



Memo

To: Patrick Brahma – Economic Development Manager
From: Stacie Kvilvang - Ehlers
Date: September 17, 2015
Subject: Analysis of Request for Assistance - PSD Apartments

The City has received a proposal from PSD LLC to construct a 122-unit market rate rental project on land it purchased from the City in January of this year. The development is expected to commence construction this fall and be completed in 2016.

Due to increased costs in construction, the Developer is requesting \$500,000 in assistance from the City. This memo is intended to review the need for TIF assistance based on our analysis of the developer’s project budget and projections, generally known as a pro forma. This memo also includes a recommendation for an amount of assistance based upon this review.

Ehlers conducted a thorough review of the developer’s budget and operating pro forma to ensure all development costs, anticipated revenues, and expenditures were represented appropriately. The table below depicts the proposed sources and uses for the project.

SOURCES		
	Amount	Pct.
Developer Financing	14,165,515	75.00%
Developer Equity	4,721,838	25.00%
TOTAL SOURCES	18,887,353	100.00%

USES			
	Amount	% of Cost	Per Unit
Acquisition	1,339,252	7.09%	10,977
Construction	15,827,368	83.80%	129,733
Professional Services	542,923.00	2.87%	4,450
Financing Costs	902,810	4.78%	7,400
Developer Fee	275,000	1.46%	2,254
TOTAL USES	18,887,353	100%	154,814

Generally, this project meets the expectations of a multifamily housing development with regards to the financing structure, projected revenues, on-going operational costs and developer fee. Following are our findings with regards to the analysis completed for the development:

- Our analysis confirms the maximum supportable first mortgage the developer can secure for this project based on current underwriting criteria is \$14.165 million, assuming a 20 year loan at 4.0%. The developer is proposing to bring approximately \$4.7 million in equity, which is 25% of total project costs. This financing structure is in line with typical market rate projects.
- The total development costs for this project are approximately \$18.9 million, or \$154,814 per unit. Based on our experience with similar projects, we would expect total development costs to range between \$150,000 and \$200,000 per unit. This development is at the lower range, due primarily to the lack of underground parking which cannot be accommodated on the site due to high water table issues.
- The developer fee of \$275,000 is under two (2) percent of total development costs. For a project of this nature, we would expect to see a developer fee between 2% to 5%, so the fee is below typical industry standards.
- Land acquisition at \$10,977/unit is within the range of \$8,000 to \$12,000 we typically see. However, we are of the opinion that the market in Ramsey is closer to the \$8,000/unit.
- Proposed rents range between \$999 per month for a 1-bedroom unit, to \$1,625 for a 3-bedroom unit. The average rent is projected at \$1.33 per square foot. Typical market rate project rents range from \$1.50 to \$2.00 sq/ft, dependent upon location. Based upon the configuration of units (several 3-bedroom units) and area rents, we are of the opinion that the market for rents in Ramsey should be in the \$1.40 to \$1.50 range.
- The operating costs are projected at \$4,300/unit (The market range of operating costs is \$3,500 to \$4,500). The management costs are projected at 4.50% of effective gross income (EGI). We would expect to find management fees ranging between 3% and 5% of EGI. Based on our analysis and conversations with the developer, we conclude that the operating expenses may be a little high, primarily due to a higher maintenance budget and caretaker unit allowance.
- Vacancy is underwritten at 7%. Although this was typical several years ago, most lending institutions are allowing a 5% vacancy rate for underwriting purposes.
- Replacement reserves of \$287/unit are slightly below the *minimum* industry standards of \$300/unit. The developer is of the opinion this is sufficient to provide for future improvements and is an acceptable amount for their lender's underwriting criteria. Generally, we would prefer to see more reserves set aside for future viability.

- The projected cash-on-cash return (COC) on investment in year three (3) is 1.5% without assistance and 4.81% with assistance. This well below industry standards of 10%. Even with assistance, the cumulative COC return in year 15 is only 6.54%, which again is below industry standards.

Changes to the Proforma to Determine If Assistance Is Needed

Based upon our review, we reformatted the developer's proforma to adjust the following items to be in line with industry standard:

1. Land acquisition at \$8,000/unit
2. Increased rents to average of \$1.45 sq/ft (increased 1 & 2 bedroom units by \$100/month and 3 bedroom units by \$200/month)
3. Increased replacement reserves to \$300/unit
4. Reduced vacancy to 5%
5. Increased developer fee to \$565,000 (3%)

Based up these revisions, the developer's return in year 3 is still only 5.91%, which is below industry standard. If we add in the requested assistance, the return in year 3 goes to 9.21% with the cumulative return in year 15 at 11.50% (closer to industry standards).

Format of Assistance and Recommendations

Based on our review of the developer's pro forma and current market conditions, the proposed development may not reasonably be expected to occur solely through private investment within the reasonably near future. Due to the costs associated with constructing a market rate multifamily housing development, this project is feasible only through assistance, in part, from City contributions.

Our recommendation, however, is that the City provide the developer a pay-as-you-go note for \$500,000 at 4% interest, which is the interest rate on the developers first mortgage. The TIF note will be paid with 85% of the TIF generated by the project over the first 4 years. It should be noted that starting in year 5, 100% of the TIF generated (approximately \$184,000/year) will go to repay the City for its overall investment in the COR to date.

The developer has indicated that they are accepting of this proposal and are willing to move forward based upon the TIF assistance.

Please contact me at 651-697-8506 with any questions.