# REVIEW OF FINANCIAL FEASIBILITY

# JACKSTRAW PROJECT KILLIAN 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 Killian Development Jackstraw 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 Jackstraw project in the Old Mill District of Bend. The following table provides a concise summary of the outcome of not awarding and awarding a MUPTE to the project, which comprises 313 apartment units and 17,500 square feet of retail space.

**Table 1 – Jackstraw Project Measures of Return With & Without MUPTE: 313 Units & 17,500 Sq. Ft. Retail**

| NO MUPTE | Residential | Retail | Total |
|---|---|---|---|
| Net Operating Income (NOI) | $6,878,606 | $691,909 | $7,570,515 |
| Total Development Cost | | | $171,197,197 |
| | Return on Investment (Cost) - NO MUPTE | | 4.4% |
| **YES MUPTE** | **Residential** | **Retail** | **Total** |
| Net Operating Income (NOI) | $8,056,220 | $734,534 | $8,790,754 |
| Total Development Cost | | | $171,197,197 |
| | Return on Investment (Cost) - MUPTE | | 5.1% |

**<u>Without MUPTE Conclusion:</u> The Jackstraw project has very challenging financial feasibility on its own.**

- Employing a minimum Return on Investment (Cost) measure of return of 6% as a result of thumb for project pursuit, the Jackstraw project's income does not justify its operating expenses, with an ROI of only 4.4%. The rule-of-thumb minimum ROI of 6% would indicate the project would be difficult to pull, all things equal.

**<u>With MUPTE Conclusion:</u> The Jackstraw project approaches financial feasibility with the MUPTE and only with the tax exemption compared to the No MUPTE scenario.**

- A MUPTE awarded that would reduce a roughly $1.2 million property tax burden for the development is estimated to enhance ROI for the project to 5.1% compared to 4.4% without the MUPTE.
- Although a MUPTE award would significantly enhance expected feasibility of the project and enhance assurance of its success, the estimated ROI with the MUPTE still does not fully rise to the applied 6% rule-of-thumb minimum. In other words, the MUPTE is a critical aid in this project happening, but it can still be viewed as a challenged project with higher risk.

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

- The Jackstraw project has rents and operating assumptions that are seemingly consistent with market conditions in Bend among newer projects.
- Development costs of the project are seemingly consistent with current construction market conditions, as verified by a comparable, planned project in the Eugene downtown market.

Otherwise overall, it was found that the Jackstraw MUPTE Application financial analysis used reasonable assumptions. Much of the independent pro forma analysis in this report utilizes similar assumptions as the Applicant. Differences in assumptions are noted in this document. The most notable difference would be that PNW ECONOMICS estimates property tax burden of this project, and the value of the MUPTE, are slightly higher than estimated by the Applicant.

# 2. Financial Feasibility Analysis

## 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 documents that 49% of total development cost will be debt financed, while 51% will be equity-financed. Although extremely unusual just a few years ago, a 50%-50% debt and equity split is consistent with observed market on other projects.

**Table 2 – Jackstraw Project Permanent Debt Finance Assumptions**

| | 313 Units 2023 Dollars |
|---|---|
| **Total Development Cost** | $171,197,197 |
| **Permanent Loan** | $84,000,000 |
| **Equity** | $87,197,197 |
| **Percent Financed** | 49% |

## Development Costs

The Applicant declares in the Jackstraw MUPTE application a total development cost of $171,197,198 development cost for the 313-unit, 480,000 square-foot improvement. The project's more urban orientation, combined parking structure and size make it a bit incomparable to Bend projects of recent development for comparisons. Accordingly, PNW Economics compares the project to the Riverfront 3A mixed-use development in Eugene as somewhat of a peer comparable for size, parking, mix of uses, and vintage of cost information. Table 3 provides a comparison of both projects with appropriate details.

The Jackstraw project overall has development cost metrics not unlike the peer reviewed Eugene Riverfront 3A project.

- Total Cost per Unit: $546,956 (Jackstraw) vs. $534,904 (Riverfront 3A)
- Total Cost per Sq. Ft.: $357 (Jackstraw) vs. $464 (Riverfront 3a)

**Table 3 – Jackstraw Project Permanent Debt Finance Assumptions**

| | Bend Jackstraw | Eugene Riverfront 3A |
|---|---|---|
| **Units** | **313** | **237** |
| **Total Sq. Ft.** | **480,000** | **272,983** |
| Land Acquisition | $7,662,931 | $2,782,504 |
| Hard Costs | $127,186,251 | $96,444,138 |
| Soft Costs & Contingencies | $36,348,016 | $27,545,538 |
| Total Development Costs | **$171,197,198** | **$126,772,180** |
| **Total Cost Per Unit** | $546,956 | $534,904 |
| **Total Cost per Sq. Ft.** | $357 | $464 |

Both projects have similar scale, though Jackstraw is larger: more residential units, slightly more commercial space, and certainly more parking spaces. Per square foot costs are lower at Jackstraw, though cost per unit is higher at Jackstraw largely by virtue of a larger parking garage and public street improvements taken on by Jackstraw that the Eugene project does not have. On the other hand, the Eugene project had significant non-clean fill soil removal and at-cost disposal costs. Overall, the cost comparison indicates Jackstraw development costs are on-par with market for larger mid-rise, mixed-use redevelopment in urban Oregon markets.

## Assumed Rents & Escalation

Table 4 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 4 – Jackstraw Project Market Apartment Rent Assumptions – 313 Units**

| MARKET RATE<br>Unit Type | Unit Mix<br>Units | Percentage | Average Unit<br>Size (Sq. Ft.) | Monthly<br>Rent | Rent per<br>Square Foot |
|---|---|---|---|---|---|
| Studio | 15 | 5% | 483 | $1,824 | $3.78 |
| One bedroom | 189 | 61% | 669 | $2,167 | $3.24 |
| Two bedroom | 91 | 29% | 1,091 | $2,993 | $2.74 |
| Three bedroom | 16 | 5% | 1,460 | $3,360 | $2.30 |
| **Subtotals/Averages** | **311** | **100%** | **824** | **$2,453** | **$2.98** |
| **INCOME RESTRICTED<br>Unit Type** | **Unit Mix<br>Units** | **Percentage** | **Average Unit<br>Size (Sq. Ft.)** | **Monthly<br>Rent** | **Rent per<br>Square Foot** |
| Studio | 0 | 0% | 0 | $0 | $0.00 |
| One bedroom | 0 | 0% | 0 | $0 | $0.00 |
| Two bedroom (TH) | 2 | 100% | 1,481 | $1,080 | $0.73 |
| **Subtotals/Averages** | **2** | **100%** | **1,481** | **$1,080** | **$0.73** |

Rents overall appear slightly higher than most other new market rate projects, though that is to be expected from under construction/newest product being delivered to the market. The Jackstraw project also has superior mixed-use district location, grocery store proximity and river/trail compared to most other newer projects, thus some kind of rent premium for superior location would be expected. Examples of going market projects include:

- **The Nest** (1609 SW Chandler Avenue, Bend): 1,049 square foot 2 bed/2 bath for $2,637 average ($2.51 per square foot)
- **Solis at Petrosa** (63190 Deschutes Market Road):
  - 620 square foot 1 bed/1 bath for $1,770 average ($2.85 per square foot).
  - 901 square foot (average) 2 bed/2 bath for $2,250 average ($2.50 per square foot).
  - 1,109 square foot 3 bed/2 bath for $2,545 ($2.29 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).

As was stated, Jackstraw rents are slightly higher than current market rents at newer projects. Between a rent premium for being the absolutely newest project in the peer group, as well as having the best single location for a mixed-use project in the Old Mill District, slightly higher rents at Jackstraw should be expected. From a MUPTE-modeling perspective, 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 are inexplicably low relative to market would run the risk of overstating MUPTE need. That is not the case here.

### Non-Rent Revenues

Table 5 summarizes the various sources of revenue for the project in addition to standard rent planned for the occupancy for units. The key feature of the project will be secured parking (212 spaces) for residential tenants for $150 per space in 2023, as well as 133 spaces for $75 per month as an option for residents, but with shared access with visitors. Retail tenants and customers will not pay parking fees under the Jackstraw plan.

**Table 5 – Jackstraw Project Mixed-Use Non-Rent Income Assumptions**

| | Monthly | Jackstraw - Annual | |
|---|---|---|---|
| **Non-Rent Revenue** | **Jackstraw** | **Units** | **2023** |
| Parking - Residential | $150 | 212 | $381,600 |
| Parking - Shared Residential | $75 | 133 | $119,700 |
| Other (Misc. Fees, Deposits) | | | $739,103 |
| Total Non-Rent Revenue: | | | **$1,240,403** |

### Operating Expenses

#### Apartment Operating Expenses

Table 6 below provides a comparison of annual operations expenses per unit anticipated by the Applicant. For context, annual per-unit operating expenses for Penn Avenue, a different proposed apartment project applying for a City of Bend MUPTE as well as recent urban apartment MUPTE applicants in the City of Eugene are compared. Based upon these findings, it was assumed that operations expenses at the project are reasonable if not somewhat low, though the larger scale of the development allows lower cost-per-unit spread.

**Table 6 – Jackstraw Project Operating Expenses Per Unit vs. Comparable Projects**

| | Per Unit Expenses Annually | | |
|---|---|---|---|
| | **Jackstraw** | **Penn Avenue** | **Eugene Projects*** |
| Before Property Tax Expenses: Stabilized | $4,903 | $4,679 | $6,700 |

*Non-55+ active community projects

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. It is also acknowledged that annually, the Jackstraw project expects $75,056 in annual operating expenses for the 17,500 square feet of planned retail ($4.29 per square foot annually, or $0.36 per square foot monthly). Relatively speaking, retail operating expenses are minor compared to the much larger residential units' operating expenses attribution and do not seem unreasonable.

## Property Taxes

Table 7 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 and Commercial Exception Value Ratio of 0.441. Finally, the tax rate of $15.8378 per $1,000 of TAV was utilized for Tax Code Area 1128 that includes the project addresses of 310 SW Industrial and 350 SW Industrial in Bend, Oregon.

**Table 7 –Jackstraw Project Estimated Property Tax: Land & Improvements in FY 23**

| | |
|---|---|
| Cost of Replacement - Improvements | $157,572,080 |
| Exception Value Ratio - Multifamily (7) | 0.461 |
| **FY 23 Taxable Assessed Value** | **$72,640,729** |
| | |
| Cost of Replacement - Retail Improvements | $5,962,187 |
| Exception Value Ratio - Commercial (2) | 0.441 |
| **FY 23 Taxable Assessed Value** | **$2,629,324** |

| | | | | Taxable Assessed Value (FY 23) | | |
|---|---|---|---|---|---|---|
| Parcel | Account # | Acres | Zoning | Land | Improvements | Total |
| 310 SW Industrial Way | 167373 | 2.15 | 301 - Industrial | $469,390 | $0 | $469,390 |
| | | | Tax Code Area 1128 (per $1,000 TAV) | 15.8378 | 15.8378 | 15.8378 |
| | | | **Total Property Tax - Land Only** | **$7,434** | **$0** | **$7,434** |
| 350 SW Industrial Way | 167955 | 2.73 | 231 - Commercial | $1,306,550 | $0 | $1,306,550 |
| | | | Tax Code Area 1128 (per $1,000 TAV) | 15.8378 | 15.8378 | 15.8378 |
| | | | **Total Property Tax - Land Only** | **$20,693** | **$0** | **$20,693** |
| 310-350 SW Industrial Way | | 4.88 | 231 - Commercial | $1,775,940 | $75,270,053 | $77,045,993 |
| | | | Tax Code Area 1128 (per $1,000 TAV) | 15.8378 | 15.8378 | 15.8378 |
| | | | **Total Property Tax - Combined** | **$28,127** | **$1,192,112** | **$1,220,239** |

# Financial Feasibility Analysis of the Jackstraw 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.

Gross Project Income: The sum of Apartment Rent Income, Retail Lease Income and Other Income streams such as parking, storage fees, electric vehicle parking fees, bike storage fees, electric bike charging fees and other related fee streams.

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.

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

Apartment Operating Expense: Annual operating expenses of $4,903 per apartment unit starting in year 1.

Retail Operating Expense: $4.29 per square foot annually in retail space operating expenses for the project.

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 Jackstraw project. Based on an estimated cost-of-replacement of $75,270,053 million in 2023 dollars and a local, existing total property tax rate of $0.0158378 (Tax Code Area 1128), the estimated MUPTE exemption beginning in year 1 would be $1,220,239. 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 Project Operating Expense plus the MUPTE (if assumed).

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.

Return on Investment (Cost): The measure of financial return for the real estate development in question of this analysis, Jackstraw. The Applicant reports Net Operating Income and total development costs, leaving the primary measure of return for evaluation for the project to be Return on Investment. ROI is calculated as Net Operating Income divided by Total Development Cost. There is no hard rule for acceptable ROI for a real estate development project, but a common minimum ROI for moving forward with a development is 6%. Developers will vary on required ROI to go through with a project, but a minimum of 6% is a common minimum.

## Jackstraw Project Pro Forma Without MUPTE

Table 8 reports the Return on Investment (Cost) pro forma for the Jackstraw project without a MUPTE.

**Table 8 – Jackstraw Project NOI and ROI Without MUPTE**

| | Residential | Retail | Total |
|---|---|---|---|
| **Income** | | | |
| Lease Income | $9,159,010 | $614,250 | $9,773,260 |
| Other Income | $1,002,453 | $237,950 | $1,240,403 |
| Less: Vacancy Loss | ($508,073) | ($42,610) | ($550,683) |
| Gross Income | $9,653,390 | $809,590 | $10,462,980 |
| | | | |
| **Expenses** | | | |
| Pre-Tax Operating Expenses | ($1,534,570) | ($75,056) | ($1,609,626) |
| Property Taxes | ($1,177,614) | ($42,625) | ($1,220,239) |
| **MUPTE Awarded** | **$0** | **$0** | **$0** |
| Capital Reserves | ($62,600) | $0 | ($62,600) |
| Total Operating Expenses | ($2,774,784) | ($117,681) | ($2,892,465) |
| | | | |
| **Net Operating Income (NOI)** | **$6,878,606** | **$691,909** | **$7,570,515** |
| | | | |
| **Total Development Cost** | | | **$171,197,197** |
| | | | |
| | | **Return on Investment (Cost) - NO MUPTE** | **4.4%** |

Combining all development assumptions of the Applicant reviewed in this document, a well as some calculations that slightly vary from Applicant math – namely the likely property tax generated by the development based on cost of replacement – project ROI without a MUPTE is calculated to be 4.4%.

4.4% is certainly below the rule-of-thumb minimum ROI of 6% for a project to get lending and/or equity investment. The project without a MUPTE would be considered a challenging project to finance and/or would require very patient capital for equity investment.

PNW ECONOMICS figures vary a bit from Applicant documentation, namely in attribution of taxable land value to portions of the project, whether residential or retail. This report also estimates that property tax owed on the project will be slightly higher than what the Applicant has estimated. This greater tax owed in this analysis would only serve to show the MUPTE is more consequential than what the Applicant demonstrates.

## Jackstraw Project Pro Forma WITH MUPTE

Table 9 reports the Return on Investment (Cost) pro forma for the Jackstraw 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 – Jackstraw Project NOI and ROI WITH MUPTE

| | Residential | Retail | Total |
|---|---|---|---|
| **Income** | | | |
| Lease Income | $9,159,010 | $614,250 | $9,773,260 |
| Other Income | $1,002,453 | $237,950 | $1,240,403 |
| Less: Vacancy Loss | ($508,073) | ($42,610) | ($550,683) |
| Gross Income | $9,653,390 | $809,590 | $10,462,980 |
| | | | |
| **Expenses** | | | |
| Pre-Tax Operating Expenses | ($1,534,570) | ($75,056) | ($1,609,626) |
| Property Taxes | ($1,177,614) | ($42,625) | ($1,220,239) |
| **MUPTE Awarded** | **$1,177,614** | **$42,625** | **$1,220,239** |
| Capital Reserves | ($62,600) | $0 | ($62,600) |
| Total Operating Expenses | ($1,597,170) | ($75,056) | ($1,672,226) |
| | | | |
| **Net Operating Income (NOI)** | **$8,056,220** | **$734,534** | **$8,790,754** |
| | | | |
| **Total Development Cost** | | | **$171,197,197** |
| | | | |
| | **Return on Investment (Cost) - MUPTE** | | **5.1%** |

Assuming a MUPTE is awarded to the project, Net Operating Income for the Jackstraw is enhanced by more than $1.2 million. The result is a Return on Investment (Cost) for the project with a MUPTE equal to 5.1% in this analysis.

Award of a MUPTE certainly enhances the ROI for the project closer to the minimum rule-of-thumb 6%. The MUPTE does not, however, push the rate of return over the minimum threshold but makes the project significantly more compelling as an investment.

As already noted, different developers will use not only different measures of return, but also different criteria for a minimum and/or successful rate of return for that measure. This analysis employs a rule-of-thumb minimum of 6% return on cost for a project to be worth the risk. On this measure alone, MUPTE makes the Jackstraw project significantly more compelling than without the MUPTE. If the Applicant internally employs a lower threshold ROI for project evaluation, such as 5%, then it can be said the MUPTE not only makes the project more compelling but certainly assures the project would worth the risk and expense in a way that would not be possible without the MUPTE.