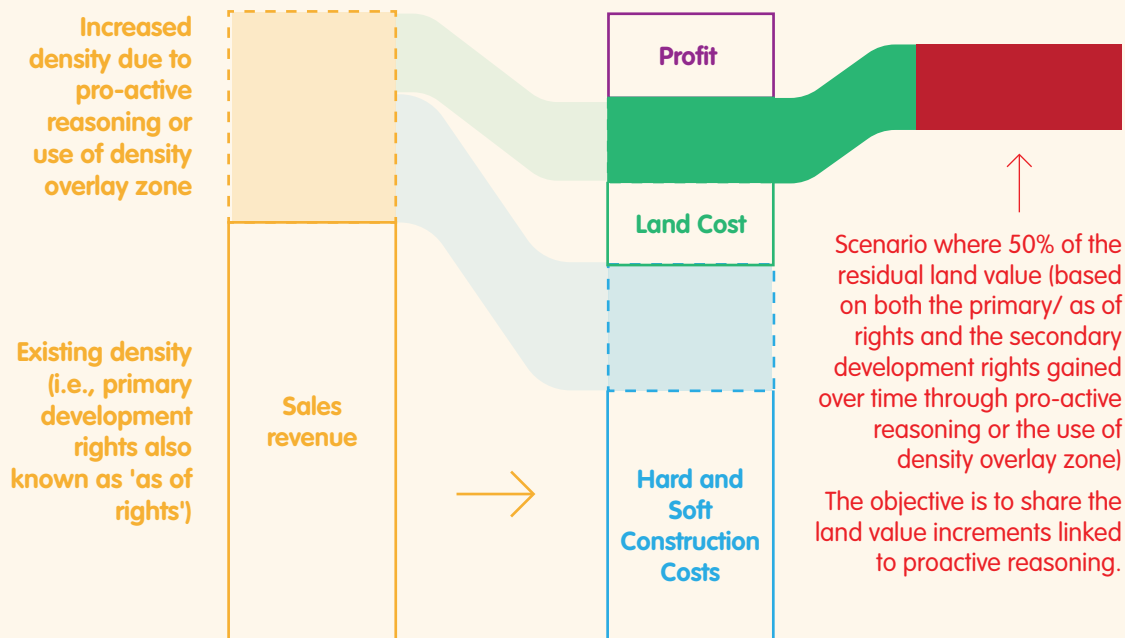
BOX 8

MANDATORY-BASED

Under a mandatory-based approach, the key idea is to establish the residual land value based on the total development bulk for the project. In the Zero2One example, the total development rights amount to 42 042m².

- Residual land value = 20% of 42 042m² (with estimated price of R35 700/m²) = R300 179 880

- Assuming the IH policy option is 50% of the actual residual land value this will translate to R150 089 940
- If it is 20% of the residual land value the IH cost offset will amount to a total of R60 035 976





SECTION 6

KEY VARIABLES TO BE CONSIDERED AS PART OF THE INCLUSIONARY HOUSING FEASIBILITY ANALYSIS

Left: Provision of state-subsidised housing is declining across South Africa and these houses are often provided on the outskirts of cities.

There are also several other ancillary issues that may need to be considered and addressed as part of a feasibility study and some of the issues worth considering include the following:

1. **Geography:** the primary question is which areas have the urban land market strength (Demand) that is suitable to support Inclusionary Housing requirements in new residential buildings?
2. **Scale of impact:** this involves projecting the scale or likely number of affordable Inclusionary Housing units to be developed over a given period. The analysis is based on evaluating development activity in the past 3-5 years and using the results to project a range for the number of likely residential units developed in the strong market or well-located areas over the next 5 years.
3. **Unit Sizes:** when evaluating IH feasibility, it is important to make explicit any assumptions about the unit sizes for the affordable units. If possible, it would help to evaluate the degree to which feasibility is sensitive to changes in the unit size assumption.
4. **Value of additional development rights:** There are instances where the IH requirement is limited to a percentage of additional bulk requested or used as an incentive. Under such circumstances, it would be helpful to set the specific percentage based on an evaluation of the value of additional bulk relative to the cost of providing affordable units. The key assumptions that set the basis for calculating the value of additional bulk/density must be explicitly stated. Depending on the nature and/or performance of the urban land markets, coupled with the real estate property market cycle position, some of the bulk rights may generate financial value that cover either full or partial capital costs for the affordable units. Therefore, it is worth the effort to develop a detailed estimate of how much the additional value associated with added bulk is and how this additional bulk value might vary between projects and locations.

5. Infrastructure Costs: Cities tend to differ in terms of how they handle or finance the infrastructure costs associated with new developments. Some cities directly fund water, sewer, electrical and transportation infrastructure for new development areas as well as existing developed areas. Others provided public financing with associated special property taxes to repay the investment. Others require private developers to self-finance infrastructure as a part of the cost of any new development. It is good practice for a feasibility study to take note of the likely infrastructure costs associated with targeted development prototypes and to assess the extent to which the public sector is likely to play a role in financing the infrastructure. In general, the greater the level of public support for infrastructure provision, the greater the likelihood that projects will be able to feasibly accommodate Inclusionary Housing. Projects that face high infrastructure costs will be more likely to struggle to incorporate the cost of affordable units.

BOX 9

CHECKLIST OF SKILLS SETS REQUIRED TO CONDUCT A FEASIBILITY STUDY



Internal Human skills:

(diverse team required from div. departments)

- Terms of Reference (ToR) writing
- Policy writing
- Stakeholder engagement
- Technical knowledge (spatial & land use planning, housing market, affordable housing programmes)

Consultancy related skills:

- Housing market study skills (incl. demographic, socio-economic aspects)
- Regulatory Impact assessment skills
- Policy Writing (if outsourced)
- Developer experience
- Development economist experience
- (Creation of feasibility calculator)
- Knowledge of the housing sector more broadly

Publications, venues etc for public participation

- Publications on the subject matter
- Ability to communicate about complex issue in accessible way
- Network of professionals and community groups
- Ability to organise stakeholder engagements (venues, invites etc.)
- Respectful way engaging non-experts

FURTHER RECOMMENDATIONS

- Inclusionary Housing as a potential mechanism for land value capture is not always explicitly stated by the relevant statutory legislation, neither is it fully appreciated or understood by the key urban development stakeholders. For instance, in South Africa, SPLUMA and any other national legislation on housing programmes do not explicitly state the ideological framework or guidelines that set the basis for IH programmes. Having a shared and clearly articulated ideological approach is crucial before commissioning a feasibility study. This is important because each ideological approach implies different sets of assumptions or rationales underpinning the methodological approach for the feasibility analysis.
- During the phase of framing the objective and nature of the feasibility study, it is highly recommended to have a shared understanding on the underlying economics that underpin the inclusionary housing development component. This is particularly important because it provides facts and figures to what would otherwise have been a purely political decision. Hence, an evidence-based approach can influence political stakeholders to take a much more moderate/less polarising position.
- To determine the ideal ideological context that sets the basis for any Inclusionary Housing policy programme, the first question that should be considered and agreed upon is who takes the cost/burden of the Inclusionary Housing requirements and whether such a cost is justified or if there is need to apply mitigating measures in the form of incentives.
- Monitoring and evaluation is an important aspect of any policy development. It is useful to ensure that there is periodic review of the overarching policy design choices underpinning the IH policy programme.
- The political support is always needed along with an openness to position the development of an IH policy institutionally.

CONCLUDING REMARKS

In conclusion, there are different contexts and rationales underpinning an IH policy programme and these can be classified as a continuum with two different extremes namely the mandatory and incentives-based approaches. In between the two extremes is a hybrid approach that combines some elements of both LVC principles and incentives that often comes at a cost for the public sector. These include tax abatements and various forms of financial subsidies. It is therefore important to have a clear understanding of the different ideology and design options underpinning the preferred approach before commissioning an IH feasibility analysis.

One of the key features of an Inclusionary Housing feasibility study is a housing market study. A housing market study is an analysis on the housing demand and supply to depict residential property market strength. It is also a useful exercise that depicts the overall demand and supply of additional development rights which is particularly important for either an incentive- or mandatory-based Inclusionary Housing programme as it helps municipalities/policy makers to establish the extent to which the policy can rely on density as a basis for leveraging IH units. The financial feasibility also involves the establishment of a clear understanding of the overall value (in monetary terms) of incentives offered to secure the provision of Inclusionary Housing units. This is quite important in terms of assessing how the cumulative value of incentives taken up/used over time compares with the number of units delivered.

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NOTES

1. Johannesburg (Feb2019 Council Approved IH policy); City of Cape Town Draft Inclusionary Housing Concept Document (2019); Western Cape (October 2022 released Inclusionary Housing Policy Framework).
2. New Jersey is one of the few if not the only one US state that has legislation where principle of planning gain or land value re-capture of windfall resulting from rezoning for the benefit of affordable housing.
3. This is based on the analysis of IH contributions proposed by several Cape Town developers and in some instances the land use planning tribunal. One example is the Fresnaye development project in Cape Town Sea Point (see NU Inclusionary Housing Case Study report).
4. It is important to note that our calculation is according to fixed hurdle rate -> see page 19. We also use different method used for incentive-based approach is different or not the same with the one used for a mandatory approach.
5. Please note that the 20% used in this exercise is just a random figure that we use for the purpose of this exercise. The percentage could be more or less depending on context and variables outlined in section 6.4.



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