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## MEMORANDUM

To: Planning and Development Board

From: Robert Muollo, Jr. Housing Planner

Cc: Candace Havens, Director Planning and Development  
Trisha Guditz, Housing Programs Manager  
Josephine McNeil, Executive Director, CAN-DO, Inc.  
Community Preservation Committee

Date: October 26, 2012

Re: 54 Eddy Street Affordable Housing Proposal

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### **1. General Framework to Consider**

Considerable public investment is not uncommon for small-scale rental developments, especially when serving lower-income populations. This development model has fewer units to spread fixed costs, leading to higher per unit development costs and less operating income to carry permanent debt, resulting in funding gaps usually filled by public subsidy.

To inform the Board in making a judicious decision, staff considered whether the proposal meets the objectives of: addressing a stated public purpose; being within the statutory intent of the CDBG Program; and providing decent affordable housing that is both initially feasible and viable throughout the affordability period.

To attain these objectives, a proposal should not contain excessive costs, but investments into capital improvements should not be cut. Improvements beyond minimum standards will increase a property's useful life for during the affordability period and reduce the likelihood of major repairs, thus reducing risk to operating stability. The property should be marketable in its rent structure and amenities to ensure successful lease-up, reduce vacancy rates and minimize turnover. The development and operating budgets should be reasonable and realistic to ensure feasibility and financial health in the long-term. Note: the full proposal can be accessed at:

<http://www.ci.newton.ma.us/gov/planning/cpa/projects/eddy.asp>

## **2. Project Overview**

The Sponsor, Citizens for Affordable Housing in Newton Development Organization (CAN-DO, Inc.), is proposing to create two units of affordable rental housing through acquisition and rehabilitation of an existing two-family house located at 54 Eddy Street, in the West Newton CDBG Target Neighborhood. The project, which consists of one 2-BR and one 3-BR unit, will target families who are at-risk of homelessness. The 2-BR unit will be affordable to households earning at or below 50% of Area Median Income (AMI) and the 3-BR unit affordable to households earning at or below 80% of AMI. The projected development cost is \$1,115,250. The Sponsor purchased the property on July 29<sup>th</sup> with a loan from The Village Bank.



The Sponsor is seeking \$690,250 in Community Development Block Grant (CDBG) funding and \$255,000 in Community Preservation Act (CPA) funding for mortgage buydown, rehabilitation and hazard removal. Housing staff from the Housing and Community Development Division has reviewed the One-Stop Application submitted by the Sponsor on June 29, 2012 and visited the Property. The Newton Housing Partnership (NHP) has reviewed the proposal and has issued a letter of support, dated August 24, 2012. As part of the funding process, the Planning and Development Board is required to review the proposal and make a CDBG funding recommendation to the Mayor.

## **3. Project Description**

The property is an existing 2,873 sq. ft. two-family house built in 1914 with a two-car garage. It is located on a 5,715 sq. ft. lot in a MR3 zone. The property has a Philadelphia-style layout, with the 2-BR unit located on the 1<sup>st</sup> and 2<sup>nd</sup> floors. The 2-BR unit includes a kitchen, living room, dining room and one bathroom. The 3-BR unit is located on the 2<sup>nd</sup> and 3<sup>rd</sup> floors. The second floor includes the kitchen, living and dining rooms, and one bathroom. The three bedrooms are located on the 3<sup>rd</sup> floor. The proposed project will consist of the following unit mix and characteristics:

Unit	Affordability Level	Proposed Rent	# of Bedrooms	# of Baths	Living type	Existing Gross Living Area
1	Up to 50% AMI	\$1,200	2	1	Duplex / Philadelphia style	1,136 sq.ft
2	Up to 80% AMI	\$1,500	3	1½	Duplex / Philadelphia style	1,737 sq.ft

## **4. CDBG Requirements**

### *4.A. Income Targeting and Rents*

As proposed, the project rents are within CDBG income targeting criteria. The units will be rented to low-and moderate-income households. Low-income households are defined as households earning at or below 50% of AMI, adjusted for household size. Moderate-income households are defined as households earning at or below 80% of AMI.

The proposed rent structure assumes that tenants will pay for utilities. Under the City's Affordable Rent Policy, *"monthly rents charged to tenants cannot exceed 35 percent (if cost of rent only) of the*

monthly adjusted income of a household whose gross income is 70 percent of the Boston AMI.” The proposed rents for these units are below this threshold, as shown below.

<b>3-BR Unit</b>		<b>Max. Allowable Rent<sup>1</sup></b> (not including utilities)	<b>Proposed Rent</b>
4 person HH	70% of AMI	\$ 1,804	\$1,500
3 person HH	70% of AMI	\$ 1,624	\$1,500
<b>2-BR Unit</b>		<b>Max. Allowable Rent</b> (not including utilities)	<b>Proposed Rent</b>
4 person HH	50% of AMI	\$ 1,426	\$1,200
3 person HH	50% of AMI	\$ 1,285	\$1,200

In contrast, the list price for 2-BR, 1 bath market rate rentals in Newton with similar amenities are in the \$1,450 - \$2,200 range. The range for 3-BR, 2 bath units is \$2,900 - \$3,150.<sup>2</sup>

#### 4.B. Eligible Costs

The proposed uses of CDBG funds are mortgage debt reduction, the costs of converting the existing steam heat delivery system, and the cost of asbestos and lead paint abatement. These are eligible CDBG costs.

#### 4.C. Affordability Period

The City will impose an initial 30-year affordability period enforced by a declaration of affordable housing covenants running with the land. The City will submit an application to the Massachusetts Department of Housing and Community Development requesting that the project’s affordability extend to in perpetuity.

#### 4.D. Labor Requirements/ Procurement

The wage requirements of the Davis-Bacon Act do not apply to this project because it consists of less than eight total units. The City’s Housing and Community Development Division will manage the sealed bid process in accordance with federal and state procurement requirements.

#### 4.E. Relocation

The Sponsor has provided documentation that upon sale, one unit was vacant and the remaining unit was occupied by a family member who was a recipient of the sales proceeds.

#### 4.F. Environmental Review

The City is required to conduct an environmental review prior to commitment of federal funds. As part of the assessment, staff will review evidence that the property is free of potentially hazardous materials and that the project will not have any adverse effect on the surrounding environment.

<sup>1</sup> Based on 35% of the gross monthly income for a household earning 70% and 50% of AMI, respectively, and adjusted for household size.

<sup>2</sup> Units in multi-family properties. Search conducted using [www.newtonpads.com](http://www.newtonpads.com) and [www.trulia.com](http://www.trulia.com)

## **5. Development Entity and Capacity**

The Sponsor has demonstrated past experience in developing affordable rental housing using the acquisition-rehabilitation model, with 10 similarly developed units in its portfolio. Each of the completed units is occupied by low-and moderate-income tenants who represent numerous ethnic and racial backgrounds. The Sponsor is also subject to financial fitness reviews by the Planning and Development Board on a quarterly basis, with the next review scheduled on November 5, 2012.

## **6. Design and Construction**

### *6.A. Site Plans & Zoning / Permitting*

The Sponsor will have to submit a site plan for Inspectional Services Department review to ensure the proposed use and work is by-right and will not require any zoning relief or special permits.

### *6.B. Proposed Rehabilitation*

The Division's Housing Rehabilitation/Construction Manager and Housing staff have visited the property and have reviewed the inspection report and preliminary scope of work. The rehabilitation scope includes the following:

- structural, electrical, plumbing and energy efficiency rehabilitation and improvements;
- driveway, retaining wall and garage rehabilitation and improvements;
- asbestos and lead paint removal;
- heating delivery system conversion;
- wall and attic insulation, roof repair;
- interior and exterior painting;
- kitchen renovations in 3-BR unit; and
- addition of ¾ bath in 3-BR unit

The estimated rehabilitation cost is \$97/square foot, which compares with recent substantial rehabilitation projects (\$105/square foot and \$113/square foot, respectively) more so than recent moderate rehabilitation projects cost \$63/square foot and \$37/square foot, respectively.<sup>3</sup> Staff believes that many specific items in the scope of work address immediate code or safety concerns, or would enhance economic life by preventing future issues. For example, the replacement of rusted cast iron waste pipes and converting the heating system will reduce future problems and maintenance cost. Other items such as the addition of a bathroom on the third floor and the kitchen reconfiguration enhance marketability and overall quality of life for the residents. The inspection report found the presence of asbestos and the Sponsor is assuming that presence of lead paint. A lead inspection report is needed to determine the extent and cost of abatement.

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<sup>3</sup> Total rehabilitation cost divided by gross building area. \$105/square foot - 61 Pearl Street; \$113/square foot - existing group residence; \$63/square foot - 20-22 Falmouth Road; \$37/square foot - 2148-50 Commonwealth Avenue

### 6.C. Heating System Conversion

Some aspects of the current system are in need of maintenance, according to the inspection report. The Newton Housing Partnership recommended converting the current heat delivery system from steam to forced hot water. Partnership members and Housing staff noted that the conversion would increase energy efficiency, tenant safety, and cost savings for the tenants and Sponsor through energy rebates. The Sponsor consulted with Conservation Services Group, an energy conservation firm, for a preliminary cost/benefit analysis of the conversion. The analysis suggests that the conversion would



achieve these desired goals, and would result in an energy cost savings of \$3,300/year based on projected annual cost of oil vs. gas fuel, with a payback period of seven to nine years. The estimated cost of the work and labor to convert the system to hot water baseboard radiation is \$25,000, after expected energy rebates (\$30,250 total when including contractor general conditions, overhead and profit, construction contingency and developer fee). Undertaking this improvement during initial rehabilitation will remove the risk that the current system, or its components, will require attention in the future. This would enable the Sponsor to use the \$31,000 expected in replacement reserves by Year 10 for other capital improvement projects and not replacement of the heating system.

### 6.D. Additional ¾ Bathroom

The scope of work includes repartitioning the third floor of the 3-BR unit to add a ¾ bathroom (consisting of shower, sink and toilet). The existing full bathroom is located on the second floor, with all 3 bedrooms on the third floor of what appears to have been converted from an attic space. Providing a ¾ bathroom would enhance unit marketability and help accelerate lease-up. In addition to being an added convenience for a tenant, the wood staircase connecting the 2<sup>nd</sup> and 3<sup>rd</sup> floors is relatively steep, narrow and spiraled and could potentially pose a safety issue.

### 6.E. Kitchen Renovation for 2<sup>nd</sup> Unit

The kitchen renovation would increase usable space and add necessary ventilation and electrical updates. The current kitchen has modest wear and tear, and outdated cabinets and appliances. However, the renovation is largely to reconfigure the current layout. The existing usable space and configuration limits the ability to accommodate necessary appliances; the refrigerator is located outside of the kitchen on a stairwell landing, presenting a possible safety hazard. The dryer (pictured to the right) is located in the pantry and the washer next to the sink.



### 6.F. Construction Contingency

The contingency is 10% of rehabilitation hard costs. Due to the property's age and likelihood that walls will be opened during rehabilitation, Staff recommends that if the winning construction bid is lower than the estimated rehabilitation costs that the savings be applied to the contingency budget.

## **7. Financial Feasibility**

The feasibility analysis is based on the revised Development Budget, dated July 30, 2012, Operating Pro Forma and 10-year Operating Budget, revised July 15, 2012, and a commitment letter from The Village Bank, dated June 20, 2012. Particular items to note are identified below:

### *7.A. Proposed Financial Structure*

The financial structure is typical of small-scale rental developments, with acquisition as the largest cost and public subsidy the largest source. The projected total development cost is \$1,115,250 (\$557,625/unit and \$472,625 public subsidy/unit). The proposed project sources are \$1,115,250 and consist of 85% public subsidy (CDBG and CPA funds), 11% permanent loan (The Village Bank), and 4% foundation grants (Charlesbank Homes). The purchase price of the property is \$660,000. The acquisition price is supported by an independent appraisal that values the as-is market value at \$670,000.

The principal reasons for the higher public subsidy per unit compared to the Sponsor's last two projects (2148-50 Commonwealth Avenue and 61 Pearl Street) are a function of the lower rents and extent of proposed rehabilitation. The projected gross monthly income (\$2,700) is less than the Commonwealth Avenue and Pearl Street projects (\$3,270 and \$3,528, respectively), effectively reducing the ability to borrow debt (and reduce subsidy). This proposal is seeking \$167,851 more for rehabilitation than was requested for the Commonwealth Ave. project.

The rents are underwritten to create an affordable housing opportunity for low-income households that do not receive rental assistance such as the Housing Choice Voucher Program or "Section 8." A greater affordability level requires additional subsidy to offset permanent debt obligations (e.g. the mortgage) that may otherwise render a project economically infeasible. The Sponsor could charge higher rents under the Newton Exception Rent/Payment Standards,<sup>4</sup> and serve very-low and low-income tenants with rental assistance. This approach would make the units unaffordable to low-income households without rental assistance.

For comparative purposes, the table below shows the total development costs and total public subsidy per unit of rental projects with similar affordable units and scope since 2004.

<b>Project Address/ Sponsor/Year</b>	<b>Project Type and Scope</b>	<b>Affordable Units</b>	<b>Total Development Cost</b>	<b>Total Public Subsidy/Unit<sup>5</sup></b>
<b>54 Eddy St. CAN-DO 2012</b>	<b>Rental – Acquisition and Rehab</b>	<b>2</b>	<b>\$1,115,250</b>	<b>\$472,625</b>
61 Pearl Street CAN-DO 2010	Rental – Acquisition and Rehab	3	\$1,370,000	\$381,667
2148-50 Commonwealth Ave. CAN-DO 2009	Rental – Acquisition and Rehab	2	\$950,000	\$337,500
11-13 Cambria Road CAN-DO 2006	Rental – Acquisition and Rehab	2	\$1,437,511	\$315,512
20-22 Falmouth Street CAN-DO 2005	Rental – Acquisition and Rehab	2	\$1,178,933	\$325,601

<sup>4</sup>Typically, housing authority payment standards to owners are based off the Fair Market Rent (FMR), as established by HUD. However, Section 8 Program rules allow exceptions to the FMR to compensate for variations in rent levels that exist within individual housing markets. The Newton Housing Authority has received this exception from HUD due to Newton's high rents, allowing the Housing Authority to use a payment standard that is more in line with Newton's rental market. The current exception rents for 2 and 3 bedrooms including utilities are \$1,612 and \$2,016, respectively.

<sup>5</sup> Includes all HOME, CDBG and/or CPA public subsidy grants and loans

<b>Project Address/ Sponsor/Year</b>	<b>Project Type and Scope</b>	<b>Affordable Units</b>	<b>Total Development Cost</b>	<b>Total Public Subsidy/Unit<sup>5</sup></b>
163 Jackson Road CAN-DO 2005	Rental – Acquisition and Rehab	2	\$1,178,048	\$325,158
19 West Street Advocates, Inc. 2004	Rental – Acquisition and Rehab	2	\$676,400	\$300,000

### *7.B. Developer Fee*

The developer fee and overhead are projected at \$81,945, or 8% of total development costs, excluding the replacement reserve fund. When adding the net present value of the projected annual cash flow over the next 10 years to the developer fee and overhead the overall return is estimated at \$101,198, or 10% of the total development cost, exclusive of the replacement reserve fund. The proposed fee is within the standard recommended by the National Council of State Housing Agencies, which is 15%.

### *7.C. Cash Flow*

The proposal is viable from a cash flow perspective, with sufficient income to cover expenses based on a projected \$11,000 of Net Operating Income (NOI) (e.g. income after expenses) in its first year of lease-up. Relative to the proposed mortgage debt service of \$120,000, cash flow is projected at approximately \$3,000/year with an adequate initial Debt Service Coverage Ratio (DSCR) cushion of 1.38 and an initial expense cushion (cash flow as a percentage of operating expenses) of 15%.

### *7.D. Long-term Operating Projections*

The 10-year Operating Budget includes a 1.5% per year increase in income and 3.5% in expenses. This achieves a net increase of expenses of 2.0% per year. Because of this assumption, the property's DSCR and cash flow cushion will deteriorate overtime with DSCR deteriorating to 1.03 and operating expense cushion of 3.3% by year 10. Typically, at this point in the life of a project, an owner will refinance senior bank debt to reduce the cost of debt and thereby reduce expenses. The vacancy rate (5%) is accurate, as it is the same as the Sponsor's rental portfolio vacancy rate (as of May, 2012).

### *7.E. Other Income*

The Operating Pro Forma lists a 5% management fee, which is consistent with a past Planning and Development Board recommendation. Although not listed in the Operating Pro Forma, the proposed amenities listed the One-Stop Application includes a coin-operated washer and dryer, which would produce marginal additional income (approximately \$200/year).

### *7.G. Operating and Replacement Reserves*

The Development Budget includes an initial replacement reserve deposit of \$10,000, capitalized with development funds. Staff strongly recommends that these funds also be available for an initial operating deficit reserve to cover revenue shortfall during the lease-up period. The proposed ongoing replacement reserve is \$2,000 (\$1,000 per unit per year, which is in line with the \$900-\$1,400 recommended by HUD). By year 10, the project is projected to have approximately \$31,000 in replacement reserves. The Sponsor should clarify whether the replacement reserve would also be used as an ongoing operating reserve. The budget should include operating reserves.

## **8. Architectural Accessibility**

### *8.A. Design and Construction Applicability*

The proposal was scoped for coverage of the accessibility *design and construction* requirements under Section 504 of the Rehabilitation Act of 1973 (Section 504), Title II and Title III of the Americans with Disabilities Act (ADA), the Fair Housing Act (FHA) and the MA Architectural Access Board (MAAB) regulations at 521 CMR. This proposal does not trigger the accessibility *design and construction* requirements of the aforementioned laws and regulations.

However, reasonable accommodation and reasonable modification provisions apply to this project. Staff has reviewed the Sponsor's reasonable accommodation and reasonable modification policy and procedures and finds it to be consistent with guidance provided by HUD and the U.S. Department of Justice.

The City's Accessibility in Affordable Housing Guidelines encourages applicants to enhance the accessibility of their projects to the extent that it is financially feasible. The Sponsor has not proposed adding accessibility features, citing that doing so would be cost prohibitive.

## **9. Fair Housing and Equal Opportunity**

Although not explicitly required by the CDBG Program, Housing staff encourages some form of affirmative marketing for projects containing four units or less. It is important to note that while the rents are targeted to households not receiving housing vouchers, the affirmative fair housing marketing plan should be clear that households with – and without – rental assistance have equal opportunity to rent the units.<sup>6</sup>

If approved, this proposal would, to the greatest extent possible, provide employment and training opportunities to lower-income area residents and businesses during construction, as required by Section 3 of the Housing and Urban Development Act of 1968.

Creating an affordable housing opportunity in the Newton rental market would help support and expand Newton's socio-economic, cultural and racial diversity. Supporting such diversity is a fair housing priority in the *FY13 Annual Action Plan*.

## **10. Community Need**

As stated in the City's *FY11-15 Consolidated Plan* and the *FY13 Annual Action Plan*, it is a priority objective to provide deeper development subsidies per unit (CDBG and HOME) in affordable housing projects so that low-income renter households ( $\leq 50\%$  AMI) have a greater range of housing choices, so long as the developer provides at least one of the following: 1) units that are accessible to persons with disabilities, where not required by applicable law; 2) units for households that do not have rental assistance; and 3) units for persons with special needs with accompanying support services.

Affordable housing for low-income households without housing assistance is in demand. As of 2005, the Newton Housing Authority waiting list for family public housing was running approximately 7-10 years, with over 200 households in the queue earning  $\leq 50\%$  AMI. The overall demand for affordable

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<sup>6</sup> Under Massachusetts fair housing law, a housing provider may not refuse to rent a unit based on source of income, such as public assistance.



housing for Newton's current residents remains high, with about 23% of the population earning below 80% of AMI according to the U.S. Census.

The proposal would also provide affordable rental housing within a CDBG Target Neighborhood. CDBG is an effective public resource in providing revitalization to improve the physical, social, economic, and housing environment for low- and moderate-income residents in these target neighborhoods.