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October 16, 1990

James P. Maloney, Treasurer
Cambridge City Hall
795 Massachusetts Avenue
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Dear Jim:

As you requested I have reviewed the resolution of the City Council passed September 17, 1990, relating to establishment of a revolving loan fund to finance improvements to rent controlled housing in the City. You asked me to consider whether City funds may be appropriated for this purpose.

For any City appropriation to be raised by borrowing, there would be very significant federal tax law issues, and it is highly unlikely that any borrowing could be done on a low cost, tax-exempt basis. For the purposes of this letter, however, I will focus my comments on the state law issues which must be addressed for any appropriation of City funds, whether raised by borrowing, direct taxation or otherwise.

There being no existing statutory authority, the City would need special legislation to finance any such revolving fund. That legislation would need to meet state constitutional standards. With a public subsidy to be involved, any legislation would need to include standards and limitations to ensure that public purposes are being served, without undue private benefit. Under prior Massachusetts cases it seems probable that strict income limitations would have to be imposed to make certain that the benefits of the fund are realized by low income or low and moderate income landlords and tenants. A program without such income limitations, one which simply makes City-subsidized loans to any landlord of rent controlled property, would be quite vulnerable to a successful taxpayers' challenge on constitutional grounds.

The application and enforcement of such income limitations would certainly result in significant administrative complexity. Moreover, regardless of how conservatively such limitations are set, there is likely to remain substantial basis for litigation by taxpayers alleging disproportionate private benefits. (Neither statutes nor cases provide clear specific guidelines for the income standards; we would need to extrapolate from statutes and regulations which have been developed for various other kinds of housing programs.)

Of most importance, however, is the substantial possibility that the kinds of income limitations that would appear necessary to meet constitutional standards would severely decrease the scope of the revolving loan program. In other words, it is quite possible that the program would have to be restricted to so few landlords that it would be insignificant or ineffectual.

I would be happy to discuss this matter with you more fully. Please let me know if you would like us to provide a more detailed formal legal memorandum.

Yours truly,

John

John G. Faria

JGF/as

CITY-WIDE REPLACEMENT RESERVE FUND:

Problem Statement

The majority of the City's wood-framed multi-family stock was built between 80-100 years ago. There are approximately 12,000 units located in all types of wood frame buildings; approximately 5,000 - 6,000 units are located in multi-family buildings regulated by Rent Control. It is this type of building - wood framed, multi-unit, built 80-100 years ago - that is most likely to need significant investment. It is also this type of building which provides housing for a relatively high percentage of lower income residents as illustrated in the recent Low Rent Report. Much of this stock has not been substantially improved and is currently experiencing some level of deterioration. As illustrated by the recent Rent Control study of lower-rent units, many of these units with the lowest rents and the most economically vulnerable tenants are barely habitable.

Typical needs of this type of building include updating of plumbing, heating, and electrical systems as well ensuring the integrity of the buildings's exterior shell. This a level of work quite different from anything needed to cure health and safety violations: it is the level of work needed if these buildings are going to continue in service into the next century. Evaluation of such capital needs is fundamentally different from housing code enforcement; code enforcement looks to the repair of a failure in an existing system, such as a leaking pipe or a shorted outlet. It does not focus on the investment needed to keep a building in service without recurrence of leaks or shorts. Unless significant capital reinvestment occurs, Cambridge will experience the most extreme effects of lack of investment - that is, units becoming uninhabitable and lost to the rental stock. Buildings like Hampshire Place, where physical problems with the property are leading to increased vacancies and attempts to demolish the building will become more common. Even now, 44% of rent control tenants feel their units are in poor or fair condition, and both non-profit housing rehab agencies and the City's multi-family programs have seen an increase in the percentage of buildings with significant capital needs. The Rent Control report also documents very poor conditions in units housing low income tenants.

For a variety of reasons, many owners of rent controlled buildings, particularly smaller property owners, have found it virtually impossible to access conventional financing for the much needed rehab of their properties. Even if conventional financing was easily accessible the amount of rehabilitation needs, in conjunction with market interest rates, would mean, in many cases, rent increases which would not be affordable to current tenants, particularly low income tenants. Even low-interest loans could result in displacement for lower income households who tend to live in these properties. In some instances, owners have found that the cost of necessary rehab results in debt burden which exceeds the actual value of the building. Owners are reluctant to incur either conventional or subsidized debt which will make their buildings essentially unmarketable.

Capital needs in buildings are typically dealt with by establishing replacement reserve funds. In many publicly financed projects a portion of the rental income is required to be escrowed by the building's owner as a capital reserve. These reserves help ensure that when a building needs major renovations - replacement of systems, ensuring the building's shell is structurally sound and weathertight, updating kitchens, baths, etc. - the renovations can be done without drastic rent increases. The reserve fund is, in this way, an important element of ongoing affordability in many projects. The inevitability of updating different building elements is anticipated and budgeted for rather than financed by large rent increases that would cause displacement.

In Cambridge, a replacement reserve fund must be established not for individual buildings where the level of necessary rehab might cause sharp rent increases, but on a City-wide basis for all rent controlled buildings. A City-wide Replacement Reserve program has a number of advantages including the ability to allow exemptions of payments to households who can't afford to contribute to the Reserve Fund. In addition, the City-wide Fund can initially be targeted at buildings with the most significant capital deficits - buildings in which units are in danger of being lost from the rent control stock due to deterioration. The tenants in assisted buildings will not be asked to bear the full cost of updating the property. Flexible terms, that is, combinations of grants and low interest loans from the Replacement Reserve Fund will be used to finance rehabilitation in conjunction with either market-rate or other low interest rate financing sources to ensure that tenants will not face displacement because of rent increases. Over a longer period of time, all rent control properties would benefit from the Fund. Property owners receiving grants or low-interest loans through the Program will be required to guarantee access for lower-income households to any vacant units. In this way, the Replacement Reserve Fund can help ensure that those most in need of housing have priority.

Replacement Reserve Fund Program

The proposed funding source of the City wide Replacement Reserve Fund is a fee paid by tenants living in rent controlled properties who can afford to pay an additional 5% of their current rent. This percentage could yield, city-wide, substantial resources to address the problem without resulting in unaffordable rents for tenants.

To protect affordability of rents, the fee would be collected only from tenants whose income is above 70% of median income adjusted for family size. In addition, if the fee plus the monthly rent would cause the residents of the unit to pay in excess of 25% of income for rent, the unit would be exempt from the fee. All persons residing together in a unit would be treated as a family for the purpose of this calculation. Initial calculations, using the average rent-controlled rent of $380 per month, and a median income for one-person family unit (because a one-person family unit has the lowest median income),[1] suggest that the fee would not result in unaffordable housing costs for most tenants:

$380 x .05	=	$19 monthly fee
$380 + $19	=	$399 total monthly rent including fee
$29,750	=	median income for one-person household
$20,825	=	70% of median income for one person family
$4,788/$20,825	=	Ratio of annual income to annual rent - 23%

As the above calculations indicate, a tenant whose income is 70% of median gross income, or $20,825 per year, who lives alone in a single family household, and who pays the average rent controlled rent of $380, would have a rent burden of 23% of income if the replacement reserve adjustment were added to the rent. The same tenant would pay 21% of income for monthly rent without the fee.

The fee will be calculated annually by the Rent Control Board. Regardless of any additional adjustments to the rent during the year, the fee will not be recalculated until the next year's annual calculation. Any change in the amount of the fee as a result of the annual calculation will be implemented as part of the annual general adjustment. The Rent Control Board will notify the landlord and tenants of the amount of the fee set as approved additional charge for the unit. The notice will inform the tenants of their right to claim an exemption based on their income.

To claim this exception, tenants will be required to complete an exemption form which will include an affidavit under pain and penalty of perjury certifying their household income and the number of individuals residing in the unit. The notice will specify that further steps to verify income information might be required of those claiming the exemption. Any such verification will be performed by a designated city agency. To control costs of such verification, it is expected that unless randomly selected spot checking reveals a need for more extensive verification, it will be limited to such investigation of randomly selected exemption claims.

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[1]Median income based on Boston SMSA, as calculated for income limits for CDBG housing programs.

Exemption forms will be collected and maintained by the Rent Control Board. The Rent Control Board will notify the landlord and tenants of which units are required to pay this approved additional charge. To preserve confidentially of income information, notices to tenants will be restricted to information about the exemption status of their own units.

The landlord will collect the fee monthly from all nonexempt units as a part of the rent and transmit it to the City quarterly, allowing the landlord to hold the funds for from one to three months for his or her collection services. In addition, the landlords will be entitled to retain two percent of the fee collected from his property as a collection fee.

Preliminary estimates indicate that this adjustment will produce a Replacement Reserve Fund of $1,200,000 per year. This estimate assumes a replacement fee of 5% of the average rent-controlled rent of $380, or $19 per month, collected from 45% of a total of 11,716 units. The total of 11,716 units includes only units located in buildings of four or more units and does not include the units in one, two and three family buildings which can be exempted from rent control through owner occupancy. Since the Abt Cambridge Housing Study found that 55% of rent-controlled tenants had gross incomes of 80% or less, this estimate assumes that 55% of the units will be exempt from the replacement reserve adjustment.

These monies, net of administrative costs, will be used to provide grants and low-interest loans to property owners who apply for funds to make needed capital improvements to rent controlled properties. In the cases that the funds are grants, there will be no rent adjustment as a result of the rehab done with those funds. In the cases that the funds are low-interest loans, the rent adjustment will be based on the actual terms of the loan which will result in significantly lower rent increases. Each building will have to be evaluated based on what tenants can afford as well as the physical needs of the property.

Funds generated by the Replacement Reserve program will be placed in a dedicated trust fund to be used solely for rehab of rent controlled properties. Selection of the properties to receive funds, determination of the scope of rehabilitation, coordination of other financing arrangements, management of construction and monitoring of the loan and any related agreement will be performed by a designated city or non-profit agency. The agency will apply eligibility criteria developed by the Trust Fund and Rent Control Boards to define priorities among properties and work to be done.

34.

CITY OF CAMBRIDGE
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EXECUTIVE DEPARTMENT
ROBERT W. HEALY
City Manager

RICHARD C. ROSSI
Deputy City Manager

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OFFICE OF THE CITY MANAGER

November 28, 1990

To The Honorable, The City Council:

RE: Awaiting Report #51 9/17/90, Re: Deteriorated Multi-Family Stock

Recent events have again focussed attention on the deterioration of a portion of the rent-controlled housing stock. The City Council has recently considered the plight of a 22-unit building in Inman Square, now half vacant and the subject of court battles over the owner's plan for demolition. A study conducted by Hearing Examiner Andrea Devine and released by Rent Control established that the poorest tenants live in the most deteriorated buildings. The report details several examples of tenants living in barely habitable quarters.

One suggested solution to the problem of deteriorated stock is a low interest loan fund capitalized by the City's tax revenue. However, in the case of the most seriously distressed properties, a low interest loan fund will not ensure units remain affordable. For example, the rent increase resulting form a loan of $50,000 at 3% for 15 years would be $350 per month. This increase, on top of the existing rent and any increase in operating costs, would result in displacement of lower income households. The funding mechanism for a rehab program that reaches seriously distressed properties must allow grants, deferred loans and low interest loans that can be tailored on a building-by-building basis to assure ongoing affordability.

The funding source necessary to support a successful solution to the problem of severely deteriorated buildings must be extremely flexible both to keep rents affordable and to provide an incentive to owners to participate. The attached memo from Bond Counsel indicates that income generated by taxes to capitalize a loan fund would not likely result in a flexible fund. In addition, the equity of taxing homeowners to pay for improvement in rent-controlled buildings is an issue to consider.

If the City does not intervene in the situation, there are a number of consequences we may expect to occur:

1. Loss of increasing number of units for the stock due to physical deterioration;

2. Continued displacement of lower income tenants due to increases resulting from conventionally financed rehabilitation; units will become less accessible to lower income tenants;

3. Continuation of low income tenants living in seriously substandard housing.

The challenge facing the City is to both preserve the stock and to ensure its affordability to lower income tenants.

The following memorandum describes a proposal for a City-wide Replacement Reserve Fund capitalized by charging a small fee to upper income tenants living in rent-controlled units. These fees would be placed in a dedicated Trust to be used to rehab initially the most distressed stock, but over time would be available to a wider range of buildings and used to prevent deterioration in the multi-family stock. An owner participating in the Program would make a commitment to rent units upon turnover, to lower income tenants thus assuring greater access to those in the greatest need.

Although the Replacement Reserve Fund is a promising approach to both preserving the multi-family stock and its affordability, there are a number of outstanding legal and administrative issues that need to be explored and resolved. I intend to continue researching these issues and will update you on them.

Yours truly,

Robert W. Healy
City Manager

RWH:SS:nb

Attachments

cc: James Maloney

Agenda # 24 F-19

Awaiting Report Item Number 51 regarding expanding the revolving loan fund.

In City Council,

January 7, 1991

-Referred to the Rent Control & Housing & Community Development Committees

Copy sent to Rent Control & Community Dev Comm. 1/10/91 DL