Affordable Housing Incentive Program Pro Forma Analysis

City Council Presentation

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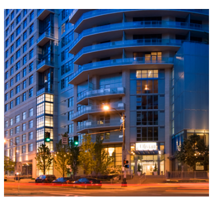
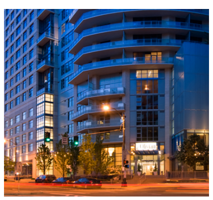
Approach/Scope of Study



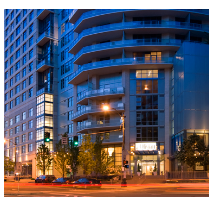
1. Background Review
2. Market Sub-Area Analysis
3. Pro Forma Economic Analysis
4. Findings and Implications for Incentive Housing Program



Market Sub-Area Analysis

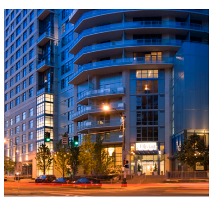
Purpose

- Understand market for new residential and office development
- Generate assumptions for economic/financial analysis



Market Geographies

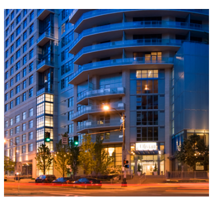
- Apartment, Condo and Office
  - Downtown Urban Center/First Hill
  - South Lake Union Urban Center
- Apartment and Condo Only
  - Zip Codes Outside of Downtown
  - Urban Centers outside Downtown and Urban Villages Citywide
  - Divided into “high”, “middle” and “low” cost areas for economic analysis



Analysis and Assumptions

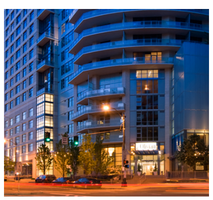
- Uses 12 development prototypes, with and without incentive
- Development cost assumptions (developer interviews and available data)
- Rent and operating cost assumptions (from market analysis and interviews)

Technical Advisory Committee



- Technical Advisory Committee (TAC) composed of local for-profit and non-profit developers
- DRA facilitated three meetings with the TAC
  1. Review draft development prototypes
  2. Review draft cost and revenue assumptions
  3. Review preliminary analysis

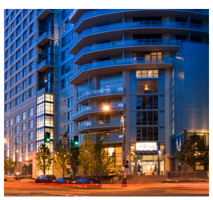
Net Impact of Incentive Program



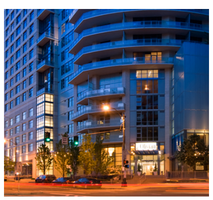
- Net value of bonus floor area
  - After cost of meeting affordable housing requirements (in lieu fee, onsite units)
- Return on Equity Analysis
  - With and without incentive
- Residual land value
  - With and without incentive

Program Options (Scenarios)






- Current in-lieu fee payment
  - $21.68 DT & SLU residential; $15.15 other residential; $24.95 commercial (plus TDR, childcare if applicable)
- Scenario 1:
  - Current performance requirement for residential: Approx. 5% of total units affordable @
    - 80% AMI for renters
    - 100% AMI for owners
  - $40/SF in lieu fee for commercial
- Scenario 2 (residential only):
  - 10% of total units affordable on-site for residential
    - same income levels as Scenario 1



Total Development Cost (TDC) Estimates Include:

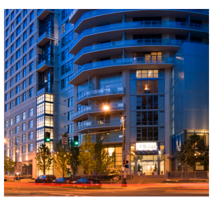
- Land acquisition costs
- Hard construction costs (including contractor fees)
- 5% contingency
- 9.5% Washington State sales tax
- Soft costs at 16% of hard costs (architectural/engineering, permits/fees, legal, taxes during construction, interest during construction, financing fees, marketing and leasing/sales)

Return on Equity (ROE) Analysis Approach

Market value of prototype

Less: Total development costs of prototype (including land)

Equals: Net project value of prototype



Return on equity (ROE) equals net project value annualized over the estimated term of investment, divided by the total amount of the equity investment

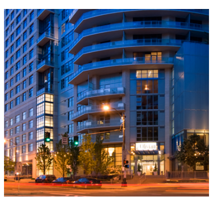
Market Value: Rental Prototypes

Rental prototypes (apartment and office)

Calculated at stabilized occupancy

Gross rents less vacancy less operating costs

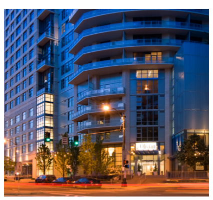
Equals: Net operating income (NOI)



NOI divided by capitalization (cap) rate

Equals: Market value of prototype






Cap Rates

- Ratio of net operating income (NOI) to sales price exhibited in sales in the market.
- Tracked by land use and market area over time
- Rates used for analysis:
  - Apartment: 4.25% (low); 5.00% (high)
  - Office: 5.00% (low); 5.50% (high)

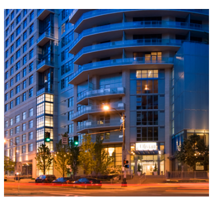
Land Residual Analysis

Market value of prototype

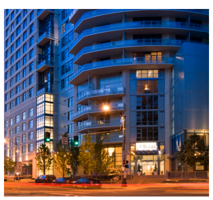
Less: Total development costs of prototype (EXCLUDING land)

Less: Minimum return on equity

Equals: Residual land value (RLV)



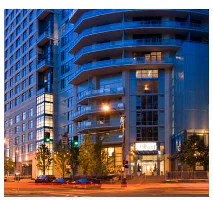
Residual land value is compared to market land prices based on sales in the market



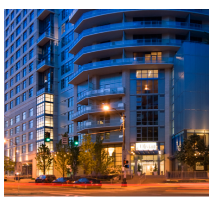
Feasibility Thresholds

- Return on equity analysis:
  - Residential: 6% to 9%
  - Commercial: 10% to 12%
- Residual land value:
  - RLV equal to or greater than market sales prices for land

Estimated Cost of Performance Requirement

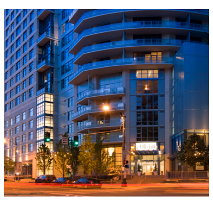


- Cost of providing affordable units on-site measured using "affordability gap analysis" approach
- Estimates amount of mortgage supportable from affordable rents
- Estimates affordable sales prices (affordable mortgage plus 5% downpayment)
- Supportable mortgage or affordable sales price subtracted from total development cost of affordable unit to estimate "gap" cost



Sensitivity Analysis

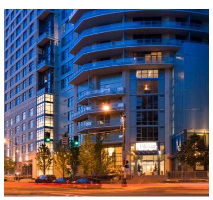
- Lower and higher cap rates
- Economic scenarios
  - Version A (Baseline): middle scenario
  - Version B: conservative underwriting
  - Version C: higher rents/sales prices



Key Findings

1. Comparison of in lieu fees and cost of performance options
2. Estimated value of the incentives
3. Impact of program on prototype financial feasibility

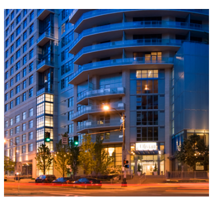





Comparison of In Lieu Fees and Cost of Performance

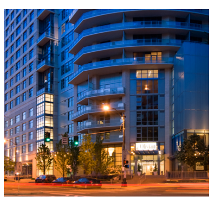
- Estimated cost of performance option substantially exceeds current in lieu fee for all Downtown and SLU prototypes
- Indicates developers in Downtown and SLU will almost always choose to pay in lieu fee
- Estimated cost of performance option lower than current in lieu fee for low-rise and mid-rise prototypes
- Suggests developers of low/mid rise prototypes would often select, and are not disadvantaged by, current performance requirement





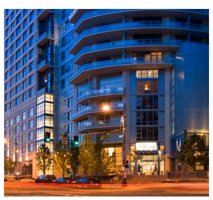

Intangible Factors

- Economic analysis does not take into account other factors that may influence developers' decisions to take the incentive and/or to pay the in lieu fee rather than build units on-site
- Such as:
  - Level of market demand for, and risk of, larger prototype (with incentive)
  - Developers' expertise with various construction types
  - Assessment of future escalation of market vs. affordable rents
  - Marketing and operational issues



Value of Incentives

- Value of incentive exceeds cost of in lieu fee and current performance option for Downtown rental and condo prototypes under certain assumptions
- Value of incentive exceeds in lieu fees for commercial prototypes in Downtown and SLU prototypes
- Indicates Downtown developers and SLU commercial developers may find incentive program attractive



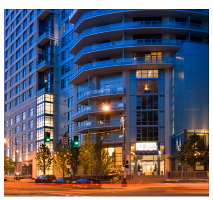
Value of Incentives (2)

- Value of incentive is negative for SLU residential prototypes, even before consideration of in lieu fee
- Value of incentive is positive in a few instances, but negative in more instances, for low- and mid-rise prototypes
- Indicates residential developers in SLU and of low-rise/mid-rise prototypes are not likely to use incentive program

Impact of Program on Financial Feasibility

- Findings are mixed, depending upon the economic scenario

- In general, at lower cap rates, there is some room to raise the in lieu fee to approximate the performance cost of current program (Scenario 1)



- In few cases do the prototypes remain feasible under the higher performance cost of Scenario 2 (10% affordable units)

- In most cases, prototypes infeasible at higher cap rates, indicating financial feasibility dependent on market and investment conditions