

AN AFFORDABLE HOUSING POLICY FOR CAMBRIDGE

Preliminary Report

Prepared by the
Committee for Responsible Rent Control
P.O. Box 683
Cambridge, MA 02139
(617) 491-8315

This paper was prepared by the Committee for Responsible Rent Control as a contribution to the formulation of a responsible policy for providing affordable housing in Cambridge. Comments and discussion are welcomed. We will continue evolution of the policies and positions discussed in this paper and expect to issue redrafts.

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AN AFFORDABLE HOUSING POLICY FOR CAMBRIDGE
PRELIMINARY REPORT

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The design of a comprehensive policy for affordable housing in Cambridge involves complex and important issues of public policy. In the short run, an affordable housing policy directly affects the economic interests of the diverse parties involved in the Cambridge housing market: tenants, owners of rent-controlled property, owners of non-controlled rental property, and home-owners and owners of non-residential property. Over the longer term, an affordable housing policy will influence the demographic characteristics of the Cambridge population along such dimensions as socioeconomic, age, and home-owner/tenant mix. The development of a sound policy requires a balanced and rational resolution of the policy issues. Such a resolution will at once meet the short-run tests of political acceptance and practicality and as well be in the best long-term interest of the community.

To assist in the development of a policy for providing affordable housing in Cambridge, the Committee for Responsible Rent Control (CRRRC) has prepared this paper. It is our hope that the thoughts and proposals presented in this paper will stimulate consideration of a number of important issues concerning housing policy and approaches to their resolution. The arguments and recommendations in this paper necessarily reflect the perspective of the CRRRC and its members; however, we have attempted to take as balanced and objective view as possible in developing our positions.

In this paper, we discuss issues that we believe are important to the formulation of an affordable housing policy for Cambridge. In the first section, we address several broad issues concerning the definition and aim of an affordable housing policy. In the second section of the paper, we summarize our recommendations regarding the formulation of an affordable housing policy for Cambridge. In the final section of the paper, we provide a detailed discussion of issues that relate to specific elements of a policy and which underlie our conclusions regarding the formulation of an affordable housing policy for Cambridge. In this discussion, we examine weaknesses of the existing composite of programs which forms the current ad hoc affordable housing policy. In addition, we identify possible approaches to structuring the policy in a way that we believe reasonably balances the diverse interests of the parties involved in the Cambridge housing process.

GENERAL ISSUES IN THE FORMULATION OF AN AFFORDABLE HOUSING POLICY

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Several broad issues lie at the heart of any effort to design an affordable housing policy for Cambridge. In the following pages, we address some of the more important issues that must be resolved to allow design and implementation of a comprehensive and effective affordable housing policy.

WHAT DOES "AFFORDABLE HOUSING" MEAN?

For a number of reasons -- including location within the metropolitan area, proximity to Harvard and M.I.T., diversity and vitality of population, mix of business and institutional activity, and quality and mix of housing stock -- Cambridge is a fundamentally attractive community: the demand to live and do business in Cambridge is high. Given a finite land area and housing stock, and high costs of new construction, market-rate housing prices in Cambridge are high by most standards. As a result, if forced to compete in an unregulated/unsubsidized market, Cambridge's low-to-moderate income households and elderly persons of limited means would face considerable difficulty in finding suitable quality, affordable housing.

A legitimate purpose of public policy is to assist the city of Cambridge's low-to-moderate income households and elderly persons of limited means in obtaining satisfactory housing. In the short run, assistance means that low-to-moderate income households can live in satisfactory quality housing at a price that does not represent a disproportionate share of income. Over the long run, such assistance may aid in preserving desirable socioeconomic, age, and ethnic diversity in the Cambridge population.

An affordable housing policy will therefore aim at providing housing at "below-market" price to a subset of the Cambridge population who would otherwise be unable to afford satisfactory housing. Because it is desirable to promote a reasonable balance between ownership and tenancy across a diversity of household socioeconomic status, an affordable housing policy should address both rental housing and owner-occupied housing. That is, to the extent possible, home-ownership should not be unreasonably restricted on the basis of income or wealth.

WHO SHOULD BE THE BENEFICIARIES
OF AN AFFORDABLE HOUSING POLICY?

The provision of housing at a below-market price to low-to-moderate income households in Cambridge will necessarily involve a subsidy. Such a subsidy involves an income transfer from the segment of the population that provides the subsidy. To minimize the income loss and economic burden resulting from this transfer, the subsidy should be allocated on the basis of need. The subsidy should benefit only those Cambridge households that would otherwise be unable to afford satisfactory housing and only in an amount sufficient to provide the housing at a price which represents a reasonable share of household income.

The appropriate elements of a needs test for Cambridge will involve traditional measures of "ability-to-pay" such as income, family size, age, and family status. In addition, it may be appropriate to assign priority for receipt of the affordable housing subsidy to Cambridge residents of some standing. This objective could be accomplished by first making units available to residents who have lived in the community for a specified period. A second priority would be assigned to current residents who have not met the initial residency period. Lowest priority would be assigned to persons seeking to move to Cambridge.¹

WHO SHOULD "PAY FOR" THE SUBSIDY -- IMPLICIT OR EXPLICIT --
INVOLVED IN PROVIDING HOUSING AT "BELOW-MARKET" PRICES?

Currently, subsidies are provided in the Cambridge housing market through several mechanisms. Each mechanism imposes its own income transfer burden. The more important mechanisms and the sources of subsidy include:

1. Federally funded housing and income assistance programs (e.g., Section 8 and Community Development Block Grants). The cost of these programs is borne by U.S. taxpayers generally.
2. State funded housing and income assistance programs (e.g., Section 707 program). The cost of these programs is borne by Massachusetts taxpayers generally.

¹ The issue of whether a length-of-residency test or waiting period should be applied depends on the extent to which Cambridge wishes to attract demand for affordable housing from outside the Cambridge community. If Cambridge has a more favorable affordable housing policy than other communities, competition for the housing and the subsidy required to provide it will increase through immigration into Cambridge.

3. Locally funded housing and income assistance programs. The cost of such programs would be borne by the payers of Cambridge property taxes. These programs do not currently exist in any material amount.
4. The rental of rent-controlled apartments at below-market rates. The subsidy implicit in renting apartments at regulated, below-market rates is borne by the owners of rent-controlled properties and other payers (direct and indirect) of the Cambridge property tax for non-rent-controlled properties.

A generally accepted principle of public finance is that the cost of a public benefit/social welfare program such as housing support ought to be borne on an indiscriminate basis by the general taxpayer base. That is, government ought not to assign arbitrarily a tax or transfer payments burden to a subset of general taxpayers as a means of paying for programs that are generally desired by or beneficial to taxpayers/voters at large. The burden of the first three of the housing subsidies listed above is borne generally by the taxpayers/voters that elect the legislative body responsible for the housing subsidy program. From a public finance perspective, the distributional burden of paying for these programs is therefore reasonable.²

The fourth category of housing subsidy -- the rental of rent-controlled apartments at below-market rates -- contains two subsidy effects:

- Owners of the rent-controlled properties receive from tenants less than a fair market value price for the rental of their properties. That is, if these properties were offered for rent on an unrestricted basis, the market rents that could be received would generally exceed -- in some instances, substantially -- the controlled rent levels.
- Because the rents that may be charged for rent-controlled properties are below the market rate, the implied sales and property taxation values are below fair market levels. As a result, the tax paid on rent-controlled properties is generally less than would be paid (at current tax rates) if the properties were not controlled and valued on an unrestricted, fair market value basis. Given a city budget that will not vary in

² Assuming that the tax structure is not unreasonably biased in favor of/against some class of the population (e.g., a highly regressive tax structure that imposes a disproportionate burden on lower-income people might be judged unreasonable or unfair).

the short run with the status of rent-control, the effect of the below-market assessment of rent-controlled properties is to require higher property tax rates than would otherwise be needed if all properties were assessed on an unrestricted, fair market value basis. The higher tax rate shifts a disproportionately large share of the property tax burden to the owners of non-controlled properties.³ Correspondingly, rent-controlled properties bear a disproportionately small share of the tax burden. It should be noted that the tenants of non-controlled rental properties also bear the burden of paying a disproportionately large share of the property tax to the extent that their rents are increased as a result of the higher property taxes paid on the non-controlled units that they occupy.

Neither of the subsidies associated with Cambridge rent control meets the test of being generally borne on an indiscriminate, non-arbitrary basis by the taxpayer population. The first subsidy burden falls on owners of rent-controlled properties. The second subsidy burden falls on other property owners, and where applicable, their tenants. In addition, the distribution of the subsidy burden between these two groups is at best arbitrary and haphazard.

An additional point regarding the existing rent-control subsidy is that, of the four categories of housing subsidy mentioned, it is perhaps the most significant in terms of the aggregate dollar amount transferred. Ironically, rent control is the only one of these housing subsidies that is not allocated on the basis of a needs test.

In fact, the recently released Cambridge Housing Study by Abt Associates Inc. shows that income, adjusted for household size, of the population occupying rent-controlled apartments is only slightly below that for non-controlled apartments.⁴ At the same time, the rent for rent-controlled apartments is well below that for non-controlled apartments. The average monthly

³ Including non-controlled rental and owner-occupied properties.

⁴ Visual interpolation of the Abt survey results indicate that the median of the ratio of Cambridge rent-controlled household income to the median household income for the Boston area is slightly under 80 percent (all values adjusted for household size); the comparable value for non-controlled apartments appears to be about 85 percent (see exhibit 3-3 from the Abt report). In addition, Exhibit 3-25 of the Abt study indicates that the mean household income for rent-controlled housing is \$22,590 and for non-rent-controlled apartment housing is \$28,591. However, the average household size (number of persons per household) for rent-controlled housing is 1.83 compared to 2.42 for non-rent-controlled apartment housing.

rent for rent-controlled apartments is \$383 or 38 percent less than the average monthly rent of \$622 for non-controlled apartments. Controlling for apartment size, about 54.5 percent of rent-controlled units rent for \$100 or less per room; in comparison, only 27.9 percent of non-controlled apartments have rents per room of \$100 or less.

With relatively little difference in the income characteristics of the populations occupying rent-controlled and non-controlled apartments but relatively substantial differences in the contract rents, it is not surprising that Abt Associates found substantial differences in the rent to income ratios for controlled and non-controlled apartments. In particular, the fraction of tenant households in rent-controlled units paying rent 20 percent or less of household income is 50.3 percent and paying 30 percent or less of household income is nearly 71 percent. In contrast, for non-controlled apartments, only 28.6 percent of households pay rent of 20 percent or less of income and 56.8 percent pay rent of less than 30 percent or less of income.

The implications are clear. Relatively similar households, from the standpoint of income, live in controlled and non-controlled apartments; however, those lucky enough to live in rent-controlled units pay a substantially lower share of income. In fact, the share of income paid by most tenants of rent-controlled apartments is well below the guideline of 30 percent established by the Federal government and financial institutions for an acceptable ratio of housing cost to income. This means that the valuable and costly subsidy provided by rent control is mostly going to a population that simply does not need it.

Finally, by using rent control and its artificially low rents to fund a substantial housing subsidy, Cambridge may increase the housing subsidy burden that must be supported by local constituencies. For example, if apartment rental rates were closer to the Section 8 ceiling rents, low-to-moderate income tenants would more frequently qualify for Federal rent support under the Section 8 program. In this way, Cambridge may forfeit opportunities to "import" additional Federal housing support funds. The results are:

- An income transfer from Cambridge property owners and tenants to the general Federal tax-paying public
- In some instances, higher payment by tenants for the rent-controlled housing than would occur if units were

rented at higher rates with rent payment assistance under the Federal Section 8 program.⁹

In conclusion, if Cambridge is to implement a rational policy for providing affordable housing to qualifying residents at below-market prices, the cost of that policy should be fairly allocated among Cambridge taxpayers. The existing discriminatory and arbitrary distribution of the subsidy burden to owners of rent-controlled properties and other payers of the Cambridge property tax should be gradually phased out. Rent control should not impede transferring to established Federal programs a greater share of the burden of paying the affordable housing subsidy.

⁹ Given the qualification criteria for Section 8 emergency and regular program assistance, it is quite plausible that low-to-moderate income households would frequently pay lower amount under competitively set rents. For example, under the emergency assistance program, if a household is paying more than 50 percent of its income for an apartment on which the rental does not exceed the Section 8 ceiling rent, the household automatically qualifies for assistance that would bring its rent payment down to 30 percent of income. As a result, if the household is paying less than 50 percent -- for example, 40 percent -- of its income for rent, then if the rent were increased by 25 percent or more, the household would qualify for the rent subsidy, bringing its rent payment down to only 30 percent of income.

RECOMMENDATIONS REGARDING THE COMPONENTS
OF AN AFFORDABLE HOUSING POLICY

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On the basis of our analysis of issues concerning an affordable housing policy for Cambridge, we developed the following recommendations for specific components of such a policy. Our discussion of the recommendations in this section is abbreviated. For a more thorough discussion of the recommendations, please see the next section of the paper which contains the detailed discussion and analysis of issues leading to the recommendations.

Although there is necessarily some overlap, our recommendations fall generally in six areas:

- Modifications to zoning policy
- Modifications to rent control
- Dedication of a portion of the existing housing stock for occupancy by low-to-moderate income households and elderly persons of limited means
- Creation of new affordable housing
- Obtaining the funding needed for an affordable housing program
- Home-ownership and the role of condominium conversion.

MODIFICATIONS TO ZONING POLICY (see also the section on
Creation of New Affordable Housing)

- Freeze down-zoning in areas where it may impede the construction of new or substantially modified affordable housing
- Adopt an affordable housing incentive as part of current zoning restrictions, particularly in residential zones C-2 and C-3, and in business, office and industrial zones. This incentive provision would allow denser-than-standard development without the need for a variance in cases where a developer agreed to dedicate a stipulated percentage of the housing for qualified low-to-moderate income households and elderly persons of limited means.

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- Housing constructed under the incentive provision would be made available to qualifying households through one of the following mechanisms:
 - The CHA might enter a long-term lease for units and subsequently lease them to qualifying tenants.
 - The CHA might purchase the units and subsequently lease them to qualifying low-to-moderate income tenants and elderly persons of limited means.
 - Non-profit organizations dedicated to providing affordable housing might purchase the units and subsequently lease them to qualifying tenants.
 - The units might be sold to randomly selected qualifying purchasers
 - Units could be dedicated as rental housing to an affordable housing pool (discussed below).

MODIFICATIONS TO RENT CONTROL

- Dedicate rent-controlled housing for occupancy only by low-to-moderate income households and elderly persons of limited means. Develop and apply a needs test for allocating rent-controlled apartments to qualified households
- To prevent deterioration and encourage rehabilitation of the existing rent-controlled housing stock, provide property owners with a fair recovery of and return on the cost of needed capital improvements.
 - An allowed return for all property owners may be established semi-annually or quarterly by adding 6 percentage points to the current yield on 30-year U.S. Treasury bonds
 - If a capital improvement must be replaced or retired through no fault of the property owner, allow full recovery of the cost of and return on a capital improvement through the normal scheduled amortization period
- To encourage effective maintenance and rehabilitation of, and to provide a fair net operating income for, all existing rent-controlled properties,

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- Establish a 1967 base-year net operating income for those properties lacking 1967 income and expense records. A statistical analysis can be used to establish 1967 rents in a manner similar to the existing "Red Book" system for 1967 operating expenses.
- Establish a minimum net operating income based on apartment size for each unit in the city of Cambridge. A possible approach is to set a minimum net operating income of not less than \$200 per room for the 1967 base year.
- As a more basic, and perhaps longer term, reform to Cambridge Rent Control, allow a gradual increase in controlled rents to the rent ceilings specified for the Boston metropolitan area under the Federal Government's Section 8 housing subsidy program. Following this adjustment,
 - Reset base-year net operating income at that time and apply rent control procedures as is done currently, or
 - Adopt a simpler version of rent control in which controlled rents would be allowed to change at the same rate as the Section 8 ceiling rents published annually by the Federal Government for the Boston area.

DEDICATION OF EXISTING HOUSING STOCK FOR LOW-TO-MODERATE INCOME
HOUSEHOLDS AND ELDERLY PERSONS OF LIMITED MEANS

- Identify the fraction of the existing rent-controlled housing stock that is needed for low-to-moderate income households and elderly persons of limited means. On the basis of our review of Abt Associates' Cambridge Housing Study, it would be reasonable to dedicate 40 to 50 percent of the rent-controlled housing stock as affordable housing.
- Permanently dedicate that fraction of the existing rent-controlled housing stock to an "Affordable Housing Pool" for occupancy *only* by households qualified by the Rent Control Board (or Cambridge Housing Association) on the basis of a needs test. So long as these units were rented, they would remain indefinitely under rent control. In addition, these units would be eligible for purchase by a qualifying household that currently occupied the unit. Such a sale might be subsidized by

the provision of low-interest loans or other public assistance for low-to-moderate income purchasers. Given the restrictions on the resale and use of such properties, sales to qualifying occupants would occur at a price that is discounted from the market. Following such a sale, the housing unit could be lived in by the purchasing household or resold or rented to another qualifying household. If an affordable housing unit(s) were offered for sale to an investor who wished to own the apartment(s) as rental property, the Cambridge Housing Authority would have a first-right-of-refusal on purchasing the offered unit(s).

- Owners of rent-controlled property select units to be assigned to the affordable housing pool in line with established guidelines concerning unit size and number of rooms. Priority is given to units with more than one bedroom and to units that are currently occupied by qualifying households wishing to remain in their units.
- In return for indefinitely assigning rental units to the affordable housing pool, allow property owners to decontrol gradually the remaining fraction of their rent-controlled units: if 40 to 50 percent were assigned as affordable housing, 50 to 60 percent would be eligible for gradual decontrol. These units would remain under a modified form of rent control until voluntarily vacated by current tenants. In the period of occupancy by a prior tenant, the rents would be increased to the Federal Government's Section 8 ceilings for the Boston area and thereafter allowed to increase, by formula, at a greater rate than would occur had the apartment remained under rent control.

CREATION OF NEW AFFORDABLE HOUSING

- To obtain new units for the affordable housing pool from new private construction:
 - Implement a rule that requires a fraction of new units or building area (e.g., 5-10 percent) to be dedicated to the affordable housing pool for occupancy by low-to-moderate income occupants¹; and/or
 - Designate affordable housing production zones in which a developer can build to a higher density

¹ Alternatively the developer would have to pay a fee per "non-built" unit into a trust for buying/constructing affordable housing.

than otherwise permitted depending on the fraction of units or building area (e.g., 20-30 percent) that the owner would assign to the affordable housing pool. Affordable housing production zones would be established in areas that historically were zoned for dense, multifamily use (C-2 and C-3), business use, office use, and industrial use.

- To obtain new affordable housing from publicly funded programs, form a Cambridge Affordable Housing Trust that would be empowered to: buy and develop new affordable housing units; or provide funds to other non-profit neighborhood trusts for buying and developing affordable housing.

OBTAINING THE FUNDING NEEDED FOR AN AFFORDABLE HOUSING PROGRAM

- Utilize to the fullest extent possible the existing programs of the Federal Government for providing affordable housing
- Implement a "linkage" mechanism under which funds would be raised for affordable housing by taxation of real estate sales in Cambridge. The one percent value recommended by the Cambridge City Council's Committee on Linkage is a reasonable level of taxation.

HOME-OWNERSHIP AND THE ROLE OF CONDOMINIUM CONVERSION.

- To enhance the opportunity for home-ownership in Cambridge, permit currently occupying households that have lived in their rent-controlled apartments for at least three years to purchase their apartments as owner-occupied housing
 - For housing that was *not* part of the affordable housing pool, no special qualification requirements would be applied
 - Housing that was part of the affordable housing pool could be purchased for owner-occupancy only by the currently occupying household, which, according to the terms outlined above, would be subject to the needs test administered by the Rent Control Board (or Cambridge Housing Authority). Public funds (Federal, State, or local) could be used to aid low-to-moderate income in buying units.

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- Designate a maximum fraction of the rental housing units dedicated to the affordable housing pool that could be sold as owner-occupied housing. Issue the indicated number of transferable "owner-occupancy sale" certificates to property owners when they assign rental housing to the affordable housing pool. Sales certificates would have to be submitted to sell an apartment from the affordable housing pool to an occupying household. If rental units were added to the affordable housing pool -- by returning an owner-occupied unit to rental status or assigning newly built rental units to the pool -- new "owner-occupancy sale" certificates would be issued to the property owner.

ISSUES RELATING TO SPECIFIC ELEMENTS
OF AN AFFORDABLE HOUSING POLICY

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A coherent affordable housing policy for Cambridge will involve several program elements. Some of these program elements are already present as part of the existing Cambridge housing policy (e.g., zoning and rent control policies); however, these program elements may require modification to produce an effective affordable housing policy. In addition, new program elements that are not part of the existing Cambridge housing policy framework will also be needed to formulate an effective affordable housing policy. In this section, we discuss specific elements of an affordable housing policy:

- The role of zoning
- The role of rent control
- Dedication of a portion of the existing housing stock for occupancy by low-to-moderate income households and elderly persons of limited means
- Creation of new affordable housing
- Obtaining the funding needed for an affordable housing program
- Home-ownership and the role of condominium conversion

ZONING POLICY AND AFFORDABLE HOUSING POLICY

Through its effect on the potential density of housing development and the cost of new or substantially modified housing, zoning is an important element of an affordable housing policy. Given its fixed supply, land in Cambridge is expensive and represents a significant fraction of the cost of new housing. Currently, there is a trend in Cambridge in favor of down-zoning: that is, reducing the permitted development density for new construction. The effects of down-zoning on housing cost and the ability to develop affordable housing are complex and generally unfavorable. Four possible effects may be identified that are relevant to the development and implementation of an affordable housing policy.

- Down-zoning reduces the number of units that can be constructed. The more densely that new housing may be constructed, the greater will be the number of housing

units that can be added. Assuming that the mix of new construction does not change and will include a fraction of units within the purchase or rental range -- perhaps with public subsidy -- of low-to-moderate income households, more units absolutely will mean more affordable housing units.

- **Down-zoning increases the land cost per unit of new construction.** To a degree, the density of permitted development will influence land value and land cost per unit of new construction. In general, as permitted development density increases, land value will also increase. However, this effect is not perfect. That is, the land cost per unit of new housing construction will not generally remain constant as the permitted development density changes for a plot of land. For example, as permitted development density decreases, aggregate land value will also generally decrease but land cost per unit of permitted construction will generally increase somewhat. With higher land cost per unit, newly constructed housing will be less likely to fall within a range that may be affordable to low-to-moderate income households and elderly persons of limited means. Alternatively, subsidies for providing affordable housing must be greater.
- **Down-zoning increases building costs per unit.** As fewer units are constructed on a building site, costs per unit typically increase (assuming fixed construction specifications). The reasons for the increase are: (1) some of the costs associated with planning and managing a project vary little with the number of units being constructed; (2) economies-of-scale in construction may be lost, increasing building cost per unit constructed. The higher per unit building costs further increases the difficulty of providing affordable housing.
- **Down-zoning will probably cause a smaller share of new construction to fall at the lower-priced end of the housing spectrum.** The density of permitted development may influence the mix of housing that a developer will build on land. Given a lower permitted development density, a property owner/developer will generally seek to build a higher "value-added" mix of units. Such a building configuration generally preserves a reasonable relationship of building to land value. This result may be particularly likely in a case where a developer has acquired property before and without the expectation of a down-zoning action. In this case, the property owner (and the city) is faced with the possibility

of a substantial loss on the value of the land. To preserve as much return as possible under the tighter zoning rules, the developer will generally seek to build more elaborate and expensive units than might have been otherwise selected. At a minimum, the developer will be less easily persuaded to build units that may fall within a price range that is affordable by low-to-moderate income households and elderly persons of limited means.

In summary, down-zoning makes the cost of new or substantially modified construction even less likely to fall within a range that will be affordable by low-to-moderate income residents and elderly persons of limited means. Where a commitment has been made to subsidize the price of new housing for low-to-moderate income households, down-zoning will increase the required subsidy and the associated burden on its payers.

In fact, in recognition of this problem, the Commonwealth of Massachusetts passed "anti-snob zoning" legislation under which a developer seeking to build affordable housing may by-pass local zoning laws and receive a variance from the State directly.

In view of these potential effects of down-zoning, the down-zoning trend in Cambridge needs to be monitored carefully to ensure that it does not obstruct the addition of new or substantially modified affordable housing. Rather, an affordable housing incentive should be adopted as part of zoning legislation. The incentive zoning provision would allow denser-than-standard development without the need for a variance in cases where a developer agreed to dedicate a stipulated percentage of the housing for qualified low-to-moderate income occupants. Incentive zoning would be desirable in residential zones C-2 and C-3, and in business, office and industrial zones.

Units constructed under the incentive provision would be made available to qualifying households through one of the following mechanisms:

- The CHA might enter a long-term lease for units and subsequently lease them to qualifying tenants.
- The CHA might purchase the units and subsequently lease them to qualifying tenants. (actions to improve CHA's ability to purchase and own affordable housing are discussed in the section titled "Obtaining the Funding Needed for an Affordable Housing Program.")
- Non-profit organizations dedicated to providing affordable housing might purchase the units and subsequently lease them to qualifying tenants.

- The units might be sold to randomly selected qualifying purchasers under a restricted appreciation contract.
- Units could be dedicated as rental housing to an affordable housing pool (discussed below).

RENT CONTROL AND AFFORDABLE HOUSING POLICY

Rent control is a partially effective, but very blunt, instrument of public policy for promoting affordable housing. Rent control has certainly prevented the rents on controlled units from increasing at the rate that would have occurred in an unregulated market. Accordingly, the rents for controlled units are measurably below those of uncontrolled units. In this way, rent control creates a subsidy/transfer to the tenants of controlled units from landlords of rent-controlled properties, the payers of property taxes on non-controlled properties, and tenants of non-controlled rental units. The tenants of controlled units therefore have greater access to affordable housing than would otherwise be possible (in the absence of rent control). However, rent control fails as a sound policy instrument for promoting affordable housing on several grounds.

In the following paragraphs, we discuss several weaknesses of the existing rent control system as part of an effective affordable housing policy. We outline approaches to reforming individual elements of the rent control system in a way that will contribute to the availability of affordable rental housing for Cambridge's low-to-moderate income households and elderly persons of limited means.

As currently structured, Cambridge Rent Control does not effectively distribute the benefits of subsidized housing to those who most need it.

Under the current system, landlords are under no obligation to offer rent-controlled units to "needy" tenants. Instead, sound management strategy argues that landlords should rent a given unit to that applicant who is most likely to pay rent on a timely basis. As a result, the landlord will generally prefer to rent the rent-controlled property to the "least needy" applicant. While it is undoubtedly true that a substantial fraction of the tenant population of rent-controlled housing would meet a reasonable needs test, the allocation of rent-controlled properties to these tenants is not guaranteed and is at best haphazard. As mentioned above, the Cambridge Housing Study by Abt Associates shows that a substantial fraction of the occupants of rent-controlled housing pay a low percentage of income

for housing and thus receive unneeded and undeserved subsidy through the rent control system.

In our view, rent-controlled housing ought to be targeted at truly needy tenants. The valuable subsidy embedded in rent-controlled housing should be allocated on the basis of need. A reasonable approach for accomplishing this objective would be for the Rent Control Board (possibly with assistance from the Cambridge Housing Authority) to apply a needs test to qualify applicants for rent-controlled units. Rent-controlled units would be dedicated for occupancy by qualified tenants. As is currently done, the CHA could also extend additional subsidy support to qualified low-to-moderate income tenants and elderly persons of limited means. We present additional ideas on the structure and administration of a program for set-aside units in a later section.

In all likelihood, a substantial number of currently rent-controlled units are not needed -- and should not be allocated -- for qualified tenants. These units should gradually be returned to a non-rent-controlled status. There is no sound public policy purpose for subsidizing the housing cost of persons who do not qualify on the basis of need for rent-controlled housing. A critical public policy issue here is what fraction of the rental housing stock ought to be reserved for occupancy on a rent-controlled/subsidy basis by qualified tenants. A minimum principle would be that the higher-rent, higher-amenity apartments under the current rent control regime ought not be reserved for subsidized housing.¹

Beyond this principle, there is a mix of subsidized and non-subsidized, market-rate rental housing that is appropriate for Cambridge; however, the decision on this proportion must be made by the Cambridge City Council. Some guidance in formulating this decision can be obtained from the ABT Associates study which assesses the demographic characteristics of the population currently occupying rent-controlled housing. For example, this study shows that about 29 percent of the households in rent-controlled housing has an income that does not exceed 50 percent of the median household income for the Boston area (family-size adjusted); just under 55 percent of households in rent-controlled housing has an income that does not exceed 80 percent of the median household income for the Boston area

¹ "Higher rent, higher amenity" does not mean larger apartments with more bedrooms. In fact, there is a considerable shortage of 2+ bedroom apartments in the rent-controlled housing stock. "Higher rent, higher amenity" apartments would be those apartments in a given size classification (i.e., number of bedrooms) that are the more highly finished and appointed, "luxury-type" apartments.

(family-size adjusted). These data suggest that it would be reasonable to dedicate 40 to 50 percent of the rent-controlled housing stock as affordable housing; correspondingly, 50 to 60 percent would not be needed as affordable housing and could be gradually returned to a non-rent-controlled status.

In its current form, Cambridge Rent Control does not effectively promote improvement and rehabilitation of the existing housing stock.

One element of a policy for promoting affordable housing in Cambridge should be to promote the rehabilitation and improved livability of the existing apartment housing stock. With rehabilitation costs substantially below new construction costs, the least expensive source of quality, affordable housing lies in the rehabilitation and improvement of the existing housing stock. If structured to give landlords an adequate financial incentive, rent control can be an effective device for promoting rehabilitation of the deteriorated apartment housing stock. However, property owners now face a dilemma in deciding to perform improvements under the existing rent control rules.

First, to undertake improvements, landlords must expect to recover the cost of the capital outlays and earn a reasonable return on their investments. Inevitably, this means that rents must increase when improvements are undertaken. As a result, the process of rehabilitating/improving deteriorated properties necessarily makes the properties less affordable to those low-to-moderate income tenants who ought to benefit most from the subsidy effect of rent control. In the existing regulatory process, improvements, even when essential to preserving the safety and welfare of building occupants, may be resisted by tenants because of the resulting rent increases.

In this light, a mechanism is needed to offset the cost of needed capital improvements that must otherwise be borne by low-to-moderate income tenants. A possible approach here is to broaden the coverage of CHA assistance to low-to-moderate income tenants, providing rent subsidies to defray the higher rents resulting from needed capital improvements on deteriorated housing stock.

Second, the recovery of capital outlay and return on capital for undertaking an improvement must adequately compensate the landlord for the cost of the capital invested in the improvement. Unfortunately, for so-called larger property owners, the current risk/reward structure does not provide a sufficient expected return to attract capital for improvement and rehabilitation of the rental housing stock. Specifically, in March 1987, the Cambridge Rent Control Board established a two-part

schedule for the allowed return on the cost of capital improvements:

1. Rate "A" is set each year by adding seven points to the the long-term Applicable Federal Interest Rate for annually-compounded loans as published in November of the preceding year by the U.S. Internal Revenue Service.² This rate applies to all property owners except those owning 35 or more residential units in Massachusetts. Rate "A" may not be set higher than 15 percent or lower than 12 percent except by specific action of the Rent Control Board.
2. Rate "B" applies to property owners who own 35 or more residential units in Massachusetts and is determined by subtracting four percentage points from rate "A".

The current rates under this schedule are 14 percent for rate "A" and 10 percent for rate "B". Several points are noteworthy. First, there is no substantial basis for the conclusion that property owners with 35 or more residential units have a cost-of-capital that is 4 percentage points lower than property owners with fewer than 35 units. Second, the cost-of-capital for so-called larger property owners is simply greater than the rate now allowed. A number of factors combine to cause the cost-of-capital for larger property owners to be as high as that for smaller owners: the risk of real estate investments, the transactions costs of obtaining debt and equity financing, the regulatory lag in gaining approval for rent collections on capital outlays, the return required by equity investors, and the interest cost charged by banks and other secondary lenders who often provide capital for improvements.

As a result of this regulation, even if landlords were confident that tenants would not be adversely affected (from an out-of-pocket economic perspective) by rehabilitation outlays, the lack of adequate financial incentive prevents the performance of needed improvements. The failure to provide property owners with an adequate financial incentive to rehabilitate properties works to the long term detriment of Cambridge's stock of quality, affordable housing. Housing that is not well-maintained will eventually deteriorate without the regular capital outlays required for upkeep of major structural elements. In addition, the opportunity is lost to rehabilitate deteriorated housing; at some point, deteriorated housing becomes unsalvageable or reclaimable only at a cost approximating that of new construc-

² For the first year this rate is used -- 1987 -- rate "A" is based on the rate published in February 1987.

tion.³ This housing stock, whose quality is jeopardized by the current regulations regarding cost recovery for capital improvements, represents Cambridge's least cost resource for providing affordable housing to low-to-moderate income households.

Changes in the current regulatory structure are needed to provide property owners with an adequate return on the capital deployed for improvements to the Cambridge rent-controlled apartment stock. Most importantly, the allowed return on capital improvements must not be less than the cost of capital to property owners who wish to undertake such improvements. A possible, but perhaps too elaborate, approach is a pro forma calculation using a generic debt/equity ratio and generic values for cost of debt and cost of equity. A more easily implemented approach would be similar to that currently used but without the small/large property owner differential. For example, adding 6 percentage points to the current yield on 30-year U.S. Treasury bonds would probably give a reasonable rate. Given the potential volatility of interest rates, this rate should be adjusted more frequently than once a year: a more reasonable frequency would be semi-annually or quarterly.

In addition, required amortization periods for capital improvements should not exceed a reasonable expected life of the improvement. Finally, recognition should be given to the probability that improvements will occasionally have to be retired prematurely and before full cost recovery for reasons beyond management's control (e.g., an appliance may "die" prematurely; vandalism may cause replacement of a door before the end of its normal amortization period). In such circumstances, property owners should not be penalized for events that are unforeseeable and beyond their control: they should be allowed to continue recovering the cost of and return on the improvement through the normal amortization period.

Cambridge Rent Control arbitrarily discriminates against the fair income potential of certain properties, thereby thwarting owners' interest in properly managing and maintaining properties.

Under the current formulation of Cambridge rent control, properties that lack income and expense records for 1967: (1) receive separate, discriminatory treatment in establishing a base-year net operating income; or (2) are effectively forced to operate without established base-year net operating incomes.

³ Such housing usually is substantially decontrolled under the Rent Board's distressed building policy or removed through new construction if demolition is ordered by the Inspectional Services Department of the City.

ISSUES RELATING TO SPECIFIC ELEMENTS
OF AN AFFORDABLE HOUSING POLICY

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A result of this treatment is that these properties do not receive fair regulatory treatment for such matters as capital improvements; landlords are reluctant to provide needed maintenance and rehabilitation of the buildings. This part of the Cambridge housing stock represents a segment of properties that, if properly maintained, can contribute to providing needed housing for low-to-moderate income households. However, under the current regulatory scheme, the majority of these properties are destined to be maintained poorly and to deteriorate to essentially an unlivable condition.

To correct this situation, a 1967 base-year net operating income should be established for those properties lacking 1967 income and expense records. A statistical analysis can be used to establish 1967 rents in a manner similar to the existing "Red Book" system for establishing 1967 operating expenses.

A similar problem exists for certain properties that have 1967 records but for which the operating income was extremely low or even negative. Such an artificially low income may have resulted from mismanagement, historical accident (e.g., uncontrollable circumstances may have caused rents to be unusually lower or costs unusually higher than normal), or incomplete documentation. Under existing rent control regulations, there is no way for such properties to earn a reasonable income and property owners have little incentive to adequately maintain and manage them.

To provide a fair income for such properties and thereby promote more effective management and maintenance of the housing stock, a minimum net operating income based on apartment size should be established for each unit in the city of Cambridge. We suggest setting such a minimum net operating income of not less than \$200 per room for the 1967 base year.*

By artificially depressing rents below competitive market levels, Cambridge Rent Control increases the subsidy burden that must be borne by local constituencies, particularly property owners.

The below-market rents resulting from rent control are usually below the rent ceilings specified for the Boston metropolitan area under the Federal Government's Section 8 housing subsidy program. These rent ceilings are based on the competitively determined rental rates in the Boston metropolitan area for

* An analysis of the approved 1967 base year net operating incomes for a sample of 222 units with 762 rooms showed that the average base year net operating income (in 1967 dollars) is \$219.

apartments judged by the Federal Government as suitable for occupancy by low-to-moderate income tenants receiving Federal rent assistance. By keeping rents substantially below these ceilings, rent control prevents some households from receiving rent assistance under the Section 8 Emergency Rent Assistance Program.

In recognition that the Federal Government has set Section 8 rent ceilings as reasonable rent levels for apartments in the metropolitan area, a more substantial, and perhaps longer term, reform to Cambridge Rent Control would be to allow a gradual increase in controlled rents to the Section 8 ceiling levels. For example, where the current, controlled rent level was below the Section 8 ceiling for a unit of a given type, the landlord might be allowed to raise the rent to the ceiling level over a period of three years.⁵

Once rents had reached the designated levels, it would be possible to reset base-year net operating income at that time and apply rent control procedures as is done currently from that point forward. Alternatively, a simpler version of rent control might be opted for in which controlled rents would be allowed to change at the same rate as the Section 8 ceiling rents published annually by the Federal Government for the Boston area.

An implication of the rental of apartments to qualified low-to-moderate income households under these new rents is that additional subsidy support would probably be needed so that households could rent units at a reasonable share of income. In line with the discussion above regarding who should bear the subsidy cost of providing affordable housing (assuming affordable housing means below-market price), it is reasonable to transfer some of the subsidy burden that is currently borne by landlords to a public authority/tax base. To the extent possible, the additional subsidy cost should be retrieved from Federally funded programs. However, Federal funds may not be adequate to address the total problem. Additional funds may be obtained from an Affordable Housing Trust that could be implemented by Cambridge. More will be discussed on this element of

⁵ In recognition that the Section 8 ceiling rents will probably increase with time, a possible schedule for increasing the rents would be as follows. In first year, increase rent by 40 percent of difference between prior-year rent and current Section 8 ceiling rent. In second year, increase rent by 60 percent of difference between prior-year rent (i.e., first-year rent) and current Section 8 ceiling rent. In third year, increase rent by difference between prior-year rent and current Section 8 ceiling rent.

an affordable housing policy in the section titled "Funding an Affordable Housing Policy."

DEDICATION OF EXISTING HOUSING STOCK FOR LOW-TO-MODERATE INCOME HOUSEHOLDS AND ELDERLY PERSONS OF LIMITED MEANS

As discussed in the previous section, a needed reform is to ensure that any subsidy provided by the Cambridge rent control system (or by other housing subsidy program) is indeed dedicated to qualifying households. One way that this objective may be met is to dedicate a fraction of existing and newly constructed housing stock to an "Affordable Housing Pool" for occupancy by qualifying households. Subsequently, these housing units could be occupied, on either a rental or purchase basis, *only* by households that had been qualified by the Rent Control Board (or Cambridge Housing Association) on the basis of a needs test and other criteria, as discussed above. In the following paragraphs, we present preliminary ideas on how a program for assigning units from the existing housing stock might be formulated.

With regard to the existing housing stock, the obvious source of obtaining housing for an affordable housing pool is from rent-controlled units. A specified fraction of the existing rent-controlled housing stock could be set aside by each property owner. These units would be permanently assigned for occupancy by low-to-moderate income households and, so long as they were rented, would remain indefinitely under rent control. An additional feature of the occupancy terms for housing units assigned to the affordable housing pool would be that these units are eligible for purchase by a qualifying household. Such a sale might be subsidized by the provision of low-interest loans or other public assistance for low-to-moderate income purchasers. Given the restrictions on the resale and use of such properties, sales to qualifying occupants would occur at a price that is discounted from the market. Following such a sale, the housing unit could be lived in by the purchasing household or resold or rented to another qualifying household. Another provision of the assignment of units to the affordable housing pool could be that, if an affordable housing unit(s) were offered for sale to a person/entity other than a qualifying occupant (that is, an investor who wished to own the apartment(s) as rental property), the Cambridge Housing Authority might have a first-right-of-refusal on purchasing the offered unit(s).

As discussed, the Cambridge City Council will need to determine the fraction of the existing rental housing stock that ought to be dedicated for occupancy by qualified low-to-moderate income households. As suggested above, on the basis of the Abt

Associates study, it may be to reasonable to dedicate 40 to 50 percent of the rent-controlled housing stock to the affordable housing pool. Once the City Council has established this fraction, property owners would be able to select the set of units that would be assigned to the affordable housing pool in line with established guidelines. These guidelines would specify the number or fraction of units/square footage that would be assigned based on the total number of rental units and occupied rooms/square footage in the building.⁶ A premium might be given for assignment of units with more than one bedroom which are in the greatest need by low-to-moderate income family-households. The guidelines might also specify that property owners could pool their assignment responsibility across buildings. Priority for assignment of units to the affordable housing pool might be given to units that were currently occupied by qualifying households that wished to remain in their currently occupied units.

In return for indefinitely assigning rental units to the affordable housing pool, property owners would be able to decontrol gradually the remaining fraction of their rent-controlled units: if 40 to 50 percent of the rent-controlled units were dedicated as affordable housing, the remaining 50 to 60 percent would eventually be able to be decontrolled. These units would remain under a modified form of rent control until voluntarily vacated by current tenants. In the period of occupancy by a prior tenant, the rent would be allowed to increase at a greater rate than would occur had the apartment remained under rent control. A possible approach would be first to allow the rent to increase to the Section 8 rent ceilings. Subsequently, the rent would be increased by the greater of:

1. The rate of change in Section 8 rent ceilings
- or
2. By the amount indicated by increasing net operating income, as currently regulated by the Cambridge Rent Control Board, at a rate that exceeds the current adjustment rate (i.e., change in the implicit GNP deflator) by a specified percentage point amount (e.g., 5 percentage points).

This one-time increase in rents the the Section 8 ceilings and the gradual increase thereafter is consistent with removing gradually the subsidy extended by landlords to tenants of rent-

⁶ Specification on the basis of rooms/square footage as well as housing units is needed to prevent landlords from assigning only their smallest units to the affordable housing pool.

controlled properties who are not qualified to occupy those properties on the basis of need.

CREATION OF NEW AFFORDABLE HOUSING

Creation of new affordable housing in Cambridge presents a substantial challenge given the cost of new construction and the price of scarce building sites. Two general approaches are possible: new affordable housing from private capital and construction activity; new affordable housing from public programs.

To obtain units for the affordable housing pool from new private construction will require an approach such as: (1) a rule that mandates a fraction of new units or building area per building (e.g., 5-10 percent) be assigned for occupancy by low-to-moderate income occupants⁷; or (2) an incentive zoning arrangement in which a developer can build to a higher density than otherwise permitted depending on the fraction of new units or building area per building (e.g., 20-30 percent) that the owner would assign to the affordable housing pool. Areas within the city might be designated as affordable housing production zones in which such incentive zoning would apply.

The primary source of affordable housing production zones will be from areas of Cambridge that were previously zoned for industrial use and are now in a transition to residential/commercial development. Likely candidates for such zoning include parts of Cambridgeport, North Cambridge, and East Cambridge (including North Point).

A second source of affordable housing production zones might be corridor areas that are currently zoned for joint business/residential use -- for example, parts of Massachusetts Avenue, River Street, Western Avenue, Cambridge Avenue, and Broadway. These areas, which are typically zoned BA, C-2, C-3, O-2, and O-3, currently allow for high-density housing uses. Density incentive bonuses might be granted for these areas.

New affordable housing units may also be provided through publicly funded programs. Our recommended approach here is similar to that supported by the Cambridge City Council's Committee on Linkage. A Cambridge Affordable Housing Trust could be formed that would be empowered to buy and develop new affordable housing units in the City. In addition, the Trust could fund other non-profit neighborhood trusts for buying and devel-

⁷ Alternatively the developer would have to pay a fee per "non-built" into a trust for buying/constructing affordable housing.

oping affordable housing. Such entities, which already exist within Cambridge, may provide a more efficient, decentralized approach for developing affordable housing. For example, the East Cambridge Land Trust operates as a non-profit land acquirer and developer of affordable housing in the East Cambridge neighborhood. Such organizations could build housing units that would be dedicated to the affordable housing pool as rental or purchase housing. Based in the neighborhood, these organizations may be able to assemble land and undertake affordable housing development with less administrative and political difficulties than a centralized entity.

The obvious difficulty in this approach is in obtaining enough funding to have a significant effect in improving availability of affordable housing. Funding for the existing organizations has been erratic, depending on occasional public grants or the voluntary largesse of the developer community. Simply stated, a reliable and substantial source of funding is required if the non-profit/public trust approach is to contribute in addressing Cambridge's affordable housing problem.

FUNDING AN AFFORDABLE HOUSING POLICY

Implementation of a comprehensive and effective affordable housing policy for Cambridge will require significant financial resources. Money is needed for:

- The subsidy required by low-to-moderate income households and elderly persons of limited means in renting units at below-market prices
- Assisting qualifying low-to-moderate income households in purchasing, as owner-occupants, their affordable housing apartments
- The purchase and rehabilitation of buildings that would be operated by public authority (e.g., CHA) as affordable housing
- The purchase of building sites and construction of new affordable housing by public and quasi-public entities (e.g., public and private, non-profit trusts for the development and operation of affordable housing).

Several sources may be considered for the additional funding needs of a comprehensive program. Some of these sources are traditional vehicles for obtaining funds while others are less conventional.

First, where possible, the existing housing programs of the Federal Government ought to be used to the maximum extent possible to pull funds into Cambridge for providing affordable housing. With a movement of rents to the Section 8 ceilings, greater reliance on Federal rent support would be both needed and presumably, more available. It should also be noted that, with rent increases for Cambridge apartments, property assessments and associated tax payments will increase, thereby enlarging the City's financial resources for implementing a comprehensive affordable housing policy.

Second, new funding sources are needed to help the city purchase and build affordable housing. Recent proposals have focused on "linkage" or a policy in which funds would be raised for affordable housing by special taxation of certain real estate-related transactions. Given the limited alternatives for increasing funding from local sources, these proposals warrant serious consideration. The proposal advanced by the Cambridge City Council's Committee on Linkage would apply a transfer tax to real estate sales in Cambridge. A suggested value for the tax is 1 percent. Analysis undertaken on behalf of the City Council by Leggat McCall Advisors indicates that this mechanism could generate about \$2 million annually.

Such a revenue mechanism is not perfect. Its incidence is somewhat arbitrary, as only those persons buying and selling property will be affected by the tax. Said another way, not all property nor all potential tax-paying persons will be subject to the tax. The actual impact of the tax on a person or property will depend on the frequency of involvement by that person or property in real estate transactions. In addition, it is not clear who will actually pay the tax.⁹ The answer to this question is complex and depends on the tightness of the Cambridge real estate market and the extent to which Cambridge real estate competes closely with real estate in nearby communities. In a "sellers market" characterized by demand that is relatively insensitive to price, buyers will bear the burden of the tax as sellers will be able to increase prices to recover the tax burden (assuming that sellers will actually remit the tax payment). The weaker and more price-sensitive the demand, the greater will be the burden of the tax on sellers of real estate.

Another potential difficulty concerning this mechanism is that state legislation is required for its implementation. It is

⁹ In this question, we do not mean who will legally be responsible for the payment. Independent of who is legally responsible, the actual distribution of the tax burden will depend on the "relative tightness" of the real estate market.

important that such legislation be written in a way that will permit funds to be used as broadly as possible for the creation of affordable housing. For example, a requirement that a percentage of the funds be used for "specified land banking" may not be beneficial or practical for Cambridge.

Nevertheless, given that Cambridge has few revenue alternatives, this mechanism should be explored as a means of raising funds for the provision of affordable housing. An important feature of this mechanism is that, if applied without exemptions, its revenue-generating ability should be regular and relatively predictable. The predictable revenue stream would provide the basis needed for long-term planning of land and housing acquisition and housing construction. In addition, the predictable revenue stream would provide a basis for issuing bonds or securing other debt as a means of paying for more affordable housing now. For example, the proceeds from issuing debt could be used by the CHA to buy affordable housing. On balance, a real estate transfer tax of one percent is probably a reasonable mechanism to be used by Cambridge in funding a broader program to address affordable housing needs.

A secondary source of funds for affordable housing could be implemented in conjunction with a requirement that residential property developers allocate a specified fraction of new construction to the affordable housing pool. As an alternative to dedicating the indicated number of units or building area to affordable housing, a developer might pay a fee into the affordable housing trust. Any such fee payment ought to be based on a stated schedule and not subject to negotiation.

The funds provided by these less conventional sources would be dedicated for the affordable housing program and could be used by the city directly (e.g., a Cambridge Affordable Housing Master Trust or the CHA) or by private, non-profit organizations to purchase land and existing housing and to build new affordable housing. Funds could also be used to assist qualified low-to-moderate income households in acquiring owner-occupied housing.

HOME OWNERSHIP AND AFFORDABLE HOUSING POLICY

An affordable housing policy ought to strike a reasonable balance between home ownership and tenancy in the effort to provide affordable housing to Cambridge households. Home ownership promotes diversity in the Cambridge population and achieves other benefits through the increased responsibility to the community and improved maintenance of the housing stock that are generally associated with home ownership. Currently, there are extremely limited opportunities for low-to-moderate

income households to purchase housing in Cambridge. Single-family housing is generally out of the price range of such households. More practical options include purchasing multi-family housing -- that is, buying a multi-family building and using the income from rented units to meet mortgage payments on the total building -- or buying condominium and cooperative housing units.

The first option is available in Cambridge. A household may purchase and "owner-occupy" a two- or three-unit building, renting the other units on a non-rent-control basis. A household may also purchase and owner-occupy a building with more than three units. However, in this case, the rented units remain under rent control, which means that, in addition to performing the normal landlord function, the property owner must also deal with the regulatory requirements of the rent control process. Unfortunately, this can prove to be an onerous administrative burden for the aspiring home owner.

The second option, purchasing condominium/cooperative housing units, offers another potentially economical approach to home ownership. However, removal restrictions under rent control considerably limit the opportunity for a prospective home owner to use this route to ownership. As discussed above, the existing housing stock perhaps offers the best source of providing affordable housing for low-to-moderate income households. The purchase of units from the existing rental housing stock is probably the least cost means for a household to become a home owner. Rent control rules deny this option to most households by making it illegal to sell a rent-controlled unit to a household intending to live in the unit as an owner-occupant unless the household has occupied the unit since August 1979. This restriction applies even though the purchase of a unit by a current occupant does not remove housing from the city's housing stock and does not displace an existing tenant household.

Permitting low-to-moderate income households to purchase condominium/cooperative units from the existing housing stock would provide a significant opportunity for home ownership and its associated benefits to the community and the owning household. In addition to the benefits cited above, the city's tax base would almost certainly increase, which broadens the funding base for providing publicly-subsidized affordable housing. It may also be noted that the wording in a decision of the Massachusetts Superior Court supports the concept of selling apartments to owner-occupants. Specifically, in a footnote to page 10 of the decision for the case Irene D. Polednak vs. Rent Control Board, March 5, 1986 - July 9, 1986, the Court stated "Ultimately, Ordinance 926 and the Cambridge Rent Control Act, St. 1976, C.36, are aimed at providing housing. There is noth-

ing inconsistent with allowing tenants to purchase their units and live in them."

A practical policy for permitting the purchase of rent-controlled apartment as owner-occupied housing could take numerous forms. Several issues that must be confronted in designing a policy include:

- Whether to require purchasers to have lived in their units before purchase and, if so, how long
- Whether to apply an income test for purchasers of owner-occupied housing
- Whether to assist low-to-moderate income households in purchasing owner-occupied units from the affordable housing pool
- Whether to limit the fraction of the city's existing rent-controlled housing stock that could be sold for owner occupancy.

We discuss these issues briefly.

Whether to require purchasers to have lived in their units before purchase and, if so, how long

It is reasonable to restrict the opportunity to purchase to a tenant household that has lived in the unit for some period of time (the current proposal by the Committee for Responsible Rent Control suggests three years). This restriction has several effects:

- First, requiring that the unit be occupied by the purchaser means that a current tenant occupant cannot be displaced
- Second, requiring that the purchasing household have lived in the unit for a number of years ensures a commitment to the Cambridge community
- Third, requiring that the unit be occupied for a reasonable period (e.g., three years) means that a landlord must wait for a considerable period with a new tenant before the option of selling the unit is even available. This waiting period would reduce any incentive for a landlord to promote turnover in apartments as a means of gaining quick sales as condominiums.

Whether to apply an income test for purchasers of owner-occupied housing

If a policy permitting the sale of rent-controlled apartments to owner occupants were adopted in conjunction with the formation of the affordable housing pool discussed above, then the sale of units from that pool would automatically be restricted to the income-qualifying occupants of the units. For units that were not part of the dedicated affordable housing pool and that were thus subject to the gradual decontrol procedure outlined above, there would be no reason for requiring a special income test to purchasers.

Whether to assist low-to-moderate income households in purchasing owner-occupied units from the affordable housing pool

Public funds from the Affordable Housing Trust or other assistance programs might be used to assist low-to-moderate income households in purchasing owner-occupied units. Such programs have frequently subsidized the interest cost of mortgages and provided mortgage insurance so that purchasers could obtain a loan with a downpayment that is less than that traditionally required. The feasibility of using Federal, State or local funds for assisting low-to-moderate income purchasers should be explored. It should also be noted that, with the restrictions applied to the resale and rental of units in the affordable housing pool, the price at which these units would be sold to low-to-moderate income tenants would be discounted from the price that would be realized if they were sold in an unrestricted market.

Whether to limit the fraction of the city's existing rent-controlled housing stock that could be sold for owner occupancy

The current limitations on the purchase of rental units as owner-occupied housing stringently limit the fraction of rental units that could ever be transferred to an owner-occupancy status. In implementing a policy that would permit sale of rental housing to households for owner occupancy, it may be reasonable to continue to reserve a fraction of the rental housing stock as permanent rental housing -- albeit, a smaller fraction than that currently reserved. Such a restriction would be implemented in conjunction with the assignment of rental units to the affordable housing pool: not more than a specified percentage of the units in that pool could ever be sold on a single-unit, owner occupancy basis.

One way of implementing the rule would be by issuing transferable "sales certificates" to the owners of rental properties that had been assigned to the affordable housing pool. For example, the Cambridge City Council might determine that not more than 50 percent of the rental housing stock assigned to the affordable housing pool could be sold as owner-occupied, single-unit housing. In this case, a property owner would be issued full and fractional certificates equal to one-half of the number of units that the property owner assigned to the affordable housing pool.

Subsequently, the property owner would be required to use the certificates in conjunction with selling some of the units to owner-occupants. Whenever a unit were transferred from rental to owner-occupied status, a certificate would be canceled, reducing the number of units that could eventually be transferred to owner-occupancy status. A property owner would also have the option of selling or buying certificates on the open-market to accomplish fewer or more sales than indicated by the initial certificate allocation. If a property owner added rental units to the affordable housing pool, either by new construction or by returning a previously owner-occupied unit to rental status, then the appropriate number of sales certificates would be issued to the property owner.

We conclude that allowing current tenants to purchase and occupy their apartments represents a viable and practical approach for providing affordable owner-occupied housing in Cambridge and urge adoption of such a measure.

S-453

Comm. from Alex Steinbergh on behalf of the
Committee for Responsible Rent Control, trans-
mitting a copy of a preliminary report entitled
"An Affordable Housing Policy for Cambridge".

June 29, 1987