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Barney S. Heath
Director

MEMORANDUM

DATE: September 7, 2018

TO: Councilor Albright, Chairman
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, Housing Development Planner
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: September 12, 2018

CC: Jonathan Yeo, Chief Operating Officer
Ouida Young, Acting City Solicitor
Planning & Development Board
City Council

The purpose of this memo is to detail a number of questions that were raised at the July 16th Zoning & Planning Committee meeting around staff's current Inclusionary Zoning proposal; and to provide a brief answer to each question, along with policy decisions that the Committee should consider as we move forward in the update of this important ordinance.

Along with this memo, staff also created an Inclusionary Zoning Ordinance Guidebook, which clearly explains the many provisions of the proposed updated ordinance and includes relevant examples where applicable.
Additionally, we have provided a clean version of the proposed updated ordinance text for the Committee to review, alongside the Guidebook and this memo.

As always, we look forward to working with ZAP to create an updated ordinance that does not stifle residential development, but rather, strikes a careful balance between the City's vast need for affordable housing and the nuanced economics of housing development.

Questions raised at the July 16, 2018 ZAP Committee meeting:

1. **How would the Inclusionary Zoning requirement for projects subject to this ordinance change if we were to favor Tier 1 units (units affordable to households at or below 50% AMI)?**

To accomplish the goal of favoring Tier 1 units and providing a deeper level of affordability for a project, the overall number of required inclusionary units would be drastically reduced across all three tiers of affordability, and may present a number of scenarios where projects of a certain size and type are not financially feasible.

Policy Decision for ZAP:

Option 1: Favor Tier 1 units
- Results in fewer overall affordable units in a project
- But a deeper level of affordability for the required inclusionary units (units affordable for low-income to moderate-income households)
- Tier 1 units tend to be the hardest to produce, as they require the deepest level of subsidy

Option 2: Provide for a balance amongst all three tiers of affordability
- As demonstrated in staff's current proposal (units for low, moderate, and middle-income households)

Option 3: Favor Tier 3 and Tier 2 units
- Provides for a greater number of required affordable units in a project, but at a higher level of affordability (moderate to middle-income versus low-income)

2. **<u>How would the Inclusionary Zoning requirement change if we reduced the parking ratio from 1.25 to 1?</u>**

By reducing the parking requirements for a project, the developer realizes a cost savings in that area and, therefore, might have greater flexibility to increase the number of inclusionary units in that project across all three tiers of affordability.

It is important to note, however, that the Financial Analysis model developed by RKG is based on the City's current parking requirements and reflects the current development landscape throughout Newton. The model scenario that utilizes a parking ratio of 1 is a hypothetical, assuming that parking requirements across the city would change in the near future, or that the City Council will provide a greater level of parking relief than what is allowed by Special Permit.

<u>Policy Decision for ZAP:</u>

<u>Option 1:</u> Develop the Number of Inclusionary Units Required Table based on the current parking requirements and development landscape

- Results in fewer overall affordable units in a project due to the higher costs of construction associated with providing greater parking spaces per unit
- Reflects a realistic view of the current development landscape and permitting realities of Newton today

<u>Option 2:</u> Develop the Number of Inclusionary Units Required Table based on an assumed lower future parking requirement and development landscape

- Will potentially yield a greater number of affordable units
- But many unknowns in terms of the development review process and future parking requirement amendments, thus risking a higher level of project infeasibility

3. **<u>What are the trade-offs associated with requiring the inclusion of affordable beds in an "Elder Housing with Services" project, versus requiring a fee-in-lieu to meet the Inclusionary Zoning requirement?</u>**

As detailed in staff's July 2018 memo to ZAP regarding the Inclusionary Zoning update, Newton is not alone in struggling to design an inclusionary policy that successfully considers the complicated nature of the pricing strategy for projects of this type. The "housing" costs are only part of the equation; the real challenge comes in trying to define how the medical costs for a household offered an inclusionary bed would be determined. No clear best practices exist to assist staff in crafting a proposal that works for both the developer and the households eligible for the inclusionary beds.

<u>Policy Decision for ZAP:</u>

<u>Option 1:</u> Require projects of this type of provide affordable beds on site

- While this model would add to the City's stock of affordable beds in projects of this type, staff remains concerned about the possibility of a low to moderate-income

tenant being priced out of a facility due to the potential of rising medical costs as they age.
- Potentially, not a long-term housing solution for the low to moderate-income tenants who are offered a bed in these facilities

Option 2: Require projects of this type to provide a cash payment to the City's Inclusionary Zoning Fund, rather than provide the beds on site
- This option works to strike a balance between the need to receive a critical contribution from projects of this type with the ability for the City to fund housing projects that provide a more stable and long-term subsidy for more income-eligible seniors

4. How would the Inclusionary Zoning requirement change if we required a project to build the required number of inclusionary units *and* provide a cash payment for all fractional requirements under 0.5?

While the fractional payment methodology proposed by staff in 2017 may result in a project delivering both inclusionary units and a cash payment to the City, many of the scenarios run utilizing RKG's model result in a financially infeasible project due to the large fractional payment required per the proposed calculation. As discussed in the RKG report, the fractional cash payment is added to the initial cost of the development, which ultimately influences the project's overall financial return. The fractional cash payment, coupled with the value loss from providing affordable units on site, erodes the developers financial return to the point of not moving forward with a project.

The RKG model, however, does not allow staff to run the scenario where a project would be required to build the required number of inclusionary units and provide a cash payment for all fractional requirements that are *only* under 0.5. The model that the consultant developed calculates the required fractional cash payment regardless of whether the fraction is less than or greater than 0.5.

The Cash Payment Calculation proposed in 2017, and which was used to develop the RKG financial analysis model, is as follows:

Inclusionary Housing Cash Payment Calculation:	
A = # of new dwelling units X IZ % Requirement (per Required Units Table)	X
Multiplied by	
B = 2017 DHCD Total Residential Dev. Costs Index (avg. of large & small unit projects)	$389,000
Total Cash Payment Due for Project	Equals A X B

And below is an example of how this calculation would be used to determine a project's IZ requirement, including any fractional cash payments (based on staff's 2017 proposed IZ requirements):

Example:

- The Inclusionary Zoning / Cash Payment requirement for a rental Inclusionary Housing Project that contains a net increase of **48 new dwelling units** would be calculated as follows:

A: Tier 1: 48 X 5% = 2.4, so the fractional requirement would be 0.4
Tier 2: 48 X 10% = 4.8, so the fractional requirement would be 0.8
Tier 3: 48 X 10% = 4.8, so the fractional requirement would be 0.8

Multiplied By

B: $389,000

= Total IZ / Cash Payment Requirement for Project =

Tier 1: 2 Inclusionary Units *plus* a Cash Payment of $155,600
Tier 2: 4 Inclusionary Units *plus* a Cash Payment of $311,200
Tier 3: 4 Inclusionary Units *plus* a Cash Payment of $311,200
Which equals a total of 10 Inclusionary Units plus a Cash Payment of $778,000

Understanding that the fractional cash payment methodology proposed by staff in 2017 offers the City the potential to receive funds for its Inclusionary Zoning Fund, which will be targeted for the creation and preservation of deed-restricted Tier 1 units (at or below 50% AMI), perhaps a more economically feasible requirement for developers would be to utilize a much lower base number for the fractional cash payment calculation, such as $20,000 per point, per tier (5% of the original base number of $389,000), up to a maximum fractional cash payment per project of $160,000; and only require a fractional cash payment where the IZ requirement falls below 0.5

Below is an example of how this calculation would be utilized, based on staff's current IZ requirement proposal:

Example:

- The Inclusionary Zoning / Cash Payment requirement for a rental Inclusionary Housing Project that contains a net increase of **48 new dwelling units** would be calculated as follows:

A: Tier 1: 48 X 0% = 0
Tier 2: 48 X 2.5% = 1.2, so the fractional requirement would be 0.2 (2 X $20,000 = $40,000)
Tier 3: 48 X 15% = 7.2, so the fractional requirement would be 0.2 (2 X $20,000 = $40,000)

= Total IZ / Cash Payment Requirement for Project =

Tier 1: 0 Inclusionary Units
Tier 2: 1 Inclusionary Unit *plus* a Cash Payment of $40,000
Tier 3: 7 Inclusionary Units *plus* a Cash Payment of $40,000
Which equals a total of 8 Inclusionary Units plus a total Cash Payment of $80,000

Policy Decision for ZAP:

Option 1: Institute the Round-Up and Build Units methodology (as detailed in staff's current IZ proposal), rather than incorporating a fractional payments requirement in addition to the building of units

- Favors the building of units, rather than the receipt of cash payments
- A more economically feasible option for developers, which may result in the creation of more affordable units throughout Newton

Option 2: Institute an amended version of the Build Units + Fractional Cash Payments methodology, as described above

- Results in projects delivering both inclusionary units and cash payments to the City for the purpose of creating and preserving more affordable units at the lowest tier of affordability
- Addition of fractional cash payments, while at a much-reduced level, may still affect the project's bottom line to the point of a developer not moving forward with a project

5. **How effective has our existing Inclusionary Zoning ordinance been over the past ten or so years?**

The current version of the Inclusionary Zoning ordinance took effect on April 22, 2003. Since that time, building permits have been issued for approximately 117 affordable units restricted to households earning at or below 80% of the Area Median Income (AMI). Of those 117 units, 14 units were required as a result of the Inclusionary Zoning Ordinance, and the remaining 103 affordable units were approved through the 40B Comprehensive Permit process. Additionally, four projects received Special Permit approval to pay a fee-in-lieu of providing the units on site. Information is unavailable for two of those projects, but the remaining two projects paid fees of $36,000 and $186,000, in lieu of providing one affordable unit each.

While only 14 affordable units have been constructed as a result of the Inclusionary Zoning ordinance since 2003, **240 more affordable units** are either under construction, permitted, or are in the process of receiving approval from the City Council.

Currently, there are a **total of 90 deed-restricted affordable units** under construction in Newton, connected to projects that received a Special Permit and were subject to the City's Inclusionary Zoning ordinance (57 units at or below 80% AMI, Tier 1 and Tier 2 units; and 33 middle-income units, Tier 3 units). It is important to note, however, that the 33 middle-income units were not required per the Inclusionary Zoning ordinance, as our current ordinance does not require those units.

There are an additional **25 deed-restricted affordable units** (at or below 80% AMI) connected to projects that have received a Special Permit, but have yet to begin construction; and another **125 deed-restricted affordable units** (at or below 89% AMI) connected to projects that have submitted a formal application to the City, but have yet to receive a Special Permit.

While it is not fully understood why there was such limited multifamily construction through the Special Permit process over the last fifteen years, staff hypothesizes that the City's development review process, coupled with an aggressive jump from a 10% to 15% IZ requirement created an environment where developers saw the Chapter 40B Comprehensive Permit process as a less expensive and more predictable path towards project approval. Additionally, there is no doubt that the housing recession played a major role in stifling multifamily development in Newton. Staff believes that post-recession, the market may have finally adjusted to the City's 15% IZ requirement, which may be one reason we are now seeing much greater Special Permit / multifamily activity throughout Newton.

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Barney S. Heath
Director

City of Newton
Inclusionary Zoning Ordinance Guidebook
(as of staff's most current IZ proposal)

1) What is Inclusionary Zoning?

Inclusionary Zoning is a popular tool used by local governments across the country to leverage private development for the creation of affordable housing. While ordinances take many forms, a common structure is to require a percentage of units in a private development be rented or sold at affordable levels to low- and moderate-income households (usually households at or below 80% of the Area Median Income, AMI).

2) When is a project subject to the Inclusionary Zoning ordinance provisions?

All residential and mixed-use developments that contain 7 or more new residential units are subject to the City's IZ provisions, regardless of the necessary approval process for that project. Existing residential units that are proposed to be demolished as part of a development shall not be counted as existing units.

Example:

- A developer proposes to build a large multifamily development on two contiguous parcels. The project contains a total of 20 new units, in four different buildings. There is an existing four-family building on one of the parcels, which the developer plans to demolish. This proposed development would be subject to the Inclusionary Zoning ordinance, based off a total of 20 new units.

- A developer proposes to build a small multifamily development, containing a total of 7 new units in two different buildings. There is an existing two-family building on site, which the developer plans to demolish. This proposed development would be subject to the Inclusionary Zoning ordinance, based off a total of 7 new units.

3) What is the Inclusionary Zoning requirement for projects subject to this ordinance?

The Inclusionary Zoning requirement is based on the total number of new units proposed for a development and whether it is a rental or ownership project. The percentage of required inclusionary units to be built on site is divided into three affordability tiers: Tier 1 are units affordable to households with annual gross incomes at or below 50% of the area median income (AMI); Tier 2 are units affordable to households with annual gross incomes greater than 50% AMI, but at or below 80% AMI; and Tier 3 are units affordable to households with annual gross incomes greater than 80% AMI, but at or below 110% AMI (middle-income units).

Where the IZ requirement results in a fraction of a unit greater than or equal to 0.5, the developer must build one inclusionary unit to capture that fraction.

Tier 1 and Tier 2 inclusionary units must be qualified as 'Local Action Units' pursuant to the requirements of the Comprehensive Permit Guidelines of the DHCD and, therefore, must be SHI-eligible units. All projects subject to the Inclusionary Zoning requirements must enter in an affordable housing deed restriction with the City, and in most cases, a Regulatory Agreement between the City, DHCD (or relevant Subsidizing Agency) and the developer. These affordable housing covenants must be recorded in the Registry of Deeds and will endure for the life of the residential development.

The percentage requirement for applicable developments is based on the following table:

Number of Inclusionary Units Required: 2018 Proposal												
Tier Level	7-9 new units		10-20 new units		21-34 new units		35-64 new units		65-100 new units		101+ new 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%***

Number of Inclusionary Units Required: 2018 Proposal Examples												
Tier Level	7 new units		16 new units		24 new units		47 new units		78 new units		225 new units	
	Rental	Owner	Rental	Owner	Rental	Owner	Rental	Owner	Rental	Owner	Rental	Owner
Tier 1, up to 50% AMI	0	0	0	0	1	0	0	0	2	0	6	0
Tier 2, 51%-80% AMI	1	1	3	1	2	2	1	4	8	8	28	28
Tier 3, 81%-110% AMI	0	0	0	2	1	2	7	5	4	6	6	11
Total	***1***	***1***	***3***	***2***	***4***	***4***	***8***	***8***	***14***	***14***	***39***	***39***

Examples:

- A developer proposes to build a multifamily rental development, containing a total of 31 new units. The IZ requirement for the development would be as follows:
  - 5% at Tier 1 = 1.55; a total of *2 units at Tier 1*
  - 7.5% at Tier 2 = 2.325; a total of *2 units at Tier 2*
  - 5% at Tier 3 = 1.55; a total of *2 units at Tier 3*
  - Total IZ Requirement: *6 inclusionary units on site*

- A developer proposes to build a multifamily ownership development, containing a total of 16 new units. The IZ requirement for the development would be as follows:
  - 0% at Tier 1 = 0; a total of *0 units at Tier 1*
  - 5% at Tier 2 = 0.8; a total of *1 unit at Tier 2*
  - 10% at Tier 3 = 1.6; a total of *2 units at Tier 3*
  - Total IZ Requirement: *3 inclusionary units on site*

4) What is the "Area Median Income" in Newton and what does 50% AMI, 80% AMI, and 110% AMI mean?

Area Median Income, or ***"AMI"*** as it is referred to regularly, is the median family income, adjusted for household size, within a given metropolitan or non-metropolitan area, updated annually by the U.S. Department of Housing and Urban Development (HUD) and used to determine eligibility for most housing assistance programs.

For Newton, the HUD Area Median Family Income (HAMFI) is based on the Boston-Cambridge-Quincy, MA-NH HUD Metro FMR (Fair Market Rent) Area Median income:

- ***$107,800,*** or 100% AMI for a family or household of 4 persons, as detailed below in the FY 2018 Income Limits Summary Table for Newton, MA[1]

50% AMI refers to a Low-Income Household whose annual gross income is at or below 50% of the area median income. In Newton, a household with 3 persons with an annual gross income at or below $48,550 would be eligible for a housing unit designated at 50% AMI, as detailed in the table below.

80% AMI refers to a Moderate-Income Household whose annual gross income is greater than 50% AMI, but at or below 80% of the area median income (also referred to as 51%-80% AMI). In Newton, a household with 5 persons with an annual gross income at or below $87,600 would be eligible for a housing unit designated at 80% AMI.

110% AMI refers to a Middle-Income Household whose annual gross income is greater than 80% AMI, but at or below 110% of the area median income (also referred to as 81%-110% AMI). In Newton, a household with 4 persons with an annual gross income at or below $118,580 would be eligible for a housing unit designated at 110% AMI.

At times, these middle-income units are also referred to as Workforce Housing. HUD defines Workforce Housing as housing affordable to households earning between 80% and 120% AMI. The Massachusetts Housing Finance Agency (MassHousing), however, defines Workforce Housing as units affordable to households with incomes greater than 60% AMI and up to 120% AMI.

FY 2018 Income Limits Summary - Newton, MA						
Income Level	Household Size					
	1	2	3	4	5	6
50% AMI	$37,750	$43,150	$48,550	$53,900	$58,250	$62,550
80% AMI	$56,800	$64,900	$73,000	$81,100	$87,600	$94,100
100% AMI	$75,500	$86,300	$97,100	$107,800	$116,500	$125,100
110% AMI	$83,050	$94,930	$106,810	$118,580	$128,150	$137,610

[1] FY 2018 Income Limits Documentation System, Newton City FY 2018 Income Limits Summary: https://www.huduser.gov/portal/datasets/il/il2018/2018summary.odn

5) When is a project that is subject to the Inclusionary Zoning ordinance allowed to make a cash payment to the City in lieu of building inclusionary units on site?

Developments with 7-9 new units may choose to make a cash payment to the City in lieu of building the inclusionary units on site, without receiving permission from the City Council through the Special Permit process.

For projects that fall outside of the 7-9 new units category, payments-in-lieu are only allowed through the Special Permit process where the City Council makes specific findings to an "unusual net benefit to allowing a fee rather than the inclusionary units."

6) How are cash payments determined for projects that are allowed or receive permission to make such payments to the City?

The total cash payment is determined by utilizing the most current Massachusetts Department of Housing and Community Development's (DHCD) Qualified Allocation Plan's (QAP) "Total Residential Development Cost Limits" Index:[2]

- ***$389,000*** (2018-2019 QAP): the average of the "Small Units" index ($379,000) and "Large Units" index ($399,000) for Production Projects in Newton, which falls within the Urban Area of Metro Boston category of the QAP

These Total Residential Development Cost Limits are published annually through the Commonwealth of Massachusetts Department of Housing and Community Development's Low Income Housing Tax Credit Program Qualified Allocation Plan.[3] The cost limits reflect project type and location and are based on the Massachusetts Housing Partnership's (MHP) extensive research on behalf of DHCD.[4]

For projects with 7-9 new units, the total cash payment is determined by utilizing $389,000 as the basis for the calculation. The payment is then adjusted for the number of new units in the project, at a decreasing percentage.

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[2] From the Commonwealth of Massachusetts Department of Housing and Community Development's Low Income Housing Tax Credit Program 2018-2019 Qualified Allocation Plan, Appendix C, https://www.mass.gov/files/documents/2018/04/26/20182019QAP.pdf

[3] DHCD is the Massachusetts allocating agency for the Low Income Housing Tax Credit (LIHTC) program, which has helped support the production or preservation of over 67,000 affordable multifamily rental units since the program's beginnings in 1987. Each year, the state allocating agency for the Low Income Housing Tax Credit is required to publish a plan describing how it intends to award the credit, including selection criteria for projects receiving tax credit allocations.

[4] To develop these cost limits, MHP researched the costs of hundreds of rental projects over a four-year timeframe in DHCD's and MHP's portfolio, and assessed multiple variables, including the cost of production versus preservation; family housing versus senior housing or special needs housing; regional variations in cost; and variations based on construction type. The cost limits, first introduced into DHCD's 2017 tax credit QAP, apply to all rental housing funded by the Massachusetts public lenders. The cost limits are to be reviewed annually and will be part of the Massachusetts public lenders' ongoing efforts to manage costs.

Examples:

- 7-unit project: 70% of $389,000 = *$272,300 total cash payment*
- 8-unit project: 80% of $389,000 = *$311,200 total cash payment*
- 9-unit project: 90% of $389,000 = *$350,100 total cash payment*

For projects with 10 or more new units, which have received permission from the City Council to make a cash payment to the City in lieu of building the inclusionary units requirement on site, the total cash payment is determined by utilizing $389,000 per unit as the basis for the calculation. The payment is then adjusted based on the percentage requirement for a project of that size and type (rental versus ownership).

Examples:

- 18-unit rental project
  - 17.5% IZ requirement: 0.175 X 18 units = 3.15
  - 3.15 X $389,000 = *$1,225,350 total cash payment*

- 36-unit ownership project
  - 17.5% IZ requirement: 0.175 X 36 units = 6.3
  - 6.3 X $389,000 = *$2,450,700 total cash payment*

- 88-unit rental project
  - 17.5% IZ requirement: 0.175 X 88 units = 15.4
  - 15.4 X $389,000 = *$5,990,600 total cash payment*

7) Are projects that consist of 100% deed-restricted affordable units subject to the Inclusionary Zoning ordinance provisions?

The short answer is no. Such projects are not required to comply with the prescribed percentage requirements per income level, as detailed in Section 5.11.4.B. of the ordinance – "Number of Inclusionary Units Required." However, projects that are 100% deed-restricted affordable are still subject to all other sections of the ordinance. For instance, such projects are required to submit an Inclusionary Housing Plan and an Affirmative Fair Housing Marketing and Resident Selection Plan for review and approval by the Director of Planning and Development, and are subject to a Regulatory Agreement and Use Restrictions, which shall endure for the life of the development, and shall be recorded at the Registry of Deeds.

Examples:

- 35-unit rental project at 100% Tier 3 (81%-110% AMI)
  - This project would not be required to provide any units at Tier 1 or Tier 2

- 75-unit rental project at 85% Tier 3 and 15% Tier 2
  - This project would not be required to provide any units at Tier 1

8) Are "Elder Housing with Services" projects subject to the Inclusionary Zoning ordinance provisions?

Yes. However, such projects fall slightly outside of the Inclusionary Zoning requirements associated with all other residential and mixed-used developments that are subject to the provisions of the IZ ordinance.

The Inclusionary Zoning ordinance defines this type of project as housing with services designed primarily for elders, such as residential care, continuing care retirement communities, assisted living, independent living, and congregate care. The ordinance does not apply to nursing homes subject to regulations by the state of Massachusetts Department of Public Health. Nor does the ordinance apply to Elder Housing with Services projects that are 100% deed-restricted, affordable.

Under the Inclusionary Zoning ordinance, 5% of the total number of beds provided as part of an Elder Housing with Services project must be affordable for seniors age 62 or older whose annual gross incomes are at or below 80% AMI. Where the IZ requirement results in a fraction of a unit greater than or equal to 0.5, the developer must provide one inclusionary bed to capture that fraction.

Inclusionary beds may be located in single-occupancy rooms or in shared rooms; must be proportionately distributed throughout a project; and must be indistinguishable from the market-rate beds.

The total monthly housing costs, inclusive of base services, must not exceed 80% of the eligible senior's annual gross income. The services provided to these residents must be comparable to the base services offered to all residents, regardless of income status, and may include long-term health care, nursing care, home health care, personal care, meals, transportation, convenience services, and social, cultural and educational programs.

Alternatively, Elder Housing with Services projects may choose to meet their Inclusionary Zoning requirement through a payment-in-lieu, without receiving permission from the City Council through the Special Permit process. The total cash payment for projects of this type is determined by utilizing DHCD's Qualified Allocation Plan Index for "Single Room Occupancy / Group Homes / Assisted Living / Small Unit Supportive Housing" of $259,000, coupled with the calculation of 5% of the total number of beds provided in the project.

Examples:

- 115-bed assisted living project:
    - 5% requirement X 115 = 5.75; therefore, *6 inclusionary beds are required on site*
    - If this project were to choose to provide the City with a cash payment, rather than provide the beds on site, the total cash payment would equal:
        - 5.75 X $259,000 = *$1,489,250 total cash payment*

- 85-bed continuing care retirement community:
    - 5% requirement X 85 = 4.25; therefore, *4 inclusionary beds are required on site*
    - If this project were to choose to provide the City with a cash payment, rather than provide the beds on site, the total cash payment would equal:
        - 4.25 X $259,000 = *$1,100,750 total cash payment*

9) What happens to the cash payments made to the City's Inclusionary Zoning Fund? How are these funds used, and by whom?

These cash payments are deposited into the City's Inclusionary Zoning Fund, which is distributed equally between the Newton Housing Authority (NHA) and the City of Newton. These funds are to be targeted for the restoration, creation, and preservation of deed-restricted units affordable to households with annual gross incomes at or below 50% AMI.

Appropriation of the funds for use by the City or the Newton Housing Authority must first be approved by the Planning & Development Board, the Finance Committee, and then the full City Council.

10) Does the City provide an incentive to developers that provide more affordable units than what is required by the Inclusionary Zoning ordinance?

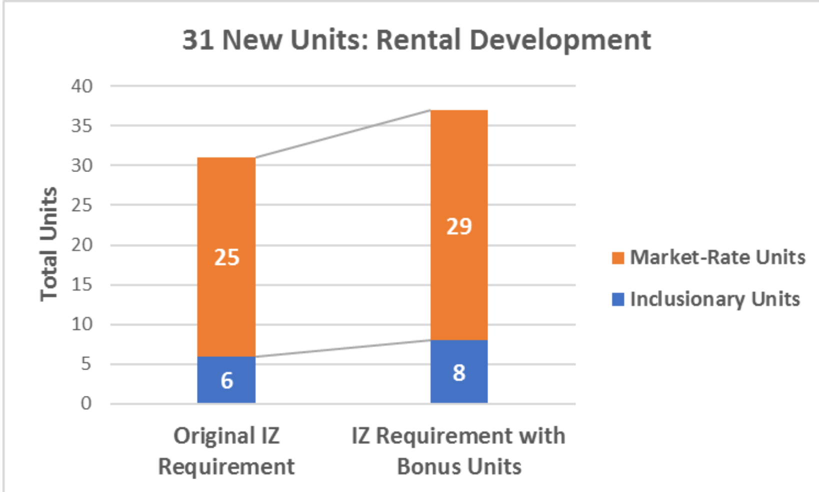
Yes. If a project that is subject to the Inclusionary Zoning provisions includes more than its required number of inclusionary units, a bonus of additional market-rate units will be offered to the project at a ratio of 2 to 1: for every additional affordable unit proposed, the project will be allowed to include 2 additional market-rate units. The additional affordable units must be set at no more than 80% AMI (Tier 2 units), and the number of additional units shall not exceed 20% of the number of units otherwise allowed on the lot under lot area per dwelling unit requirements.

Examples:

- A developer proposes to build a multifamily rental development, containing a total of 31 new units; therefore, the total IZ requirement for the development would be 6 inclusionary units: 25 market-rate units and 6 inclusionary units:
  - 5% at Tier 1 = 1.55; a total of *2 units at Tier 1*
  - 7.5% at Tier 2 = 2.325; a total of *2 units at Tier 2*
  - 5% at Tier 3 = 1.55; a total of *2 units at Tier 3*

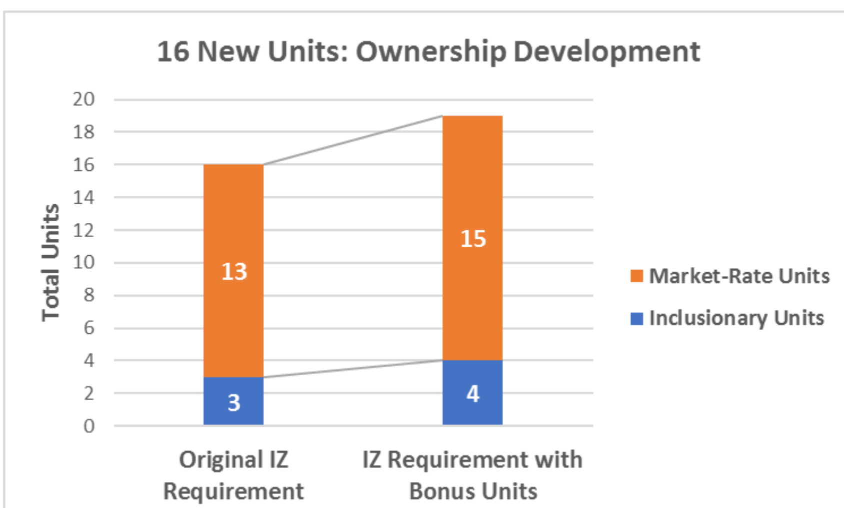
  The developer then chooses to provide 2 additional affordable Tier 2 units, which provides the project with 4 additional market-rate units, for a total of 6 additional units. The project now includes 37 total new units: 29 market-rate units and 8 inclusionary units:
  - 2 units at Tier 1
  - 4 units at Tier 2
  - 2 units at Tier 3
  - = *8 total inclusionary units* (out of 37 total units; for a project that is now 21.6% affordable)

  Note: the total number of additional units allowed for a project originally consisting of 31 new units is 6; 20% X 31 = 6.2; for a total of no more than 37 total new units, as the example demonstrates.



- A developer proposes to build a multifamily ownership development, containing a total of <u>16 new units</u>; therefore, the total IZ requirement for the development would <u>3 inclusionary units:</u> 13 market-rate units and 3 inclusionary units:
  - 0% at Tier 1 = 0; a total of <u>*0 units at Tier 1*</u>
  - 5% at Tier 2 = 0.8; a total of <u>*1 unit at Tier 2*</u>
  - 10% at Tier 3 = 1.6; a total of <u>*2 units at Tier 3*</u>

  The developer then chooses to provide 1 additional affordable Tier 2 units, which provides the project with 2 additional market-rate units, for a total of <u>3 additional units</u>. The project now includes <u>19 total new units</u>: 15 market-rate units and 4 inclusionary units:
  - 0 units at Tier 1
  - 2 units at Tier 2
  - 2 units at Tier 3
  - = <u>*4 total inclusionary units*</u> (out of 19 total units; for a project that is now 21% affordable)



11) How do the inclusionary units in a development differ from the market-rate units in terms of design, construction, location, accessibility, and amenities?

The inclusionary units in a development must be indistinguishable from the market-rate units as viewed from the exterior, and the inclusionary units must contain complete living facilities, including a stove, kitchen cabinets, plumbing fixtures, a refrigerator, a microwave, and access to laundry facilities. The materials used and the quality of construction for the inclusionary units, including heating, ventilation, and air conditioning systems, must be equal to that of the market-rate units.

The bedroom mix of the inclusionary units must be equal to that of the market-rate units. The inclusionary units must be equivalent in size to that of the market-rate units, and the inclusionary units must meet the following minimum square footage and bathroom requirements, as required by DHCD's most current Comprehensive Permit Guidelines:

- 1 bedroom – 700 square feet / 1 bath
- 2 bedrooms – 900 square feet / 1 bath
- 3 bedrooms – 1200 square feet / 1 bath + 1 half bath
- 4 bedrooms – 1400 square feet / 2 baths

The inclusionary units, and their associated parking spaces, must be proportionately distributed throughout a project and must not be located in less desirable locations than the market-rate units.

At a minimum, the inclusionary units must have an equivalent level of accessibility to that of the market-rate units.

The inclusionary units must have equal access to all amenities that are offered to the market-rate units in a project, such as parking, onsite fitness center, laundry facilities, and community rooms.

12) How are the rents and sale prices for the inclusionary units in a project determined?

The total monthly housing costs associated with an inclusionary unit must not exceed 30% of the gross monthly income for the eligible household living in that unit.

Total monthly housing costs for rental units include rent, utility costs for heat, water, hot water, and electricity, one parking space, and access to all amenities that are typically offered to a tenant in the development, such as access to an onsite fitness center, laundry facilities, etc.

Total monthly housing costs for ownership units include the mortgage principal and interest, private mortgage insurance, property taxes, condo and/or homeowner's association fees, hazard insurance, and one parking space.

Step One:

The first step in calculating an inclusionary unit's maximum affordable rent or sale price is to identify the number of bedrooms in that unit. The rent or sale price is based on the number of household members equal to the number of bedrooms in a unit plus one, regardless of the actual number of persons that end up occupying the unit.

Example:

- A 2-bedroom apartment's maximum affordable rent is based on a household size of 3 persons
  - 2 bedrooms + 1 = *3 person household*

Step Two:

Secondly, the appropriate gross annual Income Limit for that unit, adjusted for the associated household size, must be identified. HUD publishes these limits on an annual basis, and the FY 2018 Income Limits Summary Table for Newton, MA[5] is provided below.

FY 2018 Income Limits Summary - Newton, MA						
Income Level	Household Size					
	1	2	3	4	5	6
50% AMI	$37,750	$43,150	$48,550	$53,900	$58,250	$62,550
80% AMI	$56,800	$64,900	$73,000	$81,100	$87,600	$94,100
100% AMI	$75,500	$86,300	$97,100	$107,800	$116,500	$125,100
110% AMI	$83,050	$94,930	$106,810	$118,580	$128,150	$137,610

Examples:

- The income limit for a 2-bedroom apartment set at 50% AMI (3 person household size) is $48,550.
  - This means that only those households with annual gross incomes at or below this limit would be eligible for this housing unit

- The income limit for a 3-bedroom apartment set at 110% AMI (4 person household size) is $118,580.
  - This means that only those households with annual gross incomes at or below this limit would be eligible for this housing unit

Step Three – Rental Units:

Once the gross annual Income Limit associated with an inclusionary rental unit is determined, the maximum affordable annual rent can be easily determined by calculating 30% of that Income Limit and dividing by 12 to determine the maximum affordable monthly rent for an eligible household.

The table below demonstrates how the maximum gross rent for a 50% AMI unit is calculated.

[5] FY 2018 Income Limits Documentation System, Newton City FY 2018 Income Limits Summary: https://www.huduser.gov/portal/datasets/il/il2018/2018summary.odn

2018 Calculation of Maximum Affordable Rent - 50% AMI (all utilities included in rent)				
Unit Type	**Household Size (# of BR + 1)**	**50% of Adjusted Median Family Income***	**Monthly Income**	**Maximum Gross Rent (30% of income)**
Studio	1	$ 37,750.00	$ 3,145.83	$ 943.75
1 BR Unit	2	$ 43,150.00	$ 3,595.83	$ 1,078.75
2 BR Unit	3	$ 48,550.00	$ 4,045.83	$ 1,213.75
3 BR Unit	4	$ 53,900.00	$ 4,491.67	$ 1,347.50
4 BR Unit	5	$ 58,250.00	$ 4,854.17	$ 1,456.25
5 BR Unit	6	$ 62,550.00	$ 5,212.50	$ 1,563.75

The following table is a summary of the 2018 Maximum Affordable Rents for the City of Newton, broken out by Unit Type and AMI level.

2018 Maximum Affordable Rents, City of Newton (all utilities included in rent)				
Unit Type	**Household Size (# of BR + 1)**	**50% AMI**	**80% AMI**	**110% AMI**
Studio	1	$ 943.75	$ 1,420.00	$ 2,076.25
1 BR Unit	2	$ 1,078.75	$ 1,622.50	$ 2,373.25
2 BR Unit	3	$ 1,213.75	$ 1,825.00	$ 2,670.25
3 BR Unit	4	$ 1,347.50	$ 2,027.50	$ 2,964.50
4 BR Unit	5	$ 1,456.25	$ 2,190.00	$ 3,203.75

<u>Step Three – Ownership Units:</u>
Once the gross annual Income Limit associated with an inclusionary ownership unit is determined, the maximum affordable sale price must be set so that a household earning 10 percentage points lower than the identified Income Limit for that unit would not spend more than 30% of its annual income on housing costs. For example, if an inclusionary unit is set at 80% AMI, the maximum sale price for that unit must affordable for a household with an annual gross income of less than or equal to 70% AMI.

The down payment for the unit must be at least 3% of the purchase price. The mortgage loan must be a 30-year fully amortizing mortgage for not more than 97% of the purchase price with a fixed interest rate that is not more than 2 percentage points above the current MassHousing interest rate.

Below is an example of a maximum affordable sale price calculation for a 2-bedroom condo unit set at 80% AMI (for a 3 person household). The max sale price for this inclusionary unit would be <u>$222,000.</u>

2018 Max Affordable Sale Price Calculator		
Ex: 2-bedroom affordable condo set at 80% AMI		
	80% AMI Limit	**70% AMI Limit**
Sales Price	**$253,000**	**$222,000**
5% Down payment	$12,650	$11,100
Mortgage	$240,350	$210,900
Interest rate	**4.83%**	**4.83%**
Amortization	30	30
Monthly P&I Payments	$1,265.40	$1,110.35
Tax Rate	**$10.82**	**$10.82**
monthly property tax	$228	$200
Hazard insurance	**$84**	**$74**
PMI	$156	$137
Condo/HOA fees (if applicable)	**$84**	**$74**
Monthly Housing Cost	**$1,818**	**$1,596**
Necessary Income:	$72,736	$63,824
Household Income:		
# of Bedrooms	2	2
Sample Household size	3	3
110% AMI Limit	$100,375	$100,375
Target Housing Cost (110% AMI)	**$2,509**	**$2,509**
10% Window	$91,250	$91,250
Target Housing Cost (100% AMI)	**$2,281**	**$2,281**
80% AMI/"Low-Income" Limit	$73,000	$73,000
Target Housing Cost (80%AMI)	**$1,825**	**$1,825**
10% Window	$63,875	$63,875
Target Housing Cost (70%AMI)	**$1,597**	**$1,597**

The following table is a summary of the 2018 Maximum Affordable Sale Prices for the City of Newton, broken out by Unit Type and AMI level.

2018 Maximum Affordable Sales Prices, City of Newton					
Unit Type	**Household Size (# of BR + 1)**	**70% AMI**	**80% AMI**	**100% AMI**	**110% AMI**
Studio	1	$ 172,000	$ 197,000	$ 247,000	$ 271,000
1 BR Unit	2	$ 197,000	$ 225,000	$ 282,000	$ 310,000
2 BR Unit	3	$ 222,000	$ 253,000	$ 315,000	$ 349,000
3 BR Unit	4	$ 246,000	$ 282,000	$ 352,000	$ 387,000
4 BR Unit	5	$ 266,000	$ 304,000	$ 374,000	$ 418,000

13) <u>When is a project that is subject to the Inclusionary Zoning ordinance allowed to provide its inclusionary units requirement off site, at an alternative project site?</u>

Off-site inclusionary units are generally discouraged by this ordinance, and are only allowed through the Special Permit process where the City Council makes specific findings to an “unusual net benefit to achieving the City’s housing objectives as a result of allowing the required units to be built off-site.”

Projects that receive such permission from the Council must form a development agreement with a non-profit housing developer for the development of the off-site affordable units. Off-site units must be completed and occupied no later than the project’s market-rate units.

14) <u>What happens after an Inclusionary Housing project receives approval to move forward?</u>

Prior to receiving a Building Permit from the City, the developer must submit a draft Inclusionary Housing Plan for review and final approval by the Director of Planning and Development. The plan must include, among other elements, a description of the proposed project, the total number of market-rate and inclusionary units, floor plans indicating the location, size and number of bedrooms and bathrooms per unit for all the units in the project, and the projected rent levels and sale prices for all the units.

Additionally, the developer must also submit a draft Affirmative Fair Housing Marketing and Resident Selection Plan for review and final approval by the Director of Planning and Development. At a minimum, this plan must meet the requirements set out in the Comprehensive Permit Guidelines of the DHCD, and provide for a Newton local preference for up to 70% of the inclusionary units in a project.

15) <u>How are inclusionary units marketed and occupied?</u>

The inclusionary units must be marketed and occupied consistent with the City and DHCD (or the relevant Subsidizing Agency) approved Affirmative Fair Housing Marketing and Resident Selection Plan. Marketing may not take place for ***any*** units in the project until the City and DHCD have approved this plan.

The developer is responsible for carrying out this plan, and must contract with an entity that has substantial and successful prior experience in each component of the Affirmative Fair Housing Marketing and Resident Selection Plan.

To avoid discriminatory effects in violation of fair housing laws, resident selection for the inclusionary units must comply with DHCD’s approved lottery process for both the local preference and non-local preference units. The lottery process usually commences about six months prior to expected occupancy of the units.

The inclusionary units and market-rate units of a project must be occupied at the same time.

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Sec. 5.11. Inclusionary Zoning

5.11.1. Purposes

The purposes of this Sec. 5.11 are to:

A. Promote the public health, safety, and welfare by encouraging a diversity of housing opportunities for people of different income levels in the City;
B. Provide for a full range of housing choices throughout the City for households of all incomes, ages, and sizes;
C. Increase the production of affordable housing units to meet existing and anticipated housing needs within the City; and
D. Work to overcome economic segregation regionally as well as within Newton, allowing the City to be a community of opportunity in which low- and moderate-income households have the opportunity to advance economically.

5.11.2. Definitions

A. “Household Income Limit” shall mean at any given percentage of the area median income (AMI) shall be defined as being the income limit adjusted by household size at that percentage as published by the U.S. Department of Housing and Urban Development (HUD) for the designated statistical area that includes the City of Newton or, for percentage levels not published by HUD, as calculated by the City based on the HUD AMI calculation.

B. “Inclusionary Housing Project” shall mean any residential development project that meets the provisions of 5.11.3.

C. “Inclusionary Unit(s)” shall mean any finished dwelling unit that meets the provisions of 5.11.4.

D. “Area Median Income (AMI)” shall mean the median income for households within the designated statistical area that includes the City of Newton, as reported annually and adjusted for household size by HUD.

E. “Eligible Household” shall mean a household whose gross income does not exceed the amounts set forth in Section 5.11.4.

5.11.3. Application of Inclusionary Zoning Requirements

A. These inclusionary zoning provisions apply to any proposed residential or mixed-use development, including a conventional subdivision of land under M.G.L. Chapter 41, Sections 81K-81GG, in any zoning district that includes a net increase of seven or more new residential dwelling units on any parcel or contiguous parcels comprising a proposed development site. For the purposes of this section, existing residential units that are proposed to be demolished as part of the development shall have no bearing on that development’s inclusionary zoning requirement.

B. This Sec. 5.11 does not apply to accessory units.

C. No Segmentation. The inclusionary zoning provisions of this section apply to projects at one site or two or more adjoining sites in common ownership or under common control within a period of five years from the first date of application for any special or building permit for construction on the lot or lots, or for the 12 months immediately preceding the date of application for any special or building permit.

D. 100% Deed-Restricted Affordable Developments. Any proposed residential or mixed-use development that consists of 100% deed-restricted affordable units is not subject to Section 5.11.4.B; however, projects of this type are subject to all other applicable sections of this ordinance.

E. Qualification as Local Action Units. All Inclusionary Units affordable to households at or below 80% of AMI must be qualified as 'Local Action Units' pursuant to the requirements of the Comprehensive Permit Guidelines of the DHCD, Sec. VI.C "Local Action Units," as in effect June 1, 2009 as the same may be amended from time to time, and all Inclusionary Units affordable to households earning greater than 80% but less than or equal to 110% of AMI shall comply with all such requirements, unless:

1. The unit is exempted from this requirement by another provision of this Sec. 5.11; or

2. The unit is exempted from this requirement by a provision included in the special permit authorizing the development, based on special circumstances applicable to that development, or based on changes in the DHCD regulations or guidelines.

5.11.4. Inclusionary Units

A. Inclusionary Unit Tiers. Inclusionary Units are divided into three tiers based on their level of affordability. Tier 1 represents units affordable to households at or below 50% of AMI; Tier 2 represents units affordable to households greater than 50% of AMI, but at or below 80% of AMI; and Tier 3 represents units affordable to households greater than 80% of AMI, but at or below 110% of AMI.

B. Number of Inclusionary Units Required. The percentage of required Inclusionary Units in a proposed development shall be based on the total number of new units proposed on any parcel or contiguous parcels comprising a proposed development site, and whether the units are rental or ownership. Where the inclusionary zoning requirement results in a fraction of a unit greater than or equal to 0.5, the development must provide one Inclusionary Unit to capture that fraction.

The percentage requirement for applicable developments shall be based on the following table:

Tier Level	7-9 new units		10-20 new units		21-34 new units		35-64 new units		65-100 new units		101+ new 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%***

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C. Fractional Inclusionary Units. Whenever the percentage calculation for the required number of Inclusionary Units within each affordability tier described in Sec. 5.11.4.B results in a fraction of an Inclusionary Unit, there shall be provided 1 Inclusionary Unit to cover the fraction of that Inclusionary Unit.

D. Incentives for Additional Inclusionary Units. An Inclusionary Housing Project that includes more than the required number of Inclusionary Units shall be awarded bonus market-rate units at a ratio of 2 to 1. For every additional Inclusionary Unit the applicant agrees to provide, the development will be awarded 2 additional market-rate units. The additional Inclusionary Units must be affordable to households at or below 80% AMI (Tier 2 units), and the total number of additional units proposed by an applicant shall not exceed 20% of the number of units otherwise permissible on the lot under lot area per dwelling unit requirements.

E. Maximum Monthly Housing Costs, Sale Prices and Rents. Maximum sale price or rent for Inclusionary Units shall be calculated as affordable to a household with a number of household members equal to the number of bedrooms in a unit plus one, regardless of the actual number of persons occupying the unit.

1. Rental. Monthly housing costs, inclusive of rent, utility costs for heat, water, hot water, and electricity, 1 parking space, and including access to all amenities that are typically offered to a tenant in the building, such as access to an onsite gymnasium, and other such amenities, shall not exceed 30% of the monthly income for the applicable eligible household, adjusted for household size. If the utilities are separately metered, they may be paid by the tenant and the maximum allowable rent will be reduced to reflect the tenants' payment of utilities, based on the area's utility allowance for the specific unit size and type, to be secured from the Newton Housing Authority. For a household with a Section 8 voucher, the rent and income are to be as established by the Newton Housing Authority with the approval of HUD.

2. Homeownership. Monthly housing costs, inclusive of mortgage principal and interest, private mortgage insurance, property taxes, condominium and/or homeowner's association fees, hazard insurance, and 1 parking space, shall not exceed 30% of the monthly income for the applicable eligible household, adjusted for household size.

a. Maximum Sales Prices. Maximum sale prices of Inclusionary Units shall be set so that a household earning 10 percentage points lower than the household income limit for that unit would not expend more than 30% of income for the cost of purchasing the housing.

b. Homeownership Association / Condominium Association Fees. The Department of Planning and Development will review condominium fee estimates as submitted by the applicant and establish a maximum initial condominium fee for the Inclusionary Units as part of the calculation of the maximum sale price.

i. The percentage interest assigned to the Inclusionary Units must conform to the approved condominium fees, which may require a lower percentage interest being assigned to those units as compared with market-rate units. The Department of Planning and Development will review the Schedule of Beneficial

Interests in the Master Deed to confirm that the Inclusionary Units have been assigned percentage interests in the condominium that correspond to the approved condominium fees and projected special assessment fees.

ii. Condominium projects with extraordinary on-going costs (such as the cost of on-site wastewater treatment plants, elevators, parking garages, etc.) must reflect the cost of operating and maintaining such facilities in their condominium budgets (including replacement reserves).

c. Down Payment. Down payment must be at least 3% of the purchase price.

d. Mortgage Loan. Mortgage loan must be a 30-year fully amortizing mortgage for not more than 97% of the purchase price with a fixed interest rate that is not more than 2 percentage points above the current MassHousing interest rate.

e. Buyers will be eligible so long as their total housing cost including the services identified above do not exceed 38% of their income.

F. Notwithstanding the requirements of this Sec. 5.11.4, an Inclusionary Housing Project may set the price or rental rate for Inclusionary Units lower than what is required herein.

5.11.5. Cash Payment.

As an alternative to the requirements of Sec. 5.11.4., an applicant may contribute a cash payment to the City's Inclusionary Housing Fund, in lieu of constructing an Inclusionary Unit.

A. Eligibility. There are 2 circumstances in which the Inclusionary Unit requirements of Sec. 5.11.4 may be met through a cash payment instead of providing Inclusionary Units:

1. For Inclusionary Housing Projects containing 7 to 9 new dwelling units.

2. By special permit from the City Council where the Council makes specific findings that there will be an unusual net benefit to achieving the City's housing objectives as a result of allowing a cash payment rather than requiring the development of any Inclusionary Units. The findings shall include consideration of the appropriateness of the development site location for income-eligible households, including proximity to and quality of public transportation, schools, and other services; the level of uncommitted funds in the receipts reserved for appropriation fund; and the purposes identified for this section of the Ordinance found in Section 5.11.1.

B. Cash Payment Amount. The cash payment as an alternative to each required Inclusionary Unit, or fraction thereof, shall be based on a formula that utilizes the current Massachusetts Department of Housing and Community Development Index for "Total Residential Development Cost Limits" for Production Projects within Metro Boston. This index is updated annually through DHCD's Qualified Action Plan (QAP) and serves as a maximum subsidy amount per unit for affordable housing projects seeking Federal Low-Income Housing Tax Credits (LIHTC) throughout the state.

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For Inclusionary Housing Projects with 10 or more units that receive a Special Permit to make such a payment, the total cash payment is determined by utilizing the following calculation:

A x B

Where A equals the number of units in the housing development subject to the Inclusionary Zoning requirement, multiplied by the Inclusionary Zoning requirement for that size and type of project; and

Where B equals the average of the "Small Units" index and "Large Units" index for Production Projects in Newton, which falls within the Urban Area of Metro Boston category of the QAP.

For Example:

- 18-unit rental project
    - 17.5% IZ requirement: 0.175 X 18 units = 3.15
    - 3.15 X $389,000 (2018 average of Small Units and Large Units index) = *$1,225,350 total cash payment*

- 36-unit ownership project
    - 17.5% IZ requirement: 0.175 X 36 units = 6.3
    - 6.3 X $389,000 = *$2,450,700 total cash payment*

For Inclusionary Housing Projects with 7-9 new units, the total cash payment is determined by utilizing the average of the "Small Units" index and "Large Units" index for Production Projects in Newton as the basis for the calculation; and the payment is then adjusted for the number of new units in the project, at a decreasing percentage.

For Example:

- 7-unit project: 70% of $389,000 = *$272,300 total cash payment*
- 8-unit project: 80% of $389,000 = *$311,200 total cash payment*
- 9-unit project: 90% of $389,000 = *$350,100 total cash payment*

C. Payment Deadline. Any Inclusionary Unit cash payment shall be paid in full to the City prior to the granting of any Certificate of Occupancy.

D. Cash Payment Recipient. The cash payment shall be made to a receipts reserved for appropriation fund established by the City Council. Proceeds from the fund shall be distributed equally to the Newton Housing Authority and the Planning and Development Department and shall be used exclusively for construction, purchase, or rehabilitation of housing for eligible households consistent with the purposes of this Sec. 5.11 and without undue concentration of units. The Newton Housing Authority and the Department of Planning and Development shall each maintain an ongoing record of payments to the fund on their behalf and shall report annually to the City Council on the use of the proceeds for the purposes stated in this Sec. 5.11.

5.11.6. Off-Site Development

A. Eligibility. Off-site inclusionary units are generally discouraged. The Inclusionary Unit requirements of Sec. 5.11.4 may be met through the off-site development of the required Inclusionary Units by special permit from the City Council where the Board makes specific findings that there will be an unusual net benefit to achieving the City's housing objectives as a result of allowing the units to be built off-site. The findings shall include consideration of the appropriateness of the development site location for income-eligible households, including proximity to and quality of public transportation, schools, and other services; consideration relative to the concentration of affordable units in the City; and consideration of the purposes of this section of the Ordinance, found in Section 5.11.1.

B. Non-Profit Housing Developer Partnership. Any Inclusionary Housing Project that includes off-site inclusionary units must form a development agreement with a non-profit housing developer for the development of the off-site units.

C. The applicant must submit a development plan for off-site development for review and comment by the Planning and Development Department prior to submission to the City Council. The plan must include at a minimum, demonstration of site control, necessary financing in place to complete the off-site development or rehabilitation, an architect's conceptual site plan with unit designs and architectural elevations, and agreement that the off-site units will comply with Sec. 5.11.7.

D. As a condition of granting a special permit for the Applicant's development, the City Council shall require that off-site inclusionary units shall be completed and occupied no later than completion and occupancy of the applicant's market rate units. If the off-site inclusionary units are not completed as required within that time, temporary and final occupancy permits shall not be granted for the number of market rate units equal to the number of off-site inclusionary units which have not been completed. Where the Council determines that completion of off-site inclusionary units has been delayed for extraordinary reasons beyond the reasonable control of the applicant and non-profit housing developer, the City Council may, in its discretion, permit the applicant to post a monetary bond and release one or more market rate units. The amount of the bond shall be sufficient in the determination of the Planning and Development Department to assure completion of the off-site inclusionary units.

5.11.7. Design and Construction

In all cases, Inclusionary Units shall be fully built out and finished dwelling units and shall comply with the requirements set out in in the Comprehensive Permit Guidelines of the DHCD, Sec. VI.B.4. "Design and Construction Standards," as in effect June 1, 2009 as the same may be amended from time to time. Additionally, the following guidelines must apply to all Inclusionary Units:

A. Inclusionary Units provided on site must be dispersed throughout the Inclusionary Housing Project and must be sited in no less desirable locations than the market-rate units.

B. Inclusionary Units shall have exteriors that are indistinguishable in design and of equivalent materials to the exteriors of the market-rate units in the project.

C. The bedroom mix of Inclusionary Units shall be equal to the bedroom mix of the market-rate units in the Inclusionary Housing Project.

D. The materials used and the quality of construction for inclusionary units, including heating, ventilation, and air conditioning systems, shall be equal to that of the market-rate units in the Inclusionary Housing Project, as reviewed by the Planning and Development Department; provided that amenities such as so called designer or high end appliances and fixtures need not be provided for Inclusionary Units.

E. At a minimum, the Inclusionary Units must have an equivalent level of accessibility as that of the market-rate units.

5.11.8. Inclusionary Housing Plans and Covenants

The applicant shall submit an Inclusionary Housing Plan that shall be reviewed by the Planning and Development Department and shall be approved by the Director of Planning and Development and the Department of Housing and Community Development prior to the issuance of any building permit for the project. The plan shall include the following provisions:

F. A description of the proposed project and inclusionary units including, at a minimum, floor plans indicating the location of the Inclusionary units, number of bedrooms per unit for all units in the development, square footage of each unit in the development, amenities to be provided, projected sales prices or rent levels for all units in the development, and an outline of construction specifications certified by the applicant.

G. An Affirmative Fair Housing Marketing and Resident Selection Plan that, at a minimum, meets the requirements set out in in the Comprehensive Permit Guidelines of the DHCD, Sec. III., Affirmative Fair Housing Marketing and Resident Selection Plan, as in effect June 1, 2009 as the same may be amended from time to time and:

1. To the extent permitted by law, such plan shall provide for a local preference for up to 70% of the Inclusionary Units in a project.

2. Where a project results in the displacement of individuals who qualify for a unit in terms of household size and income, first preference shall be given to those displaced applicants, unless such preference would be unallowable under the rules of any source of funding for the project.

3. Where a project includes units that are fully accessible, or units that have adaptive features, for occupancy by persons with mobility impairments or hearing, vision or other sensory impairments, first preference (regardless of applicant pool) for those units shall be given to persons with disabilities who need such units, including single person households, in conformity with state and federal civil rights law, per DHCD's Comprehensive Permit Guidelines, Sec. III., Affirmative Fair Housing Marketing and Resident Selection Plan, as in effect June 1, 2009 as the same may be amended from time to time.

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H. Agreement by the applicant that resident selection shall be conducted and implemented in accordance with the approved marketing and resident selection plan and Comprehensive Permit Guidelines of the DHCD, Sec. III., Affirmative Fair Housing Marketing and Resident Selection Plan.

I. Agreement by the applicant that all Inclusionary Units, including those affordable to households earning greater than 80% but less than or equal to 110% of AMI, shall comply with all requirements of the Comprehensive Permit Guidelines of the DHCD, Sec. VI.C "Local Action Units," as in effect June 1, 2009 as the same may be amended from time to time, unless:

   1. The unit is exempted from this requirement by another provision of this Sec. 5.11; or

   2. The unit is exempted from this requirement by a provision included in the special permit authorizing the development, based on special circumstances applicable to that development, or based on changes in the DHCD regulations or guidelines.

J. Agreement by the applicant that all Inclusionary Units, including those affordable to households earning greater than 80% but less than or equal to 110% of AMI, shall comply with the Use Restrictions requirements set out in in the Comprehensive Permit Guidelines of the DHCD, Sec. II.A.1.e. "Use Restriction," and Sec. VI.B.9. "Regulatory Agreement and Use Restrictions," and that the applicant shall execute and record an affordable covenant in the Registry of Deeds for the Southern District of Middlesex County or the Land Court Registry of Deeds for the Southern District of Middlesex County as the senior interest in title for each Inclusionary Unit and which shall endure for the life of the residential development, as follows:

   For purchase units, a covenant to be filed at the time of conveyance and running in favor of the City of Newton, in a form approved by the City Solicitor, which shall limit initial sale and subsequent re-sales of Inclusionary Units to eligible households in accordance with provisions reviewed and approved by the Director of the Planning and Development Department which incorporate the provisions of this Section; and
   For rental units, a covenant to be filed prior to the issuance of an occupancy permit and running in favor of the City of Newton, in a form approved by the City Solicitor, which shall limit rental of Inclusionary Units to eligible households in accordance with provisions reviewed and approved by the Director of the Planning and Development Department which incorporate the provisions of this Section.

K. At the discretion of the applicant and with the agreement of the Newton Housing Authority, an agreement, in a form approved by the City Solicitor, to convey rental units to the Newton Housing Authority for sale or rental to eligible households.

L. In the case of rental housing, an agreement by the applicant to submit an annual compliance report to the Director of Planning and Development, in a form approved by the City Solicitor, certifying compliance with the provisions of this Sec. 5.11.

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5.11.10. Public Funding Limitation

An applicant shall not use public development funds to construct Inclusionary Units required under Sec. 5.11. Public development funds shall mean funds for housing construction or rehabilitation if provided through a program eligible to serve as a ‘subsidy’ under 760 CMR 56.00 Comprehensive Permit: Low or Moderate Income Housing. However, the applicant may use public development funds to construct those inclusionary units that are found by the Director of Planning and Development to be consistent with the following:

A. Those that represent a greater number of affordable units than are otherwise required by this subsection, and not receiving bonus market rate units according to Sec. 5.11.4.D;

B. Those that are lower than the maximum eligible income limit for some or all inclusionary units by at least 10 percentage points below that stipulated in Sec. 5.11.2; and

C. Those that exceed regulatory requirements in providing for persons having disabilities.

5.11.11. Elder Housing with Services

In order to provide affordable elder housing with services on-site, the following requirements shall apply exclusively when an applicant seeks a special permit for housing with services designed primarily for elders, such as residential care, continuing care retirement communities, assisted living, independent living, and congregate care. The services to be provided shall be an integral part of the annual housing costs, rent or occupancy related fee, shall be comparable to the services offered to all residents regardless of income status, and may include in substantial measure long-term health care, as well as nursing, home health care, personal care, meals, transportation, convenience services, and social, cultural, and education programs. This Sec. 5.11.11 shall not apply to a nursing facility subject to certificate of need programs regulated by the Commonwealth of Massachusetts Department of Public Health or to developments funded under a state or federal program which requires a greater number of elder units or nursing beds than required here.

A. Number of Inclusionary Beds Required. For all such projects, 5 percent of beds provided on-site must be Inclusionary Beds designated affordable to elderly households with annual gross incomes up to 80% of AMI. Inclusionary Beds may be located in single-occupancy rooms, or in shared rooms. The Inclusionary Beds shall be proportionately distributed throughout the site and shall be indistinguishable from the market-rate beds.

B. Definition of Elderly Households. For all such projects, an elderly household shall be defined as a single person who is 62 years of age or older at the time of initial occupancy; or two persons living together, where at least one of whom is 62 years of age or more at the time of initial occupancy.

C. Monthly Housing and Service Costs. Total monthly housing and service costs, including rent or a monthly occupancy fees, health care, personal care, meals, transportation, convenience services, social, cultural, and educational programming, and the like, shall not exceed 80% of the eligible households annual gross income.

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D. Use Restrictions. For all such projects, all Inclusionary Beds shall be subject to an affordable covenant approved by the City Solicitor, executed by the City and the developer, and recorded at the Registry of Deeds for the Southern District of Middlesex County or the Land Court Registry of Deeds for the Southern District of Middlesex County.

E. Selection. For all such projects, all Inclusionary Beds shall be subject to an Affirmative Fair Housing Marketing and Resident Selection Plan to be approved by the Director of the Planning Department. To the extent permitted by law, Newton residents shall have first opportunity to participate in the elder housing with services program set out here.

F. Fractional Units. For the purposes of calculating the number of Inclusionary Beds required per Section 5.11.11 A., any fractional unit of 0.5 or greater shall be deemed to constitute a whole bed.

G. Alternative Compliance. The applicant may choose to comply with their Inclusionary Zoning requirements through a cash payment to the City, without receiving permission from the City Council through the Special Permit process. The total cash payment for projects of this type is determined by utilizing DHCD's current Qualified Allocation Plan Index for "Single Room Occupancy / Group Homes / Assisted Living / Small Unit Supportive Housing", coupled with the calculation of 5% of the total number of beds provided in the project.

For Examples:

- 115-bed assisted living project:
    - 5% requirement X 115 = 5.75; therefore, *6 inclusionary beds are required on site*
    - If this project were to choose to provide the City with a cash payment, rather than provide the beds on site, the total cash payment would equal:
        - 5.75 X $259,000 (DHCD's current QAP for projects of this type) = *$1,489,250 total cash payment*

- 85-bed continuing care retirement community:
    - 5% requirement X 85 = 4.25; therefore, *4 inclusionary beds are required on site*
    - If this project were to choose to provide the City with a cash payment, rather than provide the beds on site, the total cash payment would equal:
        - 4.25 X $259,000 = *$1,100,750 total cash payment*

5.11.12. No Segmentation

An applicant for residential development shall not segment or divide or subdivide or establish surrogate or subsidiary entities to avoid the requirements of Sec. 5.11.11. Where the City Council determines that this provision has been violated, a special permit will be denied. However, nothing in Sec. 5.11 prohibits phased development of a property.

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5.11.13. No Effect on Prior or Existing Obligations.

The requirements of Sec. 5.11 shall have no effect on any prior or currently effective special permit, obligation, contract, agreement, covenant or arrangement of any kind, executed or required to be executed, which provides for dwelling units to be made available for sale or rental to or by the City, the Newton Housing Authority, or other appropriate municipal agency, or any cash payment so required for affordable housing purposes, all resulting from a special permit under Sec. 5.11 applied for or granted prior to the effective date of this amendment.

5.11.14. Inclusionary Housing Program Reevaluation Requirement

The City shall initiate a reevaluation of the Inclusionary Housing Requirement at an interval of no more than 5 years from the time the Inclusionary Housing Requirement was last amended and every 5 years thereafter. Such reevaluation shall include a report provided to the City Council reviewing factors such as changes in demographic characteristics and residential development activity, housing trends measured in terms of, but not limited to, vacancy rates, production statistics, prices for dwelling units, and affordability, and the relationship between Inclusionary Housing Projects and all housing in Newton. The Department of Planning and Development shall also conduct an annual review and report on the Inclusionary Housing Program.

City of Newton

Inclusionary Zoning:

Financial Feasibility Analysis

March 15, 2018

PREPARED FOR:

City of Newton
Department of Planning and Development
1000 Commonwealth Avenue, Newton, MA 02459

PREPARED BY:

RKG Associates, Inc.

CONTENTS

EXECUTIVE SUMMARY

Scope of Work

The scope of this analysis is to determine the financial impact resulting from proposed changes to Newton's existing Inclusionary Zoning (IZ) ordinance. RKG Associates Inc. (RKG) constructed a financial feasibility model to test specific scenarios chosen by the City of Newton and determine the relative impact in relation to the proposed IZ ordinance. The importance of this analysis cannot be understated, as setting the appropriate ordinance is key to ensuring the continuation of housing development for households of various income levels across the city.

Process

The process undertaken was collaborative and included engaging City staff and housing developers to understand the market dynamics unique to Newton. RKG utilized information gained from market research and interviews to construct an adaptable financial model. The model enables the City to test prototypical developments to understand the financial implications of changing the inclusionary ordinance.

Summary Findings

The results of the analysis are based upon a financial model driven by assumptions. While exact precision cannot be guaranteed, the model utilizes local-market relevant assumptions to forecast the financial return to a developer and compares the change in financial return between the existing ordinance and the proposed IZ ordinance.

Based on the analysis conducted by RKG, it appears that project size (number of units) matters in relation to the proposed IZ ordinance. The proposed IZ ordinance for small developments, defined as those under six units, seems to have a detrimental impact on the overall project financial feasibility. Most notably, the existing IZ ordinance does not require units or payments in lieu of units for small projects. The addition of an affordable unit has an outsized impact on the overall financial return of the project, as small-scale developers have greater sensitivity to changes in their development program. This increase in sensitivity is due to the inability to spread the cost of an affordable unit (or payment in lieu of a unit) across several market rate units.

For medium sized projects between six and 20 units, the proposed changes to the inclusionary zoning ordinance appear calibrated correctly, as they result in more affordable units for the City and/or cash contributions to the affordable housing fund while returning an acceptable financial outcome to the developer. The ordinance is calibrated correctly because at the proposed 20% commitment of units, the revised income threshold requirements allocate some units be priced for households earning up to 110% of AMI. From the standpoint of building affordable units, the increase in affordable unit requirements is offset by the addition of moderate income household thresholds (110% AMI) in the proposed language.

In large size projects, defined as 20 units and above, the proposed IZ ordinance as designed has a negative impact on the overall financial return in a prototypical development. The key issues within the proposed IZ ordinance is the 25% IZ requirement (10% higher than existing IZ ordinance) as well as the reintroduction of the lowest income tier (50% of AMI) requirement. Without the compensating offset of targeting higher income households, these projects become financially infeasible for the developer compared to the existing ordinance.

The proposed increase in bonus density (two market rate units for every one additional unit committed to affordability) has a positive financial impact on the overall project feasibility, but not at a level great enough to offset the impacts of 25% dedication to affordable units and the high percentage committed at 50% of AMI. Even applying a hypothetical three-to-one ratio still does not yield a positive result for larger projects. The key finding for the bonus density is that as currently structured, it is not sufficient for making these larger projects financially viable.

One possible solution towards improving the bonus density is rather than require all affordable units resulting from utilizing the bonus density to fall within the 50 percent AMI threshold, the units could be allocated across all the AMI thresholds. This spreading of affordable units ultimately helps the development financially because it offsets the units at deeper levels of affordability.

The accompanying analysis of the proposed IZ provides greater context to the summary findings and can help guide the City of Newton to modify elements of the proposal to ensure unintended impacts to the current real estate market do not result.

INTRODUCTION

The City of Newton has undertaken a substantial effort in refining its existing IZ ordinance to better preserve its economically diverse population. This effort was borne through the City's Housing Strategy process, which identified the potential to strengthen the City's existing IZ ordinance to realize the greatest public benefit from private development occurring in the City. In a memorandum dated December 8, 2017, the City's Planning and Development Department outlined a detailed proposal on modifying the Inclusionary Zoning ordinance.

Table 1. Existing IZ Ordinance

Tier Level	6+ Units*	
	Rental	Owner
Tier 1, Up to 50% AMI	7.5%	-
Tier 2, 51% - 80% AMI	7.5%	15.0%
Total	15.0%	15.0%

Source: City of Newton and RKG Associates Inc., 2018
*Ordinance has been interpreted to start at six new units

Among the recommendations included in the memorandum, the four most prominent include [1] requiring inclusionary units for projects of 4 units or larger; [2] offering a payment in lieu of delivering units for fractional requirements; [3] modifying the minimum percentage of units to be income controlled based on the size of the project, and [4] adjusting the income thresholds to be served by the IZ ordinance. The following tables reveal the existing IZ requirements (Table 1) and the proposed IZ requirements (Table 2 and 3).

Table 2 Proposed IZ Ordinance for Rental Developments

Renter Units	Tier 1 Up to 50% AMI	Tier 2 51% - 80% AMI	Tier 3 81% - 110% AMI	Total
4-6 new units	-	15.0%	-	15.0%
7-9 new units	-	15.0%	-	15.0%
10-20 new units	-	10.0%	10.0%	20.0%
21-50 new units	5.0%	10.0%	10.0%	25.0%
51-100 new units	7.5%	10.0%	7.5%	25.0%
101+ new units	10.0%	10.0%	5.0%	25.0%

Source: City of Newton and RKG Associates Inc., 2018

Table 3. Proposed IZ Ordinance for Ownership Developments				
Ownership Units	Tier 1 Up to 50% AMI	Tier 2 51% - 80% AMI	Tier 3 81% - 110% AMI	Total
4-6 new units	-	15.0%	-	15.0%
7-9 new units	-	-	15.0%	15.0%
10-20 new units	-	10.0%	10.0%	20.0%
21-50 new units	-	10.0%	15.0%	25.0%
51-100 new units	-	15.0%	10.0%	25.0%
101+ new units	-	15.0%	10.0%	25.0%
Source: City of Newton and RKG Associates Inc., 2018				

As stated by the City's staff, Newton is not alone in considering an adjustment to its IZ ordinance. In the past few years, Boston (2015), Cambridge (2017), and Somerville (2017) have all amended their inclusionary housing provisions to balance the growing need for affordable housing units in a rapidly appreciating and high-demand housing market. Cambridge increased its requirement from 11-13% to 20%; Somerville from 12.5-17.5% to 17.5% for smaller projects and 20% for larger projects; and Boston increased its payment-in-lieu requirements, and its requirement for off-site units from 15% to 18%. Wellesley's requirement has been at 20% since 2004.

RKG was retained by the City to respond to questions from the City Council regarding the financial impact of these ordinance changes on residential development. RKG Associates is a multi-disciplinary real estate, planning, and economic development consulting firm with more than 35 years of experience advising public-sector and private-sector clients on real estate development and financial feasibility. RKG provided similar advisory services to the City of Somerville when it was considering changes to the local Inclusionary Zoning ordinance. Moreover, RKG Associates has worked extensively within Newton, including its recent work on the City's Housing Strategy and the feasibility analysis for the 28 Austin Street project.

The following analysis details the approach RKG used to test the proposed IZ ordinance changes, the results of this analysis, and recommended modifications to the proposed IZ ordinance to minimize financial impacts to future residential development. The appendix section includes a glossary of terms used throughout this analysis.

MODEL

To perform the analysis, RKG Associates created a financial feasibility model based on traditional pro forma analysis standards for real estate development. The model was created in Microsoft Excel to allow for the greatest functional flexibility and analysis transparency.

The RKG Associates model focuses on Internal Rate of Return (IRR) calculations to determine financial feasibility. This measure is a standard approach to understanding the potential performance of a real estate investment. Real estate development is a risk-based venture that requires an investor to guarantee a sum of money in exchange for the potential revenue and value created by that investment. Developers seek to reduce the risk of a project (i.e. development duration and cost overruns) while maximizing the revenue potential (i.e. rent payments and reversion for a rental project and sales pricing for an ownership project).

IRR calculations are presented as percentages. A higher percent indicates the property will provide a greater return for the investor. IRR is generally compared against an investors desired return rate (or discount rate) to determine if an investment meets the perceived risk level. IRR calculations are much more detailed than overall return calculations, and account for inflation, projected income escalators and the reversion (or sale) of the property at the end of the study period (or hold period). **Boston area development industry minimum standards for a desired IRR currently are 20% for new construction ownership residential and 12% for rental residential projects.**

For analysis purposes, RKG determined the land values under the existing IZ ordinance which would realize the desired financial return under each of the seven scenarios tested and then compared the financial performance of the same projects under the proposed IZ ordinance. The land costs used are not necessarily the market value of land, but rather the value of land which would realize the desired financial return. The methodology was used because ultimately changes in the IZ ordinance would impact the financial returns on projects, and the only way to recover costs from the developer perspective is to pay less for the underlying land. The public benefit that result from inclusionary zoning ultimately comes out of the land cost because other development costs are generally fixed and the developers can negotiate the price of the land.

Not surprisingly, the resulting land values for the selected model developments fell within the expected land value range identified by local developers. These results corroborate that the marketplace has normalized to the existing IZ ordinance. To this point, the analysis provides a realistic assessment of how the proposed changes to the IZ ordinance will impact financial feasibility, and ultimately land values within the City.

Data Collection

Pro forma development modeling, particularly IRR approach modeling, requires substantial market data to generate the model assumptions needed to calculate financial performance. There are three primary data categories needed to run a pro forma model, [1] construction/development data, [2] revenue/expenditure data, and [3] finance/investment data.

- Construction and development data include the costs of land, the costs to develop the structures, and the basic assumptions of types of units, size of units, and unit amenities.

- Revenue and expenditure data includes prevailing rent rates (both market rate and income controlled), prevailing sales prices, and operation costs for rental housing. Operation cost data points include direct operations (i.e. maintenance, marketing) and indirect costs (i.e. real estate taxes).

- Financial and investment data include prevailing lending rates, debt/equity requirements, capitalization rates, and discount rates.

RKG used several tools to gather this information, with a preference to gather locally-relevant information specific to the City of Newton. In areas where local data was not available or not appropriate, RKG relied on regional data (i.e. Boston Metro). The primary data collection method was capturing primary and secondary data about the Newton housing market. RKG gathered current rent rates (per month) and sales prices (by unit type) for owner and renter housing within the City to determine potential revenues. RKG gathered sales data from the City to understand current contract pricing.

RKG also interviewed several for-profit and non-profit residential developers, and commercial lending bank professionals to garner greater understanding of the local marketplace. Finally, RKG used nationally-recognized secondary data sources, such as Marshall & Swift Valuation Services, to verify data provided by the local real estate community. The results of this effort were used to create the baseline market assumptions for the financial feasibility model.

The following section provides details on the results of the data collection, and provides the underlying performance metrics used to test the financial impacts of the proposed IZ ordinance on specific development examples.

Components of the Model

As mentioned, the model functions on a traditional pro forma analysis platform, measuring the potential revenue of a real estate investment and comparing it to the costs and expenditures to construct, operate, and sell the asset. The modeling efforts compared the financial performance of seven distinct residential development scenarios under the existing IZ ordinance against the financial performance of those same scenarios under the proposed IZ ordinance. The seven development scenarios reflect various small, medium and large-scale ownership and rental development projects that may occur within Newton. The results were compared to understand the impact of the proposed IZ ordinance on the financial feasibility of each scenario. The seven development scenarios include:

- Four-unit ownership development
- Four-unit rental development
- Eight-unit ownership development
- 20-unit rental development
- 35-unit ownership development
- 65-unit rental development
- 180-unit rental development

The model has three primary components that drive the financial performance analysis: development assumptions, financial assumptions, and affordability assumptions. Each component influences the revenue and expenditure efficiencies of the development.

- *Development Assumptions* – The development assumptions focus on the 'bricks and mortar' facets of the proposed residential developments. Factors such as total unit count, unit breakout by bedroom count, average unit size by bedroom count, type of parking, cost of land to accommodate the development, and whether the development utilizes the City's bonus density program. These factors influence construction costs, potential operational revenues (for rental housing) and sale values (for ownership housing).

- *Financial Assumptions* – The financial assumptions include factors relating to debt and equity requirements, the cost of development financing (i.e. mortgage rates), inflation and appreciation rates (for operational costs and revenues), and project return expectations. The financial data directly affects the project's financial performance by adjusting the timing and amount of capital outlays (both debt and equity).

- *Affordability Assumptions* – The affordability assumptions include the market performance data such as market rent rates, target income thresholds for the IZ units, assumptions about the size of the Inclusionary units, and the percent requirement of IZ units of the total development. These assumptions further impact potential revenue levels as well as overall construction costs.

The following section details the individual assumptions used to run the model, and how those data points were collected. As mentioned, RKG collected primary and secondary data about residential development in Newton. RKG also performed several interviews with local real estate professionals to verify those findings. That said, the model was constructed to enable the City to customize the pro forma analysis through data overrides. This flexibility in modeling allowed RKG to perform sensitivity analyses about the impacts of changes in the proposed IZ ordinance requirements. This effort informed RKG's findings.

Income Tiers – The City's IZ ordinance is based on creating affordable housing targeted to specific income thresholds. The existing IZ ordinance focuses on 50% of AMI and 80% of AMI (for an average of 65% AMI) for housing affordability. The proposed IZ ordinance adds the 110% of AMI threshold as part of the affordability matrix. Table 4 details the 2017 income thresholds for various household sizes.

Table 4. FY 2017 Income Limits Summary - Newton, MA

	Household Size					
Income Level	**1-Person**	**2-Person**	**3-Person**	**4-Person**	**5-Person**	**6-Person**
50% AMI	$36,200	$41,400	$46,550	$51,700	$55,850	$60,000
60% AMI	$49,680	$55,860	$62,040	$76,020	$72,000	$76,980
80% AMI	$54,750	$62,550	$70,350	$78,150	$84,450	$90,700
100% AMI	$72,400	$82,800	$93,100	$103,400	$111,700	$120,000
110% AMI	$79,640	$91,080	$102,410	$113,740	$122,870	$132,000

Source: City of Newton and RKG, 2018

Rent Thresholds – The model calculates potential gross income by applying the market rate threshold to market rate units, and a rent threshold equivalent to 30% of gross income (utilities included) for income controlled units. The market rate rents were calculated through RKG research of current rent levels for apartments within the City built in the past ten years. Table 5 details the thresholds for each income level.

Table 5. Maximum Affordable Rents (Utilities Included)					
Unit Type	Household Size (# of BR + 1)	50% AMI	80% AMI	110% AMI	Non-Affordable Market Rate Unit Rent
1 BR Unit	2	$1,035	$1,564	$2,277	$3,166
2 BR Unit	3	$1,164	$1,759	$2,560	$4,005
3 BR Unit	4	$1,293	$1,954	$2,844	$4,832
Source: City of Newton and RKG Associates Inc., 2018					

Sales Price Thresholds – Like rent thresholds, the sales price thresholds were established by using HUD standards for lending (28% of gross income) with the income thresholds identified in the previous section. As seen in Table 6, purchase income controlled price thresholds are substantially lower than the market rate sales price levels identified by RKG. The market rate data was compiled by averaging recent sales prices of 1, 2, and 3-bedroom ownership units within the City.

Table 6. Maximum Affordable Sales Price					
Unit Type	Household Size (# of BR + 1)	50% AMI	80% AMI	110% AMI	Non-Affordable Market Rate Unit Sales Price
1 BR Unit	2	$191,750	$220,000	$308,750	$419,000
2 BR Unit	3	$217,000	$249,000	$348,250	$637,000
3 BR Unit	4	$255,000	$292,000	$400,000	$862,000
Source: City of Newton and RKG Associates Inc., 2018					

DEVELOPMENT REVENUES

Rents

RKG collected rental rate data for relatively new luxury developments which included efficiency (studio), one-bedroom, two-bedroom, and three-bedroom apartments. The market rental rates were used as a baseline for the analysis, and compared to information obtained from developers. Generally, new units rent for an average of nearly $3.25 per square foot. Within the model the rents can be modified by the user. For more information about rental rates, see Appendix 1.

Sales Values

The sales values of housing units were determined through a combination of market research and utilizing the City Assessor database to parse the most recent sales values by bedroom count. The results are used for the baseline assumption in the model. For more information about sales values, see Appendix 1.

Other Income

Income streams outside of traditional rent and sales value stem from parking revenues. For rental units, it was assumed in the model that parking revenues of $150 per space were attainable. No parking revenues are included in ownership units because the parking space is inherently included in the price of the unit.

DEVELOPMENT COSTS

Land Costs

The amount of money a developer can pay for a piece is land is a critical component to the financial feasibility of a project. The higher the land value, the more a developer needs to offset their costs through things like higher density, lower parking rates, or increased sales prices and rents. The price of land is one of the key factors that can affect financial feasibility; and this is especially true for projects on the financial margin. From a cost perspective, the cheaper a developer can obtain the land, the greater the potential financial return. This is because in terms of development, construction and financing costs are relatively fixed. Whereas the price of land and its developable potential can significantly impact the viability of a project.

The price of land in Newton is high, and based on conversations with developers spans a large range based on the underlying zoning and the total number of units which can be developed. An example being that a single-family home can easily sell for $1 million as a tear-down project which is then replaced with two units each selling for $1.3 million. This indicates that developable land is in scarcity in and around Newton.

Developers typically calculate the residual value of the land to determine what they would be willing to pay for the land on a per unit basis. This calculation considers construction costs, financing expenditures, and expected returns. The general approach towards determining the land value is to calculate the income expectations for the developed land, subtract all expenses associated with this development, and the remainder is the land residual. The decision to pursue the project depends on whether the developer can acquire the land at a favorable price.

Within the model RKG created a land value override where the model user can input their own land value assumption. This allows the user to test financial feasibility based on the different land costs, since they may vary significantly based on development size and underlying zoning.

Construction Costs

To determine construction costs, RKG interviewed several developers and utilized the December 2017 Marshall & Swift Valuation Services booklet to build out customized per square foot construction costs for traditional townhouse, stick, and stick over podium construction. RKG assumed that new construction would have either "excellent" or "good" interior or exterior finishes. Construction costs are adjusted by using a local Boston Metro multiplier supplied by Marshall and Swift. The Marshall and Swift numbers are an industry standard, and aligned to what was generally heard through the developer interviews.

Within the model the appropriate construction cost is applied to the development based on its type and average size. Four-unit developments are assigned townhome construction costs, greater than four units but less than 35 are deemed stick construction, and greater than 35 units are classified as stick over podium construction. RKG assumed for this model that all projects would take one year to complete and construction would begin in 2018. Appendix 1 has more detailed information about construction costs.

Parking Costs

Within the model three types of parking costs were included: surface, structured above ground, and underground. The types of parking have dramatically different cost estimates. Surface parking is by far the cheapest option for parking. Typically, this type of parking is done on smaller projects which have sufficient land area to accommodate the parking requirements under zoning. Structured parking occurs in developments that have the land area to build decked parking. While underground parking is by far the most expensive and done in space scarce developments.

The parking calculations are based on the number of parking spaces required for the development scenario based on the total number of residential units. RKG differentiated the parking requirements based on if the project was in a Transit-Oriented Development (TOD) or Non-TOD location. TOD centers around the concept of higher density development taking place around transportation nodes, the type of development envisioned includes residential, commercial, and retail spaces together in single area. Appendix 1 has more detailed information about parking costs.

Financing

Development financing is possibly the most important element of any real estate deal. The ability to secure long-term financing at an affordable rate allows a developer to complete their project. Different types of financing are available depending the scale of the project. For very large projects, financing might be obtained from a national bank, institutional investors, or a debt fund. These types of entities invest capital in projects for investors, and typically provide favorable interest rates given the track records of large scale developers.

Smaller scale developers utilize traditional bank financing as the main source of funding. Local banks typically act as partners with smaller scale developers, and provide funding to projects which meet their lending standards and risk profiles. Lending at the small scale is very much relationship based.

Modeling the financing component of development requires assumptions to be made about the equity, loan terms, and interest rates. As part of the data collection process, RKG interviewed several local developers who provided reality-based data regarding project financing.

EQUITY

The equity investment on the part of the developer which is required to obtain financing is dependent on many factors, some of which include: financial wherewithal, experience, project type, etc. Lenders require developers to contribute funding towards the project. The percentage of equity required is a variable within the model that can have a significant impact on the overall financial return. Typically, if a developer can secure financing which requires a smaller percentage of equity contribution, then the overall project return will be greater because the initial out-of-pocket cost will be less. The benefit to the developer is that they minimize their risk when they do not have to contribute large amounts of equity. For the modeling exercise, the default equity requirement was set at 30% for both owner and rental developments, this value can be changed within the model by the user.

TERMS

The length of the loan is dependent on the type of project under construction. For for-sale units, the loan is repaid once the units have sold. In this case, the loan period might last for 1 or 2 years depending on the time it takes for a project to be constructed and the units sold. For rental projects, the loan term can be variable. Developers have different exit strategies depending on their investment philosophies; some developers will hold a project for 10 years and then sell it, while others just build and hold the property. For the analysis, the model was calibrated to assume as a default that the loan for a for-sale development would be two years, and that for rental properties the loan term would be 20 years.

INTEREST RATES

Financial institutions provide funding based on the viability and potential success of a project, and the interest rates charged are evaluated against the developers financial standing and ability to complete the project. A range of interest rates could be charged to a developer depending on their track record, development program, or equity contribution. The higher the interest rate, the greater the overall cost to the developer. Small fluctuations in interest rates can have large impacts on the project financial return because the cost of debt service can substantially increase, thus rendering a project infeasible. Some developers contribute greater amounts of out-of-pocket equity as a means of lowering the interest rate on the loan. The default model assumptions for interest rates were 6.0% for rental developments and 5.5% for ownership developments. The higher interest rate for rental developments was used because the loan term is longer than that of the ownership developments.

DENSITY BONUS

What is a Density Bonus?

A density bonus is a mechanism allowing a developer to build a greater number of units than the existing underlying zoning dictates in exchange for the creation of additional affordable units. This incentive works well in cases where a community is focused on building more affordable units above and beyond the required number of units. The density bonus provides a developer with an incentive to create units at deeper levels of affordability, in exchange for the ability to build more market rate units.

Existing Density Bonus

Under the existing IZ ordinance, a bonus density may be granted equal to one new market rate unit for each by-right market rate unit committed to income restriction. The existing IZ ordinance requires 65% AMI for Rental (average of ½ at 50% AMI and ½ at 80%AMI) and 80% AMI for ownership. The density bonus is limited to where lot area per dwelling unit is decreased by up to 25 percent. While the current density bonus exists in the inclusionary zoning ordinance, its usage has historically been limited. The 'one for one' ratio between affordable and market rate units is not enough of a financial incentive to induce developers to utilize the bonus.

Proposed Density Bonus

The proposed density bonus expands upon the existing bonus density by providing a greater number of additional market rate units to the developer for each by-right market rate unit committed to income controls. Under the proposed IZ ordinance, a project that includes more than the required number of inclusionary units in the Tier 1 category (50% AMI) is awarded a bonus of two market rate units, with a limitation on the number of bonus units not exceeding 20% of the number of units otherwise permissible on the lot under lot area per dwelling unit requirements.[1]

The key concept of the density bonus is to entice the developer to build affordable units at deeper levels of affordability, while at the same time offering an incentive for the developer to regain lost value from the creation of the affordable units by supplementing with market rate units. Within the model that RKG produced, it is possible to adjust the density bonus to test the implications on the financial feasibility of the project. Density bonus units tend to have greater importance on smaller projects which, from a financial perspective, may not be viable without the addition of market rate units above underlying zoning.

CASH PAYMENT

As a method to capture the full value of affordable units that do not get built under the inclusionary ordinance, the City proposes to include a cash payment amount for fractional units. The cash payment amount is applied to fractional units which result from applying the appropriate inclusionary percentage across Tier's One, Two, and Three. The proposed IZ ordinance does not round any of the units, rather it prescribes each full unit be built, and any fractional piece be captured by a cash payment.

Under the proposed IZ ordinance, the cash payment as an alternative to each required inclusionary unit, or fraction thereof, is based on a formula that utilizes the current Massachusetts Department of

[1] See City of Newton Planning Memo #109-15(2), December 8, 2017

Housing and Community Development Index for "Total Residential Development Cost Limits" for Production Projects within Metro Boston. This index is updated annually through DHCD's Qualified Action Plan (QAP) and serves as a maximum subsidy amount per unit for affordable housing projects seeking Federal Low-Income Housing Tax Credits (LIHTC) throughout the state. Based on the "Total Residential Development Cost Limits" the value of a unit is set at $389,000. The determination of fractional units is based on the calculations for each of the three tiers in the proposed IZ ordinance.

Table 7 presents an example case of the calculation of the payment-in-lieu across the affordability tiers for a development that has 48 units.

Table 7. Example Payment in-Lieu Calculation for 48 Unit Project

	Tier 1 (50% AMI)	Tier 2 (80% AMI)	Tier 3 (110% AMI)
Inclusionary Percentage	5%	10%	10%
Calculated Units Based on IZ Percentage	2.4	4.8	4.8
Whole Units	2	4	4
Fractional Units	0.4	0.8	0.8
Cash Payment Amount on Fractional	$155,600	$311,200	$311,200
Total Project Units	48		
Inclusionary Units	10		
Market Rate Units	38		
Cash Payment in Lieu	$778,000		
Source: Newton Planning Memo #109-15(2), December 8, 2017			

As part of the modeling process, two additional options were explored regarding the value of the cash payment amount for fractional units. The first option was to use the construction hard costs for developing the affordable unit. The construction hard costs can be defined as the cost of construction for the actual unit, which excludes the price of the land. Utilizing this cost method enables the city to match the cost of building the unit with payment amount requested.

The second approach towards determining the payment amount is to utilize the value gap approach. The value gap is the difference between the value of a market rate unit and that of an affordable unit. The value of a rental unit is determined by the net operating income and the capitalization rate; for an ownership unit, it is determined by the sales value of the unit. In the case of affordable units, the amount of rent or sales value is limited to restricted AMI percentages; resulting in the potential value of a unit having a ceiling. The gap in value negatively impacts the overall financials of a developer because the cost of construction and land to build either an affordable or market rate unit are essentially the same. As part of the modeling process, an option was created to utilize the value gap approach in determining the fee amount to charge for fractional units.

Within the model there is an affordable unit and cash payment calculator which determines both the number of affordable units and potential payments in lieu based under either the existing or proposed

IZ ordinance.[2] The model also calculates the dollar value of the payment in lieu of an affordable unit using either: Total Residential Development Cost Limits ($389,000); construction hard costs, or the value gap approach.

From a financial standpoint, the calculated fee in-lieu payment is added to the initial cost of the development, which ultimately influences the overall financial return. Depending on the project size, a large fee in-lieu could have a detrimental impact. Typically, a small project tends to be more sensitive to greater upfront costs because small dollar amount changes can have an outsized impact as compared to larger projects.

SCENARIO ANALYSIS

Scenarios Under Evaluation

To test the model and the underlying development assumptions, RKG ran seven development scenarios. Table 8 presents the model calibration for each of the seven scenarios. The scenarios were chosen by the City to understand the impact of the IZ changes on prototypical developments. One key difference in terms of development costs is that of parking; in scenarios 35 units or larger the assumption was made that underground parking was the default, resulting in an overall higher development cost.

Table 8. Modeled Scenarios

Scenario	Unit Type	Location	Parking	Number of Units	AMI %	Inclusionary Percentage
1	Ownership	TOD	100% Surface	4	80/110% AMI	15.0%
2	Rental	TOD	100% Surface	4	50/80/110% AMI	15.0%
3	Ownership	TOD	100% Surface	8	80/110% AMI	15.0%
4	Rental	TOD	100% Surface	20	50/80/110% AMI	20.0%
5	Ownership	TOD	100% Underground	35	80/110% AMI	25.0%
6	Rental	TOD	100% Underground	65	50/80/110% AMI	25.0%
7	Rental	TOD	100% Underground	180	50/80/110% AMI	25.0%

Source: City of Newton, and RKG Associates Inc.

The financial analysis conducted by RKG provides key insights regarding the relative impact on development finance resulting from changes in the inclusionary ordinance. RKG modeled each of the seven scenarios by calibrating the model with realistic assumptions. As part of the analysis, RKG modeled financial feasibility under the existing IZ ordinance, as well as under two proposed IZ methods. Under Method One, the conditions for inclusionary housing include the rounding up of fractional units greater than 0.50, and having no fee-in-lieu. Under Method Two, the conditions for inclusionary housing are to build whole units, and charge a fee-in-lieu for any fractional unit. For all

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[2] Based calculations of fee-in-lieu on the existing Inclusionary Zoning ordinance and proposed inclusionary zoning ordinance.

scenarios under analysis, RKG used the fee-in-lieu amount of $389,000, which is part of the proposed IZ ordinance, to calculate the payments on fractional units. The data tables for each of the scenarios show the differences between the existing IZ ordinance and both the proposed IZ ordinance methods.

Interpreting Results

The financial model calculates the basic go/ no-go decision a developer must make about a potential project. The decision to pursue a project comes down to overall financial return and risk exposure. If there is confidence that the desired returns will be reached, then the project will be pursued, otherwise the project will not be undertaken.

From a financial perspective, the model calculates outputs that can be helpful when determining whether a developer or a lender will choose to go forward with a project. Of these outputs, both the Internal Rate of Return (IRR) and Net Present Value (NPV) are industry standard financial viability metrics for a given project. While these are important metrics, they are not the sole arbitrators of financial viability, as project risk assessment and developer track record are also important factors. The IRR and NPV when examined together, offer significant insight to both a lender and developer. The IRR is the calculated annual return on investment, taking into consideration net operating income, investment holding period, and sales value. The NPV is the present value of all future cash flows (both revenues and expenditures) for the project based on an expected return rate (discount rate) and over the course of the determined holding period. Based on the size of the initial upfront capital investment in a project, small percentage changes in the IRR can have dramatic effects on the net present value. The decision factor for not pursuing a project is if the IRR does not meet the required rate of return, or if the NPV is below zero. It is possible that a project results in a positive NPV and a lower than desired IRR. In cases such as this, the decision process becomes more nuanced as the developer would have to get comfortable with realizing a lower return. Within the development industry, the standard IRR return for a new construction rental project is 12 percent and 20 percent for new construction ownership units.

As noted earlier, from a development finance standpoint the unknown in a real estate deal is the cost of land. To conduct the comparative analysis, for each of the individual seven scenarios under the existing inclusionary policy the cost of the land was calculated to make the project financially viable and meet the developer's return expectation. This cost of land was then used for each of the two proposed IZ scenarios to understand how the changes in the ordinance impact the overall development return. It should be noted that the calculated land values for each scenario fall within the range of value local developers reported to pay for similar properties, corroborating that land values are normalized to the existing IZ ordinance.

Analysis Limitations

The undertaken analysis is not without limitations. The financial model is based upon assumptions which were collected through developer interviews, market research, and professional judgement. These assumptions are the main drivers of the financial model. The developments that are modeled in this analysis are prototypical developments that could potentially be found in Newton, and not actual developments. While all the assumptions that drive the model can be customizable, RKG calibrated the model such that the base assumptions are the default. There are countless permutations that can be modeled, but RKG in consultation with the City, chose to model prototypical developments with relatively standardized inputs.

The model is not able to test every variable or possibility, rather it can be used as a ordinance tool to help inform the decision-making process. The model output helps show the relative impact of ordinance changes on development financial feasibility.

Four-Unit Ownership Development

The four-unit ownership development scenario offers a baseline assessment of how the proposed IZ ordinance impacts the existing development landscape. Under the existing IZ ordinance, inclusionary zoning does not get triggered until six units (the ordinance calls for inclusionary units once there are four net new units above the number of units allowed by-right (two units are allowed by-right)). In the case of the four-unit ownership development under the existing IZ ordinance, no inclusionary units are required. The existing IZ ordinance results were calibrated to determine the land value which would result in a 20% return to the developer. The land values used for this scenario were $189,936 per unit, and this value was held constant for each of the proposed scenarios to understand the relative changes inclusionary units and payments-in-lieu would have on financial returns. Table 9 below provides detailed information about each model run for the scenario.

Under Method One, three market rate units and one affordable unit at 80% AMI would be required. As seen in the table, the impact to the developer of having to provide the affordable unit is significant and results in a negative NPV of $316,882. A negative NPV occurs because the financial investment needed to undertake the project is greater than the cash flow generated; this outcome illustrates the investment does not make financial sense from the prospective of the developer. The reason the NPV is negative under Method One is because of the value gap between delivering a market rate unit versus an affordable unit. The value gap is due to the sales value of an affordable unit being capped at a level which is affordable to an 80% AMI household. From the developer's standpoint, the inability to realize full value from the affordable unit, which has a similar cost to that of a market unit, results in a financial loss. Under Method One, the IRR is negative 30.5 percent, which is well below the standard return of 20 percent on ownership developments.

Method Two results in a negative NPV of $233,415 and a negative IRR of 8.4 percent, indicating the project is not financially viable. Under this scenario, four market rate units would be built, and a fee-in-lieu of $233,400 would be paid to the City for the fractional unit. In this instance, the fee-in-lieu payment results in the project becoming infeasible; this is the only difference between the existing IZ ordinance and Method Two. Compared to Method One, the return to the developer while negative, is better under Method Two because the fee-in-lieu amount is less than the value gap loss under Method One.

Based on the calibrations of the model and development scenario, both Method One and Two result in the project becoming uneconomic as compared to the financial results under the existing IZ ordinance.

Table 9. Four-Unit Ownership Development					
	Existing IZ Ordinance	Method One: Proposed IZ Ordinance (Round and Build Unit)	Method Two: Proposed IZ Ordinance (Build Unit and Fee-in-lieu)	Existing IZ vs Method One	Existing IZ vs Method Two
Location	TOD	TOD	TOD		
Unit Type	Owner	Owner	Owner		
Number of Units	4	4	4		
Parking	Surface	Surface	Surface		
Special Permit	Yes	Yes	Yes		
Inclusionary %	15%	15%	15%		
Inclusionary Treatment	Build Affordable Unit	Round and Build Units	Build Units and Pay Fractional		
Inclusionary Units	0	1	0	1	0
Payment in Lieu	$0	$0	$233,400	$0	$233,400
AMI Split	80% AMI	80% AMI	80% AMI		
All Costs	$2,455,107	$2,455,107	$2,455,107		
Land Cost	$759,743	$759,743	$759,743		
Land Cost Per Unit	$189,936	$189,936	$189,936		
Average Cost Per Unit (Inclusive of Land)	$613,777	$613,777	$613,777		
IRR	**20.0%**	**-30.5%**	**-8.4%**	**-50.4%**	**-28.4%**
NPV	**($15)**	**($316,882)**	**($233,415)**	**($316,867)**	**($233,400)**

Four-Unit Rental Development

The four-unit rental development scenario offers a baseline assessment of how the proposed IZ ordinance impacts the existing development landscape. Under the existing IZ ordiance, the affordable units average 65% AMI, based on ½ the units being delivered for households earning 50% AMI and ½ the units at 80% AMI. The existing ordinance does not get triggered until six units (the ordinance calls for inclusionary units once there are four net new units above the number of units allowed by-right (two units are allowed by-right)). So, in the case of the four-unit rental development under the existing IZ, no inclusionary units are required. The existing inclusionary ordinance results were calibrated to determine the land value which would result in a 12% return to the developer. The land values used for this scenario were $210,260 per unit, and this value was held constant for each of the proposed scenarios to understand the relative changes inclusionary units and payments-in-lieu would have on financial returns. Table 10 provides detailed information about each model run for the scenario.

Under Method One three market rate units and one affordable unit at 80% AMI would be required. As seen in the table, the impact to the developer of having to provide the affordable unit is significant and results in a negative NPV of $154,826. The reason the NPV is negative under Method One is because of the value gap between delivering a market rate unit versus an affordable unit. From the developer's standpoint, the inability to realize full value from the affordable unit, which has a similar cost to that of a market unit, results in a financial loss. Under Method One, the IRR is 9.5 percent, which is well below the standard return of 12 percent on new rental developments.

Method Two results in a negative NPV of $231,702 and an IRR of 9.0 percent, indicating the project is not financially viable. Under this scenario, four market rate units would be built, and a fee-in-lieu of $233,400 would be paid to the City for the fractional unit. In this instance, the fee-in-lieu payment results in the project becoming infeasible. Compared to Method One, the return to the developer under Method Two is worse because the fee-in-lieu amount is a greater than the value gap loss from providing the affordable unit under Method One.

Based on the calibrations of the model and development scenario, both Method One and Two result in the project being uneconomic as compared to the financial results under the existing IZ ordinance.

Table 10. Four-Unit Rental Development					
	Existing IZ Ordinance	Method One: Proposed IZ Ordinance (Round and Build Unit)	Method Two: Proposed IZ Ordinance (Build Unit and Fee-in-lieu)	Existing IZ vs Method One	Existing IZ vs Method Two
Location	TOD	TOD	TOD		
Unit Type	Rental	Rental	Rental		
Number of Units	4	4	4		
Parking	Surface	Surface	Surface		
Special Permit	Yes	Yes	Yes		
Inclusionary %	15%	15%	15%		
Inclusionary Treatment	Build Affordable Unit	Round and Build Units	Build Units and Pay Fractional		
Inclusionary Units	0	1	0	1	0
Payment in Lieu	$0	$0	$233,400	$0	$233,400
AMI Split	65% AMI	80% AMI	80% AMI		
All Costs	$1,887,797	$1,849,454	$1,887,797		
Land Cost	$841,040	$841,040	$841,040		
Land Cost Per Unit	$210,260	$210,260	$210,260		
Average Cost Per Unit (Inclusive of Land)	$471,949	$462,364	$471,949		
IRR	**12.0%**	**9.5%**	**9.0%**	**-2.6%**	**-3.0%**
NPV	**$1,698**	**($154,826)**	**($231,702)**	**($156,524)**	**($233,400)**

Eight-Unit Ownership Development

The eight-unit ownership development under the existing IZ ordinance results in one affordable unit built at 80% AMI and seven market rate units. Using the residual land value calculation, the land value per unit which would result in a 20% return would be $294,688. Since this is a hypothetical development with a financial return set to 20%, the land value per unit tends to be much higher than what would normally sell in the market. If the developer could obtain the land at a lower cost ultimately their return on investment would be much higher, but for the sake of the modeling exercise we are assuming a conservative rate of return.

Under Method One, the developer would build seven market rate units and one affordable unit at 110% AMI. The NPV of the project would be a positive $81,530 and the IRR would be 26.7 percent. The financial return is greater than the industry standard return of 20 percent because of the inclusion of the additional value generated by the 110% AMI unit over the 80% AMI unit that would have been built under the existing IZ ordinance.

Under Method Two, seven market rate units, one affordable unit at 110% AMI, and a fee-in-lieu of $77,800 would be paid to the City for the fractional unit. The NPV of the project is a positive $3,730 and the IRR is 20.3 percent. While overall financially positive, the fee-in-lieu decreases the financial return as compared to Method One.

Based on the calibrations of the model and development scenario, both Method One and Two result in a better financial outcome for the developer when compared to the existing IZ ordinance. Under the proposed IZ ordinance, the requirement to build a 110% AMI unit versus an 80% AMI unit which helps the developer financially.

Table 11. Eight-Unit Ownership Development					
	Existing IZ Ordinance	Method One: Proposed IZ Ordinance (Round and Build Unit)	Method Two: Proposed IZ Ordinance (Build Unit and Fee-in-lieu)	Existing IZ vs Method One	Existing IZ vs Method Two
Location	TOD	TOD	TOD		
Unit Type	Owner	Owner	Owner		
Number of Units	8	8	8		
Parking	Surface	Surface	Surface		
Special Permit	Yes	Yes	Yes		
Inclusionary %	15%	15%	15%		
Inclusionary Treatment	Build Affordable Unit	Round and Build Units	Build Units and Pay Fractional		
Inclusionary Units	1	1	1	0	0
Payment in Lieu	$0	$0	$77,800	$0	$77,800
AMI Split	80% AMI	110% AMI	110% AMI		
All Costs	$4,765,353	$4,765,353	$4,765,353		
Land Cost	$2,357,507	$2,357,507	$2,357,507		
Land Cost Per Unit	$294,688	$294,688	$294,688		
Average Cost Per Unit (Inclusive of Land)	$595,669	$595,669	$595,669		
IRR	**20.0%**	**26.7%**	**20.3%**	**6.6%**	**0.3%**
NPV	**$476**	**$81,530**	**$3,730**	**$81,054**	**$3,254**

20-Unit Rental Development

The 20-unit rental development under the existing IZ ordinance results in three affordable units built at an average of 65% AMI and 17 market rate units. Using the residual land value calculation, the land value per unit which would result in a 12% return would be $192,567 and this value was held constant for each of the proposed scenarios to understand the changes in inclusionary units and payments-in-lieu have on financial returns. Table 12 below provides detailed information about each model run for the scenario.

Under Method One, the developer would build 16 market rate units and four affordable units (two at 80% AMI, and two at 110% AMI). The NPV of the project would be a positive $54,251 and the IRR would be 12.2 percent. The financial return is greater than the industry standard return of 12 percent because of the inclusion of the additional value generated by the 80% and 110% AMI units over the 65% AMI units that would have been built under the existing IZ ordinance.

The analysis conducted under Method Two does not yield a different result than Method One because based on a 20-unit development, the math works out such that exactly four units are required and no fractional remainders exist.

Based on the calibrations of the model and development scenario, both Method One and Two result in a better financial outcome for the developer when compared to the existing IZ ordinance. Under the proposed IZ ordinance, the requirement to build 80% and 110% AMI units versus just 80% AMI units which helps the developer financially.

Table 12. 20-Unit Rental Development

	Existing IZ Ordinance	Method One: Proposed IZ Ordinance (Round and Build Unit)	Method Two: Proposed IZ Ordinance (Build Unit and Fee-in-lieu)	Existing IZ vs Method One	Existing IZ vs Method Two
Location	TOD	TOD	TOD		
Unit Type	Rental	Rental	Rental		
Number of Units	20	20	20		
Parking	Surface	Surface	Surface		
Special Permit	Yes	Yes	Yes		
Inclusionary %	15%	20%	20%		
Inclusionary Treatment	Build Affordable Unit	Round and Build Units	Build Units and Pay Fractional		
Inclusionary Units	3	4	4	1	1
Payment in Lieu	$0	$0	$0	$0	$0
AMI Split	65% AMI	80/110% AMI	80/110% AMI		
All Costs	$8,614,029	$8,548,958	$8,548,958		
Land Cost	$3,851,349	$3,851,349	$3,851,349		
Land Cost Per Unit	$192,567	$192,567	$192,567		
Average Cost Per Unit (Inclusive of Land)	$430,701	$427,448	$427,448		
IRR	**12.0%**	**12.2%**	**12.2%**	**0.2%**	**0.2%**
NPV	**$793**	**$54,251**	**$54,251**	**$53,457**	**$53,457**

35-Unit Ownership Development

The 35-unit ownership development under the existing IZ ordinance results in five affordable units built at 80% AMI and 30 market rate units. Using the residual land value calculation, the land value per unit which would result in a 20% return would be $228,185. Since this is a hypothetical development with a financial return set to 20%, the land value per unit tends to be much higher than what land would normally sell for in the market. If the developer could obtain the land at a lower cost ultimately their return on investment would be much higher, but for the sake of the modeling exercise we are assuming a conservative rate of return.

Under Method One, the developer would build 26 market rate units and nine affordable units (four at 80% AMI, and five at 110% AMI). The NPV of the project would be a negative $739,011 and the IRR would be 5.4 percent. The financial return under Method One is lower than the existing IZ ordinance because an additional four units of affordable housing is required. Even though all the affordable units are restricted to an AMI threshold that is higher than the existing IZ ordinance, the value gap of each affordable unit continues to erode the financial return to the developer. Even with the inclusion of units at 110% AMI, that still is not enough to overcome the value loss.

Under Method Two, the developer would build 27 market rate units and eight affordable units (three at 80% AMI, and five at 110% AMI), and a fee-in-lieu of $291,750 which would be paid to the City for the fractional unit. The NPV of the project would be a negative $773,917 and the IRR would be 5.5 percent. The financial return under Method Two is lower than the existing IZ ordinance because an additional three units of affordable housing is required plus the fee-in-lieu payment. Even though all the affordable units would be built at an AMI threshold which is higher than the existing IZ ordinance, the value gap of each affordable unit continues to erode the financial return to the developer, and thus makes it uneconomic.

Based on the calibrations of the model and development scenario, both Method One and Two result in a financial return which is less than the 20 percent minimum return. This indicates that the proposed IZ ordinance is more onerous than the existing IZ ordinance. The increased number of affordable units under the proposed IZ ordinance makes the project uneconomic.

Table 13. 35-Unit Ownership Development					
	Existing IZ Ordinance	Method One: Proposed IZ Ordinance (Round and Build Unit)	Method Two: Proposed IZ Ordinance (Build Unit and Fee-in-lieu)	Existing IZ vs Method One	Existing IZ vs Method Two
Location	TOD	TOD	TOD		
Unit Type	Owner	Owner	Owner		
Number of Units	35	35	35		
Parking	Underground	Underground	Underground		
Special Permit	Yes	Yes	Yes		
Inclusionary %	15%	25%	25%		
Inclusionary Treatment	Build Affordable Unit	Round and Build Units	Build Units and Pay Fractional		
Inclusionary Units	5	9	8	4	3
Payment in Lieu	$0	$0	$291,750	$0	$291,750
AMI Split	80% AMI	80/110 AMI	80/110 AMI		
All Costs	$20,088,853	$19,810,415	$19,875,486		
Land Cost	$7,986,484	$7,986,484	$7,986,484		
Land Cost Per Unit	$228,185	$228,185	$228,185		
Average Cost Per Unit (Inclusive of Land)	$573,967	$566,012	$567,871		
IRR	**20.0%**	**5.4%**	**5.5%**	**-14.6%**	**-14.5%**
NPV	**$690**	**($739,011)**	**($773,917)**	**($739,701)**	**($774,608)**

65 Unit Rental Development

The 65-unit rental development under the existing IZ ordinance results in 10 affordable units built at an average of 65% AMI and 55 market rate units. Using the residual land value calculation, the land value per unit which would result in a 12% return would be $110,699.

Under Method One, the developer would build 48 market rate units and 17 affordable units (five at 50% AMI, seven at 80% AMI, and five at 110% AMI). The NPV of the project would be a negative $856,242 and the IRR would be 11.1 percent. The financial return under Method One is lower than the existing IZ ordinance because an additional seven units of affordable housing is required. Even though the affordable units are allocated amongst multiple AMI thresholds, the value gap of each affordable unit continues to erode the financial return to the developer. Even with the inclusion of units at 110% AMI, that still is not enough to overcome the value loss because the cost of developing an affordable unit is essentially equal to that of a market rate unit.

Under Method Two, 51 market rate units, 14 affordable units (four at 50% AMI, six at 80% AMI, and four at 110% AMI), and a fee-in-lieu of $875,250 would be paid to the City for the fractional units. The NPV of the project would be a negative $1,216,502 and the IRR would be 10.8 percent. Again, the financial return under Method Two is lower than the existing IZ ordinance because of the four extra affordable units coupled with the fee-in-lieu payment.

Based on the calibrations of the model and development scenario, both Method One and Two result in a financial return which is less than the 12 percent minimum return. This indicates that the proposed IZ ordinance is more onerous than the existing IZ ordinance. The increased number of affordable units under the proposed IZ ordinance makes the project uneconomic in this scenario.

Table 14. 65-Unit Rental Development					
	Existing IZ Ordinance	Method One: Proposed IZ Ordinance (Round and Build Unit)	Method Two: Proposed IZ Ordinance (Build Unit and Fee-in-lieu)	Existing IZ vs Method One	Existing IZ vs Method Two
Location	TOD	TOD	TOD		
Unit Type	Rental	Rental	Rental		
Number of Units	65	65	65		
Parking	Underground	Underground	Underground		
Special Permit	Yes	Yes	Yes		
Inclusionary %	15%	25%	25%		
Inclusionary Treatment	Build Affordable Unit	Round and Build Units	Build Units and Pay Fractional		
Inclusionary Units	10	17	14	7	4
Payment in Lieu	$0	$0	$875,250	$0	$875,250
AMI Split	65% AMI	50/80/110% AMI	50/80/110% AMI		
All Costs	$27,843,738	$27,448,530	$27,616,564		
Land Cost	$7,195,416	$7,195,416	$7,195,416		
Land Cost Per Unit	$110,699	$110,699	$110,699		
Average Cost Per Unit (Inclusive of Land)	$428,365	$422,285	$424,870		
IRR	**12.0%**	**11.1%**	**10.8%**	**-0.9%**	**-1.2%**
NPV	**$525**	**($856,242)**	**($1,216,502)**	**($856,766)**	**($1,217,027)**

180-Unit Rental Development

The 180-unit rental development under the existing IZ ordinance results in 27 affordable units built at an average of 65% AMI and 153 market rate units. Using the residual land value calculation, the land value per unit which would result in a 12% return would be $111,664.

Under Method One, the developer would build in 135 market rate units and 45 affordable units (18 at 50% AMI, 18 at 80% AMI, and nine at 110% AMI). The NPV of the project would be a negative $2,801,086 and the IRR would be 10.9 percent. The financial return under Method One is lower than the existing IZ ordinance because an additional 18 units of affordable housing that is required. Even though the affordable units are allocated amongst multiple AMI thresholds, the value gap for each affordable unit continues to erode the financial return to the developer. Even with the inclusion of units at 110% AMI, that still is not enough to overcome the value loss because the cost of developing an affordable unit is essentially equal to that of a market rate unit.

The analysis conducted under Method Two does not yield a different result than Method One because based on a 180-unit development, the math works out such that exactly 45 affordable units are required and no fractional remainders exist.

Based on the calibrations of the model and development scenario, both Method One and Two result in a financial return which is less than the 12 percent minimum return. This indicates that the proposed IZ ordinance is more onerous than the existing IZ ordinance. The increased number of affordable units under the proposed IZ ordinance makes the project uneconomic in this scenario.

Table 15. 180-Unit Rental Development					
	Existing IZ Ordinance	Method One: Proposed IZ Ordinance (Round and Build Unit)	Method Two: Proposed IZ Ordinance (Build Unit and Fee-in-lieu)	Existing IZ vs Method One	Existing IZ vs Method Two
Location	TOD	TOD	TOD		
Unit Type	Rental	Rental	Rental		
Number of Units	180	180	180		
Parking	Underground	Underground	Underground		
Special Permit	Yes	Yes	Yes		
Inclusionary %	15%	25%	25%		
Inclusionary Treatment	Build Affordable Unit	Round and Build Units	Build Units and Pay Fractional		
Inclusionary Units	27	45	45	18	18
Payment in Lieu	$0	$0	$0	$0	$0
AMI Split	65% AMI	50/80/110% AMI	50/80/110% AMI		
All Costs	$77,066,664	$76,082,952	$76,082,952		
Land Cost	$20,099,549	$20,099,549	$20,099,549		
Land Cost Per Unit	$111,664	$111,664	$111,664		
Average Cost Per Unit (Inclusive of Land)	$428,148	$422,683	$422,683		
IRR	**12.0%**	**10.9%**	**10.9%**	**-1.1%**	**-1.1%**
NPV	**$54,626**	**($2,801,086)**	**($2,801,086)**	**($2,855,712)**	**($2,855,712)**

BONUS DENSITY ANALYSIS

A bonus density offers an incentive to a developer to build additional affordable units in exchange for market rate units. Under the existing IZ ordinance the density bonus provides a one-to-one ratio of more market rate units to affordable units. The existing density bonus has historically been underutilized because the financial incentive is not great enough. Under the proposed IZ ordinance, the density bonus is increased to a two-to-one ratio, providing for two market rate units for every affordable unit. Additionally, all the affordable units under the density bonus are targeted toward the 50% AMI level. RKG tested the bonus impact of the proposed bonus density on the 65-unit project, as well as a hypothetical bonus density of three-to-one.

65-Unit Rental Development with Bonus Density

In the 65-unit rental development scenario under the proposed IZ ordinance, the bonus density allows for a maximum increase of bonus units of 20% of the total number of units in the development. Table 16 on the accompanying page presents the findings of the analysis. In the case of a 65-unit development the total number of bonus units allowed are 13 (65 x 20%), meaning that 78 units are allowed on the site of a 65-unit development. In the case where a two-to-one bonus density is applied seven additional affordable units are provided in exchange for 14 market rate units (14 market rate units resulted from rounding, since 13 is a prime number with no multiples). The added increase in market rate units slightly improves the financial viability of the development. In the baseline scenario where no bonus density is used, the IRR of the project is 10.8% which indicates the development does not reach market return expectations. Under the two-for-one bonus density scenario the IRR of the project improves to 11.1% but still does not reach the 12% desired return, indicating the incentive is not enough to the developer.

Applying a three-to-one bonus density results in the addition of four more affordable units in exchange for 12 market rate units (12 units results due to rounding because 13 has no multiples). The IRR of the project increases to 11.5%; however, the project still does not reach the minimum return expectation. The main reason why the bonus density is not working is because the affordable units that are provided through the bonus density are targeted towards the 50% AMI level. Due to the deep affordability level, the value loss that results is still too great for the developer to overcome.

Table 16. 65-Unit Rental Development With Bonus Density					
	Method Two: Proposed IZ Ordinance (Build Unit and Fee in Lieu, No Bonus)	Method Two: Proposed IZ Ordinance (Build Unit and Fee in Lieu, 2:1 Bonus)	Method Two: Proposed IZ Ordinance (Build Unit and Fee in Lieu, 3:1 Bonus)	Method Two vs. 2:1 Bonus	Method Two vs. 3:1 Bonus
Location	TOD	TOD	TOD		
Unit Type	Rental	Rental	Rental		
Number of Units	65	79	77	14	12
Parking	Underground	Underground	Underground		
Special Permit	Yes	Yes	Yes		
Inclusionary %	25%	25%	25%		
Inclusionary Treatment	Build Units and Pay Fractional	Build Units and Pay Fractional	Build Units and Pay Fractional		
Inclusionary Units	14	21	18	7	4
Payment in Lieu	$875,250	$875,250	$875,250	$0	$0
AMI Split	50/80/110% AMI	50/80/110% AMI	50/80/110% AMI		
All Costs	$27,616,564	$31,745,358	$31,294,727		
Land Cost	$7,195,416	$7,195,416	$7,195,416		
Land Cost Per Unit	$110,699	$91,081	$93,447		
Average Cost Per Unit (Inclusive of Land)	$424,870	$401,840	$406,425		
IRR	**10.8%**	**11.1%**	**11.5%**	**0.4%**	**0.7%**
NPV	**($1,216,502)**	**($990,672)**	**($590,854)**	**$225,830**	**$625,648**

180-Unit Rental Development with Bonus Density

Table 17 on the accompanying page presents the findings of the analysis. In the 180-unit rental development scenario under the proposed IZ ordinance, the bonus density allows for a maximum increase of bonus units of 20% of the total number of units which translates into 36 (180 x 20%) bonus units, meaning that 216 units are allowed on the site of a 180-unit development. In the case where a two-to-one bonus density is applied, 18 additional affordable units are provided in exchange for 36 market rate units. The added increase in market rate units slightly improves the financial viability of the development. In the baseline scenario where no bonus density is used, the IRR of the project is 10.9 percent which indicates the development is not financially feasible. Under the two-for-one bonus density scenario the IRR of the project improves to 11.2% but still does not reach the 12% desired return, indicating the incentive is not enough to the developer.

Applying a three-to-one bonus density results in the addition of 12 more affordable units in exchange for 36 market rate units. The IRR of the project increases to 11.7%; however, the project still does not become financially viable. The main reason why the bonus density is not working is because the affordable units that are provided through the bonus density are targeted towards the 50% AMI level. Due to the deep affordability level, the value loss that results is still too great for the developer to overcome.

Table 17. 180-Unit Rental Development With Bonus Density					
	Method Two: Proposed IZ Ordinance (Build Unit and Fee in Lieu, No Bonus)	Method Two: Proposed IZ Ordinance (Build Unit and Fee in Lieu, 2:1 Bonus)	Method Two: Proposed IZ Ordinance (Build Unit and Fee in Lieu, 3:1 Bonus)	Method Two vs. 2:1 Bonus	Method Two vs. 3:1 Bonus
Location	TOD	TOD	TOD		
Unit Type	Rental	Rental	Rental		
Number of Units	180	216	216	36	36
Parking	Underground	Underground	Underground		
Special Permit	Yes	Yes	Yes		
Inclusionary %	25%	25%	25%		
Inclusionary Treatment	Build Units and Pay Fractional	Build Units and Pay Fractional	Build Units and Pay Fractional		
Inclusionary Units	45	63	57	18	12
Payment in Lieu	$0	$0	$0	$0	$0
AMI Split	50/80/110% AMI	50/80/110% AMI	50/80/110% AMI		
All Costs	$76,082,952	$86,813,603	$87,120,486		
Land Cost	$20,099,549	$20,099,549	$20,099,549		
Land Cost Per Unit	$111,664	$93,053	$93,053		
Average Cost Per Unit (Inclusive of Land)	$422,683	$401,915	$403,336		
IRR	**10.9%**	**11.2%**	**11.7%**	**0.3%**	**0.8%**
NPV	**($2,801,086)**	**($2,367,936)**	**($964,979)**	**$433,150**	**$1,836,107**

SUMMARY FINDINGS

Based on the analysis conducted by RKG, it appears that project size (number of units) matters in relation to the IZ ordinance. The proposed IZ ordinance for small developments which can be defined as under six units seems to have a detrimental impact on the project financial feasibility. At the small scale, the addition of an additional unit of affordable housing has an outsized impact on the overall financial return of the project. Small scale developers have greater sensitivity to changes in their development program than larger developers because there are less units to spread the risk. For example, if a developer were to build a four-unit development under the proposed IZ, they would be required to pay a fee-in-lieu for the fractional unit (0.60) which would amount to $233,400. Under the rental scenario in the model a four-unit development costs about $1.8 million to build; the fee-in-lieu would be nearly 13% of the total cost. For a small project of that size, an increase in expenditures of that magnitude would have a detrimental impact.

At the medium size project level of between six and 20 units, the proposed changes to the inclusionary zoning ordinance appear calibrated correctly as they result in more affordable units for the City, and a better financial outcome to the developer. The percent allocation of affordable units between AMI thresholds is critical. Under the proposed language for ownership units between seven and nine units, the unit allocation is 15% of the units at 110% AMI; while for rental developments between 10 and 20 units the AMI allocation is 10% at 80% AMI, and 10% at 110% AMI. From the standpoint of building affordable units, these percent allocations help to incentivize the construction of units. Higher AMI thresholds minimize the value loss a developer experiences as compared to if they are required to provide units at a lower AMI threshold. The downside to this percent allocation is that housing for the lowest income levels does not get built; but if the incentive structure did not exist, then no housing would be built because the project would be financially infeasible.

At the large size rental projects defined as 35 units and above, the proposed IZ ordinance as designed has a negative impact on the overall financial return of a prototypical development. The key issue within the proposed IZ ordinance is how percentages within the affordability tiers are allocated. Table 18 below presents the affordability percentages for rental projects greater than 20 units. It can be observed that for developments falling between 51 and 100 units, there is a balance between units at 50% AMI and those at 110% AMI. However, even with the proposed affordability tiers, the balance is not sufficient to overcome the overall value loss from the creation of many affordable units.

Table 18. Affordability Tiers			
	21-50 Units	51-100 Units	101+ Units
Tiers	**Rental**	**Rental**	**Rental**
Tier 1, up to 50% AMI	5.0%	7.5%	10.0%
Tier 2, 51% - 80% AMI	10.0%	10.0%	10.0%
Tier 3, 81% - 110% AMI	10.0%	7.5%	5.0%
Total	25.0%	25.0%	25.0%
Source: City of Newton, 2018			

At the largest scale of development, those over 101 units, the affordability is further skewed downward toward the 50% AMI level. By requiring a developer to set aside 10% of their units at 50% AMI, with as an offset of only 5% of the units at 110% AMI, the financial feasibility of the project will be challenged. If the City is mandating deeper levels of affordability then there needs to be an offset or incentive that is attractive to developers. Even when factoring in the proposed bonus density of two units for every one affordable, the offset is not enough to compensate for the greater level of affordability. Within the bonus density proposal, for every market rate unit converted to an affordable 50% AMI unit, two market rate units are given. Again, the compensation for the deep level of affordability is not a sufficient incentive for the developer. A shift in the percentages within the affordability tiers may offer a solution to making developments financially feasible.

The proposed bonus density of two-for-one, while having an impact on the overall project feasibility, is not great enough to offset the number of affordable units that are required at the 50% AMI level. Even applying a hypothetical three-to-one ratio still does not yield a positive result. The key finding for the bonus density is that as currently structured, it is not sufficient for making the projects financially viable. One possible solution towards improving the bonus density is rather than require all affordable units resulting from utilizing the bonus density to fall within the 50% AMI threshold, the units could be allocated across all the AMI thresholds. This spreading of affordable units ultimately helps the development financially because it offsets the deeper affordable units.

APPENDIX 1

Baseline Model Assumptions	
Revenues	**Assumptions**
Market Rents*	
Studio	$2,233
1BR	$3,166
2BR	$4,005
3BR	$4,832
Market Sales Values for Condos**	
1BR	$419,000
2BR	$637,000
3BR	$862,000
Parking Income (Rental) (per spot)	$150
Vacancy Rate (Rental)	5%
Development Costs	
Construction Costs (PSF)	
Town House	$192
Stick	$176
Stick Over Podium	$205
Special Permit Costs (addition to soft cost)	10%
Soft Costs	20%
Land Costs Per Unit	
4 Owner	$189,936
4 Rental	$210,260
8 Owner	$294,688
20 Rental	$192,567
35 Owner	$228,185
65 Rental	$110,699
180 Rental	$111,664
Parking Costs (per stall)	
Surface	$8,000
Aboveground	$25,000
Underground	$40,000
Parking Ratios	
TOD	1.25
NON-TOD	2.00

Financing Costs	
First Year of Operations	2018
Construction Period	1 year
Inflation Rate	3%
Mortgage Term	
Rental (Years)	20
For Sale (Years)	2
Interest Rate	
Rental	6.00%
For Sale	5.50%
Equity	
Rental	30.00%
For Sale	30.00%
Capitalization Rate (Rental)	5.50%
Cost of Sale	2.00%
Reversion (Years)	
Rental (Years)	10
For Sale (Years)	1
Stabilization Period (Years)	1
Origination Fee %	1.50%
Developer Operating Expense Ratio (OE/PGI)	25.00%
Discount Rate (NPV) Rental	12.00%
Discount Rate (NPV) For Sale	20.00%
*** Based on market research**	
****Used assessment database and market research**	

GLOSSARY OF TERMS

Capitalization Rate – Ratio between the net operating income of a property and its sales value

Discount Rate – The interest rate used in discounted cash flow analysis to determine the present value of future cash flows

Density Bonus - A ordinance mechanism allowing a developer to build a greater number of units than the existing underlying zoning dictates in exchange for the creation of additional affordable units

Equity – Initial out-of-pocket investment on the part of developer that is required to obtain financing

Effective Gross Income – Gross income minus the vacancy collection loss

Fee in-Lieu – Payment made to City to account for fractional affordable unit not built.

Internal Rate of Return - Annualized rate of return sought by a developer based on the project discounted cashflow

Net Operating Income – Net income after deducting operating expenses from potential gross income

Net Present Value – Net value of the initial investment and cashflows generated from a project, discounted back to the current year

Operating Expenses – Expenses related to operating the building such as maintenance, salaries, and repairs

Other Income – Income generated from the property aside from rent, this income is parking revenues for leased spaces

Potential Gross Income – Potential income generated from rental income or sale of a property. Calculated by multiplying the number of units and rent for each unit

Residual Land Value - The price a developer pays for a piece of land. Generally, involves calculating the income expectations for the developed land, subtract all expenses associated with this development, and the remainder is the land residual

Vacancy and Collection Loss – Percent of rent that is uncollectable

Value Gap – Difference in value between a market rate unit and affordable unit