Economic Development

The Need for Improved Financing Tools

February 20, 2020
Alaska Municipal League

anchorage community development authority

AGNEW :: BECK

Introductions

Andrew Halcro
Executive Director
Anchorage Community Development Authority
ahalcro@acda.net

Shanna Zuspan, AICP
Principal::Owner
Agnew::Beck Consulting
shanna@agnewbeck.com

anchorage community development authority

What We Do

VISION: A vibrant and prosperous Municipality of Anchorage facilitated by innovative community development and public parking.

MISSION: We deliver quality development and public parking services within the Municipality of Anchorage.

How We Do It

DEVELOPMENT

ACDA brings together resources to create development using innovation, partnerships and sound planning.

ACDA is working to expand the tools available to encourage development in Anchorage.

REVITALIZATION

We're "bookending" downtown with vibrant spaces - K Street Eats and The Rooftop. This is just one way we are revitalizing the community.

COMMUNITY

We view community development as more than just new construction of buildings, it also means adding value to our community with services and partnerships.

Why Are We Here?

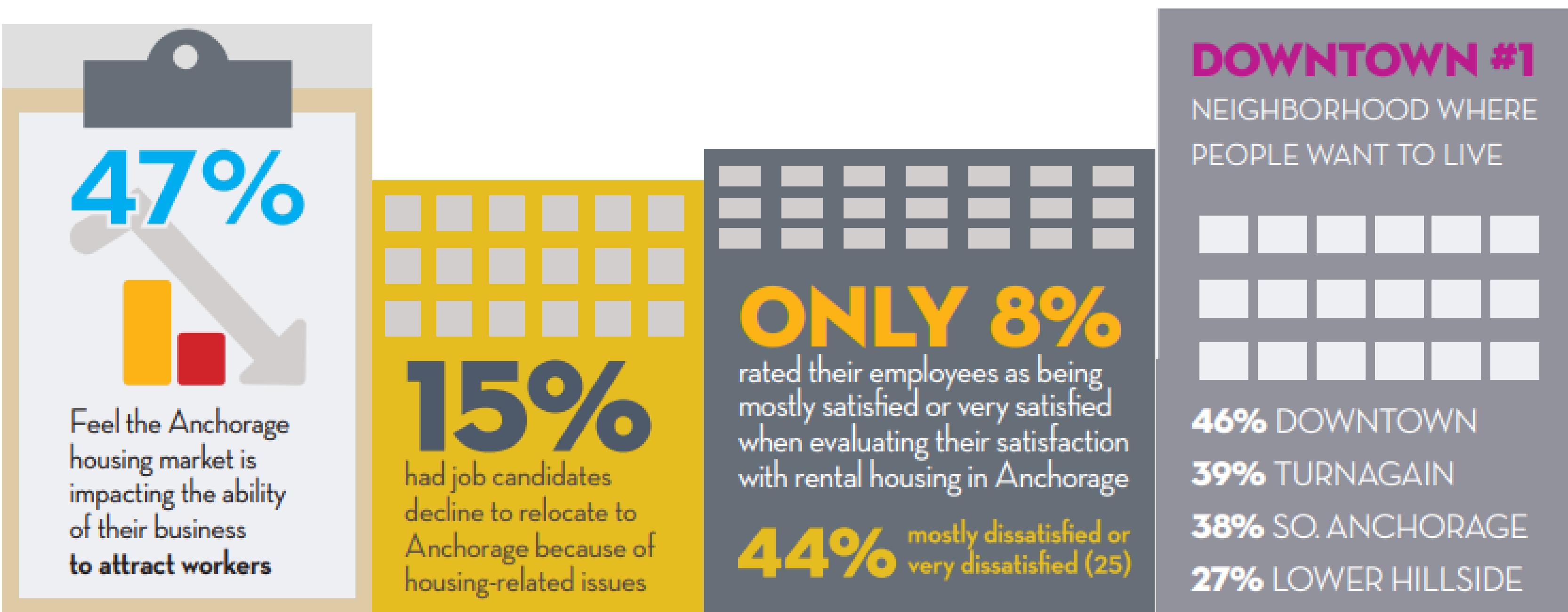
- Illustrate why it matters
- Share the math
- Propose some solutions

Why it Matters?

ECONOMIC DEVELOPMENT

Mixed Use & Housing is Economic Development

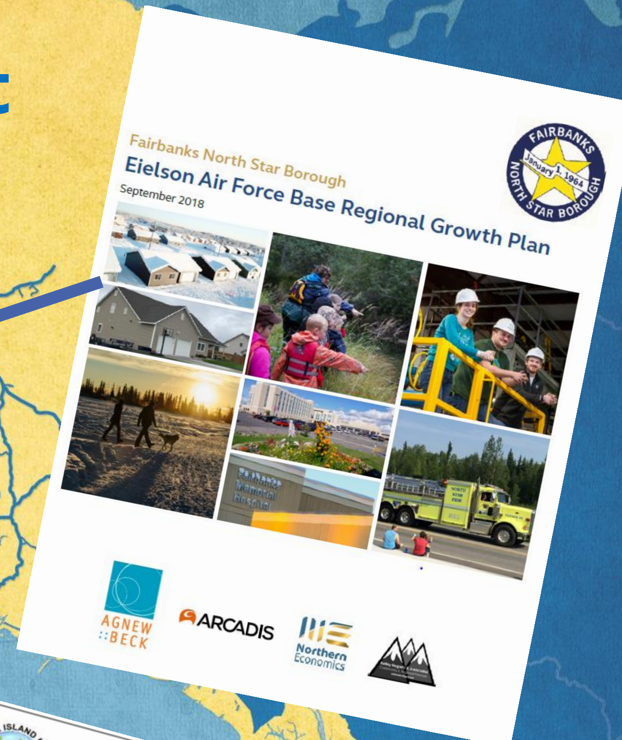
"Housing is the foundation on which Anchorage can build a stronger economic future. Lack of affordable, available and livable housing has been cited by many local businesses as a challenge to attracting and retaining employees in Anchorage." –AEDC

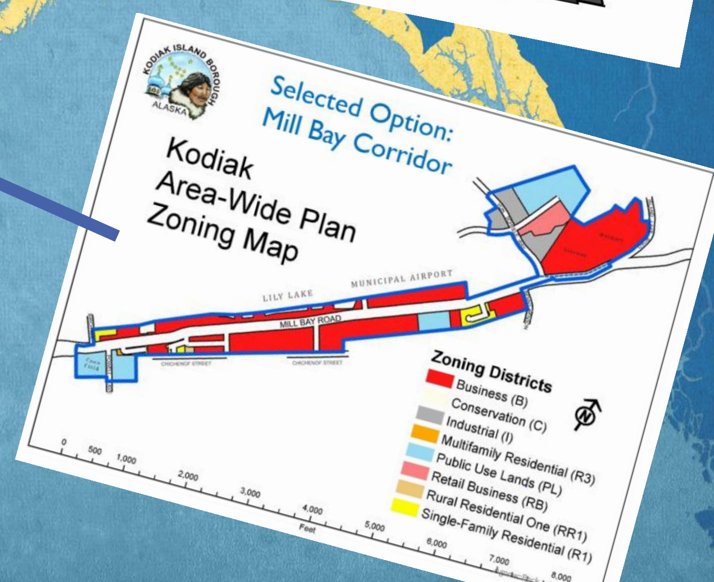


Source: Most recent AEDC Employer Survey

Housing is Economic Development

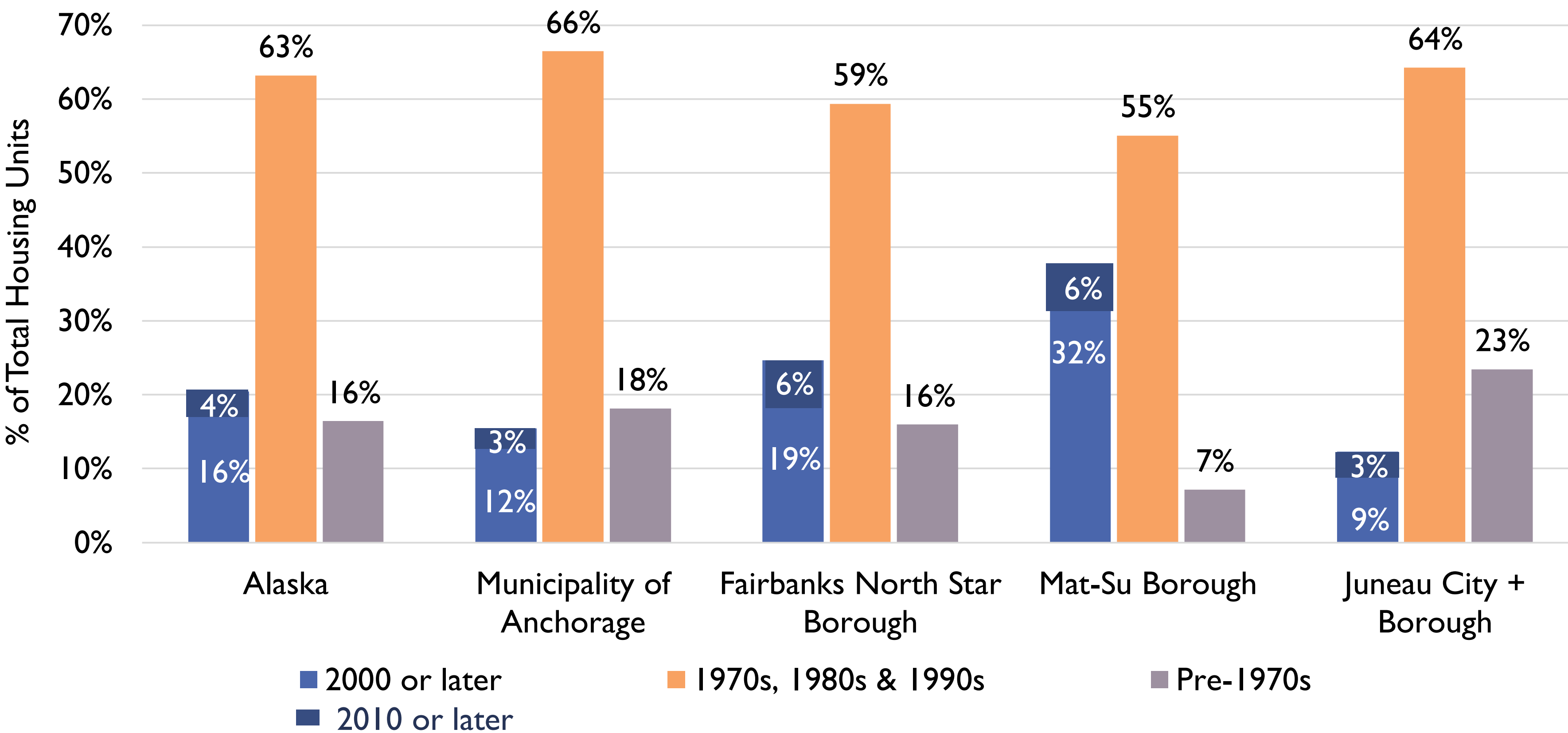
Throughout Alaska





Our Housing Stock was Built Over 20 Years Ago

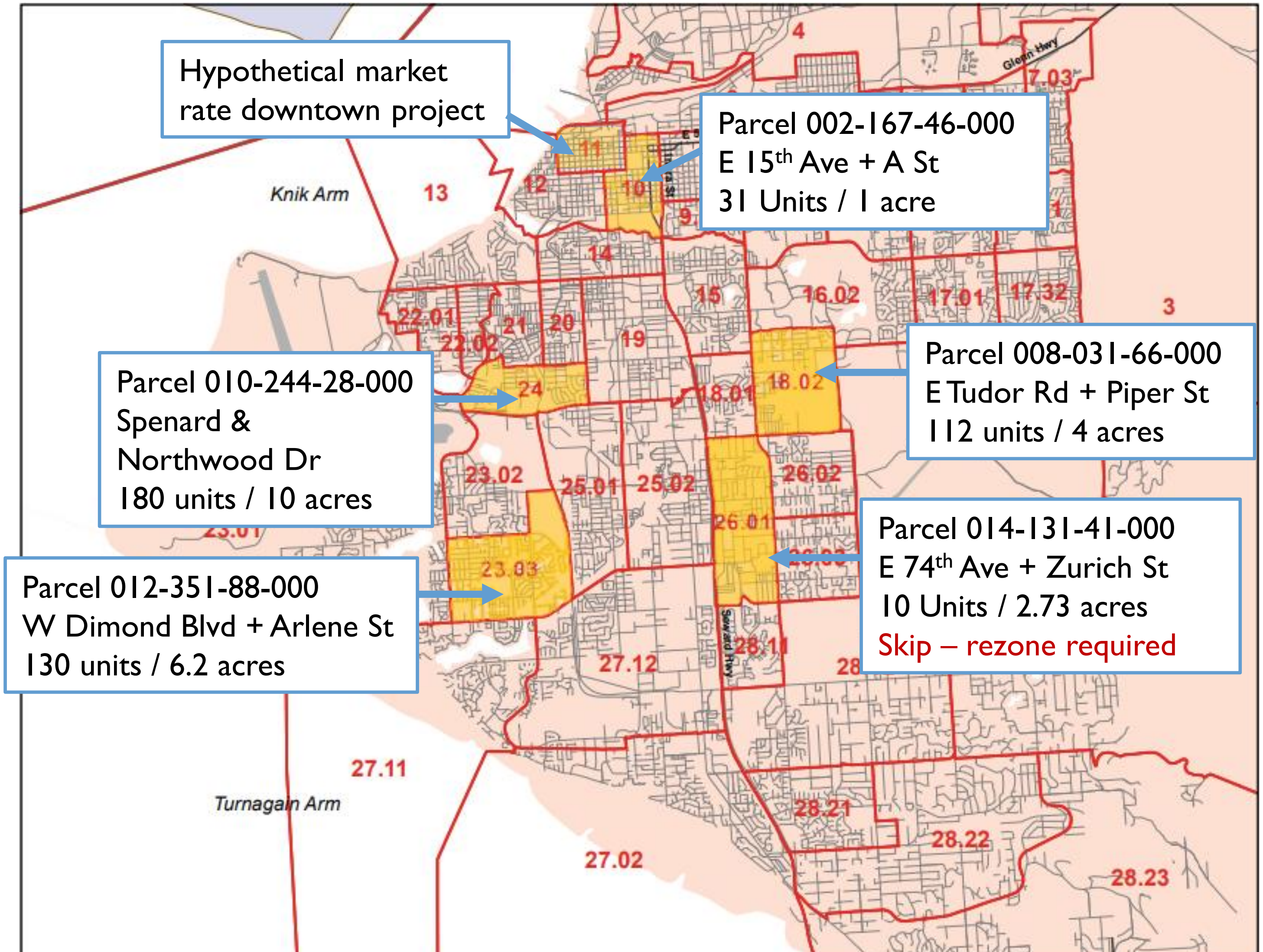
The majority of Alaska's existing housing units were built over 20 year ago and housing development has slowed significantly over the last 10 years. This is true throughout Alaska and our communities.



Financial Feasibility

LET'S LOOK AT THE MATH

6 Housing Sites Across Anchorage
All Face Feasibility Gap



Summary of Pro Forma Findings

12 Year Property Tax Incentive Reduces ~50% of the Gap

No Incentives + Market Rate Rents

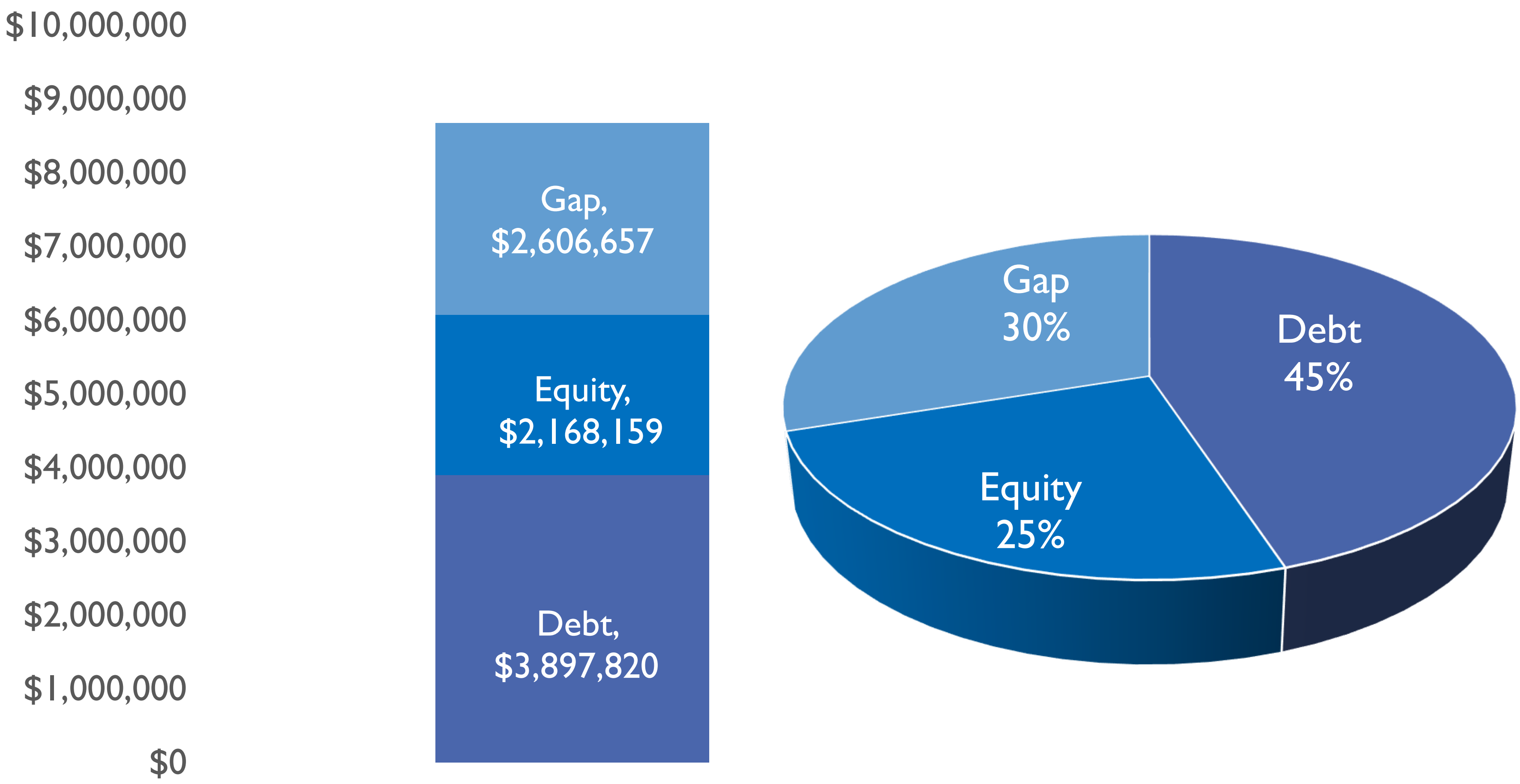
*Special Limitations

Site Name	E 15th Ave/ A St	E Tudor Rd/Piper St	Downtown Example	W 44th/ Northwood Dr	W Dimond Blvd/Arlene St
Census Tract	West Fairview	Campbell Park East	Downtown (Tract 11)	Northwood	Dimond/Jewel Lake
Lot Size (acres)	1.03	3.98	0.50	9.96	6.21
Zoning District	R4: Multifamily Residential	R3: Mixed Residential	B2C: Central Business District, Periphery	R3SL: Mixed Residential*	R3A: Residential Mixed Use
Housing Units	31	112	40	180	130
Total Development Costs (TDC)	$7,653,541	$27,014,814	$10,025,347	$48,255,178	$32,278,705
per sqft	$243	$239	$251	$250	$248
per unit	$243,489	$242,232	$250,634	$268,084	$247,637
Net Operating Income	$250,186	$906,070	$352,385	$1,485,283	$1,030,308
Property Tax Payment	$82,083	$289,859	$98,511	$512,465	$343,905
Value of Income Stream (discounted cash flow, 8%)	$2,881,018	$10,479,645	$4,164,155	$16,945,963	$11,826,266
Project Gap	($4,772,523)	($16,535,169)	($5,861,192)	($31,309,215)	($20,452,439)
Gap as % of TDC	62%	59%	58%	65%	63%

Returns are Too Low for Residential Rental Projects that are Larger in Scale

Return Ratios: Static Pro Forma Stage 1 Analysis	
Net Operating Income (NOI)	$415,767
Total Project Cost	$8,672,635
Less: Development Subsidies	*0*
Project Cost after Subsidies	$8,672,635
Return on Cost: Overall Cap Rate (NOI/Total Cost after Subsidies)	**4.8%**
Net Operating Income	$415,767
Annual Debt Service[a]	$230,099
Cash Throw-Off (Before Tax Cash Flow: BTCF)	$185,668
Total Adjusted Cost	$8,672,635
Permanent Mortgage	$3,897,820
Equity Including Gap Financing Necessary	$4,774,816
Cash-on-Cash Return (BTCF/Equity)	**3.9%**

Low returns = gaps in the financing



Financial Feasibility Limitations for Downtown

- Mixed-use residential hard to make "pencil."
  - Construction costs are 20% to 47% higher in Alaska than in other areas in the country.
  - Residential rents are not high enough to cover costs.
- Office, hotel and retail projects often "pencil" but market demand is limited.

Development Feasibility Comparison

Alaskan Communities

- Hard costs are substantial
- Rents are not high enough to cover costs
- Fewer partnership tools for redevelopment

L48 Urban Centers

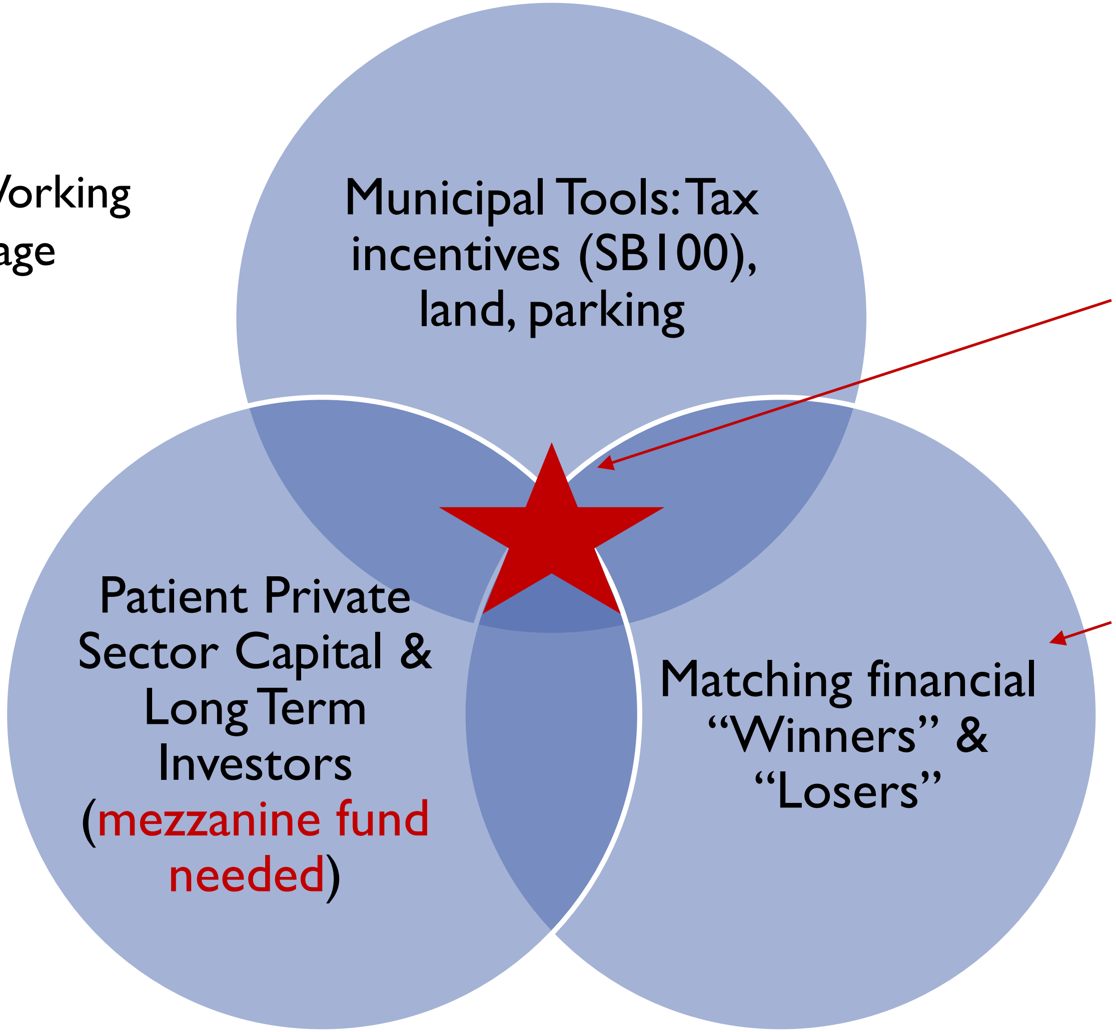
- Rents in some markets are high enough to cover costs
- Public costs can limit feasibility
- Construction costs are not as high as in Alaska
- More tools to partner.
    - Tax increment is often used
    - Mezzanine funds are more readily available

What is Working

SOLUTIONS

While the gap is large, we shouldn’t be discouraged. Let’s remember that development is both an art and a science. Many factors influence project feasibility.

What is Working in Anchorage



Successful mixed-use residential project

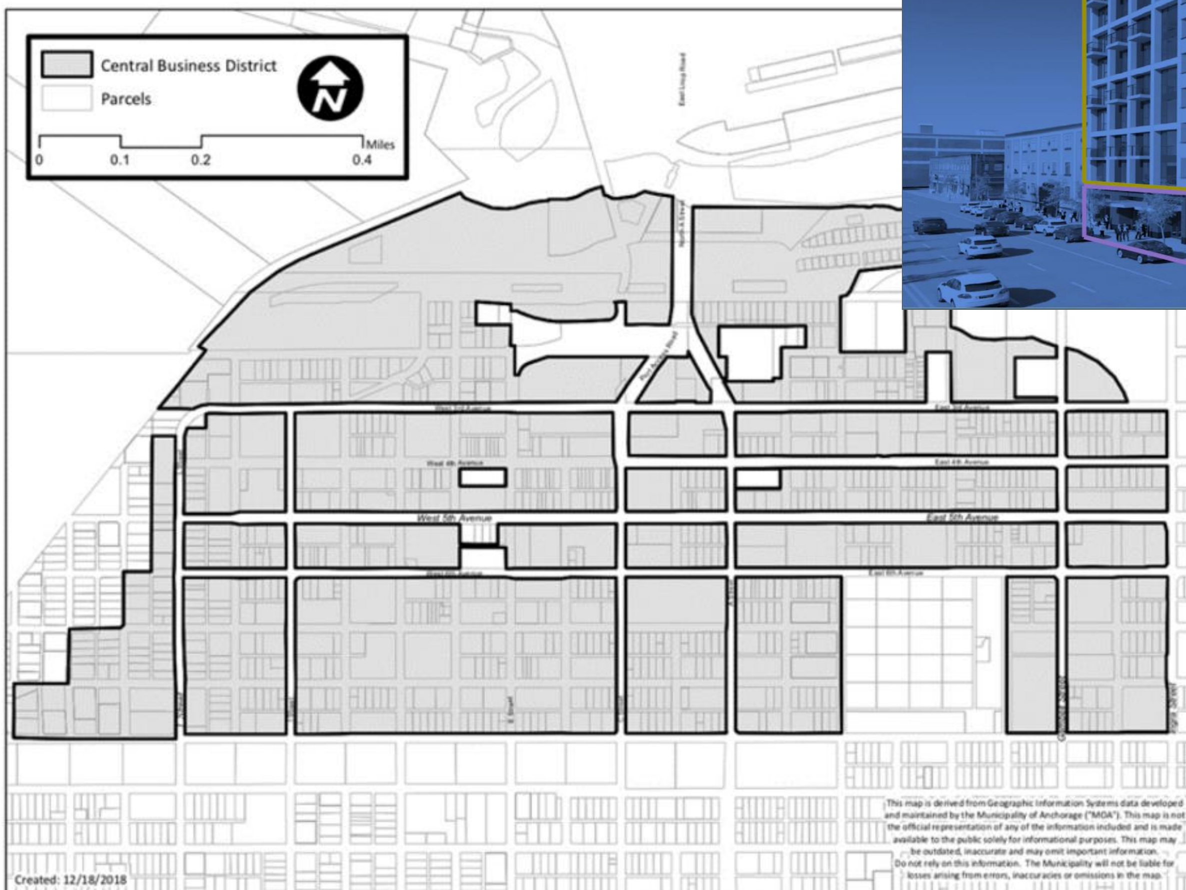
Example: hotels and office tend to pencil and when paired with residential can improve feasibility

Investing Through Land

5 Request for Proposals by MOA/ACDA

- Muni health building: **Development agreement signed**
- 7th and I: **Agreements executed & project complete**
- Transit Center: **Development agreement signed & design in process**
- 8th and K: **In negotiation**
- Block 102: **RFP cancelled – feasibility gap too large**

Role of SB 100: Anchorage's Downtown Housing Tax Incentive



72 units approved
39 units upcoming

What is Still Needed

SOLUTIONS

Pro Forma by Site – Still a Gap with 20 Year Incentive

Downtown Anchorage Example– TDC at $10 million

Incentives	No Incentives	12 Year Tax Incentive		20 Year Tax Incentive	
Rents	Market Rents*	Market Rents*	Restricted to 60% AMI	Market Rents*	Restricted to 60% AMI
Net Operating Income	$352,385	$450,896	$400,739	$450,896	$400,739
Property Tax Payment	$98,511	$0	$0	$0	$0
Value of Income Stream (discounted cash flow, 8%)	$4,164,155	$5,374,499	$4,690,474	$5,824,357	$5,139,506
Amount of Debt Project can Support	$3,303,611 33%	$4,227,150 42%	$3,756,928 38%	$4,227,150 42%	$3,756,928 38%
Equity Required	$6,721,736 67%	$5,788,192 58%	$6,242,018 62%	$5,788,192 58%	$6,242,018 62%
Cash Throw Off	$155,496	$198,965	$176,833	$198,965	$176,833
Cash on Cash Return	2.3%	3.4%	2.8%	3.4%	2.8%
Project Gap**	($5,861,192)	($4,640,842)	($5,308,471)	($4,190,984)	($4,859,440)
NPV of Tax Incentive	$0	$1,613,405	$1,610,441	$2,588,717	$2,583,962
Remaining Gap	($5,861,192)	($3,027,438)	($3,698,030)	($1,602,267)	($2,275,478)
		30% of gap		16% of gap	

**includes premium for new construction*

*** Project gap is the difference between the Total Development Cost and the capitalized value of the net operating income at an 8% cap rate*

Pro Forma by Site – What Does Pencil?

Downtown Anchorage Example– TDC at $10 million

Incentives	**32 Year Tax Incentive (Not Recommended)**	**11 Year Tax Incentive & Favorable Mezzanine Fund**
Rents	Market Rents*	Market Rents*
Net Operating Income	$450,896	$450,896
Property Tax Payment	$0	$0
Value of Income Stream (discounted cash flow, 8%)	$6,162,183	$5,302,393
Amount of Debt Project can Support	$4,227,150 42%	$4,227,150 42%
Equity Required	$5,788,192 58%	$2,503,835 25%
Cash Throw Off	$198,965	$198,965
Cash on Cash Return	3.4%	7.9%
Project Gap**	($3,853,159)	($4,712,949)
NPV of Tax Incentive	$3,916,118	$1,486,051
Mezzanine Loan	$0	$3,284,357
Remaining Gap	$62,959	$57,459

Local & State Tools Combined to Create a Pro Forma that Pencils

Repayment when cash-on-cash achieves 15% or after year 30.

**includes premium for new construction*

*** Project gap is the difference between the Total Development Cost and the capitalized value of the net operating income at an 8% cap rate*

Specific Recommendations

- Utilize SB 100 and implement property tax incentive
- Consider public land as an economic development tool
- Implement statewide financing options
  - Mezzanine fund
  - AIDEA ability to lend on residential

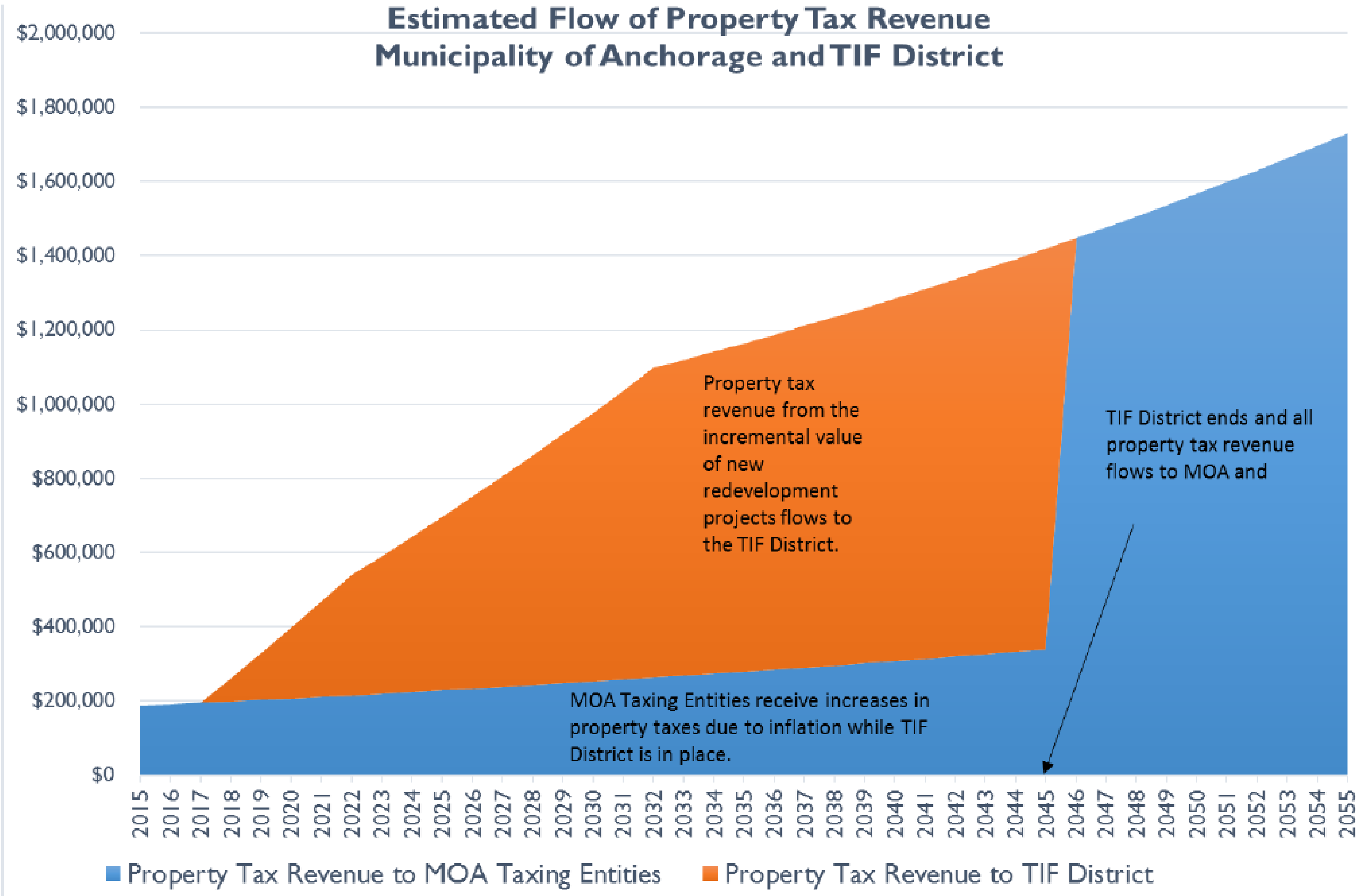
Proposed Mezzanine Fund

- 2 to 3% money
- Long terms
- Repayment structured on the pro forma
- Communities with SB 100 implemented or some "skin in the game"
- Requires developer equity of 25% minimum
- Located in a community defined area of focus (redevelopment or target area)
- Could be privately run

Community Development Initiative

More information at www.acda.net

Tax Increment Financing



Legal Issues with Increment Financing?

- Segregating Tax Increment? **Not Likely.** Alaska Constitution prohibits dedication of "proceeds of any state tax or license," but courts haven't answered whether that applies to municipalities. But if allowed & TIF overlaps a municipal service area, it would be a misappropriation of service area taxes.
- Can You Issue Debt with TIF? **Yes but its likely not feasible to do so.** Article IX, sec 9 of the Alaska Constitution requires municipal debt be for public purpose (capital improvements) and must be ratified by a majority vote.
  - Projects require direct financing & not necessarily funding for capital improvements.
  - Projects won't be able to secure majority votes EVERY time.

When is a TIF bond subject or not subject to Article IX, sec 9:

- When secured by tax increment and full faith and credit **IS** subject to Article IX, sec 9
- When secured by only the tax increment and not the full faith and credit **IS LIKELY STILL** subject to Article IX, sec 9 – the Constitution does not limit municipal debt to GO bonds.
- When secured by special assessment which would be an additional "tax" burden **NOT** subject to Article IX, sec 9
- When secured by the revenues of a TIF agency subject to appropriation from the municipality **IS NOT** subject to Article IX, sec 9 because it becomes a revenue bond and the agency has no obligation to pay. However, bond market will likely not support this. Private placement maybe.

Source: Division of Legal and Research Services, Legislative Affairs Agency, October 28, 2019 at request of Senator Natasha von Imhof

Extra More Detailed Slides to Follow

Hard Costs Comparison to L48 Projects

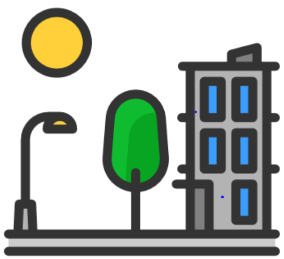
Item	**Anchorage**			**L48**	**Difference: AK Minus L48**	
	All Samples	Stick Built	Podium	Podium	All Samples	Podium to Podium
Per Sqft	$227	$220	$236	$120	$108 47%	$116 49%
Per Unit	$215,000	$233,000	$180,000	$168,000	$47,000	$12,000

Note: podium in Anchorage included micro units. Podium in L48 had larger units; this results in less of a cost differential on a per unit basis because Anchorage podium example has a lot of very small units.

COMPARISONS

SEA

TDC: $218,000 per unit
$213 per sqft in Seattle

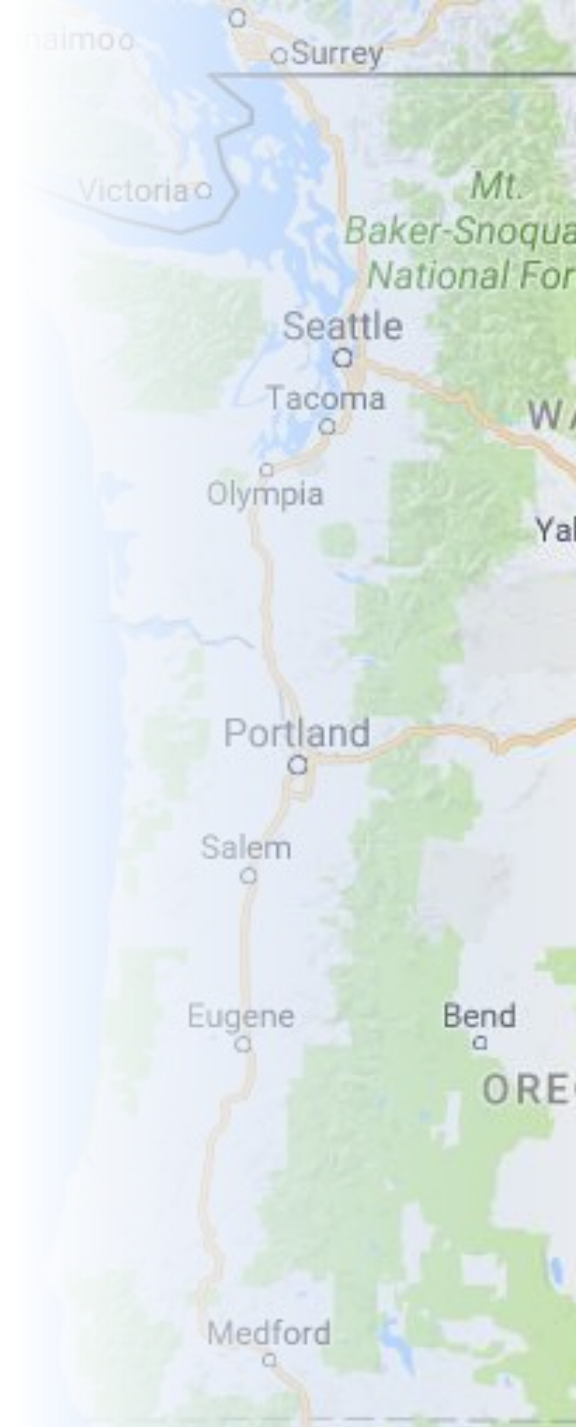


PDX

TDC: $216,000 per unit
$185 per sqft in Portland

ANC

TDC: $255,000 per unit
$241 per sqft in Anchorage



Shared by Bill Reid with PNW Economics in Portland, Oregon

Anchorage Compared to Other Places

Item	*TDC per Unit*	*TDC per Sqft*	*Hard Costs per Sqft*	*Rent Comparison*
Seattle Mid-Rise 160 Unit Building	$218,000	$213	$180	$3.50 to $3.75 per sqft
Seattle 4 Stories Wood Frame	n/a	n/a	$160	
Portland Area 3-Story Wood Frame	$216,449	$185	$140	
Anchorage Project in this Model	$255,078	$241	$192	$2.00 per sqft
Compared to Anchorage	17%	21%	20%	-44%

Shared by Bill Reid with PNW Economics in Portland, Oregon

Urban Land Institute Targets

Figure 3: Return, Absorption, and Risk Characteristics of Real Estate Sectors

Sector Category	Target Return (%)	Absorption	Risk
Land Development	20-30	Sale of project phases	High risk of not receiving entitlement
Single Family	8-15	Pre-orders for units by phase	Possible change in market from start of construction to occupancy
Multifamily For-Sale	8-15	Sales and occupancy upon completion	Possible change in market from start of construction to occupancy
Multifamily Apartments	7-12	Lease and occupancy upon completion	Possible change in market from start of construction to occupancy
Retail	7-12	Preleasing by major tenants usually required for financing Major tenants needed to ensure smaller tenant interest	Possible market change for small shops, although anchor tenants are committed
Office	7-12	Depending on market, may require leasing precommitments	Possible change in market from start of construction to occupancy
Industrial	7-12	Leasing precommitments required only for larger projects	Possible change in market from start of construction to occupancy
Lodging	10-15	Occupancy upon completion	Possible change in market from start of construction to occupancy
Mixed-Use	10-20	Sales, leasing, and occupancy upon completion	Possible weak market for some sectors. Operational risks from conflict of uses

Note: Return is annual unleveraged return on total project costs.

Source: Finance for Real Estate Development. Urban Land Institute. Charles Long. Pg. 20