Montgomery County, Maryland

# FINANCIAL ANALYSIS AND SWOT FINDINGS

# RENTAL HOUSING STUDY

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# 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

# PRESENTATION OVERVIEW

- **SWOT Analysis**
  - Market
  - Policy
  - Capacity
- **Key Policy Considerations**
  - Produce New Housing
  - Preserve Existing Housing
  - Generate Resources
- **Financial Analysis**
  - Methodology
  - Results
  - Implications

# SWOT ANALYSIS

# STRENGTHS

- **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

# WEAKNESSES

- **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

# WEAKNESSES

- **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

# OPPORTUNITIES

- **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

# OPPORTUNITIES

- **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?

# OPPORTUNITIES

- **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

# OPPORTUNITIES

- **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

# THREATS

- **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

# THREATS

- **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

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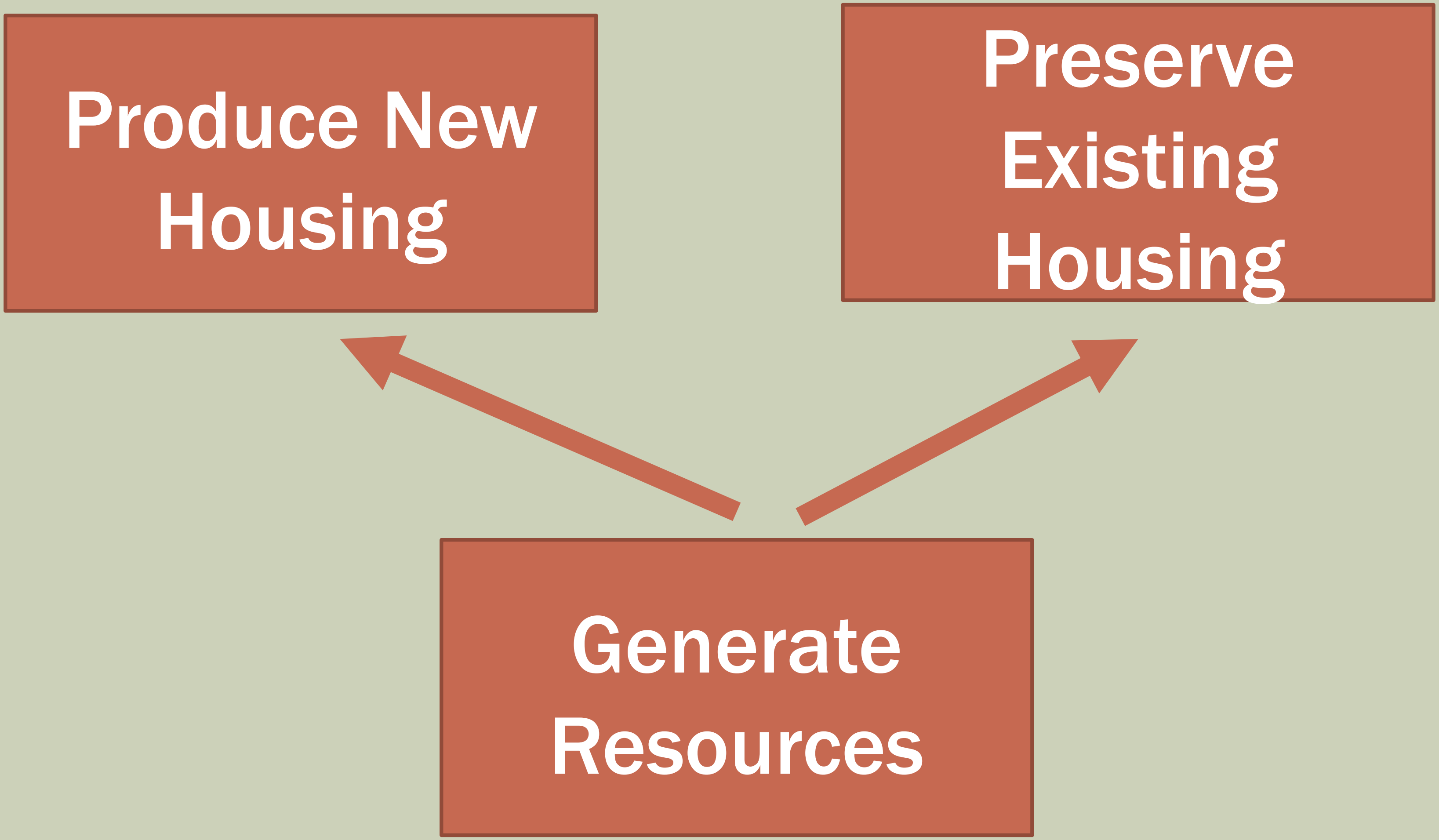
- **Successful local housing strategies are:**
  - Comprehensive
  - Flexible
  - Responsive to local needs
  - Consistent with community goals
- **Greatest needs among lowest income households, larger households**
- **Financial resources are key but land use/zoning policies are also essential**
- **Changing needs means it's necessary to revise longstanding policies**

# COMPREHENSIVE STRATEGY




Draft for Discussion Presented to the Rental Housing Market Study Advisory Committee on August 24, 2016

# 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

# POLICY OPPORTUNITIES FROM REVIEW OF BEST PRACTICES

## 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 ANALYSIS

# FINANCIAL MODEL

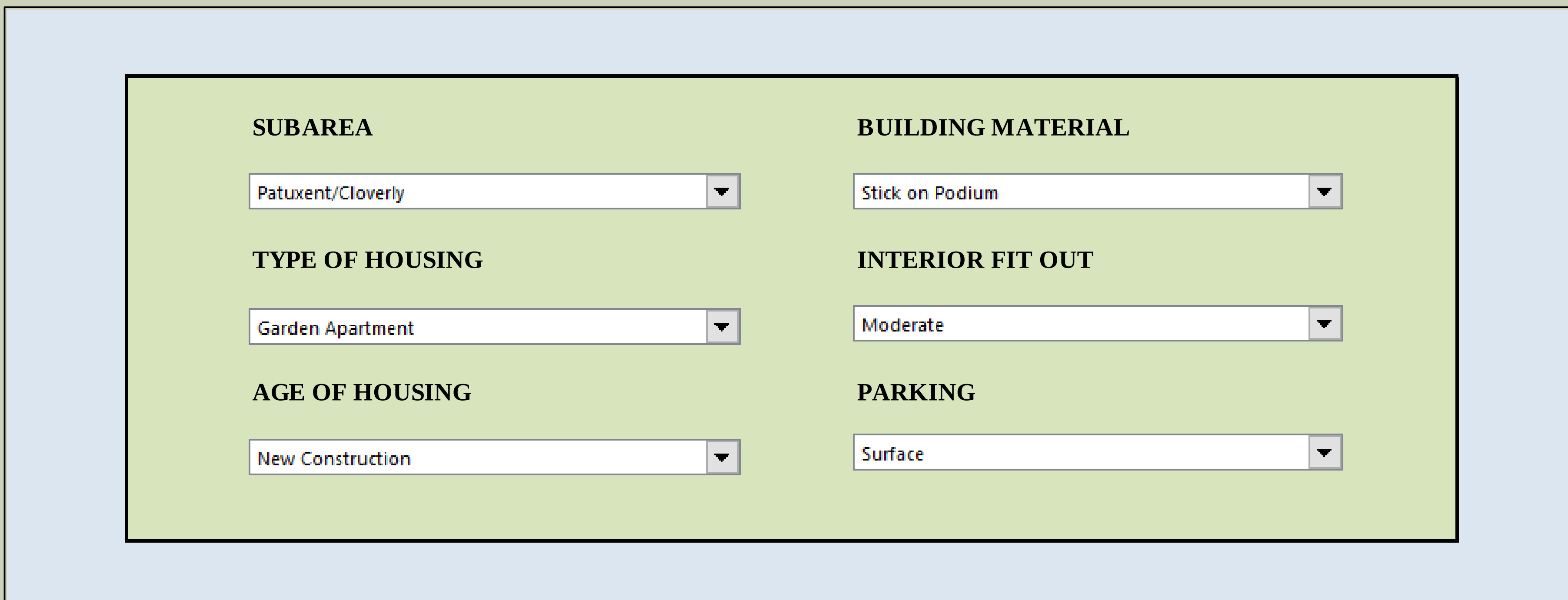
- **Built to accomplish two primary tasks**
  - Assess the value impact on units by changing AMI target
    - Difference of value for property owner
  - Analyze the proforma impacts of adjusting MDPU requirements
    - How do policy changes impact development potential?
- **Assumptions broken down based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

# VALUE IMPACT METHODOLOGY

- **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**

# METHODLOGY

- **The model is interactive, allowing customized parameters for various locations and types**
- **The model's inputs are unique to those parameters**



# METHODOLOGY

Development Assumptions

| | Input | | Existing Complexes | New Development |
|---|---|---|---|---|
| **Total Units** | 100 | | | |
| **Unit Break Out** | | | | |
| Effeciency | | % | 7% | 7% |
| One Bedroom | | % | 42% | 54% |
| Two Bedroom | | % | 43% | 39% |
| Three Bedroom | | % | 9% | 0% |
| **Unit Size** | | | | |
| Effeciency | | | 700 | 550 |
| One Bedroom | | | 900 | 700 |
| Two Bedroom | | | 1,100 | 950 |
| Three Bedroom | | | 1.300 | 1,100 |
| **Market Rate Rent Override** | | | | |
| Effeciency | | | Varies | Varies |
| One Bedroom | | | Varies | Varies |
| Two Bedroom | | | Varies | Varies |
| Three Bedroom | | | Varies | Varies |
| **% Structured Parking Below Ground** | | % | 0% | 50% |
| **New Construction Rent Premium** | | % | 35% | |
| **Rehabilitation Cost Per Square Foot** | | | $75 | |

- 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

# ASSUMPTIONS

- **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

# CAPITALIZED VALUE MATH

- **New construction high rise in Friendship Heights/Bethesda/White Flint subarea**

**ONE BEDROOM RENTAL CALCULATIONS**

| | 30% of AMI | 50% of AMI | 65% of AMI | 80% of AMI | 100% of AMI | Market Rate |
|---|---|---|---|---|---|---|
| PGI | $7,716 | $12,840 | $16,692 | $20,544 | $25,680 | $29,805 |
| VACL | $293 | $488 | $634 | $781 | $976 | $1,133 |
| OI | $0 | $0 | $0 | $0 | $0 | $0 |
| EGI | $7,423 | $12,352 | $16,058 | $19,763 | $24,704 | $28,672 |
| OE | $11,784 | $11,784 | $11,784 | $11,784 | $11,784 | $11,784 |
| NOI | ($4,361) | $568 | $4,273 | $7,979 | $12,920 | $16,888 |
| NOI/Unit | ($4,361) | $568 | $4,273 | $7,979 | $12,920 | $16,888 |
| Unit Value | ($87,229) | $11,357 | $85,470 | $159,582 | $258,399 | $337,757 |
| Value PSF | ($159) | $21 | $155 | $290 | $470 | $614 |

**TWO BEDROOM RENTAL CALCULATIONS**

| | 30% of AMI | 50% of AMI | 65% of AMI | 80% of AMI | 100% of AMI | Market Rate |
|---|---|---|---|---|---|---|
| PGI | $8,676 | $14,448 | $18,780 | $23,117 | $28,896 | $38,653 |
| VACL | $330 | $549 | $714 | $878 | $1,098 | $1,469 |
| OI | $0 | $0 | $0 | $0 | $0 | $0 |
| EGI | $8,346 | $13,899 | $18,066 | $22,238 | $27,798 | $37,184 |
| OE | $15,283 | $15,283 | $15,283 | $15,283 | $15,283 | $15,283 |
| NOI | ($6,936) | ($1,384) | $2,784 | $6,956 | $12,515 | $21,901 |
| NOI/Unit | ($6,936) | ($1,384) | $2,784 | $6,956 | $12,515 | $21,901 |
| Unit Value | ($138,724) | ($27,671) | $55,677 | $139,117 | $250,309 | $438,025 |
| Value PSF | ($252) | ($50) | $101 | $253 | $455 | $796 |

# NEW CONSTRUCTION, GARDEN

| ROUTE 29 CORRIDOR EAST | | | | | | |
|---|---|---|---|---|---|---|
| **UNIT SIZE** | **30% of AMI** | **50% of AMI** | **60% of AMI** | **65% of AMI** | **80% of AMI** | **100% of AMI** |
| Efficiency | ($159,700) | ($73,500) | ($30,400) | ($8,700) | $27,500 | $77,000 |
| One Bedroom | ($225,300) | ($126,700) | ($77,300) | ($52,600) | $6,200 | $62,800 |
| Two Bedrooms | ($272,600) | ($161,600) | ($105,900) | ($78,200) | ($4,100) | $59,500 |
| Three Bedrooms | ($342,900) | ($219,400) | ($157,700) | ($127,800) | ($34,200) | $42,600 |

| FRIENDSHIP HEIGHTS/BETHESDA/WHITE FLINT | | | | | | |
|---|---|---|---|---|---|---|
| UNIT SIZE | **30% of AMI** | **50% of AMI** | **60% of AMI** | **65% of AMI** | **80% of AMI** | **100% of AMI** |
| Efficiency | ($251,400) | ($165,300) | ($122,100) | ($100,400) | ($35,600) | $22,900 |
| One Bedroom | ($328,500) | ($229,900) | ($180,500) | ($155,800) | ($81,600) | $2,100 |
| Two Bedrooms | ($424,000) | ($313,000) | ($257,400) | ($229,600) | ($146,200) | ($35,000) |
| Three Bedrooms | ($458,200) | ($344,700) | ($273,100) | ($242,100) | ($149,500) | ($26,000) |

# NEW CONSTRUCTION, HIGH RISE

| ROUTE 29 CORRIDOR EAST | | | | | | |
|---|---|---|---|---|---|---|
| **UNIT SIZE** | **30% of AMI** | **50% of AMI** | **60% of AMI** | **65% of AMI** | **80% of AMI** | **100% of AMI** |
| Efficiency | ($220,700) | ($134,600) | ($91,400) | ($69,700) | ($5,000) | $41,000 |
| One Bedroom | ($280,300) | ($182,300) | ($132,800) | ($108,100) | ($34,000) | $30,100 |
| Two Bedrooms | ($331,900) | ($220,900) | ($165,200) | ($137,500) | ($54,100) | $24,600 |
| Three Bedrooms | ($390,100) | ($266,600) | ($205,000) | ($174,000) | ($81,400) | $14,800 |

| FRIENDSHIP HEIGHTS/BETHESDA/WHITE FLINT | | | | | | |
|---|---|---|---|---|---|---|
| UNIT SIZE | **30% of AMI** | **50% of AMI** | **60% of AMI** | **65% of AMI** | **80% of AMI** | **100% of AMI** |
| Efficiency | ($352,600) | ($266,500) | ($223,300) | ($201,600) | ($136,800) | ($50,400) |
| One Bedroom | ($425,000) | ($326,400) | ($277,000) | ($252,300) | ($178,200) | ($79,400) |
| Two Bedrooms | ($576,700) | ($465,700) | ($410,100) | ($382,300) | ($298,900) | ($187,700) |
| Three Bedrooms | ($900,200) | ($776,700) | ($715,000) | ($684,100) | ($591,500) | ($468,000) |

# IMPLICATIONS

- **Subarea, development type and bedroom count each influence the potential cost of affordability**

| VALUE DIFFERENTIAL BETWEEN MARKET AND MPDU | | | | |
|---|---|---|---|---|
| | Efficiency | 1-Bedroom | 2-Bedroom | 3-Bedroom |
| Garden, Low End | ($8,700) | ($52,600) | ($78,200) | ($126,800) |
| Garden, High End | ($100,400) | ($155,800) | ($229,600) | ($242,100) |
| High Rise, Low End | ($69,700) | ($108,100) | ($137,500) | ($174,000) |
| High Rise, High End | ($201,600) | ($252,300) | ($382,300) | ($684,100) |

# IMPLICATIONS

- **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

# IMPLICATIONS

- **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**

# SO WHAT?

- **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

- **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