



CITY OF CAMBRIDGE

Community Development Department

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MEMORANDUM

To: Richard Rossi, City Manager
From: Iram Farooq, Assistant City Manager for Community Development
Date: April 6, 2016
Re: Inclusionary Housing Study

We are pleased to transmit the Cambridge Inclusionary Housing Study recently completed by David Paul Rosen & Associates. The attached study provides in depth analyses and recommendations for changes to the City's Inclusionary Housing Ordinance by:

- reviewing the current inclusionary housing provisions of the Zoning Ordinance and comparing these standards to inclusionary housing programs in other localities;
- analyzing changes in the socioeconomic profile of the city and housing affordability in the years since the adoption of the inclusionary housing provisions in 1998;
- modeling the economic impact of the current program on typical developments seen in the City and estimating the potential impact of increased set-asides of affordable housing; and,
- outlining policy options and recommendations for consideration as changes to the inclusionary housing provisions are discussed.

Key findings of the study include:

- increases in market rents and sales prices have outstripped increases in income in recent years;
- affordable housing created under the inclusionary housing provisions has become an increasingly critical source of new affordable housing as other mechanisms to expand the affordable stock have become more challenging;
- strengthening the inclusionary housing provisions is necessary to maintain an adequate stock of affordable housing and preserve the socioeconomic diversity of the city;
- inclusionary housing provisions may be increased to a certain extent without severely compromising the production of new market-rate housing.

Background

The current inclusionary housing provisions were adopted in 1998 after two City-commissioned studies were completed. In one study completed in 1997, Peter Werwath and Associates recommended a framework for inclusionary housing provisions which became the basis for the current inclusionary housing provisions in the Zoning Ordinance. Then, a rationale study completed by Stockard, Engler & Brigham in 1998 recommended that for every 10 new market-rate housing units, 1.5 additional affordable units should be created to preserve the economic diversity of the community.

The inclusionary housing provisions apply to housing developments of 10 or more units, which include units that are affordable to households earning less than 80% of Area Median Income (AMI). The current provisions set a 15% affordable housing ratio. Most developments are eligible for an allowed 30% density bonus, which typically results in an effective affordable housing ratio of approximately 11.5% of units in many new market buildings. Developments that are not eligible for the density bonus provide a full 15% of total units as affordable. The density bonus is an important and intentional provision for which there is legal support. The application of the density bonus, however, has on occasion caused confusion about the expected number of affordable units in new buildings. There are currently 891 affordable units completed or now being developed through the inclusionary housing and similar zoning provisions. Inclusionary units have grown to become a significant component of the City's affordable housing stock and have been a critical means to create new units in recent years.

The Cambridge inclusionary housing provisions were cutting edge when adopted, and continue to be cited as a successful model for other communities. While the Cambridge program has been successful at creating new permanently affordable units, we wanted to examine the program in the context of current housing needs.

In 2014, CDD commissioned David Paul Rosen & Associates (DRA) to conduct a comprehensive new inclusionary housing study with the following objectives: to analyze the impact of new market rate residential development on housing affordability, housing supply, housing needs, demographic trends and socio-economic diversity in Cambridge; to recommend changes to the inclusionary housing provisions contained in Article 11.200 of the Cambridge Zoning

Ordinance; and to provide advice on current needs and best practices from inclusionary housing programs in other communities.

Founded in 1980, DRA provides affordable housing advisory services to public agencies, private lenders and investors, and residential developers. DRA has completed dozens of similar studies analyzing the economic impact of inclusionary housing provisions, nexus fees, housing mitigation measures, and regulatory reform on development in communities across the country, and has helped more than forty communities research and develop inclusionary housing programs and other affordable housing mitigation measures.

Comparison to Other Communities

DRA reviewed the Cambridge inclusionary housing provisions and compared these to similar provisions in other communities. DRA's comparison included communities selected by CDD staff along with communities identified by DRA as having model programs or policies and/or similar needs which would provide a worthy comparison. Communities included in this comparison included: Boston; Boulder, Colorado; Burlington, Vermont; San Francisco; Santa Monica, California; Somerville; and Washington, DC.

Overall, Cambridge's provisions compared favorably with those in other communities. Cambridge is unusual in that affordable units are built on-site in all cases, and are comparable to market units in terms of location, quality and size. While the typical effective set-aside ratio of 11.5% in Cambridge is "middle of the pack" compared to surveyed communities, DRA found that communities with higher set-aside ratios typically targeted higher income households for affordable units, and those with lower set-aside ratios targeted lower-income households. Unlike Cambridge, all but one other surveyed program had higher income limits for ownership than for rental housing. Density bonuses were offered in half of the surveyed programs. DRA also found that Cambridge's provisions are notable for their consistency and predictability, and for their success in creating mixed-income communities where high-quality affordable units are indistinguishable from market units.

Socioeconomic Diversity Analysis

DRA conducted a socioeconomic diversity analysis which analyzed how housing affordability and socioeconomic diversity in the city has changed in recent years by examining trends in market housing costs, affordable housing, household income distribution, and the affordable housing stock. DRA found

that increases in market-rate rents and sales prices have outpaced increases in income, resulting in a reduction of overall housing affordability. Household income needed to afford market-rate rental and ownership housing has increased, making it more and more unlikely that a low or moderate-income households can find an affordable home on the market. Cost burdening (i.e., paying more than 30% of a household's gross income on housing) remains a significant issue for households earning under 80% AMI, and has become an increasing issue even for households earning up to 100% AMI.

DRA found that the household income characteristics of the city have changed significantly since 2000. The biggest changes were reductions in the proportion of moderate-income households (i.e. incomes between 50% and 80% AMI) which declined from 13% of the community in 2000 to 8% in 2011, and lower-middle-income households (i.e. incomes between 80% and 100% AMI) which declined from 14% in 2000 to 8% in 2011. These changes occurred for both renters and owners but were more dramatic for renters. These changes were offset by an increase in the ratio of households earning over 120% AMI (increasing from 35% of the community in 2000 to 47% in 2011). The proportion of households with incomes under 50% AMI showed little change in this comparison.

DRA found that despite market pressures, the City has been successful in maintaining the overall ratio of affordable housing in the city at roughly 15% of the total housing stock. This has been accomplished through various housing strategies, including the current inclusionary provisions and other City-funded affordable housing. DRA noted, however, that an increasing proportion of the City's stock of affordable units are targeted to households earning less than 60% of AMI, making the inclusionary housing program one of the few mechanisms that caters to households earning up to 80% of AMI.

Economic Feasibility Analysis

DRA modeled alternative inclusionary housing set-aside standards for seven development prototypes based on typical development models. Development prototypes included large-scale rental buildings (high-rise and low-rise), moderate-scale rental and homeownership buildings, and smaller-scale rental and homeownership buildings. The economic modeling was intended to estimate the financial impact of differing set-aside standards on different types of developments to help inform discussions about increases in inclusionary set-aside ratios. No specific development project was modeled. The results are

intended to be a guide for discussing the potential impact of regulatory changes on the feasibility of market residential development.

DRA consulted with local developers and other experts to get information on land, construction and other development costs typical for each development type. Financial modeling was done using both a return on equity (ROE) and residual land value (RLV) approach for each scenario with changes in affordability set-asides. Affordability set-asides varied from the current provisions (typically 11.5%, after application of the density bonus) up to 25% affordable with varying affordability targets. For purposes of this modeling, DRA assumed that the current 30% inclusionary density bonus was available in each scenario and that no additional zoning offsets would be available (e.g. additional density or height or relaxed dimensional requirements).

Cambridge's current housing market is exceptionally strong, as demonstrated by high demand and historically low "cap rates". Cap rates are a measure of observed property sales which can be used to estimate the value of a property based on income it produces. Low cap rates in Cambridge indicate that residential property in Cambridge is a very attractive investment and that there is very strong demand for buildable land. Given the strength of the current market, DRA considered two market scenarios for each prototype, using both a cap rate that is typical of the current market and a slightly higher cap rate, in acknowledgement that cap rates seen in the current market are lower than long-term averages and that developments which are feasible today might not be as feasible in a different market climate.

DRA's analysis found that in the current market, increasing the affordability set-aside up to 20% of the total units in the prototypical developments modeled would have a financial impact, but would not necessarily render developments economically problematic. Reflecting standard industry practices, feasibility was set at a threshold of 8% ROE or a RLV at or above market land costs.

Policy Options and Recommendations

Based on changes described in its socioeconomic diversity analysis, the economic feasibility analysis of prototypical developments with varying affordability requirements, and its review of inclusionary programs in other communities and national best practices in inclusionary housing, DRA's recommendations for Cambridge include:

- Increasing the set-aside ratio for affordable units up to a net of 20% of total units built in a residential project;
- For affordable inclusionary rental housing, either maintaining the current income eligibility limit of 80% of AMI for the recommended inclusionary set-aside (i.e. up to 20% under 80% AMI), or making up to 15% of units affordable to households earning less than 80% AMI and up to 5% of units affordable to households earning less than 100% AMI;
- For affordable inclusionary ownership housing, increasing the eligibility limit to 100% of AMI and increasing affordability targets above 65% of AMI;
- Maintaining the 30% allowed increase in density for an inclusionary housing project;
- Considering a higher set-aside ratio in unique cases through zoning ordinance changes where warranted;
- Considering specifying that a portion of affordable units created must be 3-bedroom units, and/or that inclusionary housing set-aside ratios can be applied on a per-bedroom or per-square-foot basis.
- Disallowing the provision of affordable studio units, or creating a pricing structure in which studio units can be offered at a lower cost than one-bedroom units;
- Considering lowering the unit and/or square footage threshold for triggering the inclusionary housing provisions;
- For projects which result in at least one inclusionary unit and a fractional unit, permitting an in-lieu-of contribution for the fractional affordable unit rather than rounding the number of affordable units up or down;
- Allowing the option to select inclusionary units that are less premium in a development in exchange for increasing the total number of affordable units;
- Considering the impacts of the changes to the inclusionary housing provisions on the competitiveness of residential versus commercial development and land uses;
- Applying changes to the inclusionary housing provisions only to new developments.

Other Considerations

While the report contains a number of DRA recommendations which provide options for City discussions, we would also note a few other considerations to be mindful of when considering changes to the inclusionary housing provisions.

The DRA report focused on housing affordability and changes in the housing market and community since the current inclusionary provisions were adopted. There are other policy, legal and practical considerations to be aware of as we discuss recommendations and consider changes to the inclusionary provisions. It is important to consider not just the impact changes might have on overall housing production, but also other City goals such as balancing residential and commercial development, achieving excellence in urban design, reducing adverse transportation impacts, setting high standards for environmental sustainability, and engaging community members in a meaningful review of development proposals.

Finally, given the depth of this study, the myriad factors to consider as changes are discussed, the impact of inclusionary housing provisions on our ability to meet affordable and other housing goals and on the feasibility of new housing development, and other public policy goals in the city, we recommend that the City reassess the inclusionary housing provisions periodically. We recommend that the City undertake an update in five years to assess the impact of any changes made now, and to determine whether and how the inclusionary housing provisions are addressing the housing needs and priorities of the city at that time.

Next Steps

Increasing the effective ratio of inclusionary housing would be a significant step forward in addressing the continuing need for affordable housing in the community. A thoughtful increase which does not significantly alter the development landscape and continues to support the development of housing, would greatly assist in offsetting changes in socioeconomic diversity of the community from higher income households moving into new market-rate housing in the city.

We look forward to discussing this study and its recommendations with the City Council and community. In coordination with the City Council, we will reach out to and be available to meet with residents, developers, and others interested in the study. We can gather and prepare feedback on the report if that is helpful to the City Council. We will also review and discuss this study with the Affordable Housing Trust and ask that they be available to assist the City Council with this review.

As the City Council's discussion moves forward and consensus is reached on a desired set of policy changes, we will work to draft a zoning amendment that would implement the desired changes to the City's inclusionary housing provisions.