TO: Members of the Plan Commission
FROM: Hickory R. Hurie
SUBJECT: Analysis of IZ Waiver Request for Hawks Ridge Apartments
DATE: July 24, 2006

CDBG
Community Development Block Grant Program

SUMMARY:

T.M.MacKenzie Inc. proposes a 156-unit apartment development at 9201 Mid Town Road. This is a 4.74-acre site that is currently vacant land.

T. M. MacKenzie seeks a full waiver of the inclusionary zoning requirements for the apartment portion of the project due to the tight site constraints, projected costs of the building, the current approved zoning, the lack of off-setting City incentives. and the lack of financial feasibility due to the limited density of the project..

Staff recommend Plan Commission consideration of a waiver of all 24 of the onsite inclusionary units, and no payment in lieu of onsite or off site units, based on the extraordinary costs and the current zoning limitations.

This analysis for an inclusionary zoning waiver is based upon data furnished by the developer and by the Planning Unit during April and July 2006.

METHOD OF ANALYSIS:

The Council adopted a waiver provision as part of the inclusionary dwelling unit ordinance that requires an analysis of project financial feasibility. The method consists of running three or more scenarios, using data provided by the developer. The first run is based upon a scenario whereby the project, using current zoning levels, is set at market rate rentals. If this version is financially feasible according to the standards adopted by the Common Council, the project is then run with the full 15% inclusionary dwelling units included in the project. If this full IZ scenario does not meet the Council standards for financial feasibility, staff are to recommend a third 'waiver' scenario with attributes (a combination of a partial percentage of IZ units, with units off-site, or payment in lieu of units on-site or reduction of expected number of units) that will provide a sufficient return for financial feasibility.

MARKET RATE SCENARIO:

The IZ ordinance suggests that the market rate scenario should be run within the density of the current zoning classification for the parcel. According to Planning Unit staff, the current zoning for this site permits up to 156 dwelling units on the site. Running the full-market rate scenario at the current zoning density yields a project with an internal rate of return of 8.1%. The City approved an initial zoning of R-5 but limited the zoning on the apartment parcels to R-4 density. The current request does not seek additional density.

This 'market' run yields an internal rate of return that permits the project to qualify for a waiver under the feasibility standards adopted by the Common Council.

IZ SCENARIO:

Using the above conclusions, we ran several scenarios with the same cost assumptions but with the density requested by the developer, and the inclusion of the affordable units.

This second scenario, with no additional market rate units and the 24 inclusionary units (15% of 156 units 'rounded up') yields an internal rate of return of 7.6%. Hence it does not meet the feasibility standards adopted by the Council, nor does it meet 95% of the target internal rate of return margin suggested by the current zoning scenario.

MODIFIED IZ SCENARIOS WITH FEWER IZ UNITS OR PAYMENT IN LIEU:

Staff discussed other options of providing the inclusionary units with the developer and concluded that the provision of new off-site units was not likely, given developer control in the area.

Using the above conclusions, we ran several additional scenarios with the same cost assumptions but different combinations of on-site inclusionary units and waiver payments. The waiver payments were calculated on a formula defined in the ordinance (10% of the average projected value of all units in the development). Each scenario with fewer than 15% iz units and a payment in lieu for the excluded iz units produced an internal rate of return less than the standard adopted by the Common Council for rental developments.

CONCLUSION:

According to the ordinance provisions, the project does meet the initial standards of financial feasibility for a market rate project at the density levels permitted under the current zoning. Since the project does not propose a density level higher than that suggested by the current zoning, and there are no offsetting incentives like park fee reduction, the project with a combination of iz units and a payment in lieu of, or only a 'payment in lieu of' still does not achieve the target IRR. Hence, staff recommend a full waiver of the onsite units for the rental portion and no payment in lieu.

Cc: Tim MacKenzie, Randy Bruce
Alder Brenda Konkel, Paul Skidmore, Jeanne Hoffman, Brad Murphy, Barb Constans, and Mark Olinger

Note: Part of the logic inherent in the discussions leading up to the adoption of the IZ ordinance suggested that the City should not be helping an infeasible project at market rate become feasible by waiving one of the primary City public goals (affordable units within larger projects leading to economically integrated neighborhoods).)

T.M. McKenzie
Hawks Ridge Apt Full 0% IZ at Requested zoning
Rental Parameters for Determining Financial Infeasibility of Inclusionary Zoning
For the periods from August 01, 2009 through December 31, 2019

Issue	Required range	Manual Calculation	Actual
Financing			
Interest rate	Maximum prime plus 2.5	Actual current prime is 8.25%; The developer's proposal is wunder the Council-adopted standards	8.25%
Amortization period	Assume 30 years	Five years longer due to institutional investor	30
Project costs			
Land/Building acquisition - per square foot raw land	$5 per square foot - raw land $50 - $55 per square foot, downtown - vacant land $90 - $125 per square foot, downtown - improved with building		$12.64 $12.64 $12.64
Hard cost contingency	5% new, 8% rehab of AIA contract		0.0%
Soft cost contingency	5% new/rehab of soft costs	Within Council standards	0.0%
Reserves	Working capital - $750 per unit Replacement reserve - $0 per unit		$0.00 $0.00
Contractor profit	6% of AIA contract (net of profit, overhead and general requirements)		7.0%
Contractor overhead	2% of AIA contract (net of profit, overhead and general requirements)		0.0%
Contractor general requirements	6% of AIA contract (net of profit, overhead and general requirements)		0.0%
Parking	$1,000 per stall - surface $15,000 per stall - first level underground $20,000 per stall for second level underground $27,000 per stall for three levels or more of underground		No Parking
Development fees	8% of total project costs, net of development fees and reserves		0.0%
Square foot cost of construction, includes buildings including profit overhead and general requirements, site improvements and personal property	4 stories and under - $62.50 per square foot and 5 to 8 stories - $110 to $120	Within Council standards	$23.64
Soft cost	10% of cost of construction	Within Council standards	4.5%
Vacancy rate			
	MG&E vacancy rate by zip code multiplied by 120% floor of 5%. If the property is not in the MG&E service area, use citywide average vacancy rate 6 months to lease up.		10.0%
Replacement reserves			
	Up to $250 per unit per year		$0.00
Inflation factors			
Rent	2%		2.5%
Operating costs	3%		3.0%
Real estate taxes	3%		4.0%
Sales price assumptions			

Capitalization rate	Prime plus 4.5%	Based on Assessor's data.	8.0%
Cost of sale	6%		6.0%
Debt coverage ratios			
	First mortgage only - maximum of 1.15 All mortgages - maximum of 1.15		1.13 1.13
Gross operating expenses, not including real estate taxes			
	$3,000 per unit or 25% of total operating income		$2,562.82 28.8%
Internal rate of return			
Below prime plus 10.5 financial infeasibility not allowed until affordable units are below 95% of stated market IRR. If market IRR below 8% or IX IRR above prime plus 10.5 - no waiver recommended	Market run at current zoning yields a 'target IRR'; if 'market run' is below 8% or greater than prime plus 10.5%, then no waiver is permitted; if affordable run with incentives is below 95% of target IRR, then waiver is permited	The market rate scenario IRR is NOT greater than the prime rate of 8.25% plus 10.5%; therefore this project qualifies for a waiver.	8.1%
Real estate taxes			
	Fair market value multiplied by City of Madison mill rate per thousand at time of application (NOI/capitalization rate = fair value)		$399,800.00
Market rate rent			
	Minimum HUD fair market rent based on bedroom size divided by 40%	NA	See input pages on computer run

ASSUMPTIONS:

This scenario assumes density of 156 rental units as requested by the Developer, with no inclusionary dwelling units.

This is the density permitted by current zoning, which is 21.78 units/acre.

This scenario is based on the figures submitted by the developer during the period April 20, 2006

Prime rate on June 29, 2006, is 8.25%, and this figure is used in this scenario instead of the developer's 6.5%.

INTERPRETATIONS:

This scenario produces an internal rate of return of 8.1% , which is less than the Council adopted standard of prime plus 10.5%. (18.5%), and less than 95% of the target IRR.

CONCLUSION AND RECOMMENDATION:

Based upon this projection, the project qualifies for a waiver, and a full reduction in the number of iz units.

Further, due to close financial feasibility, the project does not appear to support a payment in lieu of the onsite units, and hence would qualify for a full waiver of onsite, offsite, or payment in lieu.

T.M. McKenzie

Hawks Ridge Apt Full 15% IZ at Requested zoning

Rental Parameters for Determining Financial Infeasibility of Inclusionary Zoning

For the periods from August 01, 2009 through December 31, 2019

Issue	Required range	Manual Calculation	Actual
Financing			
Interest rate	Maximum prime plus 2.5	Actual current prime is 8.25%; The developer's proposal is wunder the Council-adopted standards	8.25%
Amortization period	Assume 30 years	Five years longer due to institutional investor	30
Project costs			
Land/Building acquisition - per square foot raw land	$5 per square foot - raw land		$12.64
	$50 - $55 per square foot, downtown - vacant land		$12.64
	$90 - $125 per square foot, downtown - improved with building		$12.64
Hard cost contingency	5% new, 8% rehab of AIA contract		0.0%
Soft cost contingency	5% new/rehab of soft costs	Within Council standards	0.0%
Reserves	Working capital - $750 per unit		$0.00
	Replacement reserve - $0 per unit		$0.00
Contractor profit	6% of AIA contract (net of profit, overhead and general requirements)		7.0%
Contractor overhead	2% of AIA contract (net of profit, overhead and general requirements)		0.0%
Contractor general requirements	6% of AIA contract (net of profit, overhead and general requirements)		0.0%
Parking	$1,000 per stall - surface $15,000 per stall - first level underground $20,000 per stall for second level underground $27,000 per stall for three levels or more of underground		No Parking
Development fees	8% of total project costs, net of development fees and reserves		0.0%
Square foot cost of construction, includes buildings including profit overhead and general requirements, site improvements and personal property	4 stories and under - $62.50 per square foot and 5 to 8 stories - $110 to $120	Within Council standards	$23.64
Soft cost	10% of cost of construction	Within Council standards	4.5%
Vacancy rate			
	MG&E vacancy rate by zip code multiplied by 120% floor of 5%. If the property is not in the MG&E service area, use citywide average vacancy rate 6 months to lease up.		10.0%
Replacement reserves			
	Up to $250 per unit per year		$0.00
Inflation factors			
Rent	2%		2.5%
Operating costs	3%		3.0%
Real estate taxes	3%		4.0%
Sales price assumptions			

Capitalization rate	Prime plus 4.5%	Based on Assessor's data.	8.0%
Cost of sale	6%		6.0%
Debt coverage ratios			
	First mortgage only - maximum of 1.15 All mortgages - maximum of 1.15		1.12 1.12
Gross operating expenses, not including real estate taxes			
	$3,000 per unit or 25% of total operating income		$2,523.08 28.7%
Internal rate of return			
Below prime plus 10.5 financial infeasibility not allowed until affordable units are below 95% of stated market IRR. If market IRR below 8% or IX IRR above prime plus 10.5 - no waiver recommended	Market run at current zoning yields a 'target IRR'; if 'market run' is below 8% or greater than prime plus 10.5%, then no waiver is permitted; if affordable run with incentives is below 95% of target IRR, then waiver is permited	The market rate scenario IRR is NOT greater than the prime rate of 8.25% plus 10.5%; therefore this project qualifies for a waiver.	7.6%
Real estate taxes			
	Fair market value multiplied by City of Madison mill rate per thousand at time of application (NOI/capitalization rate = fair value)		$393,600.00
Market rate rent			
	Minimum HUD fair market rent based on bedroom size divided by 40%	NA	See input pages on computer run

ASSUMPTIONS:

This scenario assumes density of 156 rental units as requested by the Developer, with 26 inclusionary dwelling units.

This is the density permitted by current zoning, which is 21.78 units/acre.

This scenario is based on the figures submitted by the developer during the period April 20, 2006

Prime rate on June 29, 2006, is 8.25%, and this figure is used in this scenario instead of the developer's 6.5%.

INTERPRETATIONS:

This scenario produces an internal rate of return of 7.6% , which is less than the Council adopted standard of prime plus 10.5%. (18.5%)

CONCLUSION AND RECOMMENDATION:

Based upon this projection, the project qualifies for a waiver, and either a reduction in units, units off-site or a payment in lieu of the onsite units.