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Barney S. Heath
Director

MEMORANDUM

DATE: March 8, 2019

TO: Councilor Albright, Chair
Members of the Zoning and Planning Committee

FROM: Barney S. Heath, Director of Planning and Development
James Freas, Deputy Director of Planning and Development
Amanda Berman, Director of Housing & Community Development
Jennifer Caira, Chief Planner

RE: **#187-18** DIRECTOR OF PLANNING requesting amendments to the Inclusionary Housing provisions of Chapter 30, Newton Zoning Ordinance, to increase the required percentage of affordable units; to require that some affordable units be designated for middle income households; to create a new formula for calculating payments in lieu of affordable units; and to clarify and improve the ordinance with other changes as necessary.

MEETING DATE: March 11, 2019

CC: Jonathan Yeo, Chief Operating Officer
Jonah Temple, Assistant City Solicitor
Planning & Development Board
City Council

Over the last year and a half, staff has been working closely with your committee to update the City's Inclusionary Zoning ordinance to better respond to today's housing market. The Financial Feasibility Analysis Report and excel model that RKG Associates created for the City in early 2018 have been critical pieces of this update process. Staff's current proposal is closely tied to the model and the assumptions presented throughout the RKG report.

Throughout the fall and winter of 2018, however, a number of housing advocates and committee members raised questions and concerns around the current proposal and some of these

assumptions. In an effort to address these questions in a meaningful way, staff felt that a productive next step would be to re-engage RKG and bring the advocates around the table to talk through these individual issues in greater detail.

On February 19th, staff from the Planning and Law Departments joined Kyle Talente and Jahangir Akbar of RKG Associates and twelve affordable housing advocates for a two-hour roundtable discussion about the proposed Inclusionary Zoning ordinance. As defined upfront, the purpose of the meeting was to explore the advocates’ questions and concerns relative to the current IZ proposal, specifically as they related to RKG’s Financial Feasibility Analysis and Model, and to identify points of agreement and disagreement.

While detailed notes from this meeting are attached as an appendix to this memo along with a response memo from RKG, the main takeaways from this roundtable discussion, as agreed upon by the housing advocates, include the following:

➤ **Don’t reduce the existing IZ requirement at the Tier 1 and Tier 2 levels**

There was a strong desire on the part of the advocates to keep the current inclusionary zoning requirement at 15%, and to add on to that existing requirement a middle income requirement of up to 110% AMI so as not to decrease the IZ requirements of lower income levels at 50% and 80% AMI respectively. This current inclusionary zoning requirement mandates that rental projects with two or more IZ units requires an eligibility average of no more than 65% AMI, with half of the units provided at 50% AMI and the remaining half at 80% AMI. Where only one IZ rental unit is required in a project, it shall be made eligible at 80% AMI. The current requirement for ownership projects requires that projects with 3 or fewer IZ units be eligible to households at 80% AMI.

Below is a table that represents the Staff’s 2018 proposed IZ requirement.

Number of Inclusionary Units Required (2018 Staff Proposal)												
Tier Level	7-9 units		10-20 units		21-34 units		35-64 units		65-100 units		101+ units	
	Rental	Owner	Rental	Owner	Rental	Owner	Rental	Owner	Rental	Owner	Rental	Owner
Tier 1, up to 50% AMI	0.0%	0.0%	0.0%	0.0%	5.0%	0.0%	0.0%	0.0%	2.5%	0.0%	2.5%	0.0%
Tier 2, 51%-80% AMI	15.0%	15.0%	17.5%	5.0%	7.5%	10.0%	2.5%	7.5%	10.0%	10.0%	12.5%	12.5%
Tier 3, 81%-110% AMI	0.0%	0.0%	0.0%	10.0%	5.0%	7.5%	15.0%	10.0%	5.0%	7.5%	2.5%	5.0%
Total	15.0%	15.0%	17.5%	15.0%	17.5%	17.5%	17.5%	17.5%	17.5%	17.5%	17.5%	17.5%

➤ **Let's push the market in an effort to increase the number of affordable units required per project**

A large portion of the discussion focused on inclusionary zoning's connection to land values, and why this is important. Kyle Talente from RKG stressed that a significant increase in the IZ requirement would likely decrease the value of land in Newton, at least for an unforeseeable amount of time, thereby potentially chilling residential development throughout the city. There was consensus amongst the housing advocate group, however, that pushing the market in this way would not be a bad thing, if it results in a greater number of affordable units for each project.

A more detailed discussion on the topic of land values and increased affordability requirements can be found in the attached memo from RKG Associates, which is in response to the questions and requests for clarification generated from the roundtable discussion.

➤ **DHCD's QAP Index of \$389,000 should not be used as the basis for the cash payment and fractional cash payment calculations**

The advocates felt strongly that this number was too low for Newton and did not result in a fair trade in terms of providing a cash payment in lieu of building an inclusionary unit on-site. There was agreement amongst the advocates that the cash payment should more closely resemble the cost of building an actual unit of housing in Newton, and that \$389,000 is not that number.

Staff agreed that it would continue to explore alternative options for calculating the payment-in-lieu and fractional cash payments to better address the concerns of the group.

Next Steps:

Over the next few weeks, staff will continue to consider and respond to the ideas and recommendations that came out of the roundtable discussion with the housing advocates, as well as the additional comments and questions that were raised throughout the fall and winter. We are currently putting together a comparison table that details the differences between our proposed ordinance and the IZ policies of neighboring communities such as Cambridge and Somerville. At the same time, we are further exploring the Elder Housing with Services provision based on detailed comments provided during the Public Hearing process, as well as an alternative compliance option for projects that include units and supportive services for households at or below 30% of AMI.

Key to our work over the next month will be individual meetings and discussions with for-profit developers in Newton to better understand any questions and concerns they may have about our current proposal and the new ideas that came from the roundtable discussion with the housing

advocates. We look forward to providing you with a summary of these discussions at a meeting in early April.

Also in April, we hope to present some initial changes to our current proposal, which will be reflective of the feedback received from the housing advocates and for-profit developers.

Our goal is to present the committee with a new proposed ordinance in May. We are confident that we will deliver a stronger and more effective policy because of these months of continued conversation and thought.

Printed Attachments:

- RKG Memo Re: IZ Roundtable, 3.4.19
- Feb. 19th IZ Roundtable Discussion: Meeting Agenda and Notes

Digital Attachments / Additional Documents:

- Proposed Inclusionary Zoning Ordinance text (clean version), November 9, 2018:
<http://www.newtonma.gov/civicax/filebank/documents/92905>
- Proposed Inclusionary Zoning Ordinance Guidebook (November 9, 2018):
<http://www.newtonma.gov/civicax/filebank/documents/93001>
- City of Newton Inclusionary Zoning: Financial Feasibility Analysis, prepared by RKG Associates, Inc., March 2018 (not attached, but can be found on the City's IZ website:
<http://www.newtonma.gov/civicax/filebank/documents/91410>)
- Further detail and additional memos and supporting documents can be found on the City's Inclusionary Zoning website:
http://www.newtonma.gov/gov/planning/lrplan/inclusionary_zoning.asp

03.4.2019

Memo Regarding the IZ Policy Roundtable

To:

Barney Heath,
City of Newton
Planning & Development
Director; James Freas,
Deputy Director; Amanda
Berman, Director of
Housing & Community
Development

From:

Kyle Talente,
RKG Associates, Inc.
Vice President & Principal

Re:

Response Summary: IZ
Roundtable with Housing
Advocates, Feb. 19, 2019

On Tuesday, February 19, 2019, RKG Associates (RKG) joined staff from the City of Newton's Planning & Development Department and a number of housing advocates from the city to discuss the proposed Inclusionary Zoning ordinance and the financial feasibility analysis and model that RKG developed for the City in 2018. The purpose of this roundtable was to dive further into the questions and concerns raised by the advocates about the current proposal, specifically as they relate to RKG's financial feasibility analysis and model, and to discuss possible solutions for overcoming these concerns.

At the request of the City of Newton's Planning & Development Department, RKG is providing a response to questions/requests for clarification generated from this meeting. Please let me know if RKG can be of further assistance to the City as it considers changes to the Inclusionary Zoning policy.

Q: What is the IZ policy's connection to land values in Newton, and why does that matter?

While often a point of public debate, real estate development is a for-profit business. Developer/investors acquire land with the intent to build (or redevelop) the property into a land use that will generate a market-acceptable rate of return (defined by the marketplace). Several factors within the real estate development process are established by the local supply and demand equilibrium. These include the price of materials to build (i.e. the price of a brick), the cost to prepare the land for development (i.e. grading), and the income potential (whether potential rent levels or sale prices) of the new development. In other words, these revenue and expenditure factors are pegged to basic economics. The main 'variable' in the cost/revenue paradigm that a developer has some greater degree of control over is the price they are willing to pay for the land.

Changes in regulation can benefit or adversely impact the value of land (reflected in the price a developer is willing to pay for the land), depending on whether those regulations increase revenue potential (i.e. more density) or create greater cost burdens (i.e. requiring higher-cost building materials). Because most factors are fixed to the larger marketplace, developers/investors will adjust their price offers for the land accordingly.

Newton's Inclusionary Zoning policy reduces the income potential of residential development by placing price restrictions on some of the units being constructed (the required affordable units). Current market value levels for land in the City have normalized to the existing policy, as it was implemented over fifteen years ago. Any considerations to change the IZ policy could cause land to increase in value (i.e. if the City were to reduce unit/subsidy requirements) or decrease in value (i.e. if the City were to increase unit/subsidy requirements).

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Making a change to the policy that will substantially reduce revenue potential most likely will reduce land values in the City. If the reduction reaches levels considered too burdensome for developers/land owners, development could be disrupted for a period of time. The greater the impact, the more likely that disruption will last longer.

Given the paradigm described above, a change in the IZ policy that reduces potential revenue, thereby lowering the price a developer would potentially offer for land, means that the cost of the policy is carried more by the existing landowners than by developers. For developers, the cost is essentially just an additional item to be calculated into the project pro forma prior to purchasing the land. However, for the landowner, the cost represents a lower land value, effectively acting as a tax on land.

The potential chilling effect on development comes when landowners become unwilling to accept a lower price for their land and refuse to sell, holding out for some potential future increase in value. This same paradigm is in effect related to all requirements placed on development, not just IZ ordinances, and they act cumulatively.

Again, the greater the negative impact on land values, the more likely that disruption in residential development will last longer. In terms of inclusionary zoning, a slowdown in market-rate development also equals a slowdown in the creation of affordable units throughout the city.

Q: What is a “reasonable” amount to push to add in the middle-income units on top of the existing policy? Is it 2.5%? Is it 5%?

This is a hard question to answer. Our research shows that adding a 2.5% increase in inclusionary units at 110% **on top** of the City’s existing policy (7.5% requirement at 50% AMI + 7.5% requirement at 80% AMI for rental) could impact land values by as much as 10% for smaller projects (20 or fewer units) to 2% for larger projects (150-250 units). These outcomes are consistent with RKG’s similar efforts in other communities in Massachusetts and throughout the U.S.

LAND VALUE IMPACT FROM EXPANDING CURRENT IZ POLICY

Unit Count	Adding 2.5% at 110% AMI	Adding 5.0% at 110% AMI
20 Units	10.7% Impact	10.7% Impact (no new units)
35 Units	6.1% Impact	6.7% Impact
50 Units	3.4% Impact	5.4% Impact
75 Units	5.6% Impact	7.7% Impact
105 Units	3.5% Impact	4.1% Impact
150 Units	1.9% Impact	4.0% Impact
205 Units	1.9% Impact	3.8% Impact
250 Units	2.6% Impact	4.7% Impact
400 Units	2.7% Impact	4.7% Impact

NB - Assumes no payment for partial units

Is a 10% impact 'reasonable'? Some property owners may be willing to absorb that cost while others may not. To make this impact more relatable to our clients, we ask, "Would you be willing to sell your house tomorrow if it was worth 10% less than it was today without any changes to the structure itself?"

Ultimately, it is a policy decision for the City in terms of how far it wants to push the market.

Q: RKG has said, "The more value you take away from the land, the more you are likely to chill development." But how long does it take to rebound?

It is not possible to determine this answer. It depends on the investment motivation of developers, the unique situation for each parcel of land, and other policy/regulation impacts imposed by the City. Most developers in high-demand communities like Newton know that they will be asked to provide public benefits as part of the entitlement process. Many of these costs are generally known (i.e. the IZ policy) or somewhat predictable (the I&I process). The price a developer is willing to pay for land takes these potential costs into consideration. If the local jurisdiction substantially increases the cumulative cost of these benefits, the market reaction oftentimes is development slowdown (or even stoppage). However, sometimes efficiencies can be found through negotiating other benefits or finding additional sources of funding (i.e. 28 Austin Street's Workforce Housing loan through MassHousing). All that said, it is RKG's understanding that the City's last change to the IZ policy in 2003 likely was a significant contributing factor in decreasing the delivery of units through the IZ policy for close to fifteen years.

Q: Why does the IZ policy model built by RKG appear to present a different scenario than what we are seeing on the ground, a la Washington Place and Austin Street?

It is not possible to create a ‘one-size fits all’ policy in a jurisdiction with such a diverse housing market as Newton. Every location, ownership situation, and project are different; and the developer/land owner will react differently to policy changes like the one that was discussed with the housing advocates at the roundtable (7.5% at 50% of AMI, 7.5% at 80% of AMI, plus 2.5%+ at 110% or 120% of AMI). Our research shows that larger projects can better absorb more affordability requirements because there are more market rate units to spread the impact across. That said, there will always be exceptions to the rules.

RKG Associates is not familiar with the Washington place project per se, so we cannot definitively explain that situation. However, RKG was involved in the market and financial feasibility analysis on behalf of the City when it was considering 28 Austin Street. Our analysis showed the project worked at 25% of affordability at 80% of AMI for two primary reasons. First, the City was selling the land at a cost level below market average, reducing the out-of-pocket costs for the developer. Second, removing the 50% of AMI requirement increased the profitability of those units, which offset some of the cost for the additional units at 80% of AMI.

That said, the final agreement at 33% created a financial hardship for the project that would have made the development financially infeasible, and our analysis proved this. Given this increased requirement, the developer sought public funding through MassHousing’s Workforce Housing Program to ‘fill the gap’ created by that agreement, returning the project to financial feasibility. Ultimately, this was a unique project that does not ‘fit the mold’ of the typical project in Newton.

Q: Why shouldn’t Newton build a policy around these large anomaly projects – what would that mean for smaller, more “typical” projects?

Shouldn’t really is not the correct terminology. We would phrase it as, “What are the risks that Newton may incur by using these anomalous projects to set our overall policy?” **From our perspective, using the top-producing projects that have unusual circumstances to set the City’s policy may have the unintended consequence of making those outliers the only projects able to be built.** We understand how it can be frustrating to set policies to the ‘middle’ projects and not stretch to the edges of the marketplace. However, the City needs to be realistic about where most of its projects will fall within the

development prism. Any community as diverse as Newton that sets a 'one size fits all' policy runs the risk of disrupting all but the prototype project. When this prototype is atypical to the market, it can stifle investment, and in turn, development altogether.

RKG has helped communities create 'sliding scale' policies that set different thresholds for different projects based on the idiosyncrasies of the community. Our work in Somerville helped influence the City to consider different affordability requirements based on the size of the project.

Q: Is the data built into the model outdated at this point? Should we even refer to the model a year after it was originally built?

This was a topic of discussion during the advocate meeting on February 19. A datapoint was thrown out that the model's rent assumptions were not accurate because there was a project developed that had rents at and above \$6,000 a month in Newton. The City inquired to Washington Place following this meeting to understand their expected price points. They reported a target rent rate of \$3.75 per square foot for the project, which is consistent with RKG's estimates used in the IZ model built last year. I bring this example up to highlight that one year likely is not a long enough period to make real estate assumptions invalid. That said, there may be assumptions that are inconsistent with market realities (rent thresholds included) two or three years from now.

Regardless. The model is not intended to test market conditions. It was built to understand the impact of changing the City's IZ policy on the profitability of a project. All variables such as rent thresholds, land cost, development cost, and other community benefit requirements need to be held constant to understand the impact of an IZ change. In other words, the market inputs to the model (i.e. land price, rent level) do not need to be recalibrated often for the model to serve its intended purpose of understanding financial impact of changing the City's IZ policy.

Q: As we re-assess the ordinance every 3-5 years, what indicators should we be looking for to understand what effects there are on the market and what adjustments we should consider?

Simply put, changes in production levels. This means overall production of housing as well as production of units under the IZ policy. Secondary analyses should track land sale activity and sales prices of land (on a per residential unit) basis to see how the policy has (or has not) impacted the marketplace.

It is our understanding that the City's intent of having an IZ policy is to ensure the City retains opportunities for households at different income levels to find quality housing in Newton. If this policy causes development to slow/stop, then it is reasonable to say it has not met its intended purpose.



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Barney S. Heath
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Inclusionary Zoning Roundtable – February 19, 2019
Discussion with Planning Staff, Housing Advocates
and RKG Associates

Meeting Summary: Agenda and Notes

Meeting Purpose:

To explore questions and concerns relative to the current IZ proposal, specifically as they relate to the Financial Feasibility Analysis and Model, and to identify points of agreement or disagreement.

Meeting Objectives / Expected Outcomes:

1. Shared understanding of the guiding objectives staff employed in developing the current IZ proposal so that we can identify the degree to which there are shared objectives within this group.
2. Shared understanding of the Financial Feasibility Model so that we can assess its components and assumptions, as well as understand how this model relates to the standards set within the ordinance.

Meeting Agenda:

1. **Introductions and Review of Meeting Purpose and Objectives** (4:30 – 4:40 pm)
2. **Guiding Objectives for Updated Ordinance** (4:40 – 5:10 pm)
 - a. Planning staff presentation (see next page for list of objectives)
 - b. Discussion
 - c. Areas of agreement and/or disagreement
3. **Financial Feasibility Analysis and Model** (5:10 – 6:15 pm)
 - a. Presentation by Kyle Talente, Vice President and Principal of RKG Associates
 - b. Discussion
4. **Conclusion & Next Steps** (6:15 – 6:30 pm)

Guiding Objectives for Updated Ordinance

Keeping in mind that inclusionary zoning is only one of the resources in the City’s suite of affordable housing tools, staff developed a set of guiding objectives to help us focus the development of this important ordinance. Also critical to defining the objectives of the new ordinance were the key findings identified in the Housing Strategy’s Needs Assessment, including Newton’s shrinking middle-class, its declining population of younger adults and increasing population of seniors, and its lack of affordable housing options for smaller households and residents seeking to downsize.

As such, the guiding objectives that staff utilized to develop the updated Inclusionary Zoning ordinance include the following:

- To more effectively leverage private development for the creation of affordable housing throughout Newton.
- To increase the required percentage of inclusionary units from 15% up to 20%.¹
- To put forth an ordinance that considers the financial feasibility of residential development in Newton and strikes a careful balance between the City’s need for affordable housing and the nuanced economics of housing development.
- To clarify confusion and multiple interpretations around the current ordinance language.
- To introduce a tiered system of affordability requirements, including units designated for middle-income households earning between 81% - 110% AMI, to more specifically target and balance the need for affordable housing across the City’s diverse spectrum of income levels (units for low, moderate, and middle-income households).

¹ Defined as a Priority Action in the City of Newton’s 2016 Housing Strategy.

Meeting Notes

➤ **Discussion of the Guiding Objectives for the Updated Ordinance – Areas of Agreement and/or Disagreement**

- What is the role of the financial feasibility analysis?
- What are the obstacles to the creation of IZ units?
- I would be interested in understanding the history of the ordinance – NHA’s management units through the IZ ordinance? Why this change?
- Feasibility of the ordinance on specific projects?
- 3 units at Auburndale Yards came from IZ funds from NHA
- Don’t lose site of the Special Permit process vs. financial feasibility – the number of City Councilors
- Why 110% AMI vs. 120% AMI?
- In terms of goals of the ordinance - What’s possible? Up to 20% requirement? Don’t set a cap until we know what’s possible
- Very difficult to incorporate very low-income households - we do have this population in Newton – are there alternative ways to serve this population? Can we bolster the use of vouchers in Newton, so we capture more than just a third of Newton voucher holders?
- If we can’t incorporate these units through IZ, where can we create these units?
- Can’t create a subsidy great enough to cover units set at or below 30% AMI
- NHA can project-base units, but their ability to do this is constrained, currently in shortfall, hard to negotiate these contracts
- Strategy – more work to look into how to better use vouchers with this ordinance
 - It is the tool to get us units at or below 50% AMI
 - Time period when developers are required to use this
 - Don’t want to disregard federal / state connection – perpetuity
- Financial feasibility or structuring scenario to attract development – number of market-rate units that are a win-win vs. a few affordable units which are a lose-lose; need to look at who we are serving
- Cross-subsidy from market-rate units – affordable units are part of a package
- Do we have a side-by-side comparison to the other communities – Cambridge, Somerville?
- At the end of the day, it’s a math problem – fewer units at a deeper subsidy vs. more units at a higher income levels / diversity; where to find the balance point?
- 2016 Housing Study – unmet need all the way up to 250% AMI – create a continuum – to grow income vs. dichotomy
- Where are the balance points to minimize disruption to the marketplace – while considering the 5 objectives?
- Risk Return Equation – for developers, doesn’t matter where they develop, as long as they meet their return
- Feasibility is a function of land values – people at some point think about 40B, and we don’t tend to get as many 50% AMI units with 40B
 - 20% at 50% AMI
 - 25% at 80% AMI

- Get as much affordability as we can afford
- 40B is still an option here in Newton
- Taking less money for the land?
- The more value you take away from the land, the more you are willing to chill development
 - But how long does it take to rebound? We can't answer that now
 - Eventually, they will normalize – we have normalized the market through our existing IZ ordinance
- IZ policies affect land values
- Get an analysis from the neighboring communities' IZ policies
- What statement does the City want to make in terms of affecting the market – so far, this ordinance update process has assumed we didn't want to push the market
- What's the tipping point?
- Assumptions vs. real-world
 - Most recent example – Hancock Estates, 2-bedrooms renting for upwards of \$4,000
- The model tries to look at average projects
- The model is geared to measure existing policy vs. proposed policy – the delta between the two
- On goals / objectives of the updated ordinance – idea to push the market a bit – and what percentage of a push?
- We are designing the ordinance for the regular projects, and none of the current big projects are normal, what's going to happen after that?
- Part of what we are trying to accomplish is predictability
- Would it apply to Northland? Only if the proposal passes before they receive their Special Permit
- Other moving parts – the other things the City asks for in terms of mitigation – there are a number of factors
- Revenue – neutral policy
- Every project will come with different nuances
- Predictability at the front-end, but they won't agree to something they can't afford

➤ **Presentation and Discussion: Financial Feasibility Analysis and Model**

- Why was Washington Place able to move forward? Doesn't jive with the model – disconnect between on-the-ground and the model?
- The model takes square footage into account for rental rates
- Developer will not accept less than their required threshold – IRR and NPV
- Is the economy a factor? What will happen two years from now?
- \$4 / sq. ft. – how has it affected Avalon rents?
- Ordinance is static – hard to change
- Distribution of need – delta between current and new in terms of bedroom mix – substantial when you change the bedroom mix
- Have to look at a prototypical approach in your community – there will always be outliers
- How much impact are we willing to have on our current policy?

- Is there a way to assess the impact on land values? Other cities have paced the change over time to mitigate the disruption in the marketplace
- How do we want to buy the affordability as a City?
- Take the risk of chilling the marketplace? This is a legitimate conversation to have as a City
- Relationship of model levels out at 180 units – starts to normalize – where RKG capped when building the model
- The larger the project, easier to absorb changes
- 7.5% at 50% AMI, 7.5% at 80% AMI – if you want more units, and not change anything else, you will negatively impact land values in the City
- Can look for revenue neutral
- Would like to see the model built around Washington Place project
- Create the model to factor in fee-in-lieu?
- Cash component relates to actual cost of building something in town – not a real trade
- QAP – too low for Newton
- Use number to buy down the value in IZ projects
 - Buy some 3-bedrooms
 - Cash equivalent to the “harm” we are doing to you
- Cambridge changes the number of over time – effective at time of application – look at this
- Differential between cost of a unit in a large project versus a smaller project
- Calculation – administratively created?
 - Reasonableness process and how often?
 - Goal is to get the number right
- QAP is a no-go
- Dynamic – how to trade off 50% AMI vs. 80% AMI units
- 7.5% and 7.5% is a good hit – my target is at 50% AMI
- Cambridge buys their affordability – they have a lot more money
- 7.5% and 7.5% is working in Newton’s marketplace – and then layer the middle-income units on top of that
- Use recent projects as an example for building the ordinance, but be careful not to push too hard
- Next steps: March 11th ZAP – re-docket item
- Other pieces: when will these questions / issues be dealt with?