



Salem Inclusionary Zoning Update | September 30, 2019

FINANCIAL FEASIBILITY MODEL

To test the market implications of various inclusionary zoning scenarios, MAPC developed a financial feasibility model. This model is based on a pro forma analysis that is typically used by a developer to understand whether a real estate project is feasible. A development pro forma takes into account dozens of project-specific real estate development variables (many of which are listed below) to arrive at a projected level of profitability. As each of these variables changes – for example, as construction costs decrease or interest rates increase - profitability goes up or down. If profitability falls below a certain level, the project is considered infeasible.

Over the course of spring 2019, MAPC used this pro forma analysis to understand how different inclusionary requirements might impact development feasibility. The analysis began with a baseline scenario: a typical mid-sized Salem rental development project with no inclusionary zoning. From there, we explored the ways that different iterations of an inclusionary policy (for example, number of affordable units required or bonus incentives offered) might impact the project's bottom line. The model enabled the project working group to understand the tradeoffs involved in the different aspects of an inclusionary policy and to arrive at a consensus of how these different aspects should be prioritized.

BASELINE ASSUMPTIONS

An important part of the financial modeling involved market research to ensure that the model's inputs reflected Salem's local development conditions. MAPC conducted a series of interviews with local real estate professionals, including nonprofit developers, for-profit developers, lenders, and realtors, about Salem's local development conditions. Model inputs were also informed by information from CoStar, an industry real estate database, and from MAPC's Metro Boston Rental Listings Database. Below is a list of assumptions based on the interviews conducted and data collected.



Project basics

- Unit mix: 40% 1-bdrm units, 55% 2-bdrm units, 5% 3-bdrm units
- Unit size
 - 800 sq.ft. 1-bedroom
 - 1,000 sq.ft. 2-bedroom
 - 1,300 sq.ft. 3-bedroom
- Common area: 12% of total building area
- Parking: per zoning (generally 1.5 spaces/unit; 1 space/unit for existing buildings in B5)

Construction costs

- Construction costs (new construction)
 - Stick construction: \$220/sq.ft.
 - Podium construction: \$230/sq.ft.
- Parking costs
 - Surface parking: \$10,000/parking space
 - Podium parking: \$25,000/parking space
- Land cost: varies by project size; minimum of \$30,000 per unit
- Soft costs: 20% of construction costs

Operating costs

- Rents:
 - \$1,900/month 1-bedroom
 - \$2,300/month 2-bedroom
 - \$2,600/month 3-bedroom
 - Inclusionary rents per HUD requirements
- Operating costs: \$7,250 per unit annually/30% operating income
- Vacancy rate: 4%
- No separate parking charge

Financing costs

- Debt /equity: 70% permanent debt, 30% equity
- Permanent debt interest rate: 5.5%
- Mortgage term: 10-year term on 30 year amortization schedule (balloon payment at 10 years)
- DSCR 1.2; LTV 70%
- Inflation: 3%
- IRR: minimum 12%
- Cap rate: 5.5%
- Reversion: 10 years