PNW Economics

Evidenced-Based Real Estate, Land Use, & Economic Development Due Diligence

MEMORANDUM

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CITY OF BEND, OREGON

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Subject: Revised MUPTE Return on Investment Findings: Hiatus Penn Avenue Project

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This memorandum summarized revised return on investment calculations for the Hiatus Penn Avenue project in Bend, Oregon for the purposes of Mixed-Use Property Tax Exemption (MUPTE) benefit consideration by the City of Bend and its partners.

In March of 2023, PNW Economics submitted to the City of Bend a review of the Penn Avenue development MUPTE application financial pro formas required by City ordinance for the MUPTE incentive program. Since that time, Hiatus Development has submitted a revised development plan that does the following:

- Increases the number of planned units at the project to 59 (from 40);
- Provides all units with a loft and deck except two ADA units; and
- Provides 27 units affordable to households earning 120% of Area Median Income, 18 of which would be deed restricted as middle-income units (up from 12 in the prior design).

The project does have updated economics along with the updated development program, thus this memorandum is a summary of updated information about the project and a review in the context of required MUPTE pro forma review.

Project Design Update & Rents

Table 1 below provides a summary the new, larger project's economics.

Table 1 – Updated Penn Avenue Development Program (Hiatus Development) & 2026 Rents

Unit Type	Unit Mix Units	Percentage	Average Unit Size (Sq. Ft.)	Monthly Rent	Rent per Square Foot
Lofted One bed	31	53%	502	$2,476	$4.93
One bed ADA (No loft, no deck)	1	2%	450	$2,250	$5.00
MUPTE Units: 120% AMI	27	46%	492	$1,772	$3.60
Subtotals/Averages	**59**	**100%**	**497**	**$2,150**	**$4.33**

Note: 27 units are planned to rent affordably to households earning no more than 120% of AMI, 18 of which will be deed restricted as "middle income" units.

Overall, units have generally gotten slightly larger and planned monthly rent for standard Lofted one-bed units increased (to $2,476 on average compared to $2,050 monthly before). Planned average rent for the 120% of AMI "MUPTE Units" are slightly lower at $1,772 (compared to $1,888 on average before). Since almost a year has passed, it is worth reviewing how those rents compare to market presently as context for what rents might be in two years. Published rents at comparable projects are found on the following page.

- **The Current** (954 SW Emkay Drive, Bend) – the newest project to delivery identified in the city:
  - 416 average square foot Studio units for $1,649 average ($3.98 per square foot).
  - 548 square foot 1 bed units for $1,809 average ($3.30 per square foot).
- **The Nest** (1609 SW Chandler Avenue, Bend):
  - 481 average square foot Studio units for $1,890 average ($3.93 per square foot).
- **Solis at Petrosa** (63190 Deschutes Market Road):
  - 620 square foot 1 beds for $1,805 average ($2.91 per square foot).
- **The Eddy Apartments** (801 SW Bradbury Way): 678 square foot 1 bed for $1,913 average ($2.82 per square foot).
- **Outpost 44 Apartments** (643 NE Ross Road) – located more distantly from the river, central commercial district amenities and east of Highway 97 thus reflecting lower rents than the rest of the peer group.
  - 734 square foot 1 beds for $1,770 average ($2.41 per square foot).
- **Jackstraw (Planned)** - The MUPTE-approved Jackstraw project has declared market rents as follows:
  - 483 average square foot Studio units for $1,824 average ($3.78 per square foot).
  - 669 average square foot 1 bed units for $2,167 average ($3.24 per square foot).
- **Timber Yards A/1 (Planned)** - This project currently has a MUPTE application under review by the City. Its declared rents are as follows:
  - 530 average square foot Studio units for $1,805 average ($3.41 per square foot).
  - 744 average square foot 1 bed units for $2,139 average ($2.88 per square foot).

Conclusion: Two years of current market rent growth can plausibly reach planned 2026 rents at the Penn Avenue project. However, what is not clear is how much of a discount by 2026 declared rents for the 120% of AMI units will be. Clarification of 120% of AMI rent levels in 2026 given current rent level context would be appropriate elaboration to ask of the Applicant.

Should restricted rents be adequately clarified, higher realized rents in the pro forma will tend to make the need for a MUPTE less likely – higher rents covering the same operating expenses will increase cash flow in a manner that helps the project approach financial feasibility without incentives. Should rents materialize lower than documented, the opposite will be true: the Penn Avenue project will have a more challenging path to financial feasibility and so a MUPTE would be more crucial to viability of the new housing units to reach market.

Project Financing Assumptions

Table 2 on the following page provides a summary of revised development costs and project permanent financing assumptions compared to the original application in 2023. Overall, with 19 additional units and a year of significant construction industry cost increases, the project is expected to cost $21.286 million, up from $12.7 million before. The project on a per-unit basis continues to be significantly lower than other projects recently reviewed by the City of Bend; Penn Avenue's total cost per unit is $360,774 compared to $475, 415 for Timber Yards A/1 and $546,956 for the Jackstraw. At only three stories and having no concrete structured parking element, the Penn Avenue project can build with wood frame ("stick built"), which is the least expensive construction method for multi-story structures.

Table 2 – Revised Project Development Costs and Permanent Financing Assumptions

	40 Units Prior Plan	59 Units Revised Plan
Total Development Cost	$12,698,256	$21,285,691
Permanent Loan	$8,253,866	$9,148,485
Equity	$4,444,390	$12,137,206
Percent Financed	65%	43%
Annual Interest Rate	6.00%	8.00%
Amortization (Years)	30	30
Annual Permanent Debt Service	($593,833)	($805,540)

Permanent financing has changed somewhat, with the project now assumed to be only 43% debt financed, the remaining 57% coming from equity investment. The prior program assumed 65% of the project cost would be financed and the remaining 35% would be equity investment. The change seems in line with lending market as higher risk lending environment generally has led to higher equity investment shares of the total capital stack.

Somewhat unexpectedly, the 30-year interest rate on the planned loan is up to 8.00%. While every developer has different lending and equity investment relationships, an 8.00% interest rate on permanent financing seems somewhat high based on review of other recent projects. The City of Bend may want to have that assumption clarified. Even so, sensitivity analysis conducted by PNW Economics indicates that it would take an interest rate well below 7% to make a measurable difference to the rate of return for the project.

Property Tax & MUPTE Calculation

With a larger project and higher cost of replacement-based value for property tax assessment, the total potential MUPTE for the Penn Avenue project has been updated for Fiscal Year 24 Deschutes County tax information. Results are found in Table 3 on the following page. The larger, more expensive project has resulted in the following Year 1 (2026) property tax estimates for analysis purposes:

- **FY 24 Taxable Assessed Value of Improvements:** $8.391 million (compared to only $5.854 million prior).

- Year 1 Property Tax on Land Only: $2,122 (compared to $2,041 prior).
- Year 1 Property Tax on Improvements Only: $134,159 (compared to $92,713 prior). *Property tax for improvements only would be the value of a MUPTE starting in Year 1 if awarded.*
- Year 1 Total Combined Property Tax: $136,281 (compared to $94,754 prior).

Table 3 – Revised Penn Avenue Project Property Tax & MUPTE Calculations for FY24

			Cost of Replacement - Improvements	$20,823,539		
			Exception Value Ratio - Multifamily (7)	0.403		
			FY 24 Taxable Assessed Value	**$8,391,886**		
				Taxable Assessed Value (FY 24)		
Parcel	**Account #**	**Acres**	**Zoning**	**Land**	**Improvements**	**Total**
445 NE Penn	105177	0.48	RH High Density Residential	$132,740	$0	$132,740
			Tax Code Area 1001 (per $1,000 TAV)	15.9868	15.9868	15.9868
			Total Property Tax - Land Only	**$2,122**	**$0**	**$2,122**
445 NE Penn	105177	0.48	RH High Density Residential	$132,740	$8,391,886	$8,524,626
			Tax Code Area 1001 (per $1,000 TAV)	15.9868	15.9868	15.9868
			Total Property Tax - Combined	**$2,122**	**$134,159**	**$136,281**

Updated Internal Rate of Return (IRR) Results: No MUPTE and Yes MUPTE

Table 4 provides annual estimates of Internal Rate of Return (IRR) for the Penn Avenue project assuming no MUPTE is awarded as well as assuming a MUPTE is awarded, for necessary comparisons. It should be noted that Hiatus Development has chosen to express rate of return utilizing IRR, when in the original application for the smaller project design, Extended Internal Rate of Return (XIRR) was the chosen measure of return.

IRR is 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. IRR utilizes cumulative, annual income and expense performance measures, while XIRR allows for different revenues and expenses in different months during the course of a year and over the course of several years. In other words, XIRR is a more complicated model. Still, we evaluate the IRR for the project assuming 10% is the generally recognized 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.

Table 4 – Updated Internal Rate of Return (IRR) – 59 Unit Penn Avenue Project: No MUPTE and Yes MUPTE

59 One-Bed Units 27 Units at 120% of AMI	Year 1 2026	Year 2 2027	Year 3 2028	Year 4 2029	Year 5 2030	Year 6 2031	Year 7 2032	Year 8 2033	Year 9 2034	Year 10 2035
NO MUPTE										
+ MUPTE	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
Internal Rate of Return	-3.6%	3.3%	3.8%	4.2%	4.4%	4.6%	4.7%	4.8%	4.9%	5.0%
YES MUPTE										
+ MUPTE	$134,159	$138,184	$142,330	$146,600	$150,998	$155,528	$160,193	$164,999	$169,949	$175,048
Internal Rate of Return	5.5%	8.5%	7.7%	7.3%	7.0%	6.9%	6.8%	6.7%	6.7%	6.6%

Overall, we find the following:

- **Without a MUPTE**, the Penn Avenue project is assured to be a financially hamstrung development as both an investment and a lending opportunity. IRR is measured to begin at -3.6% and growing over time to no more than 5.0%, always well below the rule-of-thumb minimum IRR of 10%.
- **With a MUPTE**, the Penn Avenue project is enhanced significantly in its financial feasibility to both attract investment and lending in order to be a viable project. However, a MUPTE award of $134,159 starting in Year 1 never helps the project reach the 10% minimum IRR benchmark. In other words, the project should still be considered a financially-challenged project by general standards.

It should be noted that Internal Rate of Return IRR (and Extended Internal Rate of Return - XIRR) are measures of return uniquely utilized by the Penn Avenue applicant. Therefore the 10% rule-of-thumb minimum IRR in this review will look different (higher) than rule-of-thumb criteria for reviewing other projects that have applied for a MUPTE. Those projects, including the Jackstraw, utilized Return on Investment (ROI) rather than IRR, and so review information about those projects will look different. Each measure of return are standard for such development and individual developers will choose to evaluate their own projects with different, standard measures.

Rapidly increasing construction costs and the increased cost of financing such a project are among the contributors to challenging feasibility for this project. These factors have dragged down Internal Rate of Return estimated in the previous version of this project. But in the current market, those challenges are difficult but far from unique. Given some of the updated findings about the project's information, we'd offer these observations that are "sensitivity analysis" in nature:

- If project rents – potentially high compared to market in 2026 – do not materialize as projected, the project's feasibility will be even more challenged than documented and a MUPTE will be even more crucial.
- If permanent (and construction) financing interest rates come down compared to planned by the Applicant – 8% annual interest on permanent financing in the Applicant pro forma – the project will perform better in terms of cash flow and resulting Internal Rate of Return. 8% was observed to be on the high side compared to other recent projects.