Housing Arizona:
Meeting Development Challenges to Arizona’s Housing Shortage

Authored by
Ashlee Tziganuk, Research Analyst
Liza C. Kurtz, Research Analyst
Alison Cook-Davis, Associate Director for Research
Adison Hicks, Graduate Student Assistant

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Introduction

Arizona is facing a housing crisis spurred by a severe slowdown in the housing market after the 2008 economic recession.\(^1\) As construction halted and more people moved into the state, housing supply could not keep up with population growth. According to the Arizona Department of Housing, Arizona is now short 270,000 housing units.\(^2\) This shortage has left many struggling to find or maintain housing across all housing types, ranging from luxury to affordable. The shortage is particularly devastating for those making 0-30% of the Area Median Income (AMI), with only 26 rentals available for every 100 extremely low-income households.\(^3\) While many development companies and nonprofits seek to respond to the demand for housing in Arizona by building more housing, they are often challenged by issues outside of their control.
In Arizona, many municipalities zone about 50% of land for single-family use. High percentages of single-family zoning contribute to the housing shortage by limiting the supply of higher-density housing, such as duplexes, triplexes, and apartment complexes. The market cannot keep up with the demand for more housing because developers are limited by these policies, which leads housing prices to climb.

Diversifying the housing stock and increasing density is a quick and efficient way to tackle the housing shortage and improve neighborhoods. Neighborhoods with multifamily and higher-density housing see increased economic growth and vitality by attracting and supporting businesses, jobs, and amenities. Nationally, it was found that housing constraints and regulations lowered aggregate economic growth by 36% between 1964 and 2009.

Denser development generates ten times more tax revenue per acre than conventional suburban development and reduces fiscal burden by efficiently using public infrastructure.

“Affordability wise, it’s as tough as I’ve seen it in 20 years, because 20 years ago, we used to be worried about the people that made less, let’s say than 50% of the area median income. Right now, we’re worried about the people that make 100% of area median. So things have really just gotten worse over the years. It’s pretty amazing that for a whole set of reasons over the years, things have not improved, have gotten worse. Less money available, less money from the state.”

Previous Morrison Institute reports have demonstrated that legal barriers, such as state and municipal laws, impact the ability for affordable and multifamily housing to be built in Arizona. Such legal barriers and other challenges directly impact housing developers’ ability to help combat the housing shortage.

Developers often specialize in different types of housing development, meaning that some will only build single-family or multi-family homes, or some will only focus on affordable housing or market-rate housing. In some cases, developers have a diverse portfolio, constructing multiple housing types. To further understand additional barriers developers face when building housing, we interviewed 15 housing practitioners involved in building various affordable, single-family, multifamily, and market-rate housing developments in Arizona.

Practitioners worked for development companies, non-profits, cities, or as consultants. Practitioners worked on developments in urban and rural areas and their projects were targeted to either market-rate residents, or residents making less than or equal to 60-120% AMI. Some developers working with lower AMI also targeted special populations such as veterans and the seriously mentally ill. These developments focused on permanent supportive housing with on-site wrap-around services for tenants. The variety of housing types and locations offered by these practitioners provides a broad understanding of housing development challenges in Arizona outside of any one specific type of housing or area.

This report examines the barriers developers face when building housing and identifies potential solutions that could help to overcome development barriers.
Barriers to Housing Development

Developers noted three primary barriers to building affordable housing in Arizona: zoning, community pushback, and financing.

Zoning and Development Standards

Developers expressed that zoning is also a significant barrier to housing development because most land is not zoned for multifamily use. This often leaves multifamily housing developers having to rezone the land for multifamily use. The rezoning process varies by city, but generally entails initial applications, notifying the neighborhood, city and other committee reviews, and public hearings. The rezoning process can be detrimental to housing projects because of the time it takes to go through, which can put projects at risk of losing funding or land. One developer explains,

“...So, when you're dealing with a rezoning situation, you can expect normally 6 to 10 months or more just to rezone the land, which means you need to have a property owner who is patient enough to go through that. And in a hot market, like it is right now, those are hard to come by.

The length of time it takes to rezone varies by city. The City of Phoenix states that their rezoning process generally takes four to six months, but some developers said the process can take up to 2 years. Developers mentioned that one reason why it takes so long is because there is a lot of staff turnover in cities, causing there to be less institutional memory of processes. As previously noted, developers only have 2 years to complete a project after receiving LIHTC funding. Therefore, lengthy rezoning can put this critical funding source at risk. Some developers also mentioned needing to hire land use attorneys to help get through the rezoning process, which adds additional expense to the project.

The lack of land zoned for multifamily use also leads to more competition and higher prices for land that is already zoned multifamily.

“...And zoning, it not only affects affordable housing, it affects all multifamily housing. Most cities have now been set up to have very, very limited multifamily housing land, that’s zoned for that. And so, in order to build in these communities, you need to go through a rezoning process, which triggers all of the issues that people conjure up in their heads about how my housing values or my neighborhood is going to go to the dogs because of this project.

Beyond the rezoning process, existing development standards make housing development challenging and more expensive. Development standards are requirements that developers must meet when building, including parking minimums, setbacks (i.e. distance from curb or property line), and aesthetic design. Some developers feel that these standards are unnecessary and add to the cost of their projects.

“...And it’s never made sense to me why the city will put billions of dollars into public transit and public amenities and then make it so an affordable housing community that’s literally within 100 feet of a light rail station has to have two parking spaces per unit. It’s not that we don’t want to build parking; it’s just that we’re building parking at either sacrificing green space that could have been there in that space or more affordable units. So, it’s things like setbacks; it’s things like zoning districts, it’s just the basic entitlements. I really feel like the last six or so years, that’s really been the biggest challenge for affordability in Phoenix, especially.
Seeking changes to these standards requires a variance, which like rezoning, requires public hearings that can lead to community pushback. In some instances, community pushback is so severe that it can terminate a project or cause developers to redesign their projects which can be costlier. The following section will further explore the impact of community pushback on housing development projects.

**Community Pushback**

Developers receive community pushback on housing projects of all types, but those building multifamily and affordable housing are particularly impacted. Pushback typically arises during a rezoning or variance process, and concerns are over a variety of factors, such as decreased housing values, increased density, crime, traffic, and who is living in the housing. These concerns are often referred to as a Not in My Backyard (NIMBY) mentality, and developers have found it to be a key barrier in Arizona.\(^3\)

> I don't think I can overestimate the impact it has on our business. Like I said, we can make the math work here in the valley. It's finding sites and communities that will support it and not be swayed by NIMBYism. And we can meet till we're blue in the face with folks. We can have neighborhood meeting after neighborhood meeting. We can inform, we can show examples or renderings of what the physical product's going to look like. But at the end of the day, there's certain groups of folks that just don't want it in their backyard.\(^9\)

In 2021, at least 30 apartment developments in metro Phoenix were delayed or canceled due to community pushback, zoning issues, or political backlash.\(^4\)

Some neighborhoods, such as those with homeowners' associations (HOAs), are well organized and prepared to attend meetings and push back. These community groups put a lot of pressure on council members who may privately support the housing projects but feel they must adhere to the community's wishes. Some developers mentioned that they will avoid locations they know will have pushback because they don't want to spend the time and money getting the project approved. However, they also noted that pushback happens in all types of areas, especially if pushback is around a fear of increased density.

To handle potential community concerns, developers emphasized the importance of conducting community meetings and outreach and building relationships with community leaders early on in the process.

> But what I always try to do is start early in the process, so you give them a chance to weigh in on the design. We know parking's important to them – they don't want to see excess cars parked in their neighborhood. We also try to do things to mitigate the ability for our people in some of the higher floors to look at the neighborhood below. So, you may staiirstep a property, so it's not as high next to the existing neighborhood. You try to make concessions and work with them. And that's what we do. Additionally, what I have found, is you work with the neighborhood leadership and get them on your side, and then they become advocates for you.\(^9\)

Multiple developers shared similar stories where they had successful projects because they could meet and work with the community early on through the design process. Outside of working on design, developers in the affordable space would also try to combat the negative perceptions of the people who would be living in the housing.
They did this by showing community members the income levels of their residents, which would often be incomes for people like teachers and firefighters, or be similar to the incomes of the people already in the community. Those developers working for longstanding organizations emphasized the value of maintaining a good reputation in the community by building good quality housing and keeping the properties well maintained. Demonstrating the quality and success of previous projects can be an excellent way to show community members how housing can enhance their neighborhood and make it easier for future projects to be developed in an area.

**Financing**

**Building costs**

“Construction costs have skyrocketed in the last two years and not only have gone up, but they’re really volatile too. So, you can get bids one month, and three months later, it’s a totally different number. And so, as you try to finance these things, that gets very, very challenging because you keep having to add soft funds in another layer of that funding to come up with it somehow or another.”

Building affordable housing is expensive, especially as land, construction, and labor costs continue to increase due to inflation and supply chain issues. In Arizona, costs for 9% LIHTC awarded projects in 2022 ranged from $9 million to $45 million. Developers expressed that land is expensive and can be particularly difficult to acquire when competing with other developers. For example, one participant working for a non-profit said it is hard to compete with larger developers who can pay more for land. Once land is purchased, construction costs can offer unexpected additions to budgets, making it difficult for developers to get a handle on estimated project costs. One developer explains:

“...But right now the biggest challenge is what happens when you budget for something and that budget goes up five million dollars. Through no cost, of no fault of your own, just simply because the cost of materials went up or you can’t get something shipped in off of a cargo boat out in the ocean.”

Smaller projects, such as projects with less than 200 units, can be particularly impacted by construction costs because they are not receiving the benefits of economies of scale. Not only do smaller projects incur higher construction costs, but they also struggle to find general contractors and other workers who generally prefer to work on larger projects. Those working predominately with affordable single-family homes in community land trusts also have the unique issue of dealing with the increased cost of existing homes due to the high housing market. With the increasing price of homes, these practitioners are often selling homes to buyers for significantly less than what they are worth on the market to make them affordable. One developer explains,

“What would I be if I came in and your house next to me could appraise for $450,000, but I sell the house next to you for $100,000 less than that? I just hurt your comps; I hurt the community. I’m not going to do that. So I have to figure out a way to come up and bridge that gap, so I’m selling it at appraised value.”

In order to sell these homes at an appraised value while also making them affordable for buyers, the developer has to find funding to subsidize that difference.
Community Land Trusts

Community Land Trusts (CLT) maintain the affordability of homes by owning the underlying land a home sits on and requiring the homebuyer to only purchase the home, not the land. In this model, the homebuyer saves significant costs by purchasing the home and leasing the land. To make the home initially affordable for buyers, the CLT relies on using subsidies to bring down the purchase price for qualified buyers and then ensures long-term affordability for future buyers by using leases or deed covenants. These leases or covenants will typically be set for 99 years and include the terms under which the home can be sold to the next buyer. When the home is ready to be sold again, the CLT has a resale formula in place that determines the sales price. The sales price balances a community’s need for affordability and the opportunity for homebuyers to build wealth after selling. This ensures that the homebuyer selling the home will walk away with profit while also keeping the home affordable for the next purchaser.

Developers said rural areas particularly struggle with construction costs and contracting issues because there is a greater need for low-density housing like single-family homes. They typically have to bring in workers from other areas who need to travel over a long period of time. With the same construction costs as in urban areas and lower median incomes and rents in rural areas, developers have to find even more funding to fill that gap.

Developers of all housing types mentioned being impacted by supply chain and labor issues, especially since the COVID-19 pandemic. Specifically, participants said issues with getting materials promptly and a lack of skilled laborers available to work on projects. However, many participants noted that they believe these issues to be temporary and will work themselves out over time.

Finding gap financing

“It’s not unusual to have 4, 5, 6 levels of funding for one project from different sources.”

As developers struggle with the rising costs of affordable housing development, they must seek additional ways to cover costs. Finding ways to fund gaps was one of the most common barriers mentioned by developers. As mentioned previously, affordable housing developments are primarily funded through the federal LIHTC program (see ‘Low Income Housing Tax Credits (LIHTC)’, page 9). However, the LIHTC program is limited and competitive.
In 2022, Arizona received thirty-three 9% applications but could only fund sixteen.\textsuperscript{21} Many developers believe there are not enough tax credits to go around for all who wish to take advantage of them. The limited amount of tax credits can be particularly detrimental to rural areas that must compete with urban areas that typically receive more funding. Even with LIHTC acting as the anchoring funding source, developers still incur significant gaps that must be covered.

\begin{quote}
The Arizona Department of Housing has been helpful in trying to bridge those gaps, but again, we're talking about limited resources. That presents a lot of challenges. Then there's just the fact that we rely so heavily on Low Income Housing Tax Credit, we don't have a lot of other options of viable funding sources to do this kind of work.
\end{quote}

To fill the gaps, developers rely on other federal and local funding mechanisms. Developers mentioned using a variety of federal and local funds, such as the HOME Investment Partnership Program (HOME), Community Development Block Grant (CDBG), and American Rescue Plan Act (ARPA) funds. In the absence of funds, developers have also adapted by being more creative with local funding and partnerships. For example, one developer noted that they were short $75,000 to finish a renovation project. They partnered with a local organization to obtain the rest of the funding in exchange for reserving a certain number of units for women with serious mental illness over a 10-year period.

Some developers, especially those working in community land trusts or in affordable homeownership, do not generally use LIHTC funding and rely exclusively on other types of financing. One developer noted that there are not as many subsidies for specific buyers, such as those between 80-120% AMI, making it more challenging to fill the gap for homeownership. The U.S Department of Housing and Urban Development (HUD) and bank AMI qualifications can also make it hard to find homebuyers for these developers, as some people are just below the 80% threshold to qualify for a mortgage. This potentially indicates that funding requirements may not keep pace with the housing market. For those focused on homeownership, these gaps make it difficult to keep homes affordable, especially as the housing market increases.

Once developers secure several layers of funding, they must also comply with each source's unique funding and reporting requirements. Developers mentioned that land can be a particular issue with receiving and maintaining LIHTC funding. For example, applications for LIHTC projects are scored, and the highest-scoring applications are provided tax credits.\textsuperscript{22} Criteria such as the location of the project and its level of transit-oriented design are used in the scoring process.\textsuperscript{23} Therefore, developers want to secure land that will score well on their applications, which can make the cost more expensive or discourage them from applying if the parcel is not competitive. The project can also lose tax credits after two years if the project has not been completed.\textsuperscript{24} This can discourage developers from applying for funding if a parcel of land needs to go through a lengthy rezoning process.

Outside of LIHTC, one developer mentioned that contracts with the county or state have stricter construction requirements, which can narrow down the availability of general contractors and increase the cost. The U.S. Department of Housing and Urban Development (HUD) also updates rules and regulations regularly, which developers need to keep up with. Keeping up with the requirements of each funding source can be especially difficult, especially when there can be upwards of 5 or more funding sources on a single project.
Low Income Housing Tax Credits (LIHTC)

While affordable housing can mean different things to different people, the U.S. Department of Housing and Urban Development (HUD) defines affordable housing as housing in which the occupant is paying no more than 30 percent of their gross income on housing costs. Unlike market-rate development, it typically takes several layers of funding from various sources to make an affordable housing development financially viable. This is because affordable housing offers much lower rents than the market rate, meaning it needs to be more heavily subsidized to make up that difference for the developer. Developers in affordable housing primarily finance their projects through the Low-Income Housing Tax Credit (LIHTC) Program – a tax credit offered by the federal government to help acquire, construct, and rehabilitate affordable housing.

The importance of the LIHTC program cannot be understated for affordable housing development, resulting in over 56,000 homes developed or preserved in Arizona from 1986-2020.

The program offers 9% and 4% tax credits, which differ in the amount of equity generated and competitiveness. The 9% credit will result in about 70 percent of a development's equity, while the 4% credit will only generate around 30 percent. Due to the higher amount of equity, 9% tax credits are competitive. Developers who wish to use the 4% tax credits do so by financing through tax-exempt private activity bonds. The federal government authorizes each state to issue a specific volume of tax-exempt private activity bonds per year. These bonds fund private activities with a public benefit, such as affordable multifamily housing or mortgages for first-time home buyers. Because the amount of equity bonds a state has typically meets the demand for them, the 4% tax credit is considered automatic and non-competitive.

The general process for LIHTC begins with the federal government issuing tax credits to the state government each year on a per capita basis. The Arizona Department of Housing then awards the credits to developers through a competitive process, who then typically sell the credits to private investors to obtain project funding. Those investors can then claim the tax credit over a 10-year period. To be eligible for LIHTC, owners or developers must meet tenant income and gross rent tests. For example, one way to meet the income test is by ensuring that occupants in at least 20% of the project's units make 50% or less of the AMI. For the gross rent test, rents cannot exceed 30 percent of either 50% or 60% AMI, depending on the project's number of tax credit units. Finally, these income and gross rent requirements must be complied with for at least 15 years. Arizona has an additional extended use period of 15 years after initial compliance, meaning properties must remain affordable for 30 years.
Potential Solutions

As demonstrated in this report, developers face several challenges to building housing in Arizona. To overcome these challenges, it is essential to identify potential solutions to help make building housing in Arizona more efficient. The possible solutions discussed here were offered by the developers who participated in this study and further researched to bolster their usefulness.

"In my opinion, one is just money. So more investment by the state given it's unlikely the federal government's going to provide more. So, that's one. And I think part of that comes with workforce development and economic development is starting to get the business community engaged, get state leaders engaged to say, 'Hey, if we want to keep growing and we want to be a vibrant economy, we need a balanced housing supply as well to go with that.' Because not everyone makes, 75 grand a year, a hundred grand a year."

Zoning Changes

The crux of the zoning barrier is a lack of land zoned for multifamily use. To make development easier for housing developers, zoning code and its development standards need to be more flexible. Increased flexibility would include allowing for diverse housing types, greater density, and strategic policy to encourage building homes that fit a range of price points (see Exclusionary Zoning: A Legal Barrier to Affordable Housing for more solutions on zoning and development standards).
So, there's the long-term solutions, which I think includes increasing opportunities for land use in terms of allowing higher density housing, in terms of town homes, multifamily apartments and all that. I think that’s the long-term solution because we just need to increase the supply to release some of this pressure that’s causing rents to soar and land values and home prices to soar.

**Eliminating single-family zoning**

Alternatives to current zoning practice range from removing specific zoning code entirely to modifying existing code. In 2018, Minneapolis eliminated single-family zoning to increase the variety of housing options in low-density areas.38 This approach is often called "gentle density," or modest increases in the number of units that can be developed, by putting duplexes and triplexes into previously zoned single-family neighborhoods.39 While the zoning changes have been too recent to evaluate, eliminating single-family zoning policies in cities with high percentages of single-family zoning, such as Arizona cities, may be an effective method for increasing housing diversity and density.40 To ensure that the policy helps lower-cost housing types, however, the policy would likely need to be paired with other mechanisms, such as development incentives or inclusionary zoning, to ensure lower-cost housing is being built.41 Overall, elimination or reduction in single-family zoning would help to alleviate many of the issues developers face in the zoning process.

**Utilizing inclusionary zoning**

Inclusionary zoning is often touted as a key way to increase affordable or lower-cost housing. These policies can either require or encourage developers to set aside a certain percentage of units in new or rehabilitated projects for low- and moderate-income residents.42 Over 1,000 jurisdictions at various levels of government have adopted some form of inclusionary zoning across the country.43 Some policies are mandatory, while others are voluntary and provide incentives to developers that reduce expenses to make a project more profitable in exchange for the lower-income units.44 The number of units varies between 5% to 25% of the project's total number of units.45 Some places, like Boulder, Colorado, require every residential development to have inclusionary units, while others, like Irvine, California, only require it for larger projects that are 50 units or more.46 Most inclusionary zoning policies also have limited affordability periods, such as 30 years, and can be converted to market-rate spaces after that period.47 However, Arizona is only one of seven states that prohibit local governments from enacting mandatory inclusionary zoning (for more legal barriers to inclusionary zoning, see State-Level Legal Barriers to Adopting Affordable Housing Policies in Arizona). Despite this, Arizona cities can adopt voluntary inclusionary zoning, which can significantly help developers save costs on projects with important incentives such as height bonuses, reduced or eliminated parking minimums, fee reductions, and expedited permitting.48

**By-right development**

Modifying existing zoning codes can also help promote diverse housing types and increased density. One way to modify code to increase housing development is to make it allowable “by-right” or without the need for additional approvals in determined locations and neighborhoods.49 Doing so alleviates many of the barriers that developers noted about zoning, including having to go through lengthy rezoning or variance processes which add to the costs of projects and put funding at risk. Cities can identify and remove unnecessary obstacles to building housing types like multifamily housing by eliminating provisions that explicitly exclude it or by removing less obvious barriers that hinder multifamily development, such as parking minimums or other development standard requirements.50 Such changes help streamline the development process for multifamily homes and alternative housing forms such as backyard homes in single-family neighborhoods.
In 2021, the City of Tucson adopted a change to its zoning code, allowing for accessory dwelling units (ADUs), or backyard homes, to be built in zones that allow residential uses.51 The change in zoning code makes it much easier for ADUs to be built as they no longer need to go through special permitting processes. The city made the change to provide more flexible housing options, support aging in place, and promote sustainable infill development in the city.52 Similar amendments to zoning codes can be made elsewhere in the state for other housing types like multifamily. To further ensure changes in code are successful for diversifying housing stock, cities should also update comprehensive and long-term plans to make future development consistent with diversification.53 Doing so will help prevent local planning and zoning staff from having to make comprehensive plan amendments before approving development.54

In 2022, representatives from the Arizona Legislature co-sponsored a bill focused on by-right zoning.55 The legislation aimed to increase housing supply in the state by allowing single and multi-family housing developments to be built by-right – streamlining or skipping the traditional zoning process.56 The bill was deemed controversial as it severely limits local jurisdictions’ control over the planning and zoning process.57 While the bill did not pass, it sparked enough discussion at the Arizona Legislature to create a housing study committee that will further examine potential solutions to housing issues.58
Building Capacity and Political Will

Developers emphasized the importance of working together with governments and other organizations to ensure all actors understand development needs in order to improve processes. Strong relationships and partnerships with government and other organizations also give developers better access to potential funding opportunities and increased willingness from the government to find solutions to issues that arise.

“...so thankfully, right now, we have good relationships and good people in place who are willing to look, willing to listen. They realize we have a huge problem. How could we resolve this? They're listening to nonprofit developers and so forth and just developers in the community and trying to figure out solutions.”

Educating all actors on the processes handled by each other is also an essential part of working relationships. For example, one developer noted that it would be helpful for the state to offer sessions on tax credits to developers in more rural areas.

In addition to building relationships among stakeholders, developers also emphasized the need for more political will around creative housing solutions. For example, one developer mentioned the need to upscale existing tools such as community land trusts.

“...and then we also have other tools that I wish were just more widely implemented. Community land trust, being one of those tools that creates permanent affordability and really prevents displacement for our community members as neighborhoods do gentrify. So those tools are available, just not to the scale that we need them to, especially when you see how big those metaphorical holes are and then how small our current community land trust organizations are. And really wanting to scale up those types of organizations doing that work so we can stabilize our families and provide that permanent affordable housing within our communities.”

Local governments can play a significant role in developing CLTs and work closely with them to provide affordable homeownership opportunities. For example, the City of Tucson, in partnership with HUD and Pima County, was instrumental in developing the Pima County Community Land Trust, which has housed over 111 families/households. Local governments can also prioritize CLTs for local and federal funding and help to publicize them when working with potential homebuyers.

Finally, one developer mentioned that cities and counties have many vacant properties that could be made available for no or reduced cost to organizations such as non-profits and CLTs for affordable housing. Given that the land cost is a significant burden for developers, and little multi-family zoned land is available, publicly-owned land could offer a way to increase the state's housing supply. Some communities make surplus or underutilized public land available to developers who will build some sort of affordable housing or open up the land to market-rate developers if a bid for affordable housing is not received within a certain time frame.

Cities can also be more selective and determine on a case-by-case basis whether the land should be prioritized for affordable housing or another use. Such policies have been successful in other cities, such as King County, WA, where surplus parcels appropriate for residential development must be sold or leased for affordable housing development. In Arizona, however, it is important to factor in state laws that can prevent local jurisdictions from giving away land at no or reduced cost. In particular, the Gift Clause prevents public entities from giving donations or grants, including subsidies and other expenditures, to private parties. It also requires that any expenditures made for a public purpose do not far exceed the received benefits (see State-Level Legal Barriers to Adopting Affordable Housing Policies in Arizona for more on the Gift Clause). Therefore, using publicly owned land for housing development in Arizona will likely take political will on behalf of the state legislature.
**Improved Funding**

Of the three primary barriers developers identified, financing was the most discussed and is also the most complex.

**Increased LIHTC**

As the anchor source of funding for most affordable housing projects in Arizona, many developers felt that the LIHTC program needed to be expanded by increasing the number of credits available.

> When you win these things, you get solicited by equity sources all over the place, which shows you there's an appetite from investors for these things. So the market's there, the projects are there, let's double the Low-Income Housing Tax Credit Program, and you can see a lot more production happen.

At the end of 2021, the federal government looked poised to expand the LIHTC program when the U.S. House of Representatives passed the Build Back Better Act. The Act proposed several measures, including increasing the 9% LIHTC allocation cap by 10% plus inflation annually through 2024. If passed, it would have constituted a 41% increase in allocable LIHTC. However, the legislation failed to pass the senate and resulted in a subsequently passed Inflation Reduction Act (August 2022), which did not include any of the initially proposed LIHTC measures.

The path to increasing LIHTC ultimately lies with Congress, and the Biden administration has emphasized that expanding and strengthening the LIHTC program is a priority in the Housing Supply Action Plan. In the meantime, developers stated that other funding mechanisms at the state and local levels must also be improved. In July 2021, Arizona established a state affordable housing tax credit program, which provides $4 million annually for four years, which could leverage up to $160 million in the state for affordable housing. One developer noted that this program is a step in the right direction for increased state support for housing. Other developers said that state and local governments have a unique opportunity to use ARPA funding for housing projects and that it could be particularly beneficial because ARPA has fewer requirements and allows for up to 120% AMI. In partnership with HUD, the U.S. Department of Treasury published a how-to guide for using ARPA funding for affordable housing and preservation. The guide specifically notes that these funds may be used to fill funding gaps for 9 and 4 percent LIHTC projects. ARPA funding may also be layered with other funding opportunities, such as HOME and CDBG.

**General Obligation Bonds**

Another potential funding mechanism comes from general obligation bonds (GO bonds). These bonds are government issued and repaid from state or local general funds or a dedicated tax. GO bonds can be used to fund housing projects and programs, and their flexibility and exemption from federal and sometimes local taxes is particularly beneficial. The bonds provide a large sum of money upfront, which can be helpful for governments wishing to make large investments in a particular area or project. The main barrier to using GO bonds is that they often require approval via a public vote. For bonds that seek to address affordable housing, considerations need to be made about whether or not the bond would receive more public support if placed alongside other issues in which the bond would also be used.
In 2022, Phoenix’s Mayor and City Council approved $500 million for a proposed 2023 GO Bond program. Voters will decide whether or not to adopt the GO Bond program in a November 2023 special election. The City of Phoenix’s Housing Department and Human Services Department submitted a prioritized list of unfunded capital needs that will be reviewed by the bond’s Housing, Human Services & Homelessness Committee. The four projects submitted include the following:

- Renovating and preserving up to 610 affordable housing units at 4 properties.
- Designing and constructing a senior center.
- Providing gap funding for a choice neighborhoods housing development.
- Renovating an existing senior center.

The total cost for the four projects is projected to be $65 million. Because the bonds are a one-time funding source, the city is primarily focused on capital improvements rather than creating new housing that would require additional programmatic support. The use of GO bonds for affordable housing has been successful in other parts of the country. In 2016, voters in Portland, Oregon, approved the city’s first housing bond, which dedicated $258.4 million to create 1,300 permanently affordable homes. As of December 2021, two bond-funded projects housed 300 residents, while another 10 projects were under construction, resulting in 1,490 units of affordable housing and exceeding the original goal. Portland’s success demonstrates that GO Bonds can be invaluable for increasing the production of affordable housing in cities.

Impact fee waivers

State and local governments can incentivize housing development via financial incentives such as fee waivers and tax exemptions. Impact fees are development fees that occur during the construction process. The fees exist as a way to raise revenue to cover the cost of expanding infrastructure that results from new development. Local governments can give developers fee waivers or reductions to qualifying projects to incentivize housing development. Some developers noted that these waivers can be very helpful, especially as they try to meet their project budgets. To qualify for impact fee waivers, projects typically must meet affordability requirements, such as housing that serves a specific income level, or a minimum threshold of units that are affordable. Requirements may also dictate that the units must remain affordable for a specified period of time. In some cases, fee waivers or reductions are only available in specified zones, such as public transit corridors, or to specific developers, such as non-profits.

Some cities in Arizona, such as Tucson, already offer impact fee waivers. The City of Tucson initially set aside $1 million in 2019 to subsidize impact fees, but only for non-profit affordable housing providers. After only five projects utilized the subsidy and spent about $265,000, the city made an effort to expand the program to for-profit organizations in March 2022. Tucson’s affordability criteria include creating units for households that earn 80% or less of the area median income, and the units must remain affordable for at least 15 years. In Arizona, projects with waived impact fees also earn more points on LIHTC applications, making cities that do so more competitive in drawing in tax credit projects.
Property tax abatement or exemption

Finally, some developers mentioned that property tax abatements or exemptions would benefit project funding. Tax abatements reduce the total amount of tax owed, while exemptions adjust the value of the property, which is then used to calculate the amount of tax owed.\(^94\) For example, a city that wishes to incentivize a rehabilitation housing project can exempt the value of the project improvements for a specified period of time when calculating property tax.\(^95\) The length of time the abatement or exemption may last depends on what the city hopes to encourage, and should be long enough to incentivize developers while also not hindering the tax revenue collected by the city for other needs.\(^96\) Abatements and exemptions can be used to incentivize new housing development, preserve existing affordable housing, and more.\(^97\) Similar to impact fee waivers, projects must also typically meet affordability requirements to be eligible for abatements and exemptions.\(^98\)

In Arizona, non-profit developers can legally qualify for a property tax exemption.\(^99\) However, until June 2022, the exemption only applied to apartment communities of 200 units or less.\(^100\) Non-profit developers can now build much larger affordable housing communities while still receiving a tax exemption that tremendously helps their projects.\(^101\)

This exemption, however, does not apply to for-profit developers, many of whom are producing a lot of the state’s affordable housing.

Cities in other states have a variety of tax abatement and exemption programs for developers who meet affordability requirements. In Washington, D.C., developers can receive a 10-year abatement equivalent to 75% of the difference between the property tax owed before and after development.\(^102\) At least five percent of project units must be reserved for low-income households, and an additional 10 percent of units must be reserved for households earning up to 60% of the area median income.\(^103\) The affordable units must be maintained for at least 20 years. In Portland, OR, developers can receive a 10-year exemption if at least 20% of rental units are available to those making 60% of the area’s median income.\(^104\) Cities in Arizona can look at examples from elsewhere in the country to create their own programs that fit local needs and resources.
**Common Housing Policy Terms**

**Affordable Housing:**
Housing that costs 30% or less of household income.

**Area Median Income (AMI):**
The midpoint of income across all households within a region, often the metropolitan statistical area (MSA) or county, defined by the U.S. Department of Housing and Urban Development (HUD).

**Cost Burden:**
Households that spend more than 30% of their income on housing costs are considered cost-burdened.

**Multifamily Housing:**
A dwelling designed to have separate housing units in one building, such as a duplex, triplex, condominium, or apartment complex.

**Gap Funding:**
The amount of money needed for development that is not currently funded.

**Soft Funding:**
Funding that comes from things like subsidies, tax incentives, and donations that does not need to be repaid.

**Economies of Scale:**
Cost savings that occur due to increased and efficient production.
Research Approach

Researchers interviewed 15 housing practitioners involved with building housing in Arizona to better understand barriers to building housing. Practitioners were initially identified using the Arizona Department of Housing’s 2022 9% LIHTC reservation list. Developers from both urban and rural areas around the state were contacted to ensure that a variety of development challenges were represented. Additional participants were identified via snowball sampling, using suggestions and referrals from developers during interviews. Out of the 15 practitioners, 13 had experience developing affordable housing and eight had experience with market-rate development. Interviews were conducted online via Zoom in the summer of 2022 and lasted 30-45 minutes.

With permission from participants, all interviews were audio-recorded and transcribed. The transcriptions and interview notes were analyzed by two researchers using NVIVO qualitative data analysis software. The researchers open-coded the semi-structured focus groups using a grounded approach, in which themes could emerge from the data. After individual codebooks were formed, the analysts met to discuss each codebook and theme structure and compared and contrasted the different codes to identify which codes were similar and different. Using a collaborative process, analysts formed a joint codebook with descriptions and examples for the codes. Upon reaching agreement in this joint codebook, the analysts recoded the focus group transcripts individually using the joint codebook structure and then compared the results once more to reach a consensus.
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Endnotes

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