



Affordable Housing Development in East Jerusalem

Delivery Models

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2022

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Preface

Meeting East Jerusalem's current and future housing needs will require a step change in the financing and delivery housing. Over the past decade, a large part of housing need has been met by vast unlicensed construction in neighbourhoods beyond the wall. There is little capacity for this to continue. This same scale of construction needs to start being implemented in neighbourhoods on the western side of the wall, in a licensed manner. Until now neither the delivery nor permit systems in East Jerusalem have been capable of handling the scale of construction required. Moreover, building in a licensed manner entails significant and unavoidable additional costs in development; these include planning, engineering and legal fees as well as taxes and land confiscation for public use. New types of housing, financial products, and development models will be required to deliver the housing required in a manner that is affordable and commensurate with average salaries.

1.1 Affordability

Housing affordability can be measured in various ways. According to the World Bank, an ideal ratio of property price to annual income is three; that the value of property should be equivalent to three times a household's annual income. As a rule of thumb housing should cost no more than 30% of a household's income.¹ The advantage with measuring as an expenditure of income is that it more directly ascertains the level of financial stress placed on households in a manner obscured by price to income ratios.²

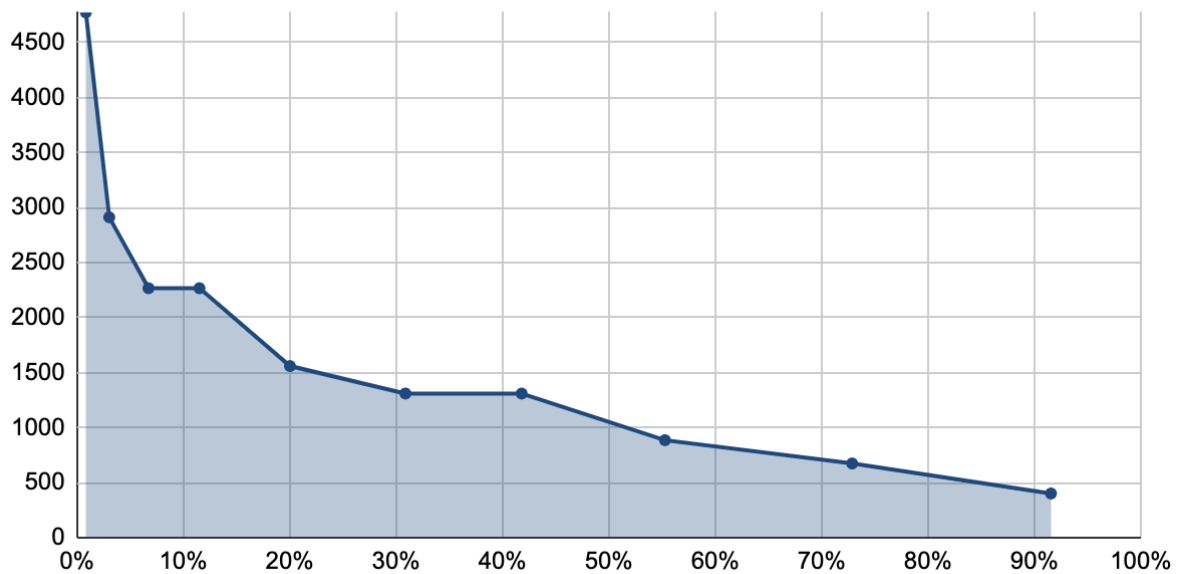
Obtaining an accurate picture of affordability in East Jerusalem is obscured by lack of disaggregated data. The most relevant income data provided by ICBS applies to the Arab population of Israel. An upper and lower bound are provided for the median monthly gross household income of between 3680-3349 USD, implying a median range of 1,000-1,100 USD for household expenditure. Using a rate of 80% of the median provides a guideline for a universally affordable cost. This would suggest affordable expenditure somewhere between USD 800-880. Given the probability of lower incomes in East Jerusalem the lower bound of USD 800 should be used as a guideline of affordable pricing in the city.

¹ McKinsey Global Institute 2014

² Meen 2018

Affordable Monthly Housing Expenditure (Arabs in Israel)

Proportion of Households (USD)



1.1.1 Shortcomings in financing

If development is to formalise in East Jerusalem, new financial products will be required to help households make up the additional costs associated with permitted development. Housing finance has been encumbered by the unregistered status of land in East Jerusalem, against which mortgages cannot be securitised. The finance sector has yet to offer an alternative housing loan that can capitalise on unregistered land at an affordable interest rate. Palestinian and Arab Banks have also been reluctant to accept liens on properties in East Jerusalem due to additional political complications in acquiring the asset in the case of default. Mortgage lending is similarly restricted by Israeli banks within Israeli Arab localities. Just to 1.8% of mortgages go to Arabs in Israel despite comprising 21.4% of the population.³ Of these, the loan to value ratios are generally quite low; the average rate in Arab localities was just 43%. As a consequence, it is believed unsecured non-housing loans are used for housing costs; over 40% of Palestinian households hold non-housing loans compared to 29% of Jewish households.⁴

³ Bol (2017)

⁴ Ibid

Table 1 - Mortgage Terms Provided to Arabs by Israeli Banks

	Mixed Localities	Non-mixed localities
LTV ratio	56%	43%
PTI payment ratio	27%	25%
Repayment term (years)	18.6	19.4
Household income (NIS)	15,030	14,450

Source: Bol 2017

Based on the ICBS income data loans of up to around USD 164,000 can be offered to the median income household in East Jerusalem. This implies an affordable loan size of USD 131,000 and an affordable house price of 187,000, assuming a 30% down payment. This rises to 234,000 for median income households. To offer these loans requires that solutions can be found to the securitisation of the loans on unregistered land.

Housing Loan Affordability

Proportion of Households (1000s USD)

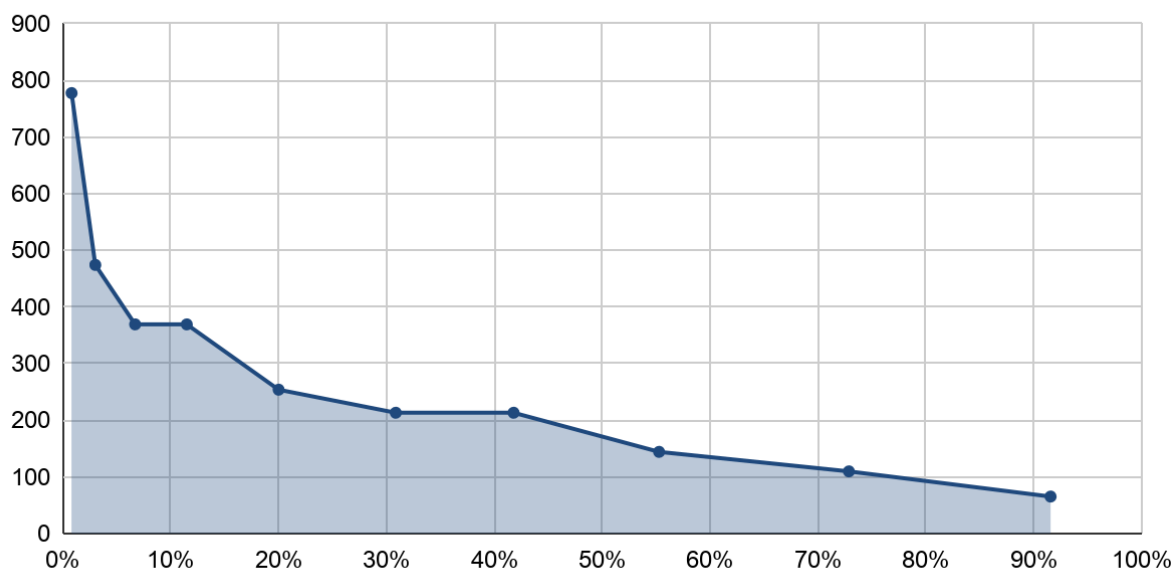


Table 2 - Housing Affordability (USD)

25 year loan, 5.5% interest

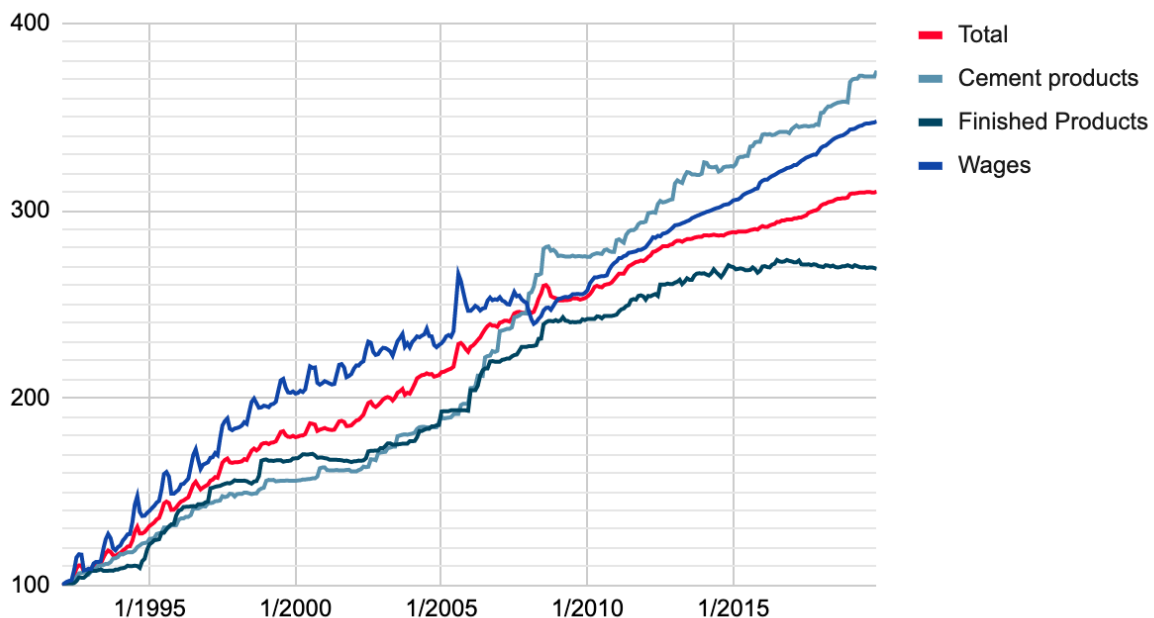
	Gross Monthly Household Income	Available for housing (30%)	Loan Available	Max House Price - 50% deposit	Max House Price - 30% deposit
Median Upper	3,680	1,104	179,766	359,532	256,809
Median Lower	3,349	1,005	163,593	327,186	233,705
Affordable Upper	2,944	883	143,813	287,626	205,447
Affordable Lower	2,679	804	130,875	261,749	186,964

1.2 Lowering Costs

There is limited scope for reducing construction costs through methods such as offsite fabrication in East Jerusalem as these methods are not suited to the local concrete and stone construction type, which is proscribed by local zoning codes. Israeli construction price indices show that finished products (kitchen fittings ect.) have flatlined since 2015 helping to bring down costs through efficiencies in offsite fabrication. There is some speculation that similar savings could be made applying the same to window fittings in Israel, however such investment in fabrication infrastructure would only be cost effective if operating at the national level.

Residential Construction Price Indices

1992-2019



There is significant scope for reducing costs through more flexible planning standards. Requirements on the minimum levels of parking space and setback would enable more efficient urban forms of development which are both more in keeping with the local vernacular and have been adopted in many European cities to encourage more urbanised, less car dependent lifestyles.

In lieu of changes to the planning regulations, the most effective way to reduce construction costs per dwelling is to reduce the size. Currently, licensed homes that come onto the market in East Jerusalem tend to be above average in size, between 100-120m². An increased rate of Arnona, municipal tax, for dwellings above 120m² reduces the attractiveness of properties above this size. The official average dwelling size in East Jerusalem is 80m². At 5.3 persons per household that equates to around 15.1m² per person. This reduces to 64m² in Silwan, 46m² in the Christian and Muslim quarters of the Old City and 35m² in Shuafat Refugee Camp, implying as little as

12.1m², 8.7m² and 6.6m² per person respectively. In this context, it is important that new builds are offered at a range of sizes. A 60m² is adequate for a young family with 1-2 children, particularly if safe outdoor recreational spaces is provided - something missing from most existing Palestinian neighbourhoods.

1.3 Development Models

The method of development has large implications for the type, quantity and cost of new housing coming onto the market. Seven models have been identified as relevant to development in East Jerusalem. Only two of which are commonly used at the moment; commercial and self-build. The other four; cooperatives, purchase groups, partnerships and development-agency, have either precedent in East Jerusalem or Israel and could all be expanded to help increase the quantity and affordability of housing delivery in the city by harnessing new models.

1.3.1 Commercial Development

Private developers supply most of the housing in the city, however most of this is informal in neighbourhoods beyond the wall. The amount of licensed commercial housing coming onto the market is insignificant. The risk and uncertainty in obtaining building permits is a major limitation to growth of the sector. To justify the risk, large profits are expected from developments. A study commissioned by the Quartet calculated average developer profits East Jerusalem to be in the range of 40%, when internationally profits of 10-15% are typical. Such profits drive up the cost of commercial housing to exorbitant levels, thereby limiting the market to the wealthiest households. Conversely, commercial housing in areas beyond the wall is some of the cheapest in the city. Here the private sector has provided an oversupply of housing; there are estimated to be around 4000 uninhabited units.

The commercial sector in East Jerusalem did not respond to the Israeli government funded TMA 38 scheme in which additional units could be added to existing housing in exchange for upgrades to the building's structure. Up to 2.5 storey addition to existing buildings built before 1980 in exchange for earthquake reinforcement, an elevator and a security room. The scheme included numerous incentives to attract developers, these include; a full exemption on the municipal betterment levy, full or partial exemption on the national betterment tax, zero-percent VAT on inputs. No further planning approval was required beyond a building permit issued by the local committee.⁵ A second scheme 'Vacate-and-Build' allows much greater densification - up to three times the current density - but no other incentives beyond that. Adoption of the schemes has not been significant. Vacate and Build added 295 units in West Jerusalem between 2000-2007. Between 2008-2015 the two schemes added a further 218 units.⁶ The scheme was popular with developers in West Jerusalem, adding a total of 4,996 units to the planning pipeline between 2015-2018. None of these are thought to have taken place in Palestinian neighbourhoods. TMA 38 was cancelled in

⁵ BoI (2015) p.244

⁶ BoI (2015) p.246

<https://www.boi.org.il/he/NewsAndPublications/RegularPublications/DocLib3/BankIsraelAnnualReport/%D7%93%D7%95%D7%97%20%D7%91%D7%A0%D7%A7%20%D7%99%D7%A9%D7%A8%D7%90%D7%9C%202015/c hap-9.pdf>

2018 and its future remains uncertain. Similar schemes will likely replace it as urban renewal is projected in the 2017 Israel Housing Strategy to supply up to 30% of new units, along with Vacate-and-Build.

1.3.2 Self-build

A significant proportion of housing is supplied through self-build. The average number of units permitted within a building permit between 1967-2012 was just four in East Jerusalem. Implying that the vast majority of construction is small scale. The main advantage with self-build is cost saving on developer fees and profits which due to the limited supply can be exorbitant. One of the main difficulties with self-build is the high degree of complexity and risk required to build a home, particularly if land purchase is required. Given the uncertainty with planning in Jerusalem, the self-build model is only applicable to families who already own land. In these cases, the build out rate will be limited to the needs and resources of the family. A family may have the means to build an additional apartment on the land but will delay construction until it is required by the family and won't be put on the market. Moreover, a single apartment within a building that is all otherwise all owned by one family may not be attractive to prospective buyers. Therefore, despite the potential cost savings, the self-build model has limitations in its ability to provide housing to the market.

1.3.3 Partnership Model

A variation of the self-build model which is currently used in East Jerusalem and can unlock housing opportunities is the partnership model. In this case, a developer manages and finances the development process and agrees to divide the final housing with the landowner; for example each taking two apartments from a four unit block. This can unlock land which would not otherwise be available on the market. The model does not overcome all of the limitations of self-build but has potential to increase supply in lower density, less urbanised neighbourhoods where housing supply is predominantly self-build and constrained by the financial resources of landowners.

1.3.4 Collective Development

Collective development addresses many of the shortcomings of other models. It broadly refers to non-profit developments in which the commercial developer is replaced by a group of prospective homeowners, in this sense it is an upscaling of the traditional self-build model. Costs are saved through economies of scale, removal of profits and in some cases, tax savings. Schemes also reduce some of the risk faced by commercial developers in that they do not need to be marketed. There are several organisational arrangements within the collective model that each have their own advantages.

1.3.5 The Cooperative / Union

The most common form of collective development in East Jerusalem is via organisations or unions representing a particular group of professionals through which the members can be vetted and organised. A successful example is the Bayt Al Maqdis Engineers Housing project which was initiated by the East Jerusalem Palestinian Engineers Association in 2006. The association selected 54 members based on a suitability and needs assessment, then established a separate association, The Bayt al Maqdis Engineers Cooperative Housing Association to manage the project. One of the benefits of using such an association is the potential to obtain grants for non-profit organisations.

The main limitation to the cooperative model is the need for an initial organisation to orchestrate the formation of the group. So far this has been confined to professional associations, which by their nature have a selective membership. Such an ad hoc model brings with it considerable inefficiencies for the housing sector, as the lack of continuation and scaling up of projects means organisational knowledge is lost.

Table 3 - Cooperative Housing Projects in East Jerusalem

Project Name	Organisation Type	Location	Units
Physicians Housing	Professional	Beit Hanina	70
Bayt Al Maqdis Engineers Housing	Professional	Beit Hanina	54
Orient House Employees Housing	Professional		35
Sur Bahir Teachers Housing	Professional	Sur Bahir	72-86
El Farouk Teachers Housing	Professional		21
Engineers Housing	Professional	Beit Hanina	26
Sharafat Latin Monastery Housing	Religious	Sharafat	60
Beit Hanina Housing Cooperative	Cooperative	Beit Hanina	21
Jerusalem Social Society	Cooperative		20
Shuafat Housing Association	Cooperative	Shuafat	135

Source: Dimensions Consulting 2015

1.3.6 Purchase Group

A variation of collective development which can enable further cost savings is the Purchase Group model.⁷ Any group deemed to be a 'purchase group' is exempt from VAT, which now stands at 17%, on all costs associated with the development including land. The model is widely used in Israel, up to a third of new developments in Tel Aviv were through purchase groups. The principal requirement for qualification as a purchase group is that land is bought by all of the members of the group on the same day. The land cannot be purchased by an association. A slightly different organisational arrangement is therefore required from the standard cooperative model. Generally a management company orchestrates the project including coordination and initiation of the purchase group, and oversees all technical functions related to the planning and delivery of the project. Companies typically charge 6-8% of the project cost as fees. Such a role could also be played by the cooperative associations reducing the price further. The main advantages of a management company are specialisation, which reduces risk, and the ability to upscale delivery.

The main disadvantage to collective development is that the members take on more risk than with a standard house purchase. Some of this risk will materialise through contingency costs for uncertainties such as betterment tax and construction delays. These costs will have to be added to the prospective cost, thereby outpricing some potential members who may well have been able to afford the final apartment base price. Additional risks relate to internal disputes or members dropping out and difficulties finding replacements. Moreover, the timescales in collective development can be long and uncertain, and during this time members will be required to pay off their loan or mortgage in addition to any costs related to their current residence.

1.3.7 Development Agency Model

One of the difficulties with large projects in East Jerusalem is their reliance on the Municipality to deliver significant amounts of new service infrastructure. The Physicians Housing in Beit Hanina experienced long delays waiting for the Municipality to deliver the required new access roads. The problem is likely to increase with larger projects. One solution is to establish a development agency for the neighbourhood which will deliver and manage the infrastructure itself, without reliance on the Municipality. In return the Municipality lowers the fees required for betterment tax and obtain a permit. This arrangement has precedent in Israel. To a certain extent, the model also has precedent in Palestinian communities. The Committee for the Development of Issawiya was formed in 1989 to, among other things, coordinate the implementation of sewage infrastructure. This could be suitable for much larger

⁷ The purchase group structure proposals are supposed to be fast tracked through the planning system although it is not clear by how much and whether this will be applicable in East Jerusalem.

projects such as the planned Al Addasseh neighbourhood north Beit Hanina, which has capacity for around 5000-6000 housing units.

1.4 Model Cost Implications

Each development model provides different efficiencies. To model the impact of these on house prices construction cost variables from the Quartet report were combined with assumed tax and profit saving of each model. Table 4 breaks down the costs of each model into land, building permits, construction, marketing and profit. Three models were included Commercial, Cooperative and Purchase Group.

Informal commercial developments were also included for comparison although in reality the prices achieved in Kafr Aqab are much lower due to higher densities and therefore substantially lower land costs.

The First Time Buyer VAT exemption was also included for comparison. In 2014 Israel introduced a VAT exemption (17%) for first time buyers purchasing properties under NIS 1.6m (USD 460,000).⁸ As they have not served in the military the VAT exemption for Palestinians is limited to purchases under NIS 950,000 (USD 270,000).⁹

⁸ <https://www.timesofisrael.com/knesset-committee-okays-tax-free-housing-bill/>

⁹ To qualify couples must be over the age of 35 and parent to at least one child.

Table 4 - Cost Breakdown by Development Model

	Commercial	Commercial - First Buyer	Time Cooperative	Purchase Group	Commercial Informal
Land					
Purchase Price	1,000,000	1,000,000	1,000,000	1,000,000	1,000,000
Purchase Tax	50,000	50,000	50,000	50,000	0
VAT (17%)	178,500	0	178,500	0	0
Building Permits					
Fees	369,000	369,000	369,000	369,000	0
Betterment Tax	200,000	200,000	200,000	200,000	0
VAT (17%)	96,730	0	96,730	0	0
Construction					
Contractor Fees	990,000	990,000	990,000	990,000	990,000
Management Fees (12%)	118,800	118,800	118,800	118,800	118,800
VAT (17%)	188,496	0	188,496	0	0
Marketing					
Fees	20,000	20,000	0	0	20,000
VAT (17%)	3,400	0	0	0	0
Profit					
Base	549,560	549,560	0	218,224	425,760
VAT (17%)	93,425	0	0	0	0
Total Costs	3,047,360	3,047,360	2,477,800	2,696,024	2,554,560
Total Tax exc. VAT	250,000	250,000	250,000	250,000	0
Total VAT	560,551	0	463,726	0	0
Total	3,857,911	3,297,360	3,191,526	2,946,024	2,554,560
Reduction	0	14.53%	17.27%	23.64%	33.78%

Assumptions

Site Variables

Site Area (m2)	1000
Land Cost (USD/m2)	1,000
Density (Gross Buildable Area)	150%
Net Area Ratio	75%
Total Net Area (m2)	1125

Source: Dimensions Consulting (2015)

Construction Costs / m2

Infrastructure Construction (1)	100
Unit Construction	350
Interior Construction	500
Construction Total	950
Project Accident Insurance	7
Contingency	33
Contingency Total	40
Land-Use Zoning to increase density	20
Building Design	13
Building Permits (Municipal Fees)	336
Design + Permits Total	369
Total	1359

1.5 Results

Of all the models Purchase Groups offer the greatest potential cost savings, totalling 23.6% reduction on the commercial base rate. This is achieved through a combination of savings on tax, marketing, and commercial profit rates.¹⁰ The Cooperative model brings savings of 17.3% through savings on marketing and profits. There is potential for further savings if the First Time Buyer VAT exemption is permitted.

Unit size is potentially the largest variable. The model does not take into account fixed unit costs and assumes a linear relationship with between cost and unit area. In reality, the relationship will not be linear and the difference between the largest and smallest units possibly less. Nonetheless, the majority of housing coming onto the market in East Jerusalem is above 100m² which is not unlikely to be affordable for median income even with suitable low interest financing options. Therefore much smaller units should be encouraged to meet the demand for young families and couples.

More empirical data is required to ascertain the impact of scale on the final unit costs. Reductions in planning and design costs would be expected with larger scale projects, although this may also increase uncertainty regarding permits and infrastructure.

Table 5 - House Prices by Delivery Model and Unit Size (USD except informal in NIS)

Unit size	Commercial	Commercial - First Time Buyer	Cooperative	Purchase Group	Commercial Informal in NIS
140	480,096	480,096	397,168	366,616	317,901
120	411,511	411,511	340,429	314,243	272,486
100	342,925	342,925	283,691	261,869	227,072
80	274,340	234,479	226,953	209,495	181,658
60	205,755	175,859	170,215	157,121	136,243
40	137,170	117,239	113,476	104,748	90,829

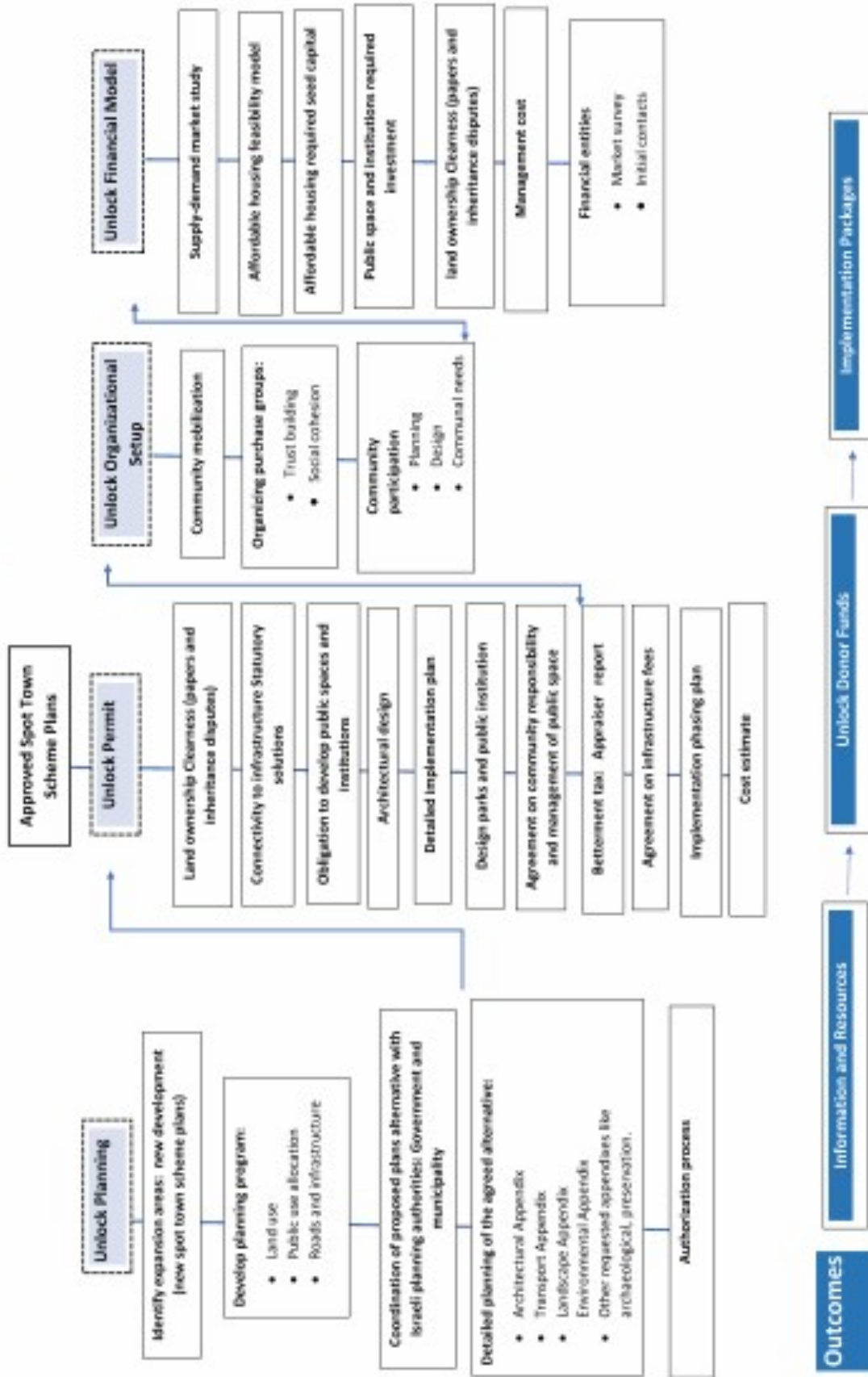
Affordability: ■ Median Income ■ Affordable (80% median)

¹⁰ Profit margins of 20% was assumed for the commercial models. Although much higher rates of up to 40% have been reported in East Jerusalem, this is more inline with expected international rates, to which East Jerusalem can be expected to align with once supply increases.

Table 6- Development Models Matrix

Model	Description	Income Group	Advantages	Disadvantages	Expansion Potential
Purchase Group	Collective development, managed by members of the purchase group. Benefits from tax breaks and lower construction costs. Up to 20% lower than market housing.	Medium - High	Costs of up to 20% saved from developers profits and tax breaks. Housing is built according to member's wishes rather than what developer's think is in demand.	Construction and legal risks borne by members of purchase group. Low public awareness and potential for scams.	Medium-High
Cooperative	Collective development managed by an association, typically professional. Examples include the Engineer's and Physician's Housing projects in Beit Hanina.	Medium	Reduces costs through economies of scale and by removing developer profits.	Requires a pre-existing organisation Limited flexibility to address changing needs such as growing membership.	Low-Medium
Housing Association	Non-profit associations building below market housing. In Jerusalem these are predominantly Waqf and Church denominations.	Low - Medium	Can provide affordable housing for low income households. Including low rental to targeted communities Existing agencies already own large amounts of land.	Requires financial support in order to expand affordability for purchasing and rent to low income classes. Little oversight in terms of funding and beneficiaries.	Medium
Self Build	Small scale additions by landowners, typically extensions to existing buildings	Low - High	Often cost efficient as little additional infrastructure is required.	Can be difficult for landowners to obtain loans. High design + planning cost for small number of additional units. Units often used exclusively for family members.	Medium
Commercial	Profit driven commercial developments providing housing at market rates.	High	Established experience practices.	Limited availability of suitable land with planning has restricted scale of private sector to small firms unable to deliver at scales large enough to bring costs below high-end developments.	Low
Partnership	Densification of existing plots with the aid of an investor. Final units shared between landowner and investor.	Low - Medium	Unlocks land owned by families who cannot afford to develop themselves but who do not want to sell. Can be cost effective and provide affordable housing.	Development is generally small scale. Generally in less urbanised neighbourhoods with poorer access to services.	Medium
Informal	Development without a building permit	Low	Provides affordable housing where the formal systems have failed.	Insecure tenure Potential structural risks Infrastructure lacking	Low

Affordable Housing Ecosystem



Recommendations

A step change is required in the planning, financing and construction of housing in East Jerusalem. Housing provision continues to be mired by obstructions at every stage. The shortage of secure affordable housing has left the majority of Palestinian households facing multiple forms of housing precarity ranging from financial insecurity to demolition.

Addressing the housing crisis requires interventions at all levels of the housing delivery process. This report has documented the major issues facing the sector and provided some possible solutions for overcoming these challenges. The proposals are intended to preserve the Palestinian rights and national interest to the city within the current political realities. They are not meant in any way to cooperate with or accommodate the Israeli occupation.

The greatest challenge is provision of affordable housing at the lowest income levels. Until now much of the lower to medium income demand has been met, albeit in a substandard manner, by informal construction beyond the wall. However, their continued growth is unsustainable as there is little low density or undeveloped land remaining and increasing the density of existing areas would entail unaffordable costs. Therefore, to avoid low-income Palestinian households being forced out of the city altogether, affordable development opportunities need to be unlocked in neighbourhoods within the wall.

This needs to happen at an unprecedented speed and scale. Until now, every year, the majority of licensed construction has taken place in West Jerusalem and the Settlements, around 2000 units compared to 400 in East Jerusalem. To meet the future demand for Palestinian household formation that balance will have to shift. Palestinian housing need has been accommodated through unlicensed construction and artificially high household sizes that do not reflect the changing cultural expectations of young families. Even if by 2035 annual licensed Palestinian construction has increased nine fold to 3600 units a year the average household size will only have reduced to the current West Bank average of 4.6.

Addressing the need will necessitate a fundamental shift in the Israeli planning system and the way it handles Palestinian applications. As the occupying power it is incumbent upon the Israeli authorities to allow Palestinians to meet their housing needs, something it has willfully failed to do. The shift of planning responsibility from the Ministry of Interior to the Ministry of Finance has helped to deliver more housing for Israelis but so far failed to deliver results for Palestinians. For change to happen, far greater transparency in the planning process is required in addition to international scrutiny and pressure at all levels of the Israeli government.

Community Planning

Considerable planning work is required to rehabilitate (urban revitalization) and formalise the existing built fabric and enable future development. Outline and Detailed plans need to be developed in parallel in order to align outline level land-use zoning with reparation of land ownership boundaries at detailed level. In addition to enabling new housing development opportunities, neighbourhood level planning is required to rehabilitate existing urban developments and improve their functionality. This includes increasing access to public spaces, facilities and infrastructure, improving pedestrian and vehicular transport networks and generating commercial and employment opportunities.

Planning can only provide solutions through close cooperation with the existing communities. This is particularly important in East Jerusalem where absence of publicly owned land is restricting new development and the functionality of public services and infrastructure. Creating sufficient public land will require a certain redistribution of ownership from private to public. This process has proved particularly difficult in East Jerusalem where the requirement for public ownership is a relatively new concept and more associated with confiscation by the Israeli government for Settlement construction. It is necessary therefore, in parallel to providing technical solutions, to work closely with communities to build awareness of, and trust in, the planning process.

Shifting away from informal development will entail significant additional upfront costs, which are currently unaffordable to a large proportion of Palestinian households. Addressing the affordability gap requires change to both the supply and demand sides of development including new development models and new financing arrangements to support them.

For the lowest income groups, the housing provision and financing will require social investment. There are opportunities for non-profit housing agencies to develop in the more affordable southern neighbourhoods. Housing agencies could adopt the partnership model to unlock small scale development opportunities that would have been overlooked by the private developers, seeking more urbanised locations.

For medium income households the purchase group model offers the greatest savings on development costs. The model has been widely used in Israel but yet to be adopted in East Jerusalem. Still, a considerable level of social investment will likely be required to support financial institutions in providing affordable loans on unregistered land.

Safe, secure housing is a human right that is being denied to Palestinians in East Jerusalem. Addressing obstacles to housing provision as outlined in this report is foundational to reversing the social and economic decline witnessed in the city in recent decades.