MEMORANDUM

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To: Kimberly Baptiste, Bergmann Associates
From: Victoria Storrs, Michael N'dolo
Date: 2/20/2017
Re: Vacuum Oil BOA Task #1

Revised Financial Pro Forma Analysis

Framework of the Analysis & Key Findings

Camoin Associates has prepared pro forma cash flow statements for a site located within the Vacuum Oil BOA in the City of Rochester, New York. The purpose of this analysis is to determine the financial feasibility of six single-family attached homes on the site. We determined if market lease rates will achieve an acceptable rate of return and make the project feasible for both a private developer and the bank financing the project.

All units are assumed to be rentals because the cost of new construction for these attached single family homes is estimated to be $123,467 per unit, substantially higher than the $80,762 median home price for the City of Rochester and far higher than the market price of homes that sold in 2016 in the BOA ($18,000 - $44,000 according to real estate reporter Zillow.com). Even with homeownership support programs to assist with financing or down payments, these units are likely to be too expensive for most city residents. According to our report, *Housing Analysis: City of Rochester, Vacuum Oil BOA*, the average Price to Income ratio for the city is 2.6, so that a new home costing $123,467 would likely be purchased by a household earning $123,467 ÷ 2.6 = $47,487 annually, compared to the city 2016 median income of $30,990 and the BOA 2016 median income of $18,539. Using the BOA median income x 2.6, there would be more demand for homes priced at $48,201, which is closer to the range in which recent sales have occurred.

Property tax rates on City residences are a major cost driver. In fact, our analysis shows that without any tax abatement, the internal rate of return (IRR) of 5.78% is below a developer's expected minimum threshold. This analysis therefore studied a project with a single set of construction costs and expenses, but varied the tax abatements according to programs for which a residential rental project is currently eligible to apply.

The first two scenarios abate a portion of the property taxes otherwise due on the improvements to the property, according to policies of the County of Monroe IDA (COMIDA) that do not require income limitations on the residents. The third scenario assumes that the units are offered as either student or limited income housing. If residents are students or have incomes below the standards established by the U.S. Department of Housing and Urban Development, the units may be eligible to pay city taxes under the Shelter Rent program, which would limit taxes to approximately 10% of the property's net income.

Key findings are as follows.

Summary Table: Vacuum Oil BOA Attached Single Family Housing Scenario Feasibility Analysis			
	Regular PILOT Agreement	**Enhanced PILOT Agreement**	**Shelter Rent for Student or Income Limited Housing**
Project Description	Single family homes for rent, sold after 10 years. In keeping with the neighborhood character of 1- and 2-family residences, units would be built in the style of a 2-family home with a shared interior wall and separate entrances. Total square footage would be 1,200 per unit, with 2 bedrooms.		
Tax Abatement Description	Through COMIDA a PILOT agreement can be entered into, reducing taxes due by 50% in year 1, with the abatement declining in increments of 5% to full taxes due in year 11. This PILOT does not reduce the City's service fees or embellishments, for example for water or snowplowing.	COMIDA has approved PILOT agreements for certain residential and mixed-use projects in the Downtown area that reduce taxes substantially. This scenario reduces taxes by 100% in year 1, declining in 10% increments to full taxes due in year 11. It is assumed that a PILOT agreement would abate only taxes and not service fees or embellishments.	COMIDA offers a Shelter Rent program for housing projects that meet HUD standards for resident income. Shelter Rent due is calculated by determining the net income generated by the housing and subtracting the cost of utilities. Taxes due are 10% of that net income amount. Shelter Rent is applied for on a per-project basis to COMIDA. Criteria for approval are not published.
Private Developer Feasibility	This project is feasible from a developer perspective. It exceeds the minimum IRR, with a 7.94% return projected. However, this IRR is at the bottom of the desired range.	This project is feasible from a developer perspective. It is in the mid-range of IRR range with a 8.13% return projected.	This project is feasible from a developer perspective if rents is set at $860/month, generating an IRR of 7.94%. Using a lower rent of $810/month, the IRR drops to 6.00%, the lowest developer threshold for feasibility. Both rental rates are lower than the 2017 HUD rate for Monroe County Fair Market Housing for a 2BR unit.
Bank Financing Feasibility	This project generates enough income in all years to meet or exceed a debt service coverage ratio (DSCR) of 1.41 in its first year, rising to 1.58 in year 10. It would likely be financed by a bank. PILOT payments for taxes increase over the financing period but increased revenues compensate and allow for improved DSCR.	This project generates enough income in all years to provide a DSCR of at least 1.51 and would likely be financed by a bank. The DSCR declines each year to a low of 1.51 in year 11 as a result of the increase in taxes owed each year under the PILOT. Increased revenues do not compensate for the increase in taxes paid.	This project is unlikely to be financed by a bank absent additional guarantees or support. At $860/month there is positive debt service coverage in all years, starting at 1.25, but it does not meet a 1.40 DSCR until year 5. At $810/month DSCR is positive but does not reach 1.40 until year 7.

Discussion	This project would be feasible from a developer perspective. This scenario is sensitive to monthly rental rates and uses $1,200/month, substantially above average for units in the BOA and more in keeping with rents in mixed-use buildings in the Downtown and South Wedge areas. Units are therefore targeted toward graduate students, faculty, and other workers at the University of Rochester, who would value proximity to the campus, rather than at the average current resident of the BOA.	This project would be feasible from a developer perspective. The IRR of 8.13% assumes a rent of $1,150/month, above average for the BOA, but slightly lower than in the Regular PILOT scenario. Likely residents would be students, graduate students, faculty, and other workers at the University of Rochester who value proximity to the campus.	This scenario is the only one that would provide housing at rents in keeping with the area. However, residents with incomes below $34,400 would spend more than 30% of income on rent for these units, meeting the definition of cost burdened (30% of income toward housing.) With a 2016 median income of $18,539, most existing BOA households would need subsidies to meet rent payments.

Base Case Scenario – New Single Family Homes, Attached

All three scenarios use the same Base Case for project cost and financing terms. In the Base Case, the project includes six new attached single family homes, each, sharing an interior wall with one other unit but with separate entrances. Key details about this Base Case are as follows:

- Development of 6 attached single family housing units with average floor plans. Finishes would be moderate; laminate floors or carpet, standard appliances, laminate countertops.
- The primary target market for the units are students, graduate students, junior or adjunct faculty, workers at the University of Rochester and young professionals with a median household income (MHI) of approximately $60,000. MHI for the City of Rochester in 2016 is $30,990 and for the Rochester Metropolitan Statistical Area it is $52,845 (both MHI from ESRI). Residents would be expected to earn more than the median household income for the region, as otherwise they would spend more than 30% of their income on rent.

Financial Assumptions

Assumptions for this analysis were developed based on information provided to Camoin Associates by Bergmann Associates, as well as market research conducted by Camoin Associates. A complete list of these assumptions is provided for the Base Case and for each scenario in the attached tables, with key assumptions crucial to the financial feasibility analysis below:

- **Construction Costs** – Bergmann provided construction cost estimates of $90 per square foot, including soft costs but exclusive of site work and land acquisition. An additional 10% was added for site work and an additional 10% for land acquisition for a total of $108 per square foot.
- **Brownfield Tax Credits** – The Project may be eligible for Brownfield Tax Credits under New York State's Brownfield Cleanup Program if one or more of the lots redeveloped into housing units is remediated. These tax credits are not included in any of the scenarios analyzed here but could improve the developer's rate of return.
- **Financing** – We assumed a loan amount of 67% of the development cost, with an interest rate of 5.32% amortized over 25 years. These are terms based on national averages for urban

townhome development.[1] While units proposed are attached single family homes, townhome rates of return are the most comparable.

- **Capitalization Rate** – We assumed an 8.03% capitalization rate[2] (the rate of return based on the expected net operating income the property will generate). This figure is used to calculate sale proceeds. At the end of year 10, we assume the property is sold, generating $365,394 net of commission and after paying off all remaining debt.
- **Lease Rates** – For the residential single family units we assume a monthly rental rate of $1,250 per unit based on a mid-range IRR for the developer. Rent is assumed to be charged on a gross basis including operating expenses, property taxes, and City embellishment fees for services.

Feasibility Tests

- **Developer:** One of the key benchmarks a developer uses to judge the feasibility of a project is IRR. A developer typically looks for a return above what could be gained through a "safe" investments over the same amount of time. The threshold depends on the level of risk associated with the project, but typically falls around between the 6% and 10% mark. The IRR for a developer doing this attached single family housing project without tax abatement would be approximately 5.78%, below the IRR threshold. Therefore, this project is not considered feasible from a private developer perspective without some form of tax abatement.
- **Bank**: The debt service coverage ratio (DSCR) is a measure of the resources available to pay debt service (calculated as the ratio of net operating income to debt service payments). Nationally, banks are typically requiring a ratio of at least 1.40. The annual debt service is the same for each scenario, as building costs and financing amounts are assumed to be the same. Deb service is estimated to be $38,719 annually. Net income depends on rents charged and the value of tax abatements but would need to be at least 1.40 times the debt service, or $54,206, to meet bank thresholds.

Incentive Scenarios:

- **PILOT Agreements**. The County of Monroe IDA has approved PILOT agreements for residential developments as well as sales and mortgage tax abatements. PILOT agreements are subject to a list of criteria published by COMIDA, including, but not limited to, the nature of the property, the economic condition of the area, the impact on businesses and economic development, and the extent to which the project will provide a benefit not otherwise available in the area. The nature of the Vacuum Oil site, and the need for replacement housing in a City where the median year a residence was built is 1939, may improve the project's attractiveness as a recipient of a PILOT agreement. The need for less costly housing in the BOA may induce support for approval of the Shelter Rent policy for that scenario.
- **Low-Income Housing Tax Credits (LIHTC)**. These credits support builders and owners of dedicated below-market rate units in order to create an incentive for these to be built and remain available, particularly if the local housing market produces higher returns for developing market rate housing.

[1] RealtyRates.com Investor Survey
[2] Based on national averages from RealtyRates.com Investor Survey

LIHTC programs are administered through the state, and New York has often favored projects with a larger number of units than would fit within the BOA's neighborhood character. As a recent example, NYS Housing Finance Agency on 12/27/16 received approval from the Public Authorities Control Board to issue multiple series of tax-exempt affordable housing and mixed income housing bonds3 for projects throughout the state. The smallest project is for 59 units in Cayuga County. A project on behalf of Depaul Upper Falls Square Apartments in the City of Rochester will offer 150 units in two buildings.

The state's pattern of focusing on large projects for direct-to-developer subsidies suggests that this approach may not be the most successful for the BOA. These tax credits are therefore not included in any of the scenarios analyzed for this housing project analysis.

Conclusion

All scenarios for developing single family housing units in the Vacuum Oil BOA require some form of tax abatement to meet minimum rate of return thresholds.

COMIDA is likely to set higher community benefit thresholds for the more generous abatement of 100% in the first year than for abating 50% in the first year. Neither PILOT scenario requires restricting residents by income level and both charge above-market rents commensurate with new projects elsewhere in the City. Both scenarios meet minimum developer rates of return and may be expected to qualify for bank financing.

The Shelter Rent scenario fits the income profile of the City and furthers the goals of housing that fits within the incomes of BOA residents. Because students are eligible residents, the project could expect to serve members of the University of Rochester community, across the river and easily accessible by road or footbridge. However, the debt service coverage ratios are weak in years 1 – 4 and may not meet standards for bank financing.

[33] https://www.budget.ny.gov/agencyGuide/pacb/122716/Agenda_12-22-16_for_12-27-16.pdf