



Memorandum

To: Queen Anne's County Division of Housing and Community Services

From: Anita Morrison
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Partners for Economic Solutions

Subject: Workforce Housing Financial Analysis

Date: May 3, 2021

To better understand the financial aspects of Queen Anne's County housing challenge, PES prepared a financial pro forma analysis of a prototypical apartment development.

The model assumes a 100-unit development on five acres within the urban portion of the county (i.e., west of Queenstown). The County's Moderately Priced Dwelling Unit (MPDU) policy requires that projects of at least 20 units in growth areas or at least 60 units outside the growth areas provide 10 percent of units offered at rents affordable to households with incomes of no more than 80 percent of Area Median Income (AMI), equivalent to not more than \$62,800 for a two-person household or \$78,500 for a family of four. Appendix Table A-1 summarizes the basic model inputs. Table 1 shows the basic model for market-rate apartment development.

The model solves for return on investment (calculated as Annual Net Operating Income divided by Total Development Costs). A developer typically targets a return that compensates for both the direct investment and the potential risks associated with development. Those risks include such events as:

- unanticipated delays in development approvals;
- unanticipated delays in construction;
- higher costs than expected due to cost inflation or unexpected developments, such as discovery of unknown site contamination or soil problems; and
- lower-than-expected rents or occupancy levels.

In these times of low interest rates, developers are typically seeking returns on total development costs of 5.5 to 6.0 percent. Projects that can't meet the required returns don't get funded, though in some rare cases, such as where the developer already owns the land, a lower return may be acceptable. Typically, when a project has a return below the required return, developers will seek out other real estate projects that support higher returns, and their investors will consider other investments.



What we found is that the high prevailing costs of construction, land and development-related fees constrain the potentials for near-term apartment development in the county.

Prevailing rents in the market suggest potential for market-rate leases at \$1,460 per month for a one-bedroom unit, \$1,700 for a two-bedroom unit and \$1,750 for a three-bedroom unit (excluding utilities). The workforce units are assumed to be offered at rents of \$1,325 for a one-bedroom unit, \$1,640 for a two-bedroom unit and \$1,710 for a three-bedroom unit. Despite these rent levels, which are somewhat high relative to local income levels, the new market-rate development would yield a return of 5.1 percent, below the required return of 5.5 to 6.0 percent. For most developers, failure to meet the target return would mean that they would not develop the project. Following are some strategies for raising the potential return on investment.

Table 1. Market-Rate Apartment Development in an Urban Location with 10 Percent Workforce Housing Units Affordable at 80 Percent of Area Median Income

		Multi-Family		
Characteristics of Project				
Site Size (Acres)	5.00			
Future Project Density (DU/AC)	20			
Base Project Size (Units)	100			
Market-Rate Units	90			
Workforce Units	10			
Parking Ratio (Spaces per Unit)	1.9			
Residential Parking Spaces	191			
Total Residential Rentable Square Feet	82,300			
Common Area	14,500			
Total Gross Square Feet	96,800			
Average Unit Size (Square Feet)	823			
Unit Mix	Sq. Ft.	Mix	Units	Monthly Rent
Market-Rate Units				
1 BR	750	35%	32	\$1,460
2 BR	850	60%	54	\$1,700
3 BR	1,000	5%	4	\$1,750
Average Market-Rate Monthly Rent	\$1,617			
Workforce Units¹				
1 BR	750	35%	3	\$1,325
2 BR	850	60%	6	\$1,640
3 BR	1,000	5%	1	\$1,710
Average Workforce Monthly Rent	\$1,553			
Average Monthly Rent	\$1,610			
Operating Expense per Square Foot, Excluding Utilities	\$8.00			
Development Costs				
Land Acquisition, Assuming Vacant Land	\$2,375,000			
Construction Costs	\$13,358,000			
Site Improvement/Infrastructure Costs	\$1,250,000			
Parking Construction Costs	\$956,000			
Soft Costs	\$3,113,000			
Development Impact Fees	\$549,000			
Sewer/Water Allocation Fees	\$876,000			
Total Development Costs	\$22,477,000			
<i>Total Development Costs/Unit</i>	<i>\$224,800</i>			
Development Feasibility				
Gross Rent (100% Occupancy)	\$1,932,500			
Vacancy and Collection Loss	5.0%			
Gross Scheduled Rent	\$1,835,900			
Operating Expenses	\$658,000			
Replacement Reserves	\$30,000			
Net Operating Income	\$1,147,900			
Return on Investment (NOI/TDC)	5.1%	Does not meet the 5.5% required threshold return		
Not Covered by Annual Operating Income	\$1,610,000	Subsidy required to meet the required threshold return		

Note: ¹The zoning ordinance requires that 10 percent of units be workforce housing with rents affordable at 80 percent of Area Median Income (AMI).

Source: Partners for Economic Solutions, 2021.



To reach the threshold return, costs would need to be reduced by \$1.61 million or \$16,100 per unit – a 7.2-percent reduction. Cost savings could be achieved by a mix of fee waivers and density increases that would require a change in County zoning. For example, rezoning to adjust the project density from 20 units per acre to 30 units would reduce land costs by \$7,900 per unit, raising the potential return from 5.0 to 5.4 percent. The development impact fee ordinance provides a fee exemption for residential units “that are subsidized by any municipal corporation, County, state, or the federal government and are intended for low-income owners or tenants” and the County funds the fees for that development. That ordinance could be revised to extend exemptions to other units with long-term affordability commitments. Exempting the workforce housing units from the development impact fees charged for school, fire and parks and recreation would lower costs by \$500 per unit. An exemption from the \$5,750 to \$14,350 water and sewer allocation fee per unit for workforce units would reduce costs by \$800 per unit. Together, the development impact fee and sewer/water allocation fee exemptions would raise the financial return by \$200,000. With fee exemptions combined with an increase in density to 30 units per acre, the development would yield a 5.5-percent return, sufficiently high to attract developer interest, as shown in Table 2.



Table 2. Market-Rate Apartment Development in an Urban Location with 10 Percent Workforce Housing Units, Affordable at 80 Percent of Area Median Income with Higher Density and Reduced Fees to Achieve Financial Feasibility

Multi-Family				
Characteristics of Project				
Site Size (Acres)	5.00			
Future Project Density (DU/AC)	30	+50%		
Base Project Size (Units)	150			
Market-Rate Units	135			
Workforce Units	15			
Parking Ratio (Spaces per Unit)	1.9			
Residential Parking Spaces	287			
Total Residential Rentable Square Feet	124,300			
Common Area	21,900			
Total Gross Square Feet	146,200			
Average Unit Size (Square Feet)	829			
Unit Mix	Sq. Ft.	Mix	Units	Monthly Rent
Market-Rate Units				
1 BR	750	35%	48	\$1,460
2 BR	850	60%	81	\$1,700
3 BR	1,000	5%	7	\$1,750
Average Market-Rate Monthly Rent	\$1,625			
Workforce Units¹				
1 BR	750	35%	5	\$1,325
2 BR	850	60%	9	\$1,640
3 BR	1,000	5%	1	\$1,710
Average Workforce Monthly Rent	\$1,540			
Average Monthly Rent	\$1,617			
Operating Expense per Square Foot, Excluding Utilities	\$7.77	Property taxes waived for workforce units		
Development Costs				
Land Acquisition, Assuming Vacant Land	\$2,375,000			
Construction Costs	\$20,176,000			
Site Improvement/Infrastructure Costs	\$1,250,000			
Parking Construction Costs	\$1,434,000			
Soft Costs	\$4,572,000			
Development Impact Fees	\$746,000	Waived for workforce units		
Sewer/Water Allocation Fees	\$1,192,000	Waived for workforce units		
Total Development Costs	\$31,745,000			
<i>Total Development Costs/Unit</i>	<i>\$211,600</i>			
Development Feasibility				
Gross Rent (100% Occupancy)	\$2,909,800			
Vacancy and Collection Loss	5.0%			
Gross Scheduled Rent	\$2,764,300			
Operating Expenses	\$966,000			
Replacement Reserves	\$45,000			
Net Operating Income	\$1,753,300			
Return on Investment (NOI/TDC)	5.5%			
Not Covered by Annual Operating Income	-\$130,000	Subsidy required to meet the required threshold return		

Note: ¹The zoning ordinance requires that 10 percent of units be workforce housing with rents affordable at 80 percent of Area Median Income (AMI).

Source: Partners for Economic Solutions, 2021.



Affordable Housing Scenario

To meet the needs of residents with incomes up to 50 percent of AMI (\$41,600 for a two-person household or \$52,000 for a four-person household), rents on the affordable units would need to be no higher than \$835 for a one-bedroom unit, \$1,020 for a two-bedroom unit and \$1,050 for a three-bedroom unit. Shown in Table 3, development with 10 percent of the units offered at affordable rents would result in an overall return of 4.9 percent, which is too low to encourage private development. To reach the threshold return of 5.5 percent, development costs would need to be reduced by \$2.5 million.



Table 3. Apartment Development in an Urban Location with 10 Percent Affordable Housing Units, Affordable at 50 Percent of Area Median Income

		Multi-Family		
Characteristics of Project				
Site Size (Acres)	5.00			
Future Project Density (DU/AC)	20			
Base Project Size (Units)	100			
Market-Rate Units	90			
Affordable Units	10			
Parking Ratio (Spaces per Unit)	1.9			
Residential Parking Spaces	191			
Total Residential Rentable Square Feet	82,300			
Common Area	14,500			
Total Gross Square Feet	96,800			
Average Unit Size (Square Feet)	823			
Unit Mix	Sq. Ft.	Mix	Units	Monthly Rent
Market-Rate Units				
1 BR	750	35%	32	\$1,460
2 BR	850	60%	54	\$1,700
3 BR	1,000	5%	4	\$1,750
Average Market-Rate Monthly Rent	\$1,617			
Affordable Units¹				
1 BR	750	35%	3	\$835
2 BR	850	60%	6	\$1,020
3 BR	1,000	5%	1	\$1,050
Average Affordable Monthly Rent	\$968			
Average Monthly Rent	\$1,552			
Operating Expense per Square Foot, Excluding Utilities	\$8.00			
Development Costs				
Land Acquisition, Assuming Vacant Land	\$2,375,000			
Construction Costs	\$13,358,000			
Site Improvement/Infrastructure Costs	\$1,250,000			
Parking Construction Costs	\$956,000			
Soft Costs	\$3,113,000			
Development Impact Fees	\$549,000			
Sewer/Water Allocation Fees	\$876,000			
Total Development Costs	\$22,477,000			
<i>Total Development Costs/Unit</i>	<i>\$224,800</i>			
Development Feasibility				
Gross Rent (100% Occupancy)	\$1,862,300			
Vacancy and Collection Loss	5.0%			
Gross Scheduled Rent	\$1,769,200			
Operating Expenses	\$640,500			
Replacement Reserves	\$30,000			
Net Operating Income	\$1,098,700			
Return on Investment (NOI/TDC)	4.9%	Does not meet the 5.5% required threshold return		
Not Covered by Annual Operating Income	\$2,500,000	Subsidy required to meet the required threshold return		

Note: ¹ Assumes rents are affordable at 50 percent of Area Median Income (AMI).

Source: Partners for Economic Solutions, 2021.



Even with a density of 30 units per acre and exemptions from development impact fees and sewer and water allocation fees associated with the affordable units, the project could achieve a return of only 5.2 percent. That would leave a financial gap of \$1.7 million still to be filled, as shown in Table 4.

The County could abate real property taxes associated with the workforce units. Project real estate taxes are estimated at roughly \$1,750 per unit. Abating the taxes associated with the workforce units would reduce operating costs and raise the return from 4.9 to 5.0 percent. A combination of higher densities, lower development fees, lower water/sewer allocation fees and real estate tax abatement could get the project to a 5.3-percent return. That would still leave the project with a financial gap of \$1,190,000 in unfunded development costs.

One way to eliminate that financial gap would be to provide an annual operating grant. That gap could be filled by an operating grant of \$65,500 per year for 10 to 20 years. Some communities fund such operating subsidies through the new property taxes generated by the project. Tax-increment financing pledges a share of the property taxes generated by the increase in assessed value associated with the new development to support public investments within a defined tax-increment financing district.

Table 4. Apartment Development in an Urban Location with 10 Percent Affordable Housing Units, Affordable at 50 Percent of Area Median Income with Higher Density and Reduced Fees to Achieve Financial Feasibility

		Multi-Family		
Characteristics of Project				
Site Size (Acres)	5.00			
Future Project Density (DU/AC)	30	+50%		
Base Project Size (Units)	150			
Market-Rate Units	135			
Affordable Units	15			
Parking Ratio (Spaces per Unit)	1.9			
Residential Parking Spaces	287			
Total Residential Rentable Square Feet	124,300			
Common Area	21,900			
Total Gross Square Feet	146,200			
Average Unit Size (Square Feet)	829			
Unit Mix	Sq. Ft.	Mix	Units	Monthly Rent
Market-Rate Units				
1 BR	750	35%	48	\$1,460
2 BR	850	60%	81	\$1,700
3 BR	1,000	5%	7	\$1,750
Average Market-Rate Monthly Rent	\$1,625			
Affordable Units¹				
1 BR	750	35%	5	\$835
2 BR	850	60%	9	\$1,020
3 BR	1,000	5%	1	\$1,050
Average Affordable Monthly Rent	\$960			
Average Monthly Rent	\$1,559			
Operating Expense per Square Foot, Excluding Utilities	\$7.77	Property taxes waived for affordable units		
Development Costs				
Land Acquisition, Assuming Vacant Land	\$2,375,000			
Construction Costs	\$20,176,000			
Site Improvement/Infrastructure Costs	\$1,250,000			
Parking Construction Costs	\$1,434,000			
Soft Costs	\$4,572,000			
Development Impact Fees	\$746,000	Waived for affordable units		
Sewer/Water Allocation Fees	\$1,192,000	Waived for affordable units		
Total Development Costs	\$31,745,000			
<i>Total Development Costs/Unit</i>	<i>\$211,600</i>			
Development Feasibility				
Gross Rent (100% Occupancy)	\$2,805,500			
Vacancy and Collection Loss	5.0%			
Gross Scheduled Rent	\$2,665,200			
Operating Expenses	\$939,750			
Replacement Reserves	\$45,000			
Net Operating Income	\$1,680,450			
Return on Investment (NOI/TDC)	5.3%	Does not meet the 5.5% required threshold return		
Not Covered by Annual Operating Income	\$1,190,000	Subsidy required to meet the required threshold return		

Note: ¹ Assumes rents are affordable at 50 percent of Area Median Income (AMI).

Source: Partners for Economic Solutions, 2021.

Table A-1. Financial Model Input Assumptions

	Rental Apartments	
Developer Targeted Return	5.5%	of total costs
Vacancy and Collection Loss	5%	% of revenues
Building Efficiency (Leaseable/Gross S.F.)	85%	percent
Size of Parking Space	350	square feet
Residential Parking Spaces (Minimum)	1.9	per unit
Monthly Parking Fees	\$0	per space
Development Cost Assumptions		
Land Price	\$475,000	per acre
Infrastructure & Site Improvements	\$250,000	per acre
Hard Costs (Including General Conditions)		
Low-Rise (1-4 Stories)	\$138	per g.s.f.
Surface Parking Costs	\$5,000	per space
Soft Costs (Incl. Const. Fin.)	20%	of hard costs
Development Fees	\$5.67	per gross square foot
Sewer/Water Allocation Fees		
Residential Units	\$14,350	per unit
One-Bedroom Apartment	\$5,750	per apartment
Two-Bedroom Apartments	\$10,050	per apartment
Replacement Reserves	\$300	per unit
Residential Operating Costs (Excluding Utilities)	\$8.00	per r.s.f.
Property Tax Rate	0.009591	

Source: Partners for Economic Solutions, 2021.