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# Pointe at Hills Farm Pro Forma Review Analysis

Prepared By:

Wendy Cohen, New Seasons Development LLC

Prepared For:

Shrewsbury Zoning Board of Appeals

Ronald I. Rosen, Chair

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## 1. Introduction and Executive Summary

### Introduction

The Shrewsbury Zoning Board of Appeals (Shrewsbury ZBA) engaged New Seasons Development LLC (New Seasons) to perform a financial assessment of a Chapter 40B comprehensive permit application for the Pointe at Hills Farm project.

The applicant is Smart Growth Design LLC. The development consultant is Bob Engler.

The 300-project originally proposed to MassHousing in November 2014 consists of two phases, totaling six (6) buildings, on two parcels of land located at 440 and 526 Hartford Turnpike (Route 20) in Shrewsbury. Under-ground parking was proposed under the four-story Phase 2 building.

The development consultant states that each building would contain an elevator. Amenities provided with the units would include a club room, game room, common kitchen, fitness center, business center, and bike storage. In addition, residents would be expected to pay for all utilities including heat and hot water, electricity, water and sewer. All units would have central air and in-unit laundry.

MassHousing issued a Project Eligibility Letter in June 2015 based on the 300-unit project plan. The developer/applicant filed its application with the ZBA in early November 2015. The comprehensive permit application indicates that the number of units to be built is 280 units of which 25% would be affordable. Phase One contained 180 units, and Phase Two contained 100 units. The clubhouse in Phase One was 9,300 SF and in Phase Two was 3,850 SF. The SF of the residential buildings in Phase One was 225,567, and the SF of the residential buildings in Phase Two was 109,941. Phase One contained five buildings and Phase Two contained one. An additional four (4) garages with six (6) parking spaces in each garage, totaling 4,800 SF, were proposed as part of Phase One.

During the hearings process, the applicant revised its proposed number of units and buildings in each phase to 248 units with four buildings in Phase One and two buildings in Phase Two, for a total of six (6) buildings. In the 248-unit model, the height of the buildings in Phase Two was reduced by two stories, eliminating the parking under the buildings. An additional four (4) garages with six (6) parking spaces in each garage, totaling 4,800 SF, were proposed as part of Phase One. Phase One contained 156 units, and Phase Two contained 94 units, approximately. The clubhouse in Phase One was 9,300 SF and in Phase Two was 2,700 SF. The SF of the residential buildings in Phase One was 191,746, and the SF of the residential buildings in Phase Two was 110,043.

The developer has since revised its pro forma for the 300-unit model to include 42% of the estimated sewer mitigation costs, for which the developer supplied an estimate of $2.9MM. The writer is told that this estimate was based on 248 units being built.

The developer's consultant states that the project is rendered "uneconomic" due to the reduction in the number of units from 300 to 248 and due to the proposed condition that the developer would pay 100% of sewer mitigation costs totaling $2.9MM. In addition, the traffic mitigation measures included in both

the 300 unit and the 248 unit pro forma total $450k, which the writer has reduced to $400k based on the actual estimate provided, because the estimate already includes a 10% design contingency and a 20% other contingency.

The developer's consultant is correct that the project is considered to be rendered "uneconomic" by the reduction in the number of units from 300 to 248 and by the increase in the planned percentage of sewer mitigation costs to be paid for by the developer from 42% to 100%, as a result of the proposed ZBA conditions. It is also clear that even if the developer were not asked to pay for any of the sewer mitigation costs, the reduction in the number of units in itself renders the project "uneconomic."

The site will be serviced by gas, sewer and water from the street. Site work costs are assumed to remain the same in both scenarios (the 300 unit version of the plans and the 248 units plans), based on the representation of the site engineer, Wayne Belec of Waterman Design. In an e-mail to the writer, he stated, "In both options of these designs, the utilities, sewer and piped drainage infrastructure remain fairly consistent. While I trust this email addresses your site costs comparison question, it unfortunately appears that reduction in unit density does not result in any signification (sic) change in site costs."

This assessment is designed to assist the Shrewsbury ZBA with its review of the project's 300-unit development pro forma, and specifically whether the financial projections are consistent with Chapter 40B guidelines, MassHousing policies and industry standards.

It is our understanding that the Shrewsbury ZBA has asked the Developer to make a 32-unit reduction in the number of proposed apartments (from 280 units to 248 units), to eliminate one building in Phase One, and to reduce the height of the Phase Two building and split it into two buildings. This request on Phase Two is partially accommodated by eliminating underground parking in Phase Two. We also understand that a proposed condition of the Shrewsbury ZBA is that the Developer pay for 100% of the sewer upgrade expenses. The Developer has not agreed to these proposed conditions, stating that such a reduction in the number of units and increase in the percentage share of sewer mitigation costs would make the proposal uneconomic.

This assessment compares the Developer's revised 300 unit pro forma with a 248-unit pro forma that was most recently updated on October 4, 2016, and provides an opinion as to whether a 248-unit project as proposed is considerably more uneconomic than the 300-unit project.

Executive Summary

As part of our analysis, we reviewed the financial section of the Developer's site eligibility application to MassHousing, his zoning application to the Shrewsbury ZBA, site development plans, architectural plans, financial pro formas, Shrewsbury ZBA initial hearing video, Shrewsbury ZBA architectural consultant report, Tocci construction cost estimates, as well as estimates with respect to site work, roadway improvements and sewer upgrade expenses, market rent comps, affordable rent assumptions, as-is appraisal, and fiscal impact report, as provided by the Shrewsbury ZBA or the Developer and/or his consultant, architect and site engineer. New Seasons also consulted with Town staff, Kristen Las, and the Town's consultant, Paul Haverty.

Our analysis of the Developer's 300-unit project reveals that the proposed development costs and rental income projections generally fall within industry standards for a mixed income rental housing project of this scale, and also meet 40B and MassHousing guidelines. The Developer's anticipated net operating income from the project is projected to be $3,291,523.32, which NSD has adjusted to be slightly lower at $3,129,600 per Section 4 of this report, or 4.23% of total development costs as adjusted by NSD.

The standard by which the impact of a reduction in units or other conditions imposed by the ZBA is judged is the lesser of 1) the ten year treasury yield as of the date the pro forma was reworked for submission to the ZBA (1.69%), plus 4.5%, or 6.19%, or 2) the ratio of Net Operating Income ("NOI") to Total Development Cost ("TDC"), also known as the a Return on Total Cost ("ROTC"), set forth in the MassHousing application for the Project Eligibility Letter, or 5.19%, per 40B regulations 760 CMR Section 56.02 (c). In this case, if the revised ROTC falls below 5.19%, then the conditions are considered to render the project uneconomic. In this case, the 300-unit project is already at least .97% below the uneconomic standard.

Our analysis of the Developer's 248-unit project indicates that, with minor exceptions, soft and hard costs assumptions generally fall within industry standards and meet 40B and MassHousing guidelines. The Return on Total Cost, however, is estimated at 3.48%. Therefore, the 248-unit project is considered significantly more uneconomic than the 300-unit project, as its Return on Total Cost is 1.72% below the uneconomic standard set by the 40B regulations.

2. Capital Cost Analysis

**Acquisition:**

The Developer has executed a purchase and sale agreement to acquire both portions of the site, according to the application to the ZBA dated September 8, 2014. An extension has been executed and submitted to the ZBA, bringing the expiration date of the agreement to September 30, 2016. The writer has requested a copy of any additional extensions. No acquisition price is disclosed in the materials provided.

Under 40B cost certification guidelines, a developer must use the lesser of the fair market value of the site (as currently zoned) and the acquisition cost of the site as the acquisition value for the project in addition to carrying costs, when calculating the maximum developer fee. Since the Developer has not acquired either portion of the site, there are no carrying costs. According to the appraisal conducted for MassHousing by The Foster Company on January 13, 2015 as part of the Developer's site eligibility application, the market value of the two sites totaling 19.43 acres is $1,835,000. The Developer is assuming a value of $1,835,000 for the site in the latest development pro forma and in his maximum fee calculation, which is the value stipulated by the aforementioned appraisal. The Developer is not assuming any carrying costs at this time as part of the acquisition value.

**Construction and Site Work Costs:**

The Developer provided third party verification of the construction costs of the proposed project, both for a 280-unit option and a 250-unit option. Tocci Construction provided the cost estimates.

Based on the cost estimates provided by Tocci Construction, the Developer is carrying a budget of a weighted average of $123.07 per square foot for the new construction of the 3-story and 5-story buildings made up of flats, including the cost of the podium for the parking underneath the 4 stories of residential in Phase Two of the 300-unit plan. NSD has increased this cost to $126.64 per SF using the Tocci Construction estimate and applying a weighted average methodology based on square footage rather than number of units in each phase.

An analysis of the Developer's $126.80/SF budget for constructing the Phase One buildings indicates that this may be on the lower end of new construction costs in the current market. According to on-line RSMeans data from 2016, an approximate square foot cost of $152.05/SF can be expected based on a 1-3 story new construction building with an elevator, including in unit laundry and all appliances. Therefore the cost per SF quoted is about 17% less than expected in the market place. The RS Means per square foot estimate is based on Worcester area wages for non-union workers, and assumes construction of a wood frame building with fiber cement siding, which is commonly used due to its durability. The estimate does not include site work, or the cost of the construction of the 9,300 SF clubhouse in Phase One.

The estimated cost of the new construction of the Phase Two building, four stories above one floor of underground parking, is $121 per SF, which is 14% below the $140.34 per square foot costs estimated by on-line RSMeans data.

A safe harbor for 40B projects under the Chapter 40B Guidelines is that the square footage cost does not exceed 110% of the applicable square footage construction cost listed in the RS Means Residential Construction Cost Data. This project does not exceed that safe harbor based on New Seasons' on-line research.

The site work costs are estimated at $6,321,000. Site work costs include those attributable to clearing the site where needed, grading, utilities, roads and walkways and some landscaping. In the package of information provided by the Developer's site engineer, an estimate from P.W. Brown was included indicating a traditional breakdown of the costs included within the site cost budget. The site engineer opined that, while this estimate is for the 280-unit version of the plan, the costs would not be much different for the 248-unit project. The site costs amount to about $18 per SF of additional costs.

The developer also provided an estimate of the Route 20 roadway improvement costs of $400,000 including a 10% design contingency and a 20% other contingency. The writer reduced the Developer's pro forma estimate from $450,000 to $400,000 based on this estimate.

The sewer mitigation cost is estimated by AECOM at $2,872,300. Forty-two percent (42%) of the cost is included in the 300-unit pro forma provided by the developer and 100% of that cost is included in the developer's 248-unit pro forma.

The Developer is carrying a 5% contingency for both the construction of the buildings and site work, which is standard for new construction work. The roadway improvements and sewer mitigation costs are carried as soft costs after the 5% soft cost contingency is calculated, so no contingency is carried.

**Soft Costs:**

The developer is carrying a soft cost budget totaling $9.3 million, including a 5% contingency, which is standard, plus an additional $1,666,000 of sewer mitigation and roadway improvement costs. These project expenses include architectural and engineering fees, carrying costs for the property, legal and financing fees and permitting costs. 40B guidelines require that a project's soft costs do not exceed 28% of hard costs (construction costs). The Developer's soft costs total 18.2% of construction costs in the current pro forma (excluding the off-site mitigation costs of $1,666,000 in the soft costs). This percentage increases to 21.5% of construction costs if mitigation costs are included in soft costs.

We have evaluated each soft cost line item and, with minor exceptions, all are standard within the industry, appropriate for this scale project and meet MassHousing fee guidelines. The exceptions are permitting fees, construction loan interest and financing fees, which are budgeted at $2.7MM, $1.89MM and $731,500, respectively, and were originally budgeted in the PEL application at $950,000, $2,000,000 and $775,800, respectively. The development consultant has explained that the costs for

permitting were based on the 248 unit version and he didn't revise that estimate when he revised the 300-unit pro forma. The writer has adjusted the permitting figure to $3.7MM based on permitting and water/sewer connection fees, and other fee schedules provided by the Town. The writer adjusted the construction loan interest and financing fees to $1,300,000 and $550,000, respectively, based on current NEF interest rates and the loan terms reflected in the financing section of the PEL application and the Marlborough Savings Bank term sheet. Construction loan interest is estimated at 50% of the permanent loan amount multiplied by the interest rate and multiplied by 1.5 years of construction. The construction and permanent loan fees are estimated at .75% of the construction loan amount and the .75% of the permanent loan amount, respectively. Both of these methodologies are standard and customary.

Other line items that have increased from PEL to the current 300-unit pro forma include Architectural and Engineering, a/k/a "A&E". This was part of the $950k for survey and permitting in the original application and is now $2,000,000 on its own. This appears to have been an oversight at the PEL application stage. A&E fees range from 4% to 8% of construction costs on most construction projects and in this case they are budgeted at 3.9% which is reasonable given the size of the project.

The development consulting fee of $200,000 has been deleted and it is now included in the developer fee line item. The developer fee itself has increased (though it is not a paid fee) due to an error in the calculation of the maximum fee and overhead per MassHousing policy (the consultant thought a new reduced fee policy applied to the project, but it did not, due to the date of the Project Eligibility Letter).

The only other line items that have changed substantially since the PEL application are construction costs (down $500,000) and mitigation costs (two line items totaling $1.666MM added by Developer's consultant to cover Route 20 improvements and pay for 42% of estimated sewer upgrade costs).

Acquisition costs went up by $335,000, because the appraisal came in and the budget was adjusted after the PEL application was submitted.

Having received these explanations from the Developer's consultant and made adjustments as needed, NSD believes the soft cost budget as presented is reasonable.

**Developer Fee/Other Sources:**

Under 40B program guidelines for rental housing projects, a developer may earn a profit of up to 5% of allowable acquisition costs (the lesser of the acquisition price, which has not been disclosed, and the as-is value of the property of $1,835,000 in this case), 15% of the first $3,000,000 of hard and soft costs, 12.5% of the next $2,000,000 of hard and soft costs, and 10% of the remaining hard and soft costs. The Developer is projecting a profit of $6.5 million, which is the maximum fee allowed. The developer is contributing back the fee and adding a contribution of equity of $15.3 million, which, along with the mortgage amount of $48.8 million, cover the projected development costs.

3. Rental Income Projection Analysis

**Affordable Units:**

The Developer is designing the 300-unit the Pointe at Hills Farm project such that 75 units (25% overall) will be made available to households earning up to 80% of area median income (AMI), which meets 40B guidelines. The Developer has calculated the affordable rents based on the 80% of area median income limits issued by HUD and posted by the 40B subsidizing agency Massachusetts Housing Partnership Fund on its web site. The industry standard is that the maximum rents are determined based on the assumption that 1.5 people will occupy one bedroom, 3 people will occupy two bedrooms, and 4.5 people will occupy 3 bedrooms.

The Developer is assuming that the tenants will pay all of their utility bills, including gas for heat and hot water, water, sewer, and electricity. Refrigerators and ranges will be supplied. Utility allowances from the Shrewsbury Housing Authority were used for the proposed utility allowances for the affordable units. These are deducted from the maximum allowable rent to determine the net rent to be charged to the residents of the affordable units.

The owner's operating budget includes common electric, common area gas, and water/sewer for the common areas including the clubhouses.

**Market-Rate Units:**

The Developer has established rental prices for the market-rate apartments as follows, based on comparable market information provided by the development consultant at other Shrewsbury housing projects. Specifically, the assumed market rents mirror the Avalon at Shrewsbury market rents.

1BR $1,560
2BR $1,889
3BR $2,089

The writer has adjusted these rents upward, based on comps from the World Wide Web for Avalon at Shrewsbury and other properties located in Shrewsbury, to the following rents:

1BR $1,600
2BR $1,900
3BR $2,125

Other Income: The Developer assumes other income of 1% of the gross residential operating income, net of the market rate vacancy of 7%.

Vacancy Assumption: The Developer assumes a 7% vacancy and rent loss, as a percentage of gross market rate residential operating income and 5% vacancy and rent loss, as a percentage of gross affordable residential operating income. These are standard and acceptable assumptions.

## 4. Operating Expense Analysis

The operating expenses for the 300-unit project are estimated at $2.2 million, or $7,200 per unit. The budget includes management fees of 3% (low) or $579 per unit (slightly low), administrative and marketing costs of $1,700 per unit (standard), maintenance costs of $2,000 per unit (low by approx. $500 per unit), utilities (water and sewer, electric and heat for common areas only) at $400 per unit, and property and other taxes for $500,000, significantly lower than the property tax revenue estimate in the fiscal impact report provided to the Town of Shrewsbury. Since operating income has increased since the fiscal impact report, the taxes estimate may be low. The remaining costs are replacement reserves (slightly low at $300 per unit; standard is $350-$500 per unit), monitoring fees of $40 per unit per year, and insurance ($120,000).

Overall, based on NSD's experience in reviewing income and operating expenses on other properties, I would expect the expenses to be higher, and have adjusted them accordingly to about $2.4MM on the 300-unit pro forma and $2.1MM on the 248 unit pro forma. Net operating income would then be lower by about $160,000 and $130,000, respectively. Debt service would be about $240,000 and $102,000 lower, respectively, based on current rates and a 1.25 rather than a 1.20 DSC ratio requirement.

Based on all of the writer's adjustments to TDC and NOI, the expected ROTC for the 300-unit project would be lowered from 4.66% to 4.23%. The expected ROTC for the 248 unit pro forma would be lowered from 3.80% to 3.48%.

## 5. Analysis of Impact of ZBA Conditions (248-Unit Analysis)

Following our review of the Developer's proposed 300-unit development pro forma, we next compared it with the Developer's 248-unit project and pro forma, as requested by the Shrewsbury ZBA. In the 248-unit scenario, the Developer has assumed there will be 1) four 3-story buildings in Phase one, four garages and 9,300 SF clubhouse, with surface parking, and 2) two 3-story buildings with a 2,700 SF clubhouse within one of the buildings and surface parking. Phase One would have 24 fewer units and Phase Two would have 24 fewer units, per the architect. This calculation is off by two units total because the architect was assuming 250 units in the reduced unit version. In addition the 248 unit version would have approximately 40,341 fewer GSF than the 300 unit version.

With respect to parking, the 300-unit plans do not indicate the number of parking spaces proposed, but there are 447 spaces (315 in Phase One and 132 in Phase Two) indicated on the March 2016 250-unit plans.

Our analysis of both hard and soft costs and new rental income projections indicates that the Developer's assumptions remain reasonable and within both industry standards and 40B guidelines. Operating expense assumptions have been adjusted per the comments below.

**Hard Costs:**

In the 300-unit development plan, the Developer was carrying a budget of $123.07 per square foot for the new construction of the five 3-story buildings and one 5-story building made up of flats, including the cost of the podium for the parking underneath. The cost of these buildings (with one fewer three story building in Phase One, the elimination of the podium parking in Phase Two, and only three stories in the two buildings in Phase Two) in the 248-unit development plan has increased to $135.37.

According to on-line RS Means data from 2016, an approximate square foot cost of $148/SF can be expected for the 300-unit plan, based on a weighted average of the individual RS Means estimates for Phase One and Phase Two buildings, and an approximate square foot cost of $145 per SF can be expected for the 248-unit plan, again based on a weighted average of the individual RS Means estimates for Phase One and Phase Two buildings. Therefore the cost per SF quoted is about 17% less than expected in the market place for the 300-unit plan and 7% less than expected in the market place in the 248-unit plan.

**Soft Costs:**

In comparison to the 300-unit plan, the soft costs in the 248 unit plan as adjusted have decreased overall and as a percentage of construction costs (17.6% vs. 16.4%), but remain within the 40B guideline of no more than 28% of construction costs.

Certain line items in the budget have decreased substantially due to the lower total hard costs and lower construction loan amount, such as construction loan interest and fees and building permits.

The developer fee calculation also resulted in lower development fees by about $150,000.

Like the 300-unit pro forma, we tested the Developer's assumptions with regard to both affordable and market-rate rents. The developer designated 62 units or 25% of the units as affordable and used the same methodology to determine the rents and the utility allowances.

The operating expenses were adjusted as well, based on expected per unit expenses and management fees. The resulting NOI decreased from $2,645,368 to $2,517,104.

## 6. Conclusion

The Developer's anticipated profit (measured as Return on Total Cost, Net Operating Income divided by Total Development Cost) is 3.48% on the 248-unit project. Therefore, the 248-unit project with 100% of the project's sewer mitigation costs paid by the developer falls well below the 5.19% minimum economic threshold in determining whether a proposed development is economically feasible and the ROTC is significantly below the 4.23% ROTC for the proposed 300-unit project with 42% of the were mitigation costs paid by the developer.

New Seasons also briefly analyzed what the ROTC would be if only 42% of the sewer mitigation costs were paid by the developer in the 248-unit version of the pro forma, and found that the ROTC would increase by only .09% to 3.57% and would still be below the 5.19% economic threshold set by 40B regulations as well as the 4.23% ROTC in the revised 300-unit pro forma, as adjusted by New Seasons.