REVIEW OF FINANCIAL FEASIBILITY

PENN AVENUE PROJECT HIATUS DEVELOPMENT

MUPTE PROGRAM APPLICATION

Prepared for: City of Bend, Oregon

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1. Executive Summary

Introduction

PNW ECONOMICS, LLC was retained by the City of Bend to review the Hiatus Development Penn Avenue Project Multi-Unit Property Tax Exemption ("MUPTE") program application as part of City review of the project application. Specifically, PNW ECONOMICS was tasked with:

- Reviewing project application assumptions including rent income, non-rent income, operating expenses, bank underwriting assumptions, and other pertinent assumptions;
- Evaluating projected return on investment for the project without MUPTE and with MUPTE, which grants a ten-year property tax exemption for the project in order to incentivize its financial performance such that investment and development is possible and positively contributes to the Bend economy in place of property underutilization; and
- Communicating all analysis and findings appropriately for review by community members and elected officials.

This document represents completion of these tasks for review by the City of Bend and its partners and stakeholders.

Summary of Findings

An independent pro forma analysis was conducted by PNW ECONOMICS for the proposed Penn Avenue project in midtown Bend. The following table provides a concise summary of the outcome of not awarding and awarding a MUPTE to the project, which comprises 40 apartment units.

Table 1 – Penn Avenue Project Measures of Return With & Without MUPTE: 40 Units

40 One-Bed Units 12 Units at 120% of AMI	Year 1 2024	Year 2 2025	Year 3 2026	Year 4 2027	Year 5 2028	Year 6 2029	Year 7 2030	Year 8 2031	Year 9 2032	Year 10 2033
NO MUPTE										
+ MUPTE	**$0**	**$0**	**$0**	**$0**	**$0**	**$0**	**$0**	**$0**	**$0**	**$0**
Extended Internal Rate of Return	**-7.3%**	**6.5%**	**6.6%**	**6.7%**	**6.8%**	**6.9%**	**6.9%**	**6.9%**	**7.0%**	**7.0%**
Cash-on-Cash Return	-5.1%	4.8%	5.3%	5.9%	6.4%	7.0%	7.6%	8.3%	8.9%	9.6%
YES MUPTE										
+ MUPTE	**$92,713**	**$95,494**	**$98,359**	**$101,310**	**$104,349**	**$107,480**	**$110,704**	**$114,025**	**$117,446**	**$120,969**
Extended Internal Rate of Return	**1.7%**	**11.7%**	**10.7%**	**10.1%**	**9.7%**	**9.4%**	**9.2%**	**9.1%**	**8.9%**	**8.8%**
Cash-on-Cash Return	-1.9%	4.8%	5.4%	6.0%	6.6%	7.2%	7.8%	8.4%	9.1%	9.8%

Without MUPTE Conclusion: The Penn Avenue project, including 12 of 40 units rent-restricted to be affordable to households earning not more than 120% of Area Median Income (AM), is not financially feasible on its own.

- 30% of available units would earn below-market rents, reducing potential project Net Operating Income.

- The project would cost the same to build with or without income-restricted units and have similar terms of finance.
- Less rent revenue and no reduction in development costs or project financing costs translates into a lower Cash Flow project with too-low measures of rate of return, starting with Extended Internal Rate of Return (XIRR).
- Being unable to offer a competitive rate of return for the risk, the project would be highly unlikely to attract the necessary equity to make up the total cost of the project that cannot be debt financed (35%).

With MUPTE Conclusion: The Penn Avenue project, including 12 of 40 units rent-restricted to be affordable to households earning not more than 120% of Area Median Income (AM), approaches financial feasibility with the MUPTE and only with the tax exemption compared to the No MUPTE scenario.

- 10.1% to 11.7% Extended Internal Rate of Return (XIRR) with a MUPTE exceeds the 10% benchmark to attract equity investment;
- XIRR with the MUPTE exceeds the long-term stock portfolio average of 8% annually; and
- XIRR with the MUPTE certainly exceeds the 6.5% to 7.0% XIRR without the MUPTE.

In final completion of this analysis, both the second-largest and third-largest bank failures in US History happened over the same March 2023 weekend. Over the next two years, economic turbulence and lending standards are likely to be affected by these large bank failures: [1]

- Lending standards will likely tighten beyond already experienced. In other words, projects are likely to be able to borrow even less of their total cost and will need to seek a greater share of financing through equity investment. Accordingly, the affirmative findings of MUPTE need in this analysis may prove even more pronounced should the Penn Avenue's lending situation constrict and the project requires even more equity investment share.
- The Penn Avenue project's sole focus on Studio units, though only 40 total units, places it in some economic risk as in the rental market, households will tend to double-up/roommate in larger units vs. solo rent studio units when economic circumstances are unfavorable or uncertain. The entire mix of Penn Avenue are Studio units and may see more difficult lending circumstances due to this factor.

Review of all development and financial assumptions in the MUPTE Application for the Penn Avenue project yielded the following other general finds and comments:

- The Penn Avenue project has proposed unit rents that are across the board higher than any identified comparable in Bend. In fact, even the 120% of AMI rents at Penn Avenue exceed

[1] PNW Economics would like to thank Greg Manning, Principal of Pioneer Project Partners, LLC for current lending market feedback and bank failure impacts upon commercial real estate lending in Oregon.

studio units and 1 bed unit rents at very new projects on the west side of Bend, where rents would be expected to be at least as high as new product in the eastside Midtown area. It would be appropriate for the City of Bend to seek clarification of rents at Penn Avenue within this context.

- Development costs of the project are seemingly consistent with current construction market conditions in Suburban Portland.

Otherwise overall, it was found that the Penn Avenue MUPTE Application financial analysis used reasonable assumptions overall and much of the independent pro forma and cash flow analysis in this report utilizes similar assumptions as the Applicant. Differences in assumptions are noted in this document.

2. Financial Feasibility Analysis

This report is a set of new, independent pro formas conducted by PNW ECONOMICS given review of the Penn Avenue project MUPTE application. In that application, the Applicant presents sophisticated pro forma/cash flow analysis that does not necessarily provide apples-to-apples comparison of a No MUPTE/Yes MUPTE comparison. For instance, terms of financing of the project with the income-restricted units (Yes MUPTE) is different than terms of financing without those units (No MUPTE). In practice, that would potentially be true as a project without income-restricted units will generate higher Net Operating Income, which then could potentially allow a project to borrow a higher percentage of its total development cost.

But by comparing Yes MUPTE vs. No MUPTE development scenarios that let terms of financing be dynamic depending upon the revenue generated by the project, it is difficult from a policy perspective to isolate the need of the MUPTE to achieve the intended public good: 30% of proposed units affordable to households that earn up to 120% of Area Median Income.

This report therefore conducts pro forma analysis isolating as much as reasonably possible about project development financing and other details in order to demonstrate whether or not the project can deliver the public good – 12 income-restricted units – with or without the MUPTE. This report also makes some conservative assumptions about development financing that do not necessarily identically match assumptions by the Applicant. Modified assumptions are not dramatically different, but are intended to offer fundamentally conservative and apples-to-apples analysis to help better answer the MUPTE policy question. Assumptions are outlined below.

Financial Feasibility ("Pro Forma") Assumptions

Debt vs. Equity & Project Financing

Table 2 provides a summary of project permanent financing assumptions considered in this analysis. The Applicant considered various lending scenarios, including a 72% Loan to Value scenario. But for conservative independent analysis, this report assumes the total project cost will be able to get 65%

financed with the remaining 35% of total project cost needing to come from equity investment sources.

Table 2 – Penn Avenue Project Permanent Debt Finance Assumptions

	40 Units	
	65% LTV	**72% LTV**
Total Development Cost	$12,698,256	$12,698,256
Permanent Loan	$8,253,866	$9,142,744
Equity	$4,444,390	$3,555,512
Percent Financed	65%	72%
Annual Interest Rate	6.00%	6.00%
Amortization (Years)	30	30
Annual Permanent Debt Service	($593,833)	($657,784)

Development Costs

At a total development cost of $12,698,256 for 40 units in a three-story "low-rise" structure, total cost per door for the Penn Avenue project is $317,456. PNW Economics recently reviewed total costs per door for two 52-unit, three-story projects in suburban Washington County for context. Those projects averaged $267,850 per door in 2022. Escalating by a modest 10% over the past twelve months translates into $294,635 per unit in total cost.

The projects used for context were more modest construction design for underserved rural markets in Washington County. Accordingly, three-story rural apartment buildings would be expected to have a construction cost discount. Based on this comparison, total development costs and costs-per-unit at the Penn Avenue project are viewed as reasonable.

Assumed Rents & Escalation

Table 3 provides a summary of apartment rents utilized in the pro forma analyses in this section. Rents assumed are planned rents for each of the unit types as proposed by the Applicant. Annually after 2023, rents are assumed to escalate by 3% annually.

Table 3 – Penn Avenue Project Market Apartment Rent Assumptions – 40 Units

Unit Type	Unit Mix Units	Percentage	Average Unit Size (Sq. Ft.)	Monthly Rent	Rent per Square Foot
Lofted One bed	24	60%	474	$2,050	$4.32
Lofted One bed Deck	4	10%	474	$2,250	$4.75
MUPTE Units: 120% AMI	12	30%	474	$1,888	$3.98
Subtotals/Averages	**40**	**100%**	**474**	**$2,021**	**$4.26**

Rents overall appear somewhat high compared to market. During review of the Applicant pro forma, the following rents were identified for most-comparable, though not perfectly comparable units at other newest competitive projects in Bend:

- **The Nest** (1609 SW Chandler Avenue, Bend): 490 square foot Studio/1 bath for $1,719 average ($3.51 per square foot)
- **Solis at Petrosa** (63190 Deschutes Market Road): 620 square foot 1 bed/1 bath for $1,850 average ($2.98 per square foot).
- **The Eddy Apartments** (801 SW Bradbury Way): 640 square foot 1 bed/1 bath for $1,800 average ($2.81 per square foot).

The Penn Avenue project's unit mix most resembles The Nest's Studio/1 bath unit in terms of size (474 sq. ft. vs 490 sq. ft. at The Next). That newer unit rents for $300 less monthly than the Penn Avenue "market rate" unit average of $2,150 per month. In fact, The Nest's Studio unit rents cheaper than the 120% of AMI units at Penn Avenue, planned to rent at $1,888.

The Solis at Petrosa and The Eddy both advertise available larger 1 bed/1 bath units that are not entirely comparable to Studio-sized units. But both projects larger 1 bed/1 bath units also rent cheaper than both the full market units at Penn Avenue and the 120% of AMI units planned under the MUPTE program.

The rent difference is not clearly explained, as the Penn Avenue project location should be viewed as a generally inferior location compared to the locations of the projects mentioned in this comparison. New development and redevelopment in Bend has intensely been done on the west side of the City, proximate to the river. The Penn Avenue location, located on the east side of town in the Midtown area, is less amenity-filled and is more distant from employment concentrations and amenities both downtown and generally on the west side. PNW ECONOMICS, therefore, would anticipate rents at Penn Avenue to *at most* be equal to rents or rents per square foot, but likely below project rents located on the west side.

Conclusion: Both full market rents and income-restricted rents at the planned Penn Avenue project are higher than new market-rate rents at better-located units on the west side of Bend in newer and revitalized areas. Accordingly, it would be appropriate of the City of Bend to ask the Applicant to clarify both full market rents ($2,150 average) as well as 120% of AMI rents ($1,880) within this competitive context.

Should market and restricted rents be adequately clarified, assuming higher rents in the pro forma will tend to make the need for a MUPTE less likely. That is, higher rent income will tend to increase cash flow for a project after debt service is accounted. Project rents that were inexplicably low relative to market would run the risk of overstating MUPTE need. That is certainly not the case here.

Non-Rent Revenues

Table 4 summarizes the various sources of revenue for the project in addition to standard rent planned for the occupancy for units. All revenue categories are standard or increasingly common for new, urban-style apartment development.

Table 4 – Penn Avenue Project Market Apartment Non-Rent Assumptions

		Annual Income	
Income Source	**Penn Avenue**	**Units**	**2023**
Parking	$180	17	$36,720
Electric Vehicle Parking	$300	3	$10,800
Bike Storage Boxes	$20	12	$2,880
Electric Bike Charging	$30	15	$5,400
Utilities	$113	40	$54,240
Total Non-Rent Revenue:			**$110,040**

Operating Expenses

Apartment Operating Expenses

Table 5 below provides a comparison of annual operations expenses per unit anticipated by the Applicant. For context, annual per-unit operating expenses for recent urban apartment MUPTE applicants in the City of Eugene are provided purely for context. Based upon these findings, it was assumed that operations expenses at the project are reasonable if not somewhat low.

Table 5 –Penn Avenue Project Operating Expenses Per Unit vs. Comparable Projects

	Per Unit Expenses Annually	
	Penn Avenue	**Eugene Projects**
Before Property Tax Expenses: Stabilized	$4,679	$6,700

For pro forma financial analysis in the next section of this report, PNW ECONOMICS assumes operating expenses supplied by the Applicant. While a bit lower, lower estimated expenses will tend to give more optimistic financial performance projections that would tend to reduce the importance of tax exemption on the bottom line, all things equal.

Property Taxes

Table 6 provides estimates for property taxes that will be paid on both the land as well as expected improvements value on a "Cost of Replacement" basis – the total development cost of improvements alone if built new.

Parcel taxable assessed value (TAV) data is directly from the Deschutes County Assessor's Office parcel database online (DIAL). Taxable assessed value estimated for the value of improvements assumes total improvement development costs as expressed by the Applicant and then converted to Measure 50 TAV via the Deschutes County 2023 Multifamily Exception Value Ratio of 0.461. Finally, the tax rate of

$15.8378 per $1,000 of TAV was utilized for Tax Code Area 1001 that includes the project address of 445 NE Penn Avenue in Bend, Oregon.

Table 6 – Penn Avenue Project Estimated Property Tax: Land & Improvements in FY 23

Parcel	Account #	Acres	Zoning	Land	Improvements	Total
			Cost of Replacement - Improvements	$12,698,256		
			Exception Value Ratio - Multifamily (7)	0.461		
			FY 23 Taxable Assessed Value	**$5,853,896**		
				Taxable Assessed Value (FY 23)		
445 NE Penn	105177	0.48	RH High Density Residential	$128,880	$0	$128,880
			Tax Code Area 1001 (per $1,000 TAV)	15.8378	15.8378	15.8378
			Total Property Tax - Land Only	**$2,041**	**$0**	**$2,041**
445 NE Penn	105177	0.48	RH High Density Residential	$128,880	$5,853,896	$5,982,776
			Tax Code Area 1001 (per $1,000 TAV)	15.8378	15.8378	15.8378
			Total Property Tax - Combined	**$2,041**	**$92,713**	**$94,754**

Financial Feasibility Analysis of the Penn Avenue Project

Introduction to Terms

To evaluate whether or not a project is financially feasible, that is whether or not the project meets investment rates of return benchmarks, a pro forma analysis is conducted. A pro forma is simply a financial modeling exercise to examine how a development project performs as a business investment over a specified period of time.

Variables that are modeled, or estimated, in this report are as follows:

Apartment Rent Income: The annual rent income if all apartment units in a project were occupied and charging full, assumed market rent. This grows by 3% each year.

Gross Project Income: The sum of Apartment Rent Income, Retail Lease Income (not present in this project), and Other Income streams such as parking, storage fees, electric vehicle parking fees, bike storage fees, electric bike charging fees, and utility revenue that represent utilities paid by the development and reimbursed with charges to units as part of rent.

Vacancy: 5% of apartment space and retail space is assumed to always be vacant and represent income loss.

Lease-Up Vacancy & Concessions: This category of expense reflects different sources of loss to revenue as a result of project vacancy and discounts to apartment rents to realize and keep an average 5% vacancy rate.

- In year 1 of the project only, PNW Economics assumes a standard 20% loss in potential rent income will occur due to new units being vacant prior to first occupancy ("absorption") as it leases up to at least 95% occupancy.

Effective Gross Income: Gross Project Income less Vacancy and Lease-Up Vacancy & Concessions.

Apartment Operating Expense: Annual operating expenses of $4,679 per apartment unit starting in year 1 and growing by 3% annually thereafter. In year 1 only, apartment operating expenses are reduced by the 20% absorption vacancy described in the Lease-Up Vacancy & Concessions definition.

Retail Operating Expense: The Penn Avenue project does not include retail space and, therefore, retail space operating expense.

MUPTE: When included, MUPTE is a 10-year exemption from local property taxes levied on the value of the improvement constructed in place, in this case the Penn Avenue project. Based on an estimated cost-of-replacement of $12.7 million in 2023 dollars and a local, existing total property tax rate of $0.0158378 (Tax Code Area 1001), the estimated MUPTE exemption beginning in year 1 would be $95,494. This would increase by an assumed 3% annually, consistent with the annual maximum under Oregon property tax law.

Net Operating Income (NOI): Effective Gross Income less Apartment Operating Expense plus the MUPTE (if assumed).

Construction Loan Interest: The interest (assumed to be 10.0%) paid on a construction loan for development of the property that is "taken out" or paid off by permanent, long-term debt financing. Such interest is only paid during the duration of construction activity until permanent financing is secured.

Equity: The share of total development cost that is funded by invested dollar assets rather than by debt.

Debt Service: The annual, fixed debt service payment made by the developer for permanent debt financing of the project.

Before Tax Cash Flow: Net Operating Income Less Debt Service.

Cash-on-Cash Return: Before Tax Cash Flow divided by development equity ($4.44 million in this analysis). Cash-on-Cash Return is also known as Return on Equity and usually needs to be at least 6%-7% in early years of a project to be a satisfactory investment for equity partners in a project. This can vary depending upon developer and equity partners, however.

Loan-To-Cost (LTC): The amount of debt a project can take on as a percentage of its cost to develop. This analysis assumes a 65% LTC ratio. In the current lending environment, commercial lenders have required at least 35% equity share of total project cost, for maximum LTC of 65%. In the current environment, LTC will likely continue to decrease through 2023-24.

Capitalization ("Cap") Rate: The percentage rate factor utilized to translate capitalize the Net Operating Income of an asset into its market value. The better an asset and/or the stronger the market for that asset, lower the cap rate tends to be. The weaker the asset and/or the worse the market for that asset, the higher the cap rate tends to be.

Value (Market Value): Net Operating Income divided by the Cap Rate. The market value of the real estate asset when potentially sold on the commercial real estate market, or purely for appraisal purposes.

Net Proceeds: (Market) Value in any particular year less cumulative payments of principal on the permanent loan.

Project Profit: In any particular year, Net Proceeds less Initial Equity invested by equity sources.

(Equity) Investor Distribution: One half of Project Profit in any particular year.

Yield: The rate of return in any specific year that factors initial equity investment outflow, investor distributions inflow, and number of years the investor(s) has committed equity including pre-development years.

Extended Internal Rate of Return (XIRR): The total rate of return on equity invested when factoring in the cumulative time investors have held interest in a project during development and during project operations, as well as investor cash-out of their initial investment. XIRR is calculated when inflows and outflows occur at some monthly basis rather than cumulative annual basis. When transactions are more simply accounted on an annual basis, Internal Rate of Return calculation is more standard. A 10% XIRR (IRR) is considered a minimum rate of return to make the risk of a real estate development attractive to the equity investment required for a project to be financed.

Penn Avenue Project Pro Forma Without MUPTE

Table 7 reports the cash flow analysis of the pro forma for the Penn Avenue project without a MUPTE.

Table 7 – Penn Avenue Project Net Operating Income & Cash Flow Without MUPTE

	Ann. Esc.	Year 1 2024	Year 2 2025	Year 3 2026	Year 4 2027	Year 5 2028	Year 6 2029	Year 7 2030	Year 8 2031	Year 9 2032	Year 10 2033
Apartment Rent Income	3%	$999,380	$1,029,362	$1,060,242	$1,092,050	$1,124,811	$1,158,556	$1,193,312	$1,229,112	$1,265,985	$1,303,964
Other - Parking	3%	*$30,257*	*$38,956*	*$40,125*	*$41,329*	*$42,569*	*$43,846*	*$45,161*	*$46,516*	*$47,911*	*$49,349*
Other - EV Parking	3%	*$8,899*	*$11,458*	*$11,801*	*$12,155*	*$12,520*	*$12,896*	*$13,283*	*$13,681*	*$14,092*	*$14,514*
Other - Bike Storage	3%	*$2,373*	*$3,055*	*$3,147*	*$3,241*	*$3,339*	*$3,439*	*$3,542*	*$3,648*	*$3,758*	*$3,870*
Other - Electric Bike Charging	3%	*$4,450*	*$5,729*	*$5,901*	*$6,078*	*$6,260*	*$6,448*	*$6,641*	*$6,841*	*$7,046*	*$7,257*
Other - Utilities Revenue	3%	*$44,694*	*$57,543*	*$59,270*	*$61,048*	*$62,879*	*$64,765*	*$66,708*	*$68,710*	*$70,771*	*$72,894*
Other Income		$90,673	$116,741	$120,244	$123,851	$127,567	$131,394	$135,335	$139,395	$143,577	$147,885
Gross Project Income		**$1,090,053**	**$1,146,103**	**$1,180,486**	**$1,215,901**	**$1,252,378**	**$1,289,949**	**$1,328,647**	**$1,368,507**	**$1,409,562**	**$1,451,849**
- Stabilized Vacancy	5%	($54,503)	($57,305)	($59,024)	($60,795)	($62,619)	($64,497)	($66,432)	($68,425)	($70,478)	($72,592)
- Lease-Up Vacancy & Concessions	-20%	($163,508)	$0	$0	$0	$0	$0	$0	$0	$0	$0
= Effective Gross Income (EGI)		**$872,042**	**$1,088,798**	**$1,121,462**	**$1,155,106**	**$1,189,759**	**$1,225,452**	**$1,262,215**	**$1,300,082**	**$1,339,084**	**$1,379,257**
Apartment Operating Expense	3%	($149,722)	($183,128)	($188,622)	($194,281)	($200,109)	($206,112)	($212,296)	($218,665)	($225,225)	($231,981)
Property Tax (Land)	3%	($2,102)	($2,165)	($2,230)	($2,297)	($2,366)	($2,437)	($2,510)	($2,586)	($2,663)	($2,743)
Property Tax (Improvements)	3%	($95,494)	($98,359)	($101,310)	($104,349)	($107,480)	($110,704)	($114,025)	($117,446)	($120,969)	($124,598)
- Operating Expenses		**($247,318)**	**($283,653)**	**($292,162)**	**($300,927)**	**($309,955)**	**($319,254)**	**($328,831)**	**($338,696)**	**($348,857)**	**($359,323)**
+ MUPTE		**$0**	**$0**	**$0**	**$0**	**$0**	**$0**	**$0**	**$0**	**$0**	**$0**
= Net Operating Income (NOI)		**$624,724**	**$805,145**	**$829,299**	**$854,178**	**$879,804**	**$906,198**	**$933,384**	**$961,385**	**$990,227**	**$1,019,934**
- Construction Loan Interest (10.0%)		($556,182)	$0	$0	$0	$0	$0	$0	$0	$0	$0
- Debt Service (65% Loan-to-Cost)		($296,917)	($593,833)	($593,833)	($593,833)	($593,833)	($593,833)	($593,833)	($593,833)	($593,833)	($593,833)
= Before Tax Cash Flow		($228,374)	$211,312	$235,466	$260,345	$285,971	$312,365	$339,551	$367,552	$396,394	$426,101

Analysis finds the following:

- Lease-up vacancy and collections loss (assumed to average 20%) costs the project roughly $220,000 in Effective Gross Income (EGI) in the analysis, reflecting that the project will take some time in its first year to fill up.

- Operating expenses are estimated to grow from roughly $150,000 in Year 1 to almost $232,000 annually by project Year 10.
- The property tax bill for improvements put in place is estimated to grow from roughly $95,500 in Year 1 to almost $125,000 by Year 10. Property tax bill growth is due solely to the Measure 50 3% taxable assessed value growth rate cap.
- Net Operating Income (NOI), calculated as EGI less Operating Expenses (which include property taxes), is estimated to grow from nearly $625,000 in Year 1 to roughly $1.02 million by Year 10.
- Except for the first year, when the project is assumed to only be 80% occupied due to active lease-up and construction loan interest is attributed, Cash Flow is positive and grows from roughly $211,000 in Year 2 to approximately $426,000 by Year 10. Again, Cash Flow is calculated as that year's NOI less any debt service payments. Debt service for the project is significant, estimated to be roughly $600,000 annually.

Given the above cash flow findings, Figure 8 provides Measures of Return for the Penn Avenue project without a MUPTE. Two measures of return are displayed at the bottom of Table 8: Extended Internal Rate of Return (XIRR – utilized by the Applicant) and Cash-on-Cash Return, another measure of attractiveness of a project to equity investors for context.

Table 8 – Penn Avenue Project Measures of Return Without MUPTE

Value - 5.5% Cap Rate	5.5%	$11,358,623	$14,639,002	$15,078,172	$15,530,517	$15,996,432	$16,476,325	$16,970,615	$17,479,734	$18,004,126	$18,544,249
Equity Holding Period (Year)		1	2	3	4	5	6	7	8	9	10
Interest Payment		($495,232)	($488,968)	($482,328)	($475,289)	($467,829)	($459,920)	($451,538)	($442,652)	($433,233)	($423,249)
Principal Payment		($98,601)	($104,865)	($111,505)	($118,544)	($126,004)	($133,913)	($142,296)	($151,181)	($160,600)	($170,584)
Net Proceeds		$3,203,358	$6,588,602	$7,139,277	$7,710,166	$8,302,086	$8,915,892	$9,552,477	$10,212,777	$10,897,769	$11,608,478
Less: Initial Equity		$4,444,390	$4,444,390	$4,444,390	$4,444,390	$4,444,390	$4,444,390	$4,444,390	$4,444,390	$4,444,390	$4,444,390
Project Profit		($1,241,032)	$2,144,212	$2,694,888	$3,265,776	$3,857,696	$4,471,502	$5,108,088	$5,768,387	$6,453,380	$7,164,088
Investor Distribution		($620,516)	$1,072,106	$1,347,444	$1,632,888	$1,928,848	$2,235,751	$2,554,044	$2,884,194	$3,226,690	$3,582,044
Yield		-3.0%	3.7%	3.9%	4.0%	4.1%	4.2%	4.2%	4.3%	4.3%	4.3%
Equity Holding Period (Years)											
Equity + Investor Distribution		$3,823,874	$5,516,496	$5,791,833	$6,077,278	$6,373,238	$6,680,141	$6,998,433	$7,328,583	$7,671,080	$8,026,434
50% of Cash Flow		($114,187)	$105,656	$117,733	$130,173	$142,985	$156,182	$169,775	$183,776	$198,197	$213,050
Extended Internal Rate of Return (XIRR)		**-7.3%**	**6.5%**	**6.6%**	**6.7%**	**6.8%**	**6.9%**	**6.9%**	**6.9%**	**7.0%**	**7.0%**
Cash-on-Cash Return		-5.1%	4.8%	5.3%	5.9%	6.4%	7.0%	7.6%	8.3%	8.9%	9.6%

Without a MUPTE, the 40-unit Penn Avenue project, including 12 units with rents restricted to 30% of 120% of AMI, is estimated to have **a maximum Extended Internal Rate of Return (XIRR) of 7.0%** for any equity holding period in the first ten years.

In other words, when investors place their own equity into this project, no matter how quickly after the project fills up or how long after they hold and receive cash disbursements as return before they ultimately cash out, those investors considering this project are estimated to never earn more than 7.0% on their money.

7.0% maximum XIRR, or equivalently Internal Rate of Return (IRR), is insufficiently low because they have choices that will be far better. Investors weigh different opportunities for best choice, their risk, and the relative return for that risk. Considering that a balanced, traditional stock portfolio will tend to average 8% growth annually, a 7.0% XIRR is below that and an investor would be better off simply investing in traditional stock funds or finding another equity investment opportunity with measurably better XIRR/IRR.

Given that real estate development is significantly riskier than traditionally stock portfolios, particularly a project that is unprecedented in the market area where it will be located, XIRR/IRR needs to higher than just 8% to pay higher return for the higher risk taken. PNW ECONOMICS agrees with the Applicant that a 10% XIRR/IRR minimum is a reasonable benchmark of whether equity investment will be interested in a real estate development project. 10% would reflect a 2% risk premium over lower effort, lower risk traditional stock portfolio rate of return.

Conclusion: The Penn Avenue project, including 12 of 40 units rent-restricted to be affordable to households earning not more than 120% of Area Median Income (AM), is not financially feasible on its own.

- 30% of available units would earn below-market rents, reducing potential project Net Operating Income.
- The project would cost the same to build with or without income-restricted units, and cost the same to finance making the same annual debt service payments.
- Less rent revenue and no reduction in development costs or project financing costs translates into a lower Cash Flow project with too-low measures of rate of return, starting with Extended Internal Rate of Return (XIRR).
- Being unable to offer a competitive rate of return for the risk, the project would be highly unlikely to attract the necessary equity to make up the total cost of the project that cannot be financed (35%).

Penn Avenue Project Pro Forma WITH MUPTE

Table 9 reports the cash flow analysis of the pro forma for the Penn Avenue project with a MUPTE. All operations findings are the same as the Without MUPTE scenario, except for the addition of the property tax exemption each year equal to the value of the property taxes paid on improvements put in place.

Table 9 – Penn Avenue Project Net Operating Income & Cash Flow WITH MUPTE

	Ann. Esc.	Year 1 2024	Year 2 2025	Year 3 2026	Year 4 2027	Year 5 2028	Year 6 2029	Year 7 2030	Year 8 2031	Year 9 2032	Year 10 2033
Apartment Rent Income	3%	$999,380	$1,029,362	$1,060,242	$1,092,050	$1,124,811	$1,158,556	$1,193,312	$1,229,112	$1,265,985	$1,303,964
Other - Parking	3%	*$30,257*	*$38,956*	*$40,125*	*$41,329*	*$42,569*	*$43,846*	*$45,161*	*$46,516*	*$47,911*	*$49,349*
Other - EV Parking	3%	*$8,899*	*$11,458*	*$11,801*	*$12,155*	*$12,520*	*$12,896*	*$13,283*	*$13,681*	*$14,092*	*$14,514*
Other - Bike Storage	3%	*$2,373*	*$3,055*	*$3,147*	*$3,241*	*$3,339*	*$3,439*	*$3,542*	*$3,648*	*$3,758*	*$3,870*
Other - Electric Bike Charging	3%	*$4,450*	*$5,729*	*$5,901*	*$6,078*	*$6,260*	*$6,448*	*$6,641*	*$6,841*	*$7,046*	*$7,257*
Other - Utilities Revenue	3%	*$44,694*	*$57,543*	*$59,270*	*$61,048*	*$62,879*	*$64,765*	*$66,708*	*$68,710*	*$70,771*	*$72,894*
Other Income		$90,673	$116,741	$120,244	$123,851	$127,567	$131,394	$135,335	$139,395	$143,577	$147,885
Gross Project Income		**$1,090,053**	**$1,146,103**	**$1,180,486**	**$1,215,901**	**$1,252,378**	**$1,289,949**	**$1,328,647**	**$1,368,507**	**$1,409,562**	**$1,451,849**
- Stabilized Vacancy	5%	($54,503)	($57,305)	($59,024)	($60,795)	($62,619)	($64,497)	($66,432)	($68,425)	($70,478)	($72,592)
- Lease-Up Vacancy & Concessions	-20%	($163,508)	$0	$0	$0	$0	$0	$0	$0	$0	$0
= Effective Gross Income (EGI)		**$872,042**	**$1,088,798**	**$1,121,462**	**$1,155,106**	**$1,189,759**	**$1,225,452**	**$1,262,215**	**$1,300,082**	**$1,339,084**	**$1,379,257**
Apartment Operating Expense	3%	($149,722)	($183,128)	($188,622)	($194,281)	($200,109)	($206,112)	($212,296)	($218,665)	($225,225)	($231,981)
Property Tax (Land)	3%	($2,102)	($2,165)	($2,230)	($2,297)	($2,366)	($2,437)	($2,510)	($2,586)	($2,663)	($2,743)
Property Tax (Improvements)	3%	($95,494)	($98,359)	($101,310)	($104,349)	($107,480)	($110,704)	($114,025)	($117,446)	($120,969)	($124,598)
- Operating Expenses		**($247,318)**	**($283,653)**	**($292,162)**	**($300,927)**	**($309,955)**	**($319,254)**	**($328,831)**	**($338,696)**	**($348,857)**	**($359,323)**
+ MUPTE		**$95,494**	**$98,359**	**$101,310**	**$104,349**	**$107,480**	**$110,704**	**$114,025**	**$117,446**	**$120,969**	**$124,598**
= Net Operating Income (NOI)		**$720,218**	**$903,504**	**$930,609**	**$958,528**	**$987,283**	**$1,016,902**	**$1,047,409**	**$1,078,831**	**$1,111,196**	**$1,144,532**
- Construction Loan Interest (10.0%)		($556,182)	$0	$0	$0	$0	$0	$0	$0	$0	$0
- Debt Service (65% Loan-to-Cost)		($296,917)	($593,833)	($593,833)	($593,833)	($593,833)	($593,833)	($593,833)	($593,833)	($593,833)	($593,833)
= Before Tax Cash Flow		($132,880)	$309,671	$336,776	$364,694	$393,450	$423,069	$453,576	$484,998	$517,363	$550,699

Analysis finds the following:

- Effective Gross Income for the project under this scenario is identical to the No MUPTE scenario. That is, after a first year of reduced revenue due to units being vacant prior to full lease-up, EGI is positive in Year 2 and grows to $1.452 million by Year 10 in this analysis.
- Identically to the No MUPTE scenario, operating expenses are estimated to grow from roughly $150,000 in Year 1 to almost $232,000 annually by project Year 10.
- **Value of the MUPTE:** The 10-year property tax exemption for this project (based on the value of property tax on improvements), if awarded, is estimated to **grow from roughly $95,500 in Year 1 to almost $125,000 by Year 10**.
- Net Operating Income (NOI), calculated as EGI less Operating Expenses (which include property taxes, but exempted in the With MUPTE scenario), is estimated to grow from roughly $720,000 in Year 1 to almost $1.145 million by Year 10 due to the enhancement of the MUPTE.
- After the project is entirely leased up (by 2025), Cash Flow is positive and grows from roughly $310,000 in Year 2 to approximately $551,000 by Year 10.

Given the above cash flow findings, Figure 10 provides Measures of Return for the Penn Avenue project WITH a MUPTE. The same two measures of return are displayed at the bottom of Table 9: Extended Internal Rate of Return (XIRR – utilized by the Applicant) and Cash-on-Cash Return

With a MUPTE, the 40-unit Penn Avenue project, including 12 units with rents restricted to 30% of 120% of AMI, is estimated to have **a maximum Extended Internal Rate of Return (XIRR) of 11.7%**, with XIRR calculated to exceed the benchmark of 10% through the fourth year of the project.

Table 10 – Penn Avenue Project Measures of Return WITH MUPTE

Value - 5.5% Cap Rate	5.5%	$13,094,882	$16,427,348	$16,920,168	$17,427,773	$17,950,607	$18,489,125	$19,043,799	$19,615,113	$20,203,566	$20,809,673
Equity Holding Period (Year)		1	2	3	4	5	6	7	8	9	10
Interest Payment		($495,232)	($488,968)	($482,328)	($475,289)	($467,829)	($459,920)	($451,538)	($442,652)	($433,233)	($423,249)
Principal Payment		($98,601)	($104,865)	($111,505)	($118,544)	($126,004)	($133,913)	($142,296)	($151,181)	($160,600)	($170,584)
Net Proceeds		$4,939,616	$8,376,948	$8,981,274	$9,607,423	$10,256,260	$10,928,691	$11,625,661	$12,348,156	$13,097,210	$13,873,901
Less: Initial Equity		$4,444,390	$4,444,390	$4,444,390	$4,444,390	$4,444,390	$4,444,390	$4,444,390	$4,444,390	$4,444,390	$4,444,390
Project Profit		$495,227	$3,932,558	$4,536,884	$5,163,033	$5,811,871	$6,484,302	$7,181,271	$7,903,766	$8,652,820	$9,429,512
Investor Distribution		$247,613	$1,966,279	$2,268,442	$2,581,517	$2,905,935	$3,242,151	$3,590,636	$3,951,883	$4,326,410	$4,714,756
Yield		1.1%	6.3%	6.1%	5.9%	5.7%	5.6%	5.5%	5.4%	5.4%	5.3%
Equity Holding Period (Years)											
Equity + Investory Distribution		$4,692,003	$6,410,669	$6,712,832	$7,025,906	$7,350,325	$7,686,540	$8,035,025	$8,396,273	$8,770,800	$9,159,145
50% of Cash Flow		($66,440)	$154,835	$168,388	$182,347	$196,725	$211,534	$226,788	$242,499	$258,681	$275,349
Extended Internal Rate of Return (XIRR)		**1.7%**	**11.7%**	**10.7%**	**10.1%**	**9.7%**	**9.4%**	**9.2%**	**9.1%**	**8.9%**	**8.8%**
Cash-on-Cash Return		-3.0%	7.0%	7.6%	8.2%	8.9%	9.5%	10.2%	10.9%	11.6%	12.4%

In other words, the annual exemption of property tax payments, which are calculated to grow from roughly $95,400 in Year 1 to $124,600 by Year 10, make a significant difference to the rate of return for investors who will be needed to make this project happen under known market conditions.

- 10.1% to 11.7% XIRR (IRR) with a MUPTE exceeds the 10% benchmark to attract equity investment;
- XIRR with the MUPTE exceeds the long-term stock portfolio average of 8% annually; and
- XIRR with the MUPTE certainly exceeds the 6.5% to 7.0% XIRR without the MUPTE.

Conclusion: The Penn Avenue project, including 12 of 40 units rent-restricted to be affordable to households earning not more than 120% of Area Median Income (AM), approaches financial feasibility with the MUPTE and only with compared to the No MUPTE scenario.