City of Salem

In the year Two Thousand and Twenty-Three

An Ordinance to amend the zoning ordinance by adding, "Inclusionary Housing".

Be it ordained by the City Council of the City of Salem, as follows:

Section 1. Section 5- Regulations of the Zoning Ordinance is hereby amended by adding the following new section;

5.4 - INCLUSIONARY HOUSING

5.4.1 Purpose and Intent. The purpose of this section is to expand the City of Salem's housing stock, especially its Affordable Housing Units; to leverage market-rate housing production towards the production of Affordable Housing Units; to provide for housing choices for households of all incomes, ages, and sizes; to increase the production of Affordable Housing Units to meet employment needs; and to establish standards and guidelines in order to implement the foregoing.

At a minimum, Affordable Housing produced through this regulation shall be in compliance with the requirements set forth in G.L. c. 40B sect. 20-24 and other Affordable Housing programs developed by state, county, and local governments. It is intended that the Affordable Housing Units that result from this section be considered as Local Action Units, in compliance with the requirements specified by the Massachusetts Local Initiative Program. Definitions pertaining to this section can be found in Section §10.0 of this ordinance.

5.4.2 Applicability.

1. This Section §5.4 applies to any subdivision or development, whether new construction, conversion, adaptive reuse or expansion of an existing structure, involving the creation of six (6) or more dwelling units. Section §5.4 applies to all residential dwelling types as defined by the Salem zoning ordinance with the exception of assisted living residences, nursing or convalescent homes, and other similar uses.

    a. A subdivision or division of land shall mean any subdivision as defined in the Subdivision Control Law, G.L. c.41, §81K-81GG, or any division of land under G.L. c.41, §81P, into lots for residential use.

    b. Developments shall not be segmented or phased to avoid compliance with this Section. "Segmentation" shall mean any development or any division of land that would cumulatively result in an increase of six or more residential lots or dwelling units above the number existing on a parcel of land or contiguous parcels in common ownership up to twenty-four months prior to the application. Where such segmentation occurs, it shall be subject to this Section.

2. This Section §5.4 does not apply to the rehabilitation, repair or reconstruction of any building or structure, all of or substantially all of which is destroyed or damaged by fire or other casualty or a natural disaster; provided, however, no rehabilitation, repair or reconstruction shall result in a net increase of six (6) units beyond what previously existed prior to the damage or destruction thereof except in conformance with this Section.

3. No special permit or site plan review for a development requiring a special permit or site plan review, and no building permit for a use permitted as of right, shall be issued for a development subject to this Section §5.4 unless the applicant provides the percentage of the total dwelling units in the development as Affordable Housing Units as described herein.

4. For projects in the Central Business (B5) District, this Section §5.4 shall be applicable upon approval of an Economic Feasibility Analysis by the Executive Office of Housing and Livable Communities.

5.4.3 Mandatory Provision of Affordable Units.

1. Affordable Housing requirement. As a condition of development, the applicant shall contribute to the local stock of Affordable Housing Units in accordance with the following requirements:

   a. In any development subject to this Section §5.4:

      i. For developments up to twenty (20) units in size, at least eight (8) percent of the dwelling units shall be Affordable Housing Units.

      ii. For developments twenty-one (21) units or larger in size, at least ten (10) percent of the dwelling units shall be Affordable Housing Units.

   b. Affordable Housing Units required by this Section §5.4 shall be made available to eligible households with incomes at or below 60% of Area Median Income (AMI) at purchase prices or rents that adhere to the income limits determined by the U.S. Department of Housing and Urban Development (HUD) applicable to the City of Salem, and shall comply with the Massachusetts Local Initiative Program regulations.

   c. Nothing in this Section shall preclude the applicant from providing additional Affordable units, or greater affordability, or both, than the minimum requirements.

2. Special Permit for Tiered Affordability

   a. Purpose. Adaptive reuse of abandoned, underutilized or functionally obsolete properties as housing enables growth in established locations while preserving or restoring the architectural fabric of Salem. In the event that an adaptive reuse project in the Central Business (B5) zoning district would not be feasible with the Affordable unit requirements of Section 5.4.3, the Affordability unit requirements of Section 5.4.3 may be met by a special permit from the Planning Board that would allow tiered affordability levels of the required Affordable units up to 80 percent of the area median income if all the criteria of Section 5.4.3(2) are met.

b. Eligibility.

   i. The project must be located in the Central Business (B5) zoning district.

   ii. The incentives of Section 5.4.4 are not permitted if the Affordable unit requirements of Section 5.4.3 are met by a special permit.

   iii. The applicant shall obtain a letter from the Salem Historical Commission that determines:

      1. The building is located on the State Register of Historic Places or that the building is significant in the history, archaeology, architecture or culture of Salem.
      2. The building is a minimum of 50 years old.
      3. The exterior work comply with the Secretary of the Interior Standards.

   iv. The applicant shall obtain a positive recommendation letter from the Affordable Housing Trust Fund Board concerning the proposed affordability tiers.

c. Criteria for a Tiered Affordability Special Permit.

   i. Increasing the affordability level of any of the required Affordable units above 60 percent of the area median income is discouraged. The applicant shall demonstrate to the Affordable Housing Trust Fund Board that all other resources have been exhausted.

   ii. The applicant shall provide financial pro-forma to the Affordable Housing Trust Fund Board that demonstrates the affordable unit provisions in Section 5.4.3(1) would prevent the adaptive reuse project from being financially feasible. The pro-forma shall use EOHLC's Chapter 40B Guidelines for determining whether the project is "uneconomic" and related terms such as "return on total cost" and "net operating income" or other guidelines that are recognized by real estate and affordable housing industry standards that are determined to be acceptable by the Affordable Housing Trust Fund Board.

   iii. The pro-forma will be peer reviewed by a third-party accountant chosen by the Affordable Housing Trust Fund Board and paid for by the applicant. The Affordable Housing Trust Fund Board shall include consideration of the criteria in Section 5.4.3(2)(c) i and ii in their recommendation letter to the Planning Board.

iv. A permanent preservation restriction mutually agreed upon between the applicant and the City of Salem Historical Commission shall be provided to the City of Salem to protect the historically significant features of the exterior of the building.

3. On-site requirement. All Affordable Housing Units shall be provided on-site.

4. Fractions. When the requirement for Affordable Housing Units results in a fraction of a unit, the applicant shall have the choice to round up to the next whole number or convert the fraction of a unit to a cash payment to the Salem Affordable Housing Trust Fund. For example, a 24-unit project would require 2.4 Affordable Housing Units (10% of 24); the last 0.4 unit may be satisfied by providing an additional Affordable Housing Unit (for a total of 3 Affordable Housing Units) or through a cash payment equivalent to 0.4 unit.

   The payment shall be based on the total development cost limit for urban areas outside Metro Boston as articulated in the most current Massachusetts Qualified Allocation Plan for the Low Income Housing Tax Credit Program, issued by the Department of Housing and Community Development (DHCD), the Executive Office of Housing and Livable Communities (EOHLC), or its successor agency.

   For projects using historic tax credits or other historic preservation incentives, the cost of the historic credit or incentive may be subtracted from the total development cost limit.

5.4.4 Housing Bonus and Parking Reduction. Developments subject to this Section 5.4, with the exception of those obtaining a special permit pursuant to Section 5.4.3.2, may incorporate either or both of the following:

1. Housing Bonus. Developments in compliance with the requirements of this Section §5.4 are permitted an increase of up to 25% of the total number of dwelling units allowable in the applicable zoning district. The requirements of Section 5.4.3.1 shall be calculated based on the total number of new units, including units created through the housing bonus.

   a. The minimum lot area per dwelling unit required in the applicable zoning district shall be reduced by the amount necessary to permit the additional units. This reduction of the minimum lot area per dwelling unit shall be by right for developments in compliance with the requirements of this Section §5.4.

   b. The number of stories allowable in the applicable zoning district may be increased by one story provided it does not exceed the maximum height, and all yard and setback requirements normally required in the applicable zoning district may be reduced by up to 50%, with a Special Permit granted by the Planning Board. In granting a Special Permit, the Planning Board will consider the Special Permit criteria established in Section 9.4.2 and whether the permit is necessary to provide for the additional units permitted by the density bonus.

2. Parking Reduction. Developments in compliance with this Section §5.4 are permitted to reduce the number of required parking spaces as follows:

a. For developments located within a half mile of a commuter rail station, the development is permitted to reduce the number of parking spaces to one parking space per dwelling unit. This parking reduction shall be by right for developments in compliance with the requirements of this Section §5.4.
b. For developments located further than a half mile from a commuter rail station, the development is permitted to reduce the number of parking spaces to one parking space per dwelling unit with a Special Permit granted by the Planning Board, if Transportation Demand Management (TDM) practices are incorporated, as evidenced by a Transportation Demand Management Plan to reduce demand for parking, and approved by the Planning Board as a condition of project approval. The Planning Board will assess the need for TDM measures based on site location. TDM methods to reduce parking demand on site may include but are not limited to:

    i) Shared Parking: To implement shared on-site parking, the applicant shall demonstrate that proposed uses are non-competing. In mixed-use developments, applicants may propose a reduction in parking requirements based on an analysis of peak demand for non-competing uses;
    ii) Use off-site parking to satisfy parking requirements;
    iii) Pay a stipend to residents without cars;
    iv) Provide a guaranteed emergency ride home;
    v) Provide transit pass subsidies;
    vi) Provide covered bicycle parking and storage;
    vii) Provide bicycle or car sharing on site;
    viii) Other means acceptable to the Planning Board.
c. For historical renovation projects located within the Central Business (B5) district, the development is permitted to reduce the number of parking spaces to zero parking spaces per dwelling unit.

5.4.5 Provisions Applicable to Affordable Housing Units.

1. Location. All Affordable Housing Units must be dispersed evenly throughout the development.

2. Exterior design. The exterior of Affordable Housing Units must be indistinguishable from the market-rate units in terms of design, appearance, materials, and quality of construction.

3. Interior size and finishes. The size and interior finishes of the Affordable Housing Units may differ from the market-rate units within the parameters described below:

    a. The Affordable Housing units must be supplied with the same base appliances and fixtures as the market rate units; for example, if market-rate units include a dishwasher, Affordable units must include one as well. However, the product specifications for the fixtures, appliances, and interior finishes in Affordable units may differ from those in the market-rate units, provided that such finishes and features are durable, of good quality, consistent with contemporary standards for new housing, and in compliance with the standards set forth by Local Initiative Program design and construction standards.

b. Affordable Housing Units must be supplied with the same mechanical systems and energy efficiency features as market-rate units, including windows, insulation, plumbing, and heating and cooling systems.

c. The bedroom mix in the Affordable Housing Units shall be proportionate to the bedroom mix of the market-rate units.

d. Residents of Affordable Housing Units shall have similar access to all building and site common areas and amenities as residents of market-rate units, including but not limited to outdoor spaces, amenity spaces, storage, parking, bicycle parking facilities, and resident services.

e. Compliance with Section 5.4.5 shall be determined by Salem Department of Planning and Community Development staff.

4. Timing of construction of Affordable units and payment made. Affordable Housing Units must be constructed at a proportion of one (1) affordable unit for every five (5) Market Rate Units. The payment for fractional units, if applicable, shall be made before issuance of the Certificate of Occupancy.

5.4.6 Resident Selection and Marketing Plan for Affordable Units.

1. Applicants creating new Affordable Housing Units under this Section §5.4 are required to select qualified homebuyers or renters via lottery under an Affirmative Fair Housing Marketing Plan (AFHMP) prepared and submitted by the applicant and approved by the Salem Department of Planning and Community Development and the Executive Office of Housing and Livable Communities as part of the Local Initiative Program. The AFHMP must include a plan to address AFHMP requirements upon resale of ownership units. The marketing plan shall comply with federal and state fair housing laws and guidelines in effect on the date of filing of the special permit or other permit application with the City of Salem. No Certificate of Occupancy for a development subject to §5.4 shall be issued unless the Salem Department of Planning and Community Development has determined that the applicant's AFHMP complies with this requirement. The affirmative marketing costs for the Affordable Housing units shall be the responsibility of the applicant.

2. For ownership units, if the applicant agent is unable to find an eligible homebuyer within 180 days of marketing the unit, in accordance with the AFHMP, the applicant may sell the property to a household earning up to 80% of the area median income upon approval of the Affordable Housing Trust Fund Board.

5.4.7 Preservation of Affordability. Each Affordable Housing Unit created in accordance with this Section shall have limitations governing its resale through the use of an Affordable Housing Restriction. The purpose of these limitations is to preserve the long-term affordability of the unit and to ensure its continued availability for households at income levels required by this Section §5.4.

1. As a condition of development, all Affordable Housing Units provided under this Section §5.4 shall be subject to an Affordable Housing Restriction in a form consistent with the LIP guidelines or any other applicable guidelines issued by DHCD, EOHLC, or its successor agency acceptable to the Planning Board, that ensures Affordable units can be counted toward Salem's Subsidized Housing Inventory. The Affordable Housing restriction shall run with the land and be in force in perpetuity or for the maximum period allowed by law, and be enforceable under the provisions of MGL c. 184, § 26 or §§ 31 and 32. Affordability restrictions shall be contained in applicable Affordable Housing Restrictions, regulatory agreements, deed covenants, contractual agreements, land trust arrangements and/or other mechanisms to ensure compliance with the affordability requirements of this Section.

   The applicant shall be responsible for preparing and complying with any documentation that may be required by DHCD, EOHLC, or its successor agency to qualify Affordable Housing Units for listing on the Chapter 40B Subsidized Housing Inventory as Local Action Units.

2. The Affordable Housing Restriction shall contain limitations on use, occupancy, resale and rents, and provide for periodic monitoring, by the City or its designee named in the deed rider as the monitoring agent, to verify compliance with and enforce said restriction. This monitoring is intended to verify that Affordable homeownership units remain owner-occupied and are resold at a price consistent with this Section §5.4, and that Affordable rental units are occupied by tenants earning incomes described in this Section §5.4 at rents they can afford. The applicant is responsible for providing ongoing monitoring through an organization qualified to serve as a monitoring agent on behalf of the City.

3. The restriction shall establish that Affordable units created under the provisions of §5.4 shall remain affordable to the designated income group in perpetuity, or for as long as legally permissible, per Affordable Housing restrictions that comply with Local Initiative Program requirements as they may be amended for inclusion in the Chapter 40B Subsidized Housing Inventory and is enforceable under G.L. c. 184, § 26 or §§ 31-32.

4. The restriction shall grant the City of Salem or its designee the right of first refusal to purchase the property in the event that a subsequent qualified homebuyer cannot be located. In any and all instances Section 5.4.7(3) shall remain in effect.

5. The Affordable Housing Restriction shall provide that initial sales and rentals of Affordable Housing units and subsequent re-sales and rentals shall comply with federal, state and local fair housing laws, regulations and policies, and Local Initiative Program

guidelines. For Affordable homeownership units, the procedure for resale and the responsibilities of the homeowner, the City and/or its monitoring agent, and EOHLC are described in detail in the Local Initiative Program regulations.

6. The Affordable Housing Restriction shall provide that, in the event that any Affordable rental unit is converted to a condominium unit, the condominium unit shall be restricted in perpetuity as Affordable to the income level required for Affordable ownership units in Section 5.4.3.1.

7. No Certificate of Occupancy shall be issued until the applicant executes an enforceable agreement with the City and provides evidence acceptable to the Salem Department of Planning and Community Development that the agreement has been recorded at the Essex County Registry of Deeds. It is the applicant's responsibility to prepare a complete regulatory agreement, to obtain the necessary signatures and to record a fully executed agreement at the Registry of Deeds prior to the issuance of any Certificate of Occupancy (or in the case of a subdivision, lot releases).

8. For an Affordable homeownership unit, no Certificate of Occupancy shall be issued until the applicant submits documentation acceptable to the Salem Department of Planning and Community Development that an Affordable Housing deed rider has been signed by the homebuyer and recorded at the Essex County Registry of Deeds.

5.4.8 Conflict with Other Sections. The provisions of this Section §5.4 shall be considered supplemental of existing sections of this zoning ordinance. To the extent that a conflict exists between this Section §5.4 and others, the provisions of this Section §5.4 shall apply.

5.4.9 Severability. If any portion of this Section is declared to be invalid, the remainder shall continue to be in full force and effect.

Section 2. The Salem Zoning Ordinance Section 10 Definitions is hereby amended by following definitions:

Affordable Housing Restriction: A deed restriction, contract, mortgage agreement, or other legal instrument, acceptable in form and substance to the City of Salem, that effectively restricts occupancy of an affordable housing unit to qualified purchaser or qualified renter, and which provides for administration, monitoring and enforcement of the restriction during the term of affordability. An affordable housing restriction shall run with the land in perpetuity or for the maximum period of time allowed by law, and be enforceable under the provisions of Chapter 184, Sections 26 or 31-32 of the Massachusetts General Laws.

Affordable Housing Unit: A dwelling unit that is affordable to and occupied by a low- or moderate-income household and meets the requirements of the Massachusetts Local Initiative Program, for inclusion on the Chapter 40B Subsidized Housing Inventory.

Area Median Income: The median income for households within the metropolitan area that includes the City of Salem, as defined in the annual schedule of low-income limits published by the U.S. Department of Housing and Urban Development, adjusted for household size.

Commuter rail station: Any Massachusetts Bay Transportation Authority (MBTA) commuter rail station with year-round, rather than intermittent, seasonal, or event-based, service.

Eligible Household: A household of one or more persons whose maximum income does not exceed the income limits established in Section 5.4.

Eligible Buyer: An individual or household certified by the Monitoring Agent to have met all of the eligibility requirements set forth in the Affordable Housing Restriction and applicable Program Guidelines to buy an Affordable unit, including limits on income and assets, suitability of financing, etc.

Local Action Unit: An Affordable Housing unit developed through a city's zoning or permit issuance process as part of the Local Initiative Program and eligible for inclusion on the Subsidized Housing Inventory.

Local Initiative Program: A program administered by the Executive Office of Housing and Livable Communities (EOHLC), formerly the Massachusetts Department of Housing and Community Development (DHCD), pursuant to 760 CMR 56.00 to develop and implement local housing initiatives that produce low- and moderate-income housing, with or without a comprehensive permit as defined in Chapter 40B.

Low- or moderate-Income Household: A household with income at or below 80% of area median income, adjusted for household size, for the metropolitan area that includes the City of Salem, as determined annually by the United States Department of Housing and Urban Development (HUD).

Market Rate Unit: All dwelling units in a development subject to Section 5.4 that are not Affordable Housing Units as defined therein.

Maximum Affordable Purchase Price or Rent: A selling price or monthly rent that does not exceed the maximum purchase price or rent guidelines of the program used to qualify Affordable Housing Units for inclusion on the Massachusetts Chapter 40B Subsidized Housing Inventory. For homeownership units, the maximum affordable purchase price shall account for the monthly cost of a mortgage payment, property taxes, insurance, and condominium fees where applicable. For rental units, the maximum affordable rent shall account for the monthly cost of rent and utilities. The household income used to compute the maximum affordable purchase price or rent shall be adjusted for household size, considering the household size for which a proposed affordable unit would be suitable under guidelines of the Local Initiative Program or any successor affordable housing program established by the state.

Monitoring Agent: The Monitoring Agent is a qualified individual or agency for the purposes of administration, monitoring and enforcement of the Affordability Requirement for a Project pursuant to the Affordability Monitoring Services Agreement.

Salem Affordable Housing Trust Fund: A fund established by the City of Salem pursuant to Massachusetts General Laws, Chapter 44, Section 55C, for the purpose of creating or preserving

Affordable Housing in the City of Salem for the benefit of low- and moderate-income households.

Subsidized Housing Inventory (SHI): The Executive Office of Housing and Livable Communities (formerly the Department of Housing and Community Development) Chapter 40B Subsidized Housing Inventory as provided in 760 CMR 31.04.

Section 3. This Ordinance shall take effect as provided by City Charter.

In City Council October 26, 2023
Referred to the Planning Board to schedule a Joint Public Hearing with the City Council by a roll call vote of 11 yeas, 0 nays and 0 absent

ATTEST:

ILENE SIMONS
CITY CLERK

CITY OF SALEM, MASSACHUSETTS
Dominick Pangallo
Mayor

Office of the Mayor

October 26, 2023

Salem City Council
Salem City Hall
93 Washington Street
Salem, MA 01970

Dear Councillors:

I am pleased to file with you the enclosed Inclusionary Housing (IH) zoning ordinance. There are over 100 municipalities in Massachusetts that have some form of inclusionary housing zoning. It is widely used because it is an effective tool that leverages the private marketplace to create affordable housing without public subsidies. IH is a critical part of our efforts to meet our community's housing goals, in fulfillment of the Housing Roadmap and our shared vision of a more affordable community for all.

The ordinance before you builds on work started in 2020 and includes more recent changes to address current local market conditions. The City engaged with the Metropolitan Planning Council (MAPC) to update the financial feasibility analysis to reflect the amount and depth of affordability supportable in the City today, using information gathered from real estate and construction sources and from interviews with developers who work in Salem.

As you may be aware, most IH ordinances target income levels at 80% of the area median income (AMI) and include opt-out options, including in-lieu fees that developers can pay to avoid having to create affordable units in their project. The proposed ordinance before you is more robust and dynamic. It is tailored to Salem's housing market and is one of the most progressive inclusionary housing ordinances in the Commonwealth in several respects.

First, the ordinance mandates affordability at the deeper level of 60% AMI. The 60% AMI level is more consistent with the income levels of a typical Salem household, as identified in the Housing Roadmap, completed in 2022. Second, the ordinance requires that the affordable units be equitable to the market rate units. This means the affordable units are not allowed to be offsite in a different building from the market rate project and they must be proportional in terms of bedroom mix and square footage to the market rate units. Third, the ordinance does not allow an in-lieu payment of the affordable units. The construction of actual homes is far more important than a financial contribution, especially when that dollar amount of such payments often fails to cover the full cost of constructing a unit. Further, the policy also includes a requirement that developers pay a fractional fee: when the required number of affordable housing units results in a fraction of a unit, the developer has the option to build the additional unit or that fractional difference can be paid as a dollar amount to the City's Affordable Housing Trust Fund (AHTF). This will establish a funding stream for the AHTF that will enable it to further advance our goals of affordable housing creation and preservation.

Like most inclusionary housing ordinances, this ordinance includes incentives. Bearing in mind that affordable units cost just about as much to build as market rate units, it is critical for the ordinance to strike a balance between meeting Salem's affordability goals and being financially feasible. To that end, MAPC updated the financial feasibility model created for the previous effort in 2020, to reflect the current economic context and test the market implications of various zoning scenarios. The model was based on a pro-forma analysis that considered housing market data from the Warren Group and the US Census Bureau, as well as interviews with Salem residents and local housing experts including lenders, developers, and land use board members. This recent update also includes information gathered from professional real estate and construction sources and from interviews with developers who work in Salem.

Since 2019, MAPC's research has found that construction costs have increased moderately, while both rents and financing costs have increased significantly. Through this feasibility model, it was determined that in order to get 10% of the units at the deeper affordability level of 60% of AMI, the ordinance would need to include a 25% housing bonus, as well as flexibility for parking requirements, especially for developments that are proximal to the commuter rail station. The model found requiring a greater percentage of units to be affordable, deeper affordability, or not offering the stated incentives resulted in the hypothetical project being financially infeasible, which would result in no units being built.

Additionally, the model shows that in these market conditions, projects of more than 20 units can support the desired affordability of 10% of units at 60% AMI with the proposed incentives. For projects of 20 units or fewer, the financial feasibility is less certain. Given Salem is interested in supporting these smaller, often in-fill types of projects, the proposed ordinance allows for 8% of units at 60% AMI for those smaller projects, which the model found to be supportable.

Salem needs a diverse housing stock to meet the current and future needs of our residents. To support diverse housing, we need a broad range of housing tools and inclusionary zoning is an important tool at our disposal. However, this ordinance alone will not meet all the affordable housing needs we have in our community. We must continue working to advance the other housing strategies identified in our Housing Roadmap into 2024 and beyond.

Requiring private developments to create new units at 60% AMI with no public funds will create affordable housing that is more consistent with a Salem household's typical income, a need that was well underscored in the Housing Roadmap. The units will be of the same character and quality as the market rate units, and they will be located on site. Lastly, the ordinance will ensure that affordable units are constructed, rather than allowing an in-lieu of payment.

The enclosed ordinance is accompanied by a memorandum from MAPC that outlines the methodology and findings of the financial feasibility model that underpin the recommendations found within the ordinance.

As written and with the referenced financial feasibility analysis, we believe that the proposed ordinance is compliant with MGL Chapter 40A Section 3A, which requires MBTA communities, including Salem, to have a zoning district with as-of-right multifamily housing. Salem has currently received a designation of interim compliance from the Executive Office of Housing and Livable Communities (EOHLC) for the B5 Zoning District and the City has filed for a final determination. EOHLC and City staff have been in communication concerning the City's consideration of IH zoning, as well.

I'm very grateful to MAPC for their technical assistance in the development of this important measure and to the members of the Affordable Housing Trust Fund Board for the multiple meetings they conducted to review and shape the draft of this ordinance.

Thank you for your shared commitment to pro-actively addressing the growing housing affordability challenge in our community. The lack of affordable housing is the foremost challenge facing Salem today, and this ordinance represents an important step forward in addressing that challenge. I look forward to continuing this discussion with you at the joint public hearing with the Planning Board.

Sincerely,

Dominick Pangallo
Mayor
City of Salem

DOMINICK PANGALLO
MAYOR

TOM DANIEL, AICP
DIRECTOR

CITY OF SALEM, MASSACHUSETTS
DEPARTMENT OF PLANNING AND COMMUNITY DEVELOPMENT

98 WASHINGTON STREET, 2ND FLOOR ♦ SALEM, MASSACHUSETTS 01970
978-619-5685

October 6, 2023

Mayor Dominick Pangallo
City of Salem
93 Washington Street
Salem, MA 01970

Re: Proposed Amendments to the City of Salem Zoning Ordinance to Affordable Housing

Dear Mayor Pangallo:

I am pleased to provide the enclosed Inclusionary Zoning (IZ) ordinance — a result of a years-long effort by City staff, community stakeholders, and a planning consultant from the Metropolitan Planning Council (MAPC). As you know, several current housing developments in Salem are exceeding the affordability requirements proposed in the IZ ordinance. It is important to note that most of these developments are subsidized with public financing tools such as Low Income Housing Tax Credits. The IZ ordinance will strengthen Salem's quantity and quality of affordable housing by requiring housing developments that are not subsidized with public financing to meet affordability requirements.

In February 2020, a proposed Inclusionary Zoning ordinance was introduced to the City Council. That proposal was built upon a robust public engagement process and lengthy collaboration between the community, City staff, board and commission members, and the consultant team. The proposal was supported by a model to ensure the financial feasibility of the affordability requirement, which was based on a pro-forma analysis that considered housing market data from the Warren Group and the US Census Bureau as well as interviews with Salem residents and local housing experts including lenders, developers, and land use board members. Ultimately, the ordinance failed by a vote of seven councillors in favor and four opposed.

In the intervening years, the Planning Board revised its Affordable Housing Policy, so that all residential projects of six or more new units that come before it are expected to provide 10% of units at 60% Area Median Income (AMI). However, there remained a desire to see Inclusionary Zoning adopted, to ensure the policy would be consistently applied and provide maximum affordability without dampening development.

This desire led to a renewed effort in 2023. The City contracted with MAPC to update the financial feasibility analysis to reflect current local market conditions and to revise the ordinance according to its findings. The resulting proposed ordinance advances the goals espoused in the Planning

Board's Affordable Housing Policy and further strengthens the City's response to the need for affordable housing. The feasibility analysis found that in current market conditions, with certain incentives, projects of more than 20 units can support 10% of units at 60% of AMI and smaller projects of 20 or fewer units can support 8% of units at 60% AMI. The incentives include a 25% housing unit bonus as well as flexibility for parking requirements, especially for developments that are proximal to a commuter rail station. The model found requiring a greater percentage of units to be affordable, deeper affordability, or not offering the stated incentives resulted in the project being financially infeasible, which would result in no units being built.

The ordinance also requires that the affordable units be equitable to the market rate units. This means the affordable units are not allowed to be provided offsite in a different building from the market rate project and they must be proportional in terms of bedroom mix and square footage. Third, the ordinance does not allow a payment in lieu of the affordable units. The construction of actual homes is far more important than a financial contribution, especially when that number often fails to capture the full cost of constructing a unit. Further, the policy also includes a requirement that developers pay a fractional fee, wherein when the required number of affordable housing units results in a fraction of a unit, the developer has the option to build the additional unit or that fractional difference shall be realized as a cash payment made to the Affordable Housing Trust Fund Board (AHTF). This will establish a consistent funding stream for the AHTF that will enable it to further advance its goals of affordable housing creation and preservation.

Additionally, as written and with the referenced financial feasibility analysis, we feel confident that this ordinance is compliant with MGL Chp. 40A Section 3A, which requires MBTA communities, including Salem, to have a zoning district with as-of-right multifamily housing. Salem has currently received a designation of interim compliance from the Executive Office of Housing and Livable Communities (EOHLC) for the B5 Zoning District and the City has filed for a final determination. EOHLC and City staff have been in communication concerning the City's consideration of Inclusionary Zoning and this will continue.

The proposed ordinance is accompanied by a memorandum from MAPC that outlines the methodology and findings of the financial feasibility model that underpin the recommendations found within the ordinance.

In summary, this Inclusionary Zoning Ordinance is a strong addition to Salem's existing toolkit of strategies to respond to the local need for affordable housing. It is tailored to Salem's housing market and is one of the most progressive inclusionary zoning ordinances in the Commonwealth.

Lastly, much of this information is available on Imagine Salem (https://imaginesalem.org/), which will continue to be updated as this process continues.

Please do not hesitate to contact me to discuss further.

Sincerely,

TMDaniel

Tom Daniel, AICP
Director

MAPC

METROPOLITAN AREA PLANNING COUNCIL

Smart Growth & Regional Collaboration

Memorandum

To: Amanda Chiancola and Elena Eimert
Department of Planning & Community Development, City of Salem

From: Alexis Smith, Metropolitan Area Planning Council

On: October 4, 2023

Re: Inclusionary Zoning Financial Feasibility Analysis

In 2019, the City of Salem worked with the Metropolitan Area Planning Council (MAPC) to conduct a financial analysis to test the impact of various inclusionary housing scenarios on the feasibility of new market-rate residential development and subsequently develop recommendations for a citywide inclusionary zoning (IZ) ordinance. While an inclusionary policy was not adopted in 2019, since that time there has been renewed interest in inclusionary zoning in Salem. Inclusionary Zoning advances several goals identified in the Salem Housing Roadmap, including the creation of affordable housing units at 60% Area Median Income, which is needed given Salem's lower median household incomes, and the expansion affordable homeownership opportunities. Accordingly, the City has partnered with MAPC to revisit the 2019 analysis, update associated market data, assess the 2019 policy proposal in the context of Salem's current housing market, and confirm or update the recommendations accordingly.

Since the original IZ proposal was drafted, the state adopted MGL Chapter 40A Section 3A, which requires MBTA communities have a zoning district where multifamily housing can be built by right. On March 24, 2023, the Executive Office of Housing and Livable Communities (EOHLC) determined that the City of Salem achieved interim compliance with Section 3A. Since then, Salem has submitted an application for full compliance assuming that the Central Business zoning district (B5) meets the requirements set forth in Section 3A.

According to EOHLC's Section 3A Compliance Guidelines, an inclusionary zoning policy that requires residential units to be affordable to incomes lower than 80% of the area median income (AMI) is not considered "as of right" and therefore would not be in compliance with Section 3A. However, the guidelines state that EOHLC may, at its discretion, allow for affordability deeper than 80% AMI if the affordability requirements applicable in the Section 3A multi-family zoning district are supported by an economic feasibility analysis, prepared for the municipality by a qualified and independent third party acceptable to EOHLC, and using a methodology and format acceptable to EOHLC.

The 2019 proposed IZ ordinance would have required that 10% of units in new development be affordable to households earning 60% of area median income, a level of affordability that aligns with local need but goes beyond the threshold set by EOHLC in the Section 3A Compliance Guidelines. As such, an Economic Feasibility Analysis (EFA) is needed for the IZ requirements to be applied in Salem's Section 3A district. To that end, the feasibility analysis described herein will, along with forthcoming supplemental documentation, satisfy the requirements for an EFA to secure EOHLC approval of Salem's inclusionary policy.

This memorandum describes the analysis methodology, subsequent findings, and updated policy recommendations for an inclusionary policy in Salem per the methodology set forth by EOHLC.

PREVIOUS ANALYSIS AND RECOMMENDATIONS

Because inclusionary zoning leverages the private housing market to create Affordable Housing, municipalities must be cognizant of how an IZ policy will impact private housing development. If a municipality asks for too little, it has not fully leveraged the potential for public benefit. However, if it asks for too much, it risks increasing market rents or deterring housing development altogether. A financial analysis helps decision-makers understand how various policy components interact within the context of the local housing market and balance policy requirements to achieve Affordable Housing priorities without dampening development.

MAPC's 2019 analysis investigated the ways in which different policy components impact new market-rate housing, explored how these components could be combined to achieve Affordable Housing priorities without dampening development, and identified policy options that minimize impact on development feasibility by balancing affordability requirements and cost offsets in various combinations. This analysis—along with permitting data, local need, community input, City priorities, best practices, and extensive input from the project working group—was used to inform recommendations for the proposed IZ policy.

Components of the 2019 proposed policy included:

- New residential development, including both rental and ownership housing, would be required to provide 10% of units affordable to households earning 60% of area median income (AMI).
    - For ownership housing, if an eligible buyer at 60% AMI cannot be found after 180 days, the affordable unit may be sold to an eligible buyer earning up to 80% AMI with the approval of the Affordable Housing Trust Fund Board.
    - Adaptive reuse projects in the B5 zoning district may provide tiered affordability at a range of income levels with the approval of the Planning Board.
- In exchange for providing the required affordable units, projects would be eligible for a 25% housing unit bonus and a reduced parking requirement of one space per unit (combined with other measures that would reduce the need for more than one car per household) and could increase the number of stories by right provided the maximum height is in compliance with underlying district.
- The policy would apply citywide to projects that result in the creation of 6 or more new residential units.
- Developers would not be permitted to pay an in-lieu fee instead of building the required Affordable Housing units.
- Inclusionary units must be provided on-site in the same building or on the same property as market rate units.

- Fractional units would be required to pay a proportionate fee based on the project construction cost. For example, a 12-unit project would be required to provide 1.2 units; one unit would be built on-site and the project would pay a fee equal to the construction cost of the remaining 0.2 unit. Alternatively, the developer may opt to build the additional affordable unit instead of paying the fee.

METHODOLOGY

MAPC's analysis utilizes a development pro forma, a tool that is typically used by a developer to understand whether a real estate project is financially feasible. A pro forma takes into account dozens of project-specific real estate development variables to arrive at a projected level of profitability. As each of these variables change—for example, as construction costs decrease or interest rates increase—profitability goes up or down. If profitability falls below a certain level, the project is considered infeasible.

The purpose for undertaking such an analysis is twofold. First, understanding how a policy might impact the housing market is a best practice and MAPC strongly encourages municipalities to undertake feasibility studies to ensure their inclusionary policies both meet affordability goals and minimize the risk of dampening development. Second, the proposed inclusionary policy of 10% of units at 60% AMI goes beyond the baseline levels set by EOHLC. For the inclusionary policy to apply to the B5 district, which is the district that Salem will use to achieve 3A compliance, an economic feasibility analysis demonstrating that the proposed policy will not be detrimental to new residential development is required. Because a substantial share of new residential development in the city occurs in the B5 district, it is critical that any new inclusionary policy can be applied in that district. The methodology outlined in this section is consistent with EOHLC's 3A feasibility analysis guidelines.

MAPC's financial model considers development costs (including land acquisition, construction, and soft costs like legal and permitting fees), financing costs, and operating costs for projects of varying sizes. An important part of financial modeling involves market research to ensure that the model's inputs reflect Salem's local development conditions. This analysis also relies on interviews with real estate professionals active in Salem and familiar with local development conditions, along with information from industry real estate database CoStar. A full list of assumptions can be found in an appendix to this memorandum.

To understand how the proposed 2019 inclusionary requirements might impact development feasibility, MAPC developed a baseline development scenario with no inclusionary zoning requirements and no cost offsets for projects at a range of sizes common in Salem. From there, MAPC tested how the policy would impact the project's bottom line. In instances where the feasibility of the 2019 policy was less certain—notably for smaller projects—MAPC explored changes that would result in a more balanced policy (for example, fewer affordable units or greater cost offsets). Likewise, at the request of the City, MAPC explored a limited number of policy iterations that would allow for even greater affordability than was recommended in 2019. Those results are included in this memorandum for informational purposes and, while not included in the current updated policy recommendations, may be used as the basis for future analysis should the City wish to revisit inclusionary zoning in the future.

To assess impact to the project's bottom line, the feasibility referenced above, this analysis utilizes Internal Rate of Return (IRR), one of many metrics that developers use to determine anticipated profitability of a potential development project. The minimum IRR required to advance a project varies depending on the developer's requirements, those of their lenders and equity investors, and project-specific conditions. For the purposes of this analysis, MAPC considered the comparative IRR between no inclusionary zoning and the proposed inclusionary zoning rather than absolute financial feasibility. In other words, the analysis is focused on the extent to which various policy elements increase or decrease a project's IRR, making it more or less feasible, rather than whether the IRR is above a specific threshold. This approach was used because it is more broadly applicable to a range of projects that may have differing IRR targets; for example, a small project in which the developer provides the equity may require a 13% IRR, while a larger project seeking regional investors might target an IRR of 16% or higher. This is particularly important in Salem, where new housing is often built by small, local developers with slim profit margins.

This analysis assumes that a medium- or large-sized market-rate project can reasonably absorb a negative change in IRR of up to one percent. This change roughly approximates the impact of an inclusionary policy with modest affordability requirements (10% of units required to be Affordable Housing for households earning 80% of Area Median Income) that require minimal cost offsets (for example, a minor housing bonus or parking reduction), which is common across Massachusetts. Such a change would make a project less profitable, effectively asking the developer to assume some of the cost of the Affordable Housing development, but the project would likely remain viable. A negative change of greater than one percent was considered substantial enough to risk project feasibility and therefore a policy with this effect is considered viable.

For smaller projects, the analysis aims to maintain a change in IRR up to one-half percent. This lower target was set based on assessor, permitting, and industry data as well as MAPC's conversations with local developers. Small projects have higher per-unit development costs than larger projects and thus have less leeway to absorb additional costs. Relative to other urban municipalities closer to Boston, development in Salem has a comparatively low profit margin, which means that small, local developers have even less wiggle room. Salem also sees a high share of historic renovations, which can come with additional risk and uncertainties. When combined with the heightened variability and risks inherent in small projects, an overly ambitious inclusionary zoning policy could make a small project untenable. Additionally, EOHLC is aware that smaller projects tend to have smaller profit margins and risk being disproportionately impacted by inclusionary policies, so ensuring the viability of small projects must be a particular focus of an inclusionary policy when applied to a 3A district. Demonstrating this viability is a critical component of the required Economic Feasibility Analysis. These smaller infill projects are a critical piece of developing housing sustainably in Salem's walkable, amenity-rich downtown, so the analysis takes care to ensure that the increased risk and decreased margins inherent in small development are considered.

POLICY ANALYSIS

The impacts of the affordability requirements and cost offsets considered in this analysis are shown in Table 1 below. In all cases, the change in IRR is in relation to the baseline project (no affordability and no cost offsets).

Table 1. Affordability requirements and cost offsets, 25-unit rental project.

	Affordability Requirements

		No affordability	10% units at 80% AMI	15% units at 80% AMI	10% units at 60% AMI	12% units at 60% AMI
Cost Offsets	No offsets	14.0% IRR **(Baseline)**	13.3% IRR **-0.7%**	12.8% IRR **-1.2%**	12.4% IRR **-1.6%**	11.9% IRR **-2.1%**
	Housing unit bonus	14.5% IRR **+0.5%**	13.9% IRR **-0.1%**	13.6% IRR **-0.4%**	12.9% IRR **-1.1%**	12.5% IRR **-1.5%**
	Parking reduction to 1.0 spaces/unit	14.5% IRR **+0.5%**	13.8% IRR **-0.2%**	13.3% IRR **-0.7%**	12.9% IRR **-1.1%**	12.5% IRR **-1.5%**
	Housing unit bonus + Parking reduction to 1.0 spaces/unit	15.0% IRR **+1.0%**	14.4% IRR **+0.4%**	14.1% IRR **+0.1%**	13.4% IRR **-0.6%**	12.9% IRR **-1.1%**

Percentages in **bold** indicate a given scenario's change from the baseline IRR.
Scenarios highlighted in yellow indicate a combination of affordability requirements and cost offsets that falls within the defined change from the baseline project.
The scenario highlighted in orange indicates the 2019 policy proposal.

The first row in Table 1 demonstrates the impact that varying affordability requirements would have on the baseline project if no cost offsets were offered. Note that the policy scenarios with affordability at 80% AMI were not under consideration, given the demonstrated need in Salem for more deeply affordable housing units, but are shown here for illustrative purposes.

Unsurprisingly, as the percentage of required Affordable Housing units increases, the impact on project feasibility becomes more substantial. Just as important, as the required affordability levels become deeper, the impact on the project's IRR becomes more deleterious. For example, the impact from a requirement of 10% of units at 60% AMI is roughly double that of a requirement of 10% of units at 80% AMI, even though both scenarios would require the same number of Affordable Housing units.

Conversely, the first column demonstrates the extent to which various cost offsets positively impact IRR in the absence of inclusionary requirements. While MAPC does not recommend utilizing any of these cost offsets for projects that do not include an Affordable Housing component, this column is instructive in that it clearly indicates the degree to which some cost offsets are more effective than others and the need to combine offsets to reach deeper levels of affordability.

The remainder of the columns and rows demonstrate the degree to which each cost offset mitigates each affordability requirement. For each affordability scenario, the minimum combination of cost offsets that would be required to avoid an untenable reduction in IRR is highlighted.

Of the affordability requirements shown in Table 1, only the requirement for 10% of units at 80% AMI —which neither maximizes the number of Affordable Housing units nor requires affordability at a depth consistent with Salem's need—could likely be absorbed without cost offsets.[1] This is consistent with the findings of the 2019 analysis. Any of the scenarios requiring affordability at 60% of AMI, including the 2019 policy proposal, would require cost offsets to maintain development feasibility.

[1] This analysis is limited to financial feasibility; all inclusionary policies should provide some degree of cost offsets to ensure the policy is on sound legal ground.

The 2019 proposal combines two moderate cost offsets to achieve deeper affordability. The first is an increase up to 25% of the total number of units that would normally be permitted by right in the applicable zoning district. An increase in allowable density is one of the most common cost offsets offered by inclusionary policies in Massachusetts. A bonus housing unit reduces costs by increasing the number of market-rate units a developer can build on a given site, thereby increasing a project's rental income.

The second cost offset included in the 2019 proposal is a parking reduction to 1.0 required spaces per unit for projects within a half mile of a commuter rail station and/or for projects incorporating transportation demand management practices. Under current zoning, new development projects in Salem must provide 1.5 off-street parking spaces per dwelling unit. Off-street parking is expensive to build ($30,000 or more per space for podium parking; $10,000-$15,000 or more per space for surface parking). Parking spaces also use space that could otherwise be devoted to housing: one parking space alone uses at least 300 square feet of space, one third the size of a two-bedroom housing unit. Thus a reduction in the number of required spaces offers great potential as a cost offset.

In both the 2019 analysis and the current analysis, either of these cost offsets alone could support an affordability requirement of 15% units at 80% AMI, but neither are sufficient to reach the policy goal of affordability at 60% AMI. However, using the two together allows a 60% AMI affordability requirement that is more consistent with local need.

Small projects

The specific IRR and impacts shown in the tables above and below are based on a medium-sized, 25-unit project. In general, the IRR for a medium project is slightly lower than that of a large project, and the IRR for a small project is slightly lower than that of a medium project. Broadly, in Salem's market the impact of various affordability requirements and cost offsets is proportionally similar across medium and large projects but, as highlighted previously, can be lower and more unpredictable for small projects.

Small projects are more difficult to make "pencil." They have lower profitability thresholds—meaning the baseline IRR is lower—and are riskier and cost more to develop per unit because they lack economies of scale. While there is no clear juncture at which a small project become a more feasible medium-sized project, based on permitting and assessor' data, MAPC determined that projects under and including units were on the cusp of uncertain feasibility and the policy should adjust to accommodate these smaller projects.

This can be accomplished by requiring small projects to provide 8% affordable units rather than the 10% required for larger projects. This ensures on-site affordable housing units in smaller developments, which comprise much of the in-fill development in Salem.

Other policy components

Fractional payment. The 2019 recommendations included a fee for fractional units based on the construction cost represented in the project's building permit application. However, MAPC recommended using a different methodology for the current policy for several reasons: construction costs can vary substantially from project to project; a project may pull supplementary building permits for different construction phases such as site work, thus resulting in an unequal assessment of the fee; it can be a burden on a municipality to determine and assess a new fee for each project. Instead, MAPC recommended that the fee reference the development cost limit per unit articulated in the state's Qualified Allocation Plan for Low Income Housing Tax Credits. This latter metric is more predictable, does not require calculations, and is simpler to administer because it is automatically updated by the state every other year. It is also a common method for setting in-lieu fees in Massachusetts municipalities.

The impact of the fractional unit payment is less variation in feasibility based on project size. For example, under a policy without a fractional payment, a 24-unit project with 2 affordable units (rounded down from 2.4) would be significantly more profitable than a 25-unit project with 3 affordable units (rounded up from 2.5) despite only a one-unit difference in project size.

In-lieu fee. To ensure geographic equity in the location of units and to ensure that the policy results in actual affordable units constructed, the 2019 recommendations did not allow projects to satisfy its affordability requirements through payment of a fee in lieu of providing on-site units. As such, MAPC did not consider the impacts of an in-lieu fee in its current analysis.

Unit design. Some policies allow a certain degree of difference in unit size and finishes for Affordable Housing units from their market-rate counterparts. While this can result in a modest cost offset and is part of the 2019 recommendations, some developers prefer "floating" Affordable Housing units not tied to a physical unit so unit comparability was not considered as a cost offset in this analysis.

Geography. The 2019 proposal was for citywide inclusionary zoning, so MAPC did not analyze differing IZ requirements for different areas of the city.

Stories. The 2019 proposal allowed for an increase in stories by right so long as the resulting height still complied with the requirements of the underlying zoning districts. This element has been retained in this version of the ordinance. For the purposes of the financial analysis, the impact of this component is captured in the housing unit bonus.

SUMMARY

In summary, due to the balance of cost offsets and affordability requirements, the 2019 inclusionary zoning policy for the most part remains a viable policy with regards to medium and larger projects, which we define as projects of greater than 20 units. For small projects, feasibility can be attained by reducing the required percentage of affordable units from 10% to 8% at 60% AMI. With this change, the City can confidently advance its inclusionary policy with little risk of negatively impacting residential development.

This analysis was grounded in the EFA guidelines provided by EOHLC and will satisfy the requirement to demonstrate feasibility of an inclusionary zoning policy in a 3A district, in Salem's case the B5 zoning district. The analysis demonstrates that Salem's proposed policy will not risk dampening residential development and will enable the City to apply its inclusionary policy in the B5 zoning district while remaining compliant with Section 3A.