CITY OF CAMBRIDGE | CDD Community Development

MEMORANDUM

To: Yi-An Huang, City Manager

From: Melissa Peters, Assistant City Manager for Community Development

Christopher Cotter, Director of Housing

Date: June 30, 2025

Re: Awaiting Report 25-30 regarding a review of barriers to housing production, a timeline for next Inclusionary Housing Study, and the feasibility of additional development incentives

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In response to AR 25-30 regarding remedies to address the slowdown in housing starts, a timeline for the next Inclusionary Housing Study, potential amendments to the Inclusionary Zoning Ordinance, and other incentives to encourage housing development, we submit the following report, which includes the following sections.

1. Existing barriers to housing production
2. Timeline and overview of the proposed Inclusionary Housing Study
3. Zoning amendments for consideration and preview of other policy options

1. Existing barriers to housing production

Private housing development is affected by both macroeconomic factors and local policies. While creating conditions that encourage housing production is a key policy priority in Cambridge, developers are highly sensitive to market conditions outside of the City's control that impact the financial feasibility of housing construction. Major cost components of new housing development include construction costs and borrowing costs which are largely driven by larger macroeconomic factors. Land costs are another major cost component and can be affected both by larger market forces as well as local policies. Local policies can also affect the operation of new housing when they impact the revenue or costs developers can expect for their completed buildings over time. Below we outline both the macroeconomic factors and local policies and market conditions that impact the financial feasibility of private housing development.

Melissa Peters | Assistant City Manager for Community Development
Sandra Clarke | Chief of Administration & Operations

344 Broadway
Cambridge, MA 02139

617-349-4600
cddat344@cambridgema.gov

www.cambridgema.gov/CDD

Macroeconomic Factors

The upfront costs for the land, materials, and labor needed for multifamily construction require large amounts of debt and equity funding. The cost of land, materials, labor, debt, and equity funding are all market driven. All of these cost factors have gone up significantly in recent years, making it increasingly difficult for developers to make the investment return and profit that would induce them to move forward with new projects. These factors have reduced housing production across the economy with new deliveries of multifamily housing nationwide down 25% compared to this time last year, according to commercial real estate firm Cushman and Wakefield. And new multifamily housing construction in the Boston Metro Area is at 10-year low levels according to real estate services firm Colliers.

Construction Costs: Construction materials have been affected by the same post-pandemic inflation that has driven up costs for goods and services across the economy. This has made it increasingly difficult to accurately model total development costs and ensure financial feasibility. While costs have gone up nationwide, Massachusetts is second only to Hawaii in terms of construction cost per square foot. Additionally, there is a significant labor shortage in the construction industry in the Boston area that is particularly challenging for multifamily projects that require coordination of large construction crews in various trades. Demand for construction labor outstripping supply has made labor costs also increase. The labor shortage also increases risks of completion delays that can further increase cost for developers.

Interest Rates: The federal reserve rate hikes aimed at curbing inflation have hampered multifamily development, significantly increasing borrowing costs and raising the returns demanded by equity investors. Interest rates on construction loans are now averaging 8-10% or even higher on riskier projects, up from 4-6% in 2020. Banks are simultaneously increasing debt service coverage requirements and reducing the amount they are willing to lend relative to project cost. This is significantly increasing borrowing costs, raising demands on cash flow, and making developers rely more on equity investments as a source of capital. At the same time, given the increased risk faced by construction projects, equity investors are also demanding higher returns, compounding the difficulty developers are facing financing projects.

Tariffs & Continuing Economic Uncertainty: Much of the lumber, steel, and mechanical equipment needed for multifamily construction comes from other counties, meaning that new or increased tariffs imposed by the federal government threaten to add more to construction costs. To avoid tariff levies, many developers may try to stockpile materials, but this also comes with added cost

in the form of storage fees. The overall uncertain economic outlook is likely also causing developers and investors to hold back and wait for more stability.

Local Regulatory Factors

While the City cannot control the market or national policies that challenge private housing development, it does control zoning, permitting, and development requirements that can affect housing production. Below are some of the local policy levers available with information on recent changes and current requirements.

Zoning: Recent changes such as the Citywide Multifamily Housing Amendments and planned future rezoning on north Mass. Ave, Cambridge Street, and Central Square are intended to enable increased multifamily housing by-right. These changes create more favorable economic conditions for housing development by allowing larger buildings and reducing the time and uncertainty of permitting approvals. As a result, land costs may increase to reflect the potential value of what can be built. There has already been increased interest in multifamily housing development since new zoning was adopted in February.

Permitting: As part of the Citywide Multifamily Housing Amendments, the threshold for Project Review Special Permits was increased from 50,000 square feet to 75,000 square feet and special permits are no longer required for smaller-scale townhouse and multifamily developments in some neighborhoods. Advisory review is still required in some cases, but removing the time and uncertainty of special permit approvals (which are legally appealable) makes housing development more feasible.

Inclusionary Housing: Cambridge's inclusionary housing ordinance, adopted in 1998, has been a key tool for creating housing opportunities for low to moderate income households that are not being produced by the market, helping to maintain the City's socioeconomic diversity as new housing is built. In housing developments of at least 10 units or 10,000 square feet, Cambridge currently requires 20% of residential floor area to be set aside as income restricted housing affordable to income-eligible households (before 2016, the required rate was effectively 11-12%). The 20% requirement is similar to inclusionary requirements in Boston and Somerville. Because developers must charge below-market rents for affordable units, the requirement can reduce the rental revenue and cashflow of a project, making it more challenging to achieve the income needed to cover debt service and building operations. Prior to the Citywide Multifamily Housing Amendments, the inclusionary policy offered a density bonus of up to 30% in floor area and unit

count which provided additional income to multifamily housing developers. After the adoption of the Citywide Multifamily Housing Amendments the density bonus is no longer applicable as density on multifamily housing is no longer capped citywide, and in C-1 districts, buildings with inclusionary units can be built with 2 additional stories.

Parking Requirements: Parking spaces are estimated to add up to $100,000 or more per space in multifamily developments with structured parking. The City Council amended the Zoning Ordinance in 2022 to eliminate minimum parking requirements in new developments. This change lets developers determine how much parking is needed for their buildings based on site-specific considerations, including overall project costs, and allows for reduced costs for developments that seek to build without parking.

Building Decarbonization: Reducing carbon emissions is a key priority of the City. Both the fossil fuel-free ordinance and the specialized energy stretch code are required for most new buildings in Cambridge, and rooftop solar is encouraged. We anticipate that these requirements can increase capital costs for new buildings but will substantially decrease operating costs over time, especially as these technologies mature.

Local Market Considerations

Land Availability: Cambridge is built out without significant areas of vacant, unused land. While there are redevelopment opportunities, redevelopment of built out sites usually requires a more protracted process than developing on vacant land, with complications related to displacement of existing uses which may be profitable to landowners, community opposition, or past uses that limit redevelopment potential or add remediation cost, among other things. Additionally, the large footprint and development aims of the city's large universities, the desirability of Cambridge to well financed business sectors, and community priorities around preserving and expanding open space, all limit the availability of land for housing development.

Land Costs: With access to high paying jobs, public amenities, and world class universities, Cambridge is an extremely desirable community and competition for land among residential, commercial and institutional buyers drives up the land costs, which in turn push up development costs for residential projects. Land costs are also linked to local policies like zoning and inclusionary housing requirements since the value of land is driven by the potential value of what is allowed to be developed on it. In practice, land cost changes lag behind changes to local policy,

and this is especially true when policy changes lower the value of what can be developed by adding new or expanded requirements.

2. Timeline and overview of the proposed Inclusionary Housing Study

We will be undertaking a new Inclusionary Housing Study in FY26. The study will update the legal basis for the Inclusionary Zoning Ordinance and review the impact of current and potential inclusionary housing requirements on the financial feasibility of building new housing. We will solicit proposals from qualified consultants who can carry out the study through an RFP process in early FY26. The study will assess whether there is an essential nexus and rough proportionality between the requirement for private housing developers to provide affordable housing in market-rate projects and the impact of market-rate housing development on the socioeconomic diversity of the community. Additionally, the study will assess the impact of the existing inclusionary housing requirements, as well as potential alternative requirements, on the financial feasibility of housing development in the City.

The last inclusionary housing study was completed in 2016 by David Paul Rosen & Associates. While the updated study will assess different policy options, prototype developments, and market scenarios, we expect similar general components. The 2016 study is linked here for review - Cambridge Inclusionary Study.

More recently, in 2023 we completed an Economic Feasibility Analysis (EFA). This analysis was required by the Commonwealth's MBTA Communities Act for municipalities with inclusionary housing requirements above 10% and provided insight into the development economics. The EFA found that as-of-right inclusionary condominium projects generally meet assumed financial return requirements at that time, but that "multifamily rental projects [did] not meet assumed financial return requirements with Cambridge's inclusionary zoning requirements, this result reflect[ed] the current challenging financial market conditions rather than the City's inclusionary zoning requirements." It noted that the high interest rates and investment return requirements made it difficult to finance multifamily rental housing regardless of inclusionary housing requirements. The EFA was submitted to the Executive Office of Housing and Livable Communities, which found Cambridge to be in compliance with the MBTA Communities requirements.

As we prepare to undertake a new study, we wanted to share an outline of the proposed scope of the study, which will include:

Melissa Peters | Assistant City Manager for Community Development
Sandra Clarke | Chief of Administration & Operations

344 Broadway
Cambridge, MA 02139

617-349-4600
cddat344@cambridgema.gov

www.cambridgema.gov/CDD

1. Review of the existing inclusionary zoning ordinance and comparison to similar programs in comparable communities
2. Analysis of the Socio-Economic Diversity of the community and changes since 2016
3. Financial Feasibility Analysis for New Housing Development, including:
    i. Review of development data and trends in Cambridge and the region
    ii. Interviews with real estate and construction professionals
    iii. Projection of feasibility of various prototype developments under different policy and market scenarios
4. Recommendations

Components of the Financial Feasibility Analysis:

Development prototypes

In the 2016 study, the consultant approximated total development costs, operating expenses (rental), net operating income (rental) as well as sales proceeds (homeownership) for 7 prototype developments (5 rental and 2 homeownership) to calculate return on investment under different inclusionary set-aside scenarios and estimate financial feasibility of different types of development. The development prototypes from the 2016 study ranged from 6 to 300 units rental developments and 6 to 40-unit condominiums. The new study will also develop prototypes to reflect several different scales of residential development to approximate projects expected under current zoning regulations. We will also add several new prototypes to reflect recent and potential changes in the zoning, including developments building to new standards in C-1 districts or to take advantage of increased height along corridors where zoning changes are being discussed.

Modeling a range of inclusionary housing requirements

*For affor*dable housing units to be built through the inclusionary program, set-aside requirements and other provisions of the program should be set at levels that make multifamily development financially feasible with the understanding that macroeconomic factors outside the city's control (outlined in section 1) also impact the ability of developers to move forward with projects. The study will look at alternative inclusionary zoning requirements ordinance (under different market scenarios) to model how potential changes impact the financial feasibility of the different development prototypes.

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We have assembled a list of ideas or questions to explore in the study based on what has been discussed by Council or has come up in discussion staff have had internally or with stakeholders. Comments on these and additional suggestions are welcome to help develop the study scope.

- A range of set-aside requirements, including those with requirements under the current 20% (e.g. 10% to 15% of net residential floor area);
- a set-aside ratio that varies based on building size;
- the impact of setting affordable rents based on affordability targets (e.g. 60% or 65% of AMI) rather than rents calculated as 30% of actual tenant household income on development financial feasibility;
- reducing the threshold for compliance with inclusionary requirements from 10 units or 10,000 s.f. to 6 or 8 units;
- the feasibility and advisability of a variable set-aside requirement (with set maximum and minimum requirements) which could adapt to different market conditions.

Study Timeline

We are currently drafting the RFP to select a consultant for the study and expect to issue the RFP in early FY26. We are planning to request responses in September so that the study can begin in October. The RFP will ask each respondent to provide a schedule for completion of the study. For planning purposes, we expect that the study will take approximately 6 months. Having a clear scope for the study will be important to have it done expeditiously and changes to the scope while the study is underway could add time.

We expect to have the study completed for review with the City Council in the spring of 2026. Based on the Council's input, staff could prepare a zoning petition for review and potential adoption later in 2026.

3. Zoning amendments for consideration and preview of other policy options

The Council could consider taking some short-term actions before a study is completed next year. These include time-limited zoning changes and other policy options to incentivize new residential development that we are now discussing or that are being implemented in other communities. We

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cddat344@cambridgema.gov

www.cambridgema.gov/CDD

are continuing to look at several non-zoning approaches and will provide a more detailed report on these options in a follow-up report.

Completing the study before taking action would help provide clearer guidance on what policy options might lead to better outcomes. The goal of any short-term action would be to counteract some of the current economic difficulties and spur housing production sooner. However, there is no guarantee that short-term actions would result in more housing in the short-term, and they could have consequences in the short-term or long-term.

A. Zoning Amendment - temporary, sunsetting inclusionary rate reduction

The City Council could amend the Zoning Ordinance to reduce the 20% inclusionary housing set aside ratio, which is the "ceiling" established by the previous study. This could be done on a temporary basis, with a new requirement contingent on projects being built within a specific timeframe. The goal would be to encourage some projects to move forward while the study is being completed and to reflect the current economic conditions that are making development so challenging. Given the current market conditions and continuing uncertainty in key economic factors, it is difficult to determine if reducing the set-aside ratio requirement would have a broad impact on housing production and the creation of new affordable units, but it could assist stalled projects and might make those that are advancing through review more likely to seek building permits.

An economic feasibility analysis conducted by Karl F Seidman Consulting Services and Karp Strategies in 2024 noted that interest rates and construction costs may be stalling housing development in a way that would not be corrected by changing inclusionary housing policy. As summarized below, some Cambridge developers have suggested inclusionary rate cuts could help their stalled projects, but other developers have said that development would be challenging in the current climate even without any inclusionary housing requirement.

The City Council also recently adopted a major zoning reform with the Citywide Multifamily Housing Amendments, and its effect on encouraging housing is unknown. Several developers have begun to discuss development proposals under the new zoning that would be subject to the 20% requirement. Another major change in zoning policy, if only temporary, could have the unintended effect of causing further delays as the development market readjusts to an interim policy before having to adjust to a more permanent policy a year or two later. An interim change may also create

a greater incentive for new developments to take advantage of the Citywide Multifamily Housing Amendments before we can assess the specific impact of that significant zoning change.

If the Council wants to consider a time-limited change such as reducing the inclusionary housing ratio for developments that receive building permits within two years, staff would need to know this relatively soon if the desire is to adopt that before the end of this Council term. A time-limited change would require a zoning amendment which would require the normal review and ordination process for zoning changes. This would require at least 4-6 months to draft and submit a Council zoning petition, hold public hearings, and receive reports from the Planning Board and Ordinance Committee, before voting on ordination. It may also require a reprioritization of other zoning initiatives requested by Council.

There are many complex and dynamic factors that affect financial viability which developers must balance, and each development will face different challenges. Some developers are taking steps to advance projects with the 20% requirement while others note that they are stalled. Any reduction in the set-aside or other relaxing of requirements would be available to all projects in the approval process for special permits or building permits when changes are adopted. Projects that have already received a special permit with the 20% requirement could seek to amend their special permit to benefit from the reduced set-aside.

Current housing production pipeline and the inclusionary housing requirements:

While housing production in Cambridge has slowed, mirroring the regional and national trend, there is mixed evidence that a reduction in the inclusionary set-aside rate will result in any significant increase in housing starts. With investors skittish about economic uncertainty and interest rates as well as construction costs remaining high, it is unclear whether a rate reduction alone would move forward projects that are currently stalled or result in other new developments beyond those that we may see move forward under the Citywide Multifamily Housing Amendments. For example, a recent article from CoStar News highlights how lenders have been reluctant to provide financing for new residential buildings at Cambridge Crossing, despite that development continuing to be subject to the previous inclusionary zoning requirements that effectively require only 11.5% of units to be set aside as affordable. This is consistent with regional and national trends.

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cddat344@cambridgema.gov

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Staff are now working with projects that are looking to move forward under the 20% requirement, and there may be new interest in multifamily development in areas upzoned through the Citywide Multifamily Housing Amendments.

Current Developments

Staff are now working with development projects that have received Planning Board special permits. There has also been new interest in multifamily development in areas upzoned through the Citywide Multifamily Housing rezoning through which new developments can apply directly for building permits.

Current developments with special permits include:

- 745 Concord Avenue (236 units - special permit approved)
- 75 First Street (90 units - special permit approved)
- 2400 Massachusetts Avenue (56 units - special permit approved)

These developments would be required to provide inclusionary housing at the current 20% set-aside ratio. Staff are reviewing an inclusionary housing plan for one development where the developer anticipates starting construction later this year with the 20% inclusionary housing. In other cases, developers have indicated that their projects are not financially viable at least in part due to the inclusionary housing requirements. Some have indicated that development may be feasible with inclusionary housing ratios at 8% or 10%, while others have noted that developments may not be feasible unless the inclusionary housing requirements are reduced more significantly or eliminated and/or other local incentives are provided.

New projects under Citywide Multifamily Housing Amendments

Staff from several City departments are also now seeing new interest in multifamily development on smaller lots in areas upzoned through the Citywide Multifamily Housing Amendments. Staff from CDD, Housing, ISD and the Historical Commission have all met with developers actively working on proposals for new housing under the recent zoning changes, several of which are being planned to include inclusionary housing. Developers are aware of the 20% inclusionary housing requirement for buildings of more than 10 units, 10,000 square feet, or above 4 stories in C-1 districts. These developments are in the planning stage. It will be some time before we see if any of these developments will move forward and obtain building permits.

San Francisco 2023 Rate Reduction

San Francisco implemented a temporary rate reduction in 2023. Prior to the rate reduction, San Francisco required 15-24% of units to be set aside as affordable, depending on project size and tenure (there were also options for off-site provision of units and payments-in-lieu). The rate was lowered to 12% for projects that had been approved before 2023 but were stalled, and 15% for new projects. Projects that had already been approved were given until 2029 to obtain a building permit under the 12% requirement. New projects under the 15% requirement have until 2026 to get building permits. The policy will be reassessed next year.

Staff discussed the outcomes of the rate reduction with city staff in San Francisco. The key takeaway was that despite lowering requirements for developers, San Francisco has not seen a significant increase in multifamily housing starts since enactment. This is likely due to larger market conditions – interest rates and construction costs – and the fact that the policy allows developers to keep the reduced requirements until 2026 or 2029, which has allowed developers to obtain permitting approvals and then wait for potential improvements to market conditions. Developers in San Francisco also benefit from California's density bonus law that overrides local zoning to allow a 50% density bonus to projects that set aside 15% of units as affordable. A recent change now allows some inclusionary housing units to qualify for this bonus. That bonus seems to have had a more significant impact on advancing stalled developments.

B. Initial Report - other policy options to unlock housing production

Staff have begun to assemble and discuss other ideas that could assist in making new residential development more feasible in the current market. We are sharing some initial information here. More discussion and analysis from several departments is needed and we will provide more detail and analysis on these ideas and others we identify in a later report.

Tax Incentives

Cities around the country have used tax abatements and rebates to stimulate housing production. In Massachusetts, state law governs tax incentive options available to cities. We are exploring available options and requirements to take advantage of them. Tax incentives may require approval from the state, and some require districts to be established or only offer limited short-term tax incentives which may be less impactful. Tax incentive policies that are broadly available

and impactful might require home rule legislation, however there may be circumstances where it would be possible to assist developments that meet specific criteria. Tax incentives would lower operating costs, increasing operating income and improving investment returns to help projects that would otherwise not move forward to be constructed. In those cases, the tax increment would not have been received if the tax-assisted developments are not built. The length of the incentive would need to be studied to determine what the maximum benefit could be as Cambridge's low residential tax rate limits the amount of tax incentive that the city can provide. Providing tax relief to new multifamily developments may also require shifting costs for City services associated with new buildings onto other property owners in a way that would have to be considered. Tax incentives are a new approach which will require more analysis and discussion. We are aware that Boston has begun to use tax incentives as a tool to help with new development and are reviewing their approaches to see how we might use a similar model. We will provide more details in a follow-up report.

Funding Inclusionary Housing

City funding for affordable housing has traditionally been used to preserve and create deeply affordable housing in fully affordable buildings. We are reviewing whether it could be possible to fund inclusionary housing units in mixed-income buildings. As we look at options for this, we will consult the Affordable Housing Trust which administers City funding for affordable housing. If possible, and if funded through the Trust, developers would have to request funds from the Trust for each new inclusionary building in a discretionary process which would add time and potential cost to the developments. There could also be some uncertainty for developers who may be competing with requests from affordable housing providers which typically leverage other available public and private funding for affordable housing to lower the need for Trust funds. If there were a significant number of inclusionary developments seeking funding from the City or Trust it might also impact the City's ability to fund the pipeline of all-affordable housing development and preservation projects, including deeply affordable and/or service-enriched housing. We are continuing to explore if this is possible and advisable and will provide more information in a follow-up report.

Capital Funding for Housing Production

The City could look at whether it is feasible to create a revolving loan or equity fund to help close the financing gap on multifamily residential projects. Unlike tax abatements that subsidize projects on the operating side, providing financing up front could ease the difficulty developers are

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Cambridge, MA 02139

617-349-4600
cddat344@cambridgema.gov

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having putting together debt financing and equity investment needed to build in this high-interest rate environment. Rather than direct subsidy, City support could be structured as below-market-rate-interest, short-term loan or as preferred equity with a below market return.

We are continuing to explore if this is possible and how it could be done. One local example of a city doing this is the Boston Housing Accelerator Fund, a partnership between the City of Boston and MassHousing to which Boston has invested $110 million to finance private multifamily development that includes inclusionary units. Staff will continue to explore and analyze ways in which capital investment from the City might assist with new residential development and provide more information in a follow-up report.

Exempting Multifamily Projects from Building Permit Fees

Building permit fees are a smaller but still significant cost for multifamily developers. Multifamily projects pay a fee of $20 for every $1,000 of estimated construction cost. Reducing building permit costs could also assist with making new development more financially feasible.

We will continue to explore these strategies and continue to look for others which individually or through a combined approach may provide a balanced set of new incentives to encourage new residential development.

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