August 24, 2016

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FINANCIAL ANALYSIS AND SWOT FINDINGS
RENTAL HOUSING STUDY

Montgomery County, Maryland
PROJECT OVERVIEW

Task 1: Project Kickoff/Data Collection
- Identify Data Needs
- Identify Key Stakeholders
- Review Background Materials

Task 2: Secondary Analysis
- Focus Groups and Stakeholder Interviews
- Neighborhood Assessment
- Local and State Policy Analysis
- Best Practices Analysis ★

Task 3: Narrow Options
- Identify Options ★
- Financial Feasibility Model ★
- Cost/Benefit Assessment

Task 4: Recommendations
- Develop Recommendations
- Draft Final Report
- Meet with Advisory Committee, Planning Board, County Executive and County Council

Draft for Discussion Presented to the Rental Housing Market Study Advisory Committee on August 24, 2016
SWOT Analysis
- Market
- Policy
- Capacity

Key Policy Considerations
- Produce New Housing
- Preserve Existing Housing
- Generate Resources

Financial Analysis
- Methodology
- Results
- Implications
SWOT ANALYSIS
Market

- Local and regional market demand strong at all incomes
  - Data indicate households continue to seek MC opportunities
  - Most profitable along Metro, Purple line, and within ICC
  - Best serving 60% to 80% right now
- Certain areas have broader appeal
  - Metro corridors, inner subareas, well regarded elementary schools
  - Also tied to available amenities
- Substantial supply of traditional ownership (single-family) units augments rental market (large units)
STRENGTHS

- **Policy**
  - MPDU program very effective at delivering units
    - Focused in the 50% to 70% range only
  - MPDU program has distributed the price controlled housing throughout the County
  - CR zoning has a reward system for additional MPDU production
  - Right of first refusal program for sale of multifamily developments
  - Code enforcement responsive in addressing resident concerns
  - Housing trust fund (HIF) to incent price appropriate housing
  - Use of County-owned land to develop income controlled housing
    - Co-location
STRENGTHS

- Capacity
  - Leadership proactively seeking to enhance price appropriate rental housing
    - Elected officials, planning board, advocates
  - HOC is a stable, well positioned implementation partner
  - DHCA helpful and proactive in going through the MPDU approval process
    - Still has many requirements to be met
  - Committed, experienced non-profit affordable housing development partners in the region
WEAKNESSES

Market

- Imbalance of supply and demand pushing rents higher
  - Continued increase in rents
  - Not enough rental housing for households earning less than $50,000
- Many of the more cost effective areas do not have the amenities or transportation support demanded
- Limited land availability for development
  - Redevelopment costly
  - Placing developable parcels in to Ag Reserve reduces supply
- In older buildings, renovation costs start to be comparable to redevelopment
  - Building efficiency/competitiveness
**Market (cont.)**

- Not enough large 3+ bedroom large unit housing to accommodate families
- Not enough housing built to accommodate special needs persons
  - Physical/mental disabilities
  - Homeless/transitioning households
    - Not enough on-site services at existing facilities
WEAKNESSES

Policy
- CR Zoning includes affordable housing in menu of benefits – but developers not required to choose that benefit
  - More cost effective to avoid housing option
- Lack of flexibility in MPDU program delivery (e.g., limited off-site units)
- Housing one of several priorities in Montgomery County
- County policies focused on regulating to stop something, not encourage something
- Certain County spending priorities determined ad hoc (HIF)
  - Can change with staffing change/political will
- The time from project initiation to opening can take too long
  - Entitlement risk; construction risk; market risk
- County impact fees/taxes on new development onerous to providing affordable housing
Policy (cont.)

- There is a perception that approval process/requirements are inconsistent and inconsistently applied
  - Unpredictability = cost
  - Process needs to be constantly improved to be as consistent and predictable as possible
- Timeline for approvals is perceived as too long
  - Similar to other DMV communities
- Montgomery County non-competitive with other regions in state for LIHTC funds
- Entrenched position to “keep doing things the same way”
WEAKNESSES

Capacity

- Not enough money/resources being put to meet local needs (region-wide)
- Cost of development is a barrier to entry for smaller developers
- Limited number of affordable housing developers to partner with
Market
- Tap into the value of ‘excess’ public land
  - Right of way land not needed for transportation projects
  - Co-locating public services with rental housing development
- Preservation of existing units is more cost effective in certain markets
  - Preservation does not necessarily mean keep the exact unit
  - Incentivize redevelopment that keeps same number of affordable units or total bedroom count
- Retrofit older commercial corridors with mixed use development
- Recapture development potential of parking fields
  - Metro areas in particular
- Use of micro units in transit areas
**Policy**

- Flexibility in meeting County MPDU requirements
  - Provide lower MPDU percentage for units meeting lower income targets
  - Make MPDU requirement on square footage rather than unit count
  - Allow for off-site unit delivery
    - Create distance requirement for proximity
  - Payment in lieu of units
    - Has to be at market rate value, though
- Increase density and height allowances in certain areas to enable additional supply
- Increase use (funding) of right of first refusal
- Tier priority for preservation based on set of criteria
  - Serve vulnerable populations?
  - Already receive Federal funding?
Policy (cont.)

- Use public land for price appropriate housing development
  - Ag Reserve property swaps
- Continue to work towards creating more predictable and efficient development approval process
  - Metric-based requirements
  - Administrative approvals for smaller projects
- Modify waiver of impact fees for more MPDUs
  - Adjustment of % requirement
  - Same flexibility in terms of income target
- Create County voucher program to augment Federal program
- Lobby state government to allocate LIHTC pool for Montgomery and Prince George’s County
OPPORTUNITIES

Policy (cont.)

- Tie access to certain funds for development/rehabilitation that incorporates accessible units
Capacity

- Increase investment in Housing Investment Fund
  - Mandate HIF for construction/preservation only
  - Require HIF contribution for commercial/residential projects
- Regional housing program to attract Federal/foundation support
  - Local communities control their own money
Market

- Portion of resident base that opposes multifamily and/or increased density development
- Locating new developments away from services and transportation access (value to lower-income HHs)
- Purple Line displacement as redevelopment/rent increases occur
- Redevelopment of existing market rate affordable properties will reduce 3+ bedroom supply
  - Unless policy change in delivery of MPDU units
- Reversion of rented single family units back into ownership will impact supply-demand balance
- Displacement of communities (particularly ethnic communities) that disrupt social networks
Market (cont.)

- Key renter market segments have different needs
  - County demographics are changing
- Housing affordability challenges include credit worthiness, not just income
- Senior households with disabled adult children at risk
  - Caretakers for both
- Transportation accessibility for extremely low income and disabled persons
THREATS

- **Policy**
  - Off-site/in lieu development is counter to County’s history of prioritizing mixed-income developments
  - Increasing inclusionary zoning requirement without offsetting benefits could chill market
  - Using blanket policies may not be the most effective way to develop/preserve housing
    - Should be done on case-by-case basis
  - Placing redevelopment restrictions on existing market rate affordable properties disproportionately impacts owners
  - Have to balance tax burden on residents with investments in programs such as housing trust fund
THREATS

- **Capacity**
  - Lack of increase in financial funding will limit effectiveness
  - Equity investors only interested in “A” rental developments
    - Hard to get funding for secondary/tertiary locations
KEY POLICY CONSIDERATIONS
Successful local housing strategies are:
- Comprehensive
- Flexible
- Responsive to local needs
- Consistent with community goals

Greatest needs among lowest income households, larger households

Financial resources are key but land use/zoning policies are also essential

Changing needs means it’s necessary to revise longstanding policies
POLICY OPPORTUNITIES FROM REVIEW OF BEST PRACTICES

PRODUCE NEW HOUSING

- Add flexibility to the MPDU program
  - Varying income targets and affordability requirements
  - Include an off-site and/or in lieu option

- Key issues
  - Consistency with County’s mission/goals
  - Appropriateness in different markets
  - Getting the parameters right both to serve households in needs and to avoid stalling housing activity
POLICY OPPORTUNITIES FROM REVIEW OF BEST PRACTICES

PRODUCE NEW HOUSING

- Increase use of density averaging and density transfers
- Expand public land program
- Other potential smaller-impact interventions
  - ADUs
  - Development review process
  - Parking requirements
PRESERVE EXISTING HOUSING

Key Issues
- Make use of existing programs (e.g. Right of First Refusal)
  - Resources (see below)
- Carrot and stick approaches
  - Tax exemption abatement
  - Demolition tax
- Plan for preservation as part of redevelopment
POLICY OPPORTUNITIES FROM REVIEW OF BEST PRACTICES

GENERATE RESOURCES

- **Expand access to tax credits**
  - Need to work at the state level

- **Other Key Issues**
  - Possible to expand sources of revenue for affordable housing
    - Commercial linkage fee, demolition tax, TIFs, developer fees
  - Assess who pays/what impact/political will
FINANCIAL MODEL

- **Built to accomplish two primary tasks**
  - Assess the value impact on units by changing AMI target
    - Difference of value for property owner
  - Analyze the proforma impacts of adjusting MDPU requirements
    - How do policy changes impact development potential?

- **Assumptions broken down based on availability**
  - Subarea level (i.e. rents)
  - County level (i.e. interest rates)
  - Regional level (i.e. construction costs)

- **Proforma piece not complete yet**
  - Waiting on additional market data from local operators/developers
  - Should be ready for September meeting

Draft for Discussion Presented to the Rental Housing Market Study Advisory Committee on August 24, 2016
Measured the capitalized value of affordable units against a similar market rate unit
- Same market subarea
- Same building type
- Same bedroom count

Used market data to determine thresholds
- Rent – 2014 Rent survey
- Vacancy and collection loss (VACL) – REIS
- Operating expenses – REIS
- Cap rates – REIS, Capital One

Will refine results based on feedback from development/operator community
The model is interactive, allowing customized parameters for various locations and types.

The model’s inputs are unique to those parameters.

<table>
<thead>
<tr>
<th>SUBAREA</th>
<th>BUILDING MATERIAL</th>
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<tr>
<td>Patuxent/Cloverly</td>
<td>Stick on Podium</td>
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<table>
<thead>
<tr>
<th>TYPE OF HOUSING</th>
<th>INTERIOR FIT OUT</th>
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<tbody>
<tr>
<td>Garden Apartment</td>
<td>Moderate</td>
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<table>
<thead>
<tr>
<th>AGE OF HOUSING</th>
<th>PARKING</th>
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<tbody>
<tr>
<td>New Construction</td>
<td>Surface</td>
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</table>

Draft for Discussion Presented to the Rental Housing Market Study Advisory Committee on August 24, 2016
Every variable can be customized based on specific input requirements.

Allows user to assess very specific projects with real-time, specific pro forma and cost impact results.
Some performance metrics do not change with income limits
- Vacancy and collection loss percentage
- Operating expenses
- Cap rate

Units operate with same costs to the developer
- Construction
- Operating expenses (set to market rate units)

Areas with no typology representation used
  Countywide average
- Variable override built into the model to customize as necessary
- New construction high rise in Friendship Heights/Bethesda/White Flint subarea

### ONE BEDROOM RENTAL CALCULATIONS

<table>
<thead>
<tr>
<th>AMI Percentage</th>
<th>PGI</th>
<th>VACL</th>
<th>OI</th>
<th>EGI</th>
<th>OE</th>
<th>NOI</th>
<th>NOI/Unit</th>
<th>Unit Value</th>
<th>Value PSF</th>
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<tr>
<td>30% of AMI</td>
<td>$7,716</td>
<td>$293</td>
<td>$0</td>
<td>$7,423</td>
<td>$11,784</td>
<td>$(4,361)</td>
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<td>$(87,229)</td>
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<td>50% of AMI</td>
<td>$12,840</td>
<td>$488</td>
<td>$0</td>
<td>$12,352</td>
<td>$11,784</td>
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<td>$568</td>
<td>$11,357</td>
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<tr>
<td>65% of AMI</td>
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<td>$634</td>
<td>$0</td>
<td>$16,058</td>
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<td>$4,273</td>
<td>$4,273</td>
<td>$85,470</td>
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<tr>
<td>80% of AMI</td>
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<td>$781</td>
<td>$0</td>
<td>$19,763</td>
<td>$11,784</td>
<td>$7,979</td>
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### TWO BEDROOM RENTAL CALCULATIONS

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<th>EGI</th>
<th>OE</th>
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<th>NOI/Unit</th>
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<th>Value PSF</th>
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<th>UNIT SIZE</th>
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<th>50% of AMI</th>
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<td>($161,600)</td>
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<td>($78,200)</td>
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<th>65% of AMI</th>
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<td>($242,100)</td>
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# New Construction, High Rise

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<th>50% of AMI</th>
<th>60% of AMI</th>
<th>65% of AMI</th>
<th>80% of AMI</th>
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<td>($220,700)</td>
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<td>($69,700)</td>
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<td>($108,100)</td>
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<tr>
<td>Two Bedrooms</td>
<td>($331,900)</td>
<td>($220,900)</td>
<td>($165,200)</td>
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<td>($54,100)</td>
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<td>($205,000)</td>
<td>($174,000)</td>
<td>($81,400)</td>
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<table>
<thead>
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<th>UNIT SIZE</th>
<th>30% of AMI</th>
<th>50% of AMI</th>
<th>60% of AMI</th>
<th>65% of AMI</th>
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<tbody>
<tr>
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<td>($715,000)</td>
<td>($684,100)</td>
<td>($591,500)</td>
<td>($468,000)</td>
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*Draft for Discussion Presented to the Rental Housing Market Study Advisory Committee on August 24, 2016*
Subarea, development type and bedroom count each influence the potential cost of affordability.

### Value Differential Between Market and MPDU

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<thead>
<tr>
<th></th>
<th>Efficiency</th>
<th>1-Bedroom</th>
<th>2-Bedroom</th>
<th>3-Bedroom</th>
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<tbody>
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<td>Garden, Low End</td>
<td>($8,700)</td>
<td>($52,600)</td>
<td>($78,200)</td>
<td>($126,800)</td>
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<tr>
<td>Garden, High End</td>
<td>($100,400)</td>
<td>($155,800)</td>
<td>($229,600)</td>
<td>($242,100)</td>
</tr>
<tr>
<td>High Rise, Low End</td>
<td>($69,700)</td>
<td>($108,100)</td>
<td>($137,500)</td>
<td>($174,000)</td>
</tr>
<tr>
<td>High Rise, High End</td>
<td>($201,600)</td>
<td>($252,300)</td>
<td>($382,300)</td>
<td>($684,100)</td>
</tr>
</tbody>
</table>
Location has the greatest impact on value differential
  - Highest along Metro Corridors and inside the ICC
  - Where demand is the greatest

Lower affordability level = larger value loss
  - $150,000 to $230,000 per unit for 30% of AMI (from MPDU)

Gap for garden apartments lower due to lower rent threshold numbers
  - Owners in certain parts of the market not interested in selling to garden density since land price is based on total unit count
    - Capitalizing on higher development densities
  - Denying density likely will result in suppressing development or encouraging move to low density ownership housing

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Attaining deeper subsidies in high cost areas requires less tradeoff of units

- Value loss the same in all areas due to the fixed price
- However, amount of value loss from market varies
  - $70,000 in Route 29; $202,000 in FH/B/WF
  - So, trade off from 65% to 30% is 3:1 in Route 29; 2:1 in FH/B/WF

Actual trade-off varies by subarea, development type

- Type of development impacts the tradeoff ratio
  - High rise vs garden...

It is better to buy-down cost in some areas and trade unit totals in others
Net Present Value of 1-Bedroom Unit in a new construction high rise within FH/B/WF (10% return)
- $28,700 at market rate rent
- ($92,800) at MPDU level
- ($175,900) at 30% of AMI

How do we pay for 12.5% 1-bedroom units at 30% of AMI in a high rise in the FH/B/WF subarea?
- 36.5% additional market rate units (density bonus)
- 33% reduction in impact fees for project
- $83,000 cash payment FOR EACH UNIT at approval
- Reduce MPDU requirement from 12.5% to 7.5%
Rehabilitation costs are harder to project

- Costs are variable based on property condition/need
- Costs reported to vary from $50 to $100+ per square foot
  - Can range from $30,000 to $125,000 per unit
- **Waiting on AOBA data to have more solid numbers

However, cost per unit for preservation substantially lower than new construction

- Rents naturally tend lower for older properties
  - If acquisition is necessary
- Rehabilitation costs less than new construction costs
  - When acquisition not necessary
- Better “deal” in higher-cost areas (i.e. Metro corridors)
NEXT STEPS