BALTIMORE INCLUSIONARY ZONING STUDY

STUDY SUMMARY

NOVEMBER 2022

Enterprise

HR&A Analyze. Advise. Act.

POLICY GOALS

The goal of an IZ policy is to support Baltimore's housing needs by creating of affordable housing **that the market would not build**.

Benefits Of Successful IZ

- **Increases affordable housing supply** by creating new affordable units as a part of new development
- **Fosters mixed-income development** rather than 100% market-rate housing projects
- **Provides affordable housing in areas of opportunity** with greater access to jobs, services, and amenities, where new development is occurring
- **Captures a portion of the value of rising land costs** to fund affordable housing

SUMMARY OF FINDINGS AND RECOMMENDATIONS

- **2007 Policy:** The 2007 IZ policy set ambitious affordability goals but is limited by funding constraints.

  Implication: Realizing the full potential of the 2007 policy would **require identifying additional sources of funding** for the City to support the increased cost of the policy.

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- **Potential New IZ Policy:** A new IZ policy, which puts the onus for meeting requirements on the developer, could support a 10% affordability set aside with the provision of tax abatements.

  Implication: Despite a lower affordability requirement than current policy, a new policy would result in an **increase in the production of affordable housing units over the current policy**.

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  Implication: Despite a lower affordability requirement than the current policy, a new policy would result in an **increase in the production of affordable housing units over the current policy**.

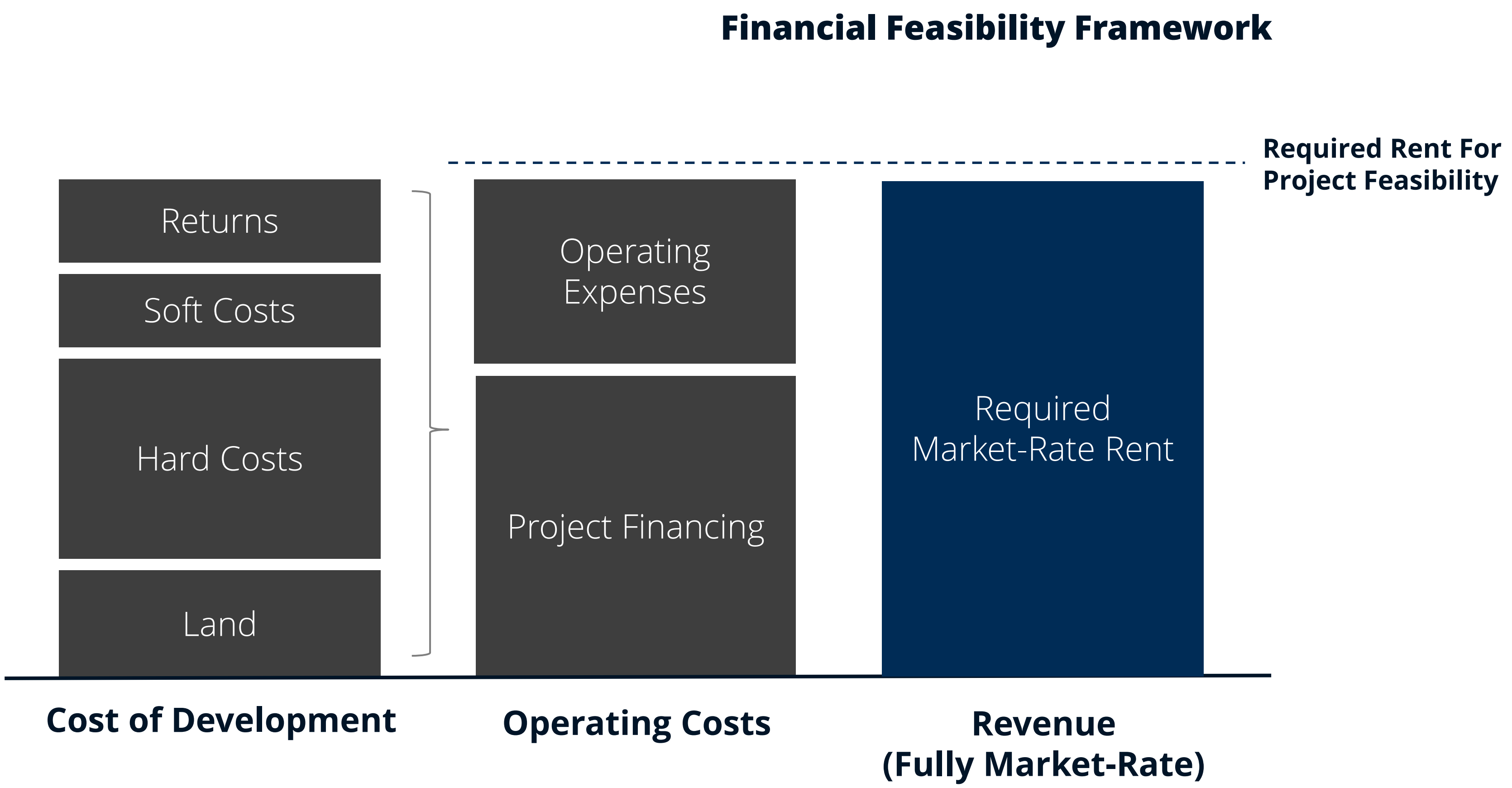
- **Market Conditions:** Market rate development feasibility is generally limited to Core Market locations and to rental apartments.

  Implication: Wide variation in market conditions throughout Baltimore suggests an IZ policy will be most successful when **targeted geographically to the strongest market locations**.

  Implication: Meeting policy goals to support affordable housing in disinvested neighborhoods will require **structuring an in-lieu fee that can be allocated to meet those goals**.

POLICY FEASIBILITY | GUIDING FRAMEWORK

An inclusionary zoning policy must **balance public policy objectives with what the local real estate market can support**.



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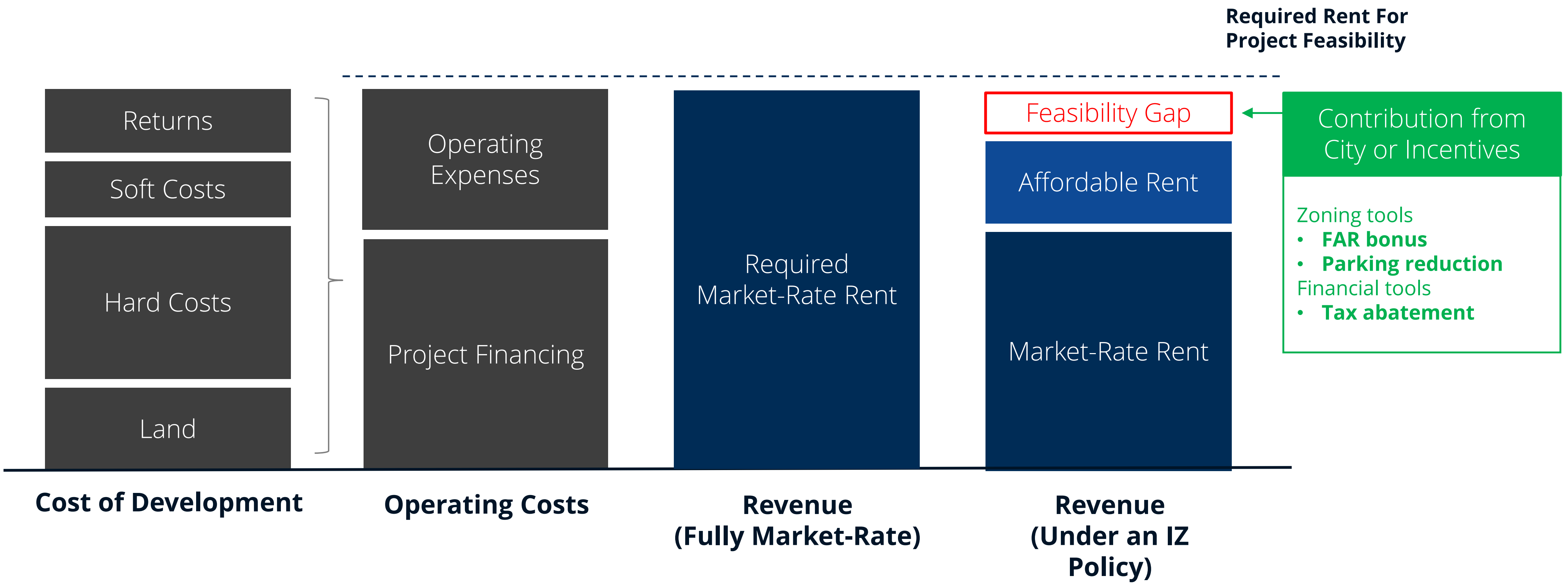
Financial Feasibility Framework



POLICY FEASIBILITY

If a policy is not **calibrated appropriately to the local market**, it can harm housing production and limit the affordable units produced.

Public Policy Objectives

Affordability Level
Number of Units

Project Feasibility

Highest and Best Use
Public Incentives

When public policy goals and real estate economics are misaligned, both are ultimately harmed.

Case Study: Portland

- After Portland's IZ policy took effect in 2017, multifamily **building permit applications decreased nearly 65%**
- Key issue: Decrease occurred because the policy **failed to provide sufficient incentives**

FINANCIAL ANALYSIS | KEY QUESTIONS

The Team's financial analysis evaluated an IZ policy to ensure that reductions in revenue can be offset by incentives or other project value, centered around **three guiding questions**:

1. What is the **baseline feasibility** of market rate multifamily development without IZ?
2. What are the **incentives available** to support the City's inclusionary goals?
3. How can **affordability be maximized** based on available tools?

FINANCIAL ANALYSIS | MARKET RATE DEVELOPMENT

Based on market conditions, fully market rate multifamily development (no affordable units) is only **feasible in core market locations**.

	Core		Strong		Transitional	
Building Typology	Mid-rise New Construction	High-rise New Construction	Mid-rise New Construction	Mid-rise Rehab	Mid-rise New Construction	Mid-rise Rehab
Feasibility Threshold – Target Yield on Cost	6.00%	6.00%	6.50%	6.50%	7.00%	7.00%
Δ Target Yield on Cost	**+0.10%**	**+0.09%**	**-1.36%**	**-0.79%**	**-2.42%**	**-1.98%**
Feasibility	**Feasible**	**Feasible**	**Infeasible**	**Infeasible**	**Infeasible**	**Infeasible**

Multi-family rental development within core markets is feasible

Multi-family development outside of core markets are currently infeasible based on market conditions

Note: The Yield on Cost feasibility threshold is determined based on the capitalization rate (cap rate) in each location plus a spread of 125 basis points.

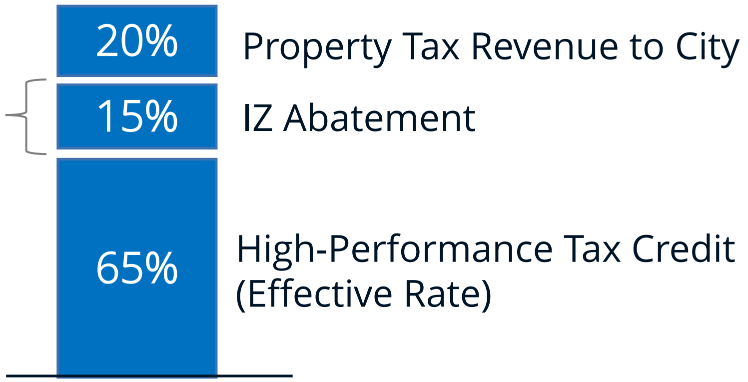
Note: Baseline analysis assumes inclusion of High-Performance Tax Credit, since the incentive is available to most new development occurring in Baltimore.

FINANCIAL ANALYSIS | INCENTIVES

This analysis only considers tax abatements given market constraints in Baltimore that generate little project value through land use tools.

	Typical IZ Incentives	Included in Analysis?
Land Use Incentives	• Density Bonus • Parking Reductions	**No** Land use tools do not provide project value in local market
Subsidy Incentives	• Tax abatement	**Yes** 15% tax abatement for the full development, in addition to existing High-Performance Tax Credit

Modeled Property Tax Structure



FINANCIAL ANALYSIS | IZ REQUIREMENT+ ABATEMENT

With a 15% tax abatement, scenarios providing up to a 10% set aside can be supported for development of multi-family **rental housing** in **core markets.**

Core Market Locations

Baseline Feasibility: 0 Affordable Units	Scenario 1: 5% at 60% AMI	Scenario 2: 5% at 80% AMI	Scenario 3: 10% at 80% AMI	Scenario 4: 5% at 60% AMI 5% at 80% AMI (10% total)	Scenario 5: 6% at 30% AMI 5% at 60% AMI 5% at 80% AMI 4% at 100% AMI (20% Total)
Feasible	Feasible	Feasible	Feasible	Feasible	Infeasible

Market conditions and available incentives maintain overall feasibility of development up to a 10% set aside

Larger set-asides place an unsupportable cost-burden on development based on current market conditions and available incentives

POLICY FRAMEWORK

POLICY ELEMENT	2007 POLICY	FEASIBLE FUTURE POLICY
SET-ASIDE REQUIREMENT	Targeted **10-20%** affordability set aside (**actual set aside much lower** due to exemptions)	**10%** affordability set aside
AFFORDABILITY LEVEL	Targeted **30-100% AMI**	5% of units at **60% AMI** 5% of units at **80% AMI**
GEOGRAPHY	**Citywide**	**Core market** locations
INCENTIVES	Direct **City contribution** to developers	New 15% **tax abatement**
APPLICABILITY	**30+ unit** rental and homeownership development (via policy trigger)	**30+ unit** rental development receiving a major public subsidy
EXEMPTIONS	**Units with costs above threshold** exempted	**None**

PRECEDENT IZ POLICIES

City	Affordability Level	Share Of Development (% of units or habitable space)
New Orleans, LA	60% AMI	10% (Tier 1); 5% (Tier 2); voluntary (Tier 3)
Boston, MA	70% AMI	13% (citywide; AMI varies by zone)
Newtown, MA	80-120% AMI	10%
Norwalk, CT	60% AMI	10%
Seattle, WA	60% AMI	5-7%
Yonkers, NY	65-100% AMI	10%
Washington, D.C.	60% AMI	8-10%

- Precedent policies typically target AMI levels between **60% to 80% AMI**, with affordable unit **set asides ranging from 5% to 15% of units**
- IZ units **typically make up a small percentage of market rate development**
- New Orleans and Boston both have policies **tiered by geographic location**
- **Few IZ policies are effectively able to serve extremely low-income households** (30% AMI) because of the deep subsidy/incentive required

APPENDIX | FINANCIAL ANALYSIS INPUTS AND ASSUMTPIONS

APPENDIX | MODEL INPUTS (PROGRAM ASSUMPTIONS)

	Core			Strong		Transitional	
Building Typology	Mid-rise New Construction	High-rise New Construction	Mid-rise For-sale	Mid-rise New Construction	Mid-rise Rehab	Mid-rise New Construction	Mid-rise Rehab
Total Units	285 Units	360 Units	250 Units	250 Units	200 Units	150 Units	100 Units
Building GSF	253,147 GSF	319,765 GSF	275,000 GSF	222,059 GSF	177,647 GSF	133,235 GSF	88,824 GSF
Building NSF *(85% Efficiency)*	215,175 NSF	271,800 NSF	233,750 NSF	188,750 NSF	151,000 NSF	113,250 NSF	75,500 NSF
Land SF	59,564 SF	51,994 SF	78,571 SF	74,020 SF	71,059 SF	106,588 SF	88,824 SF
Modeled FAR	4.3 FAR	6.2 FAR	3.5 FAR	3.0 FAR	2.5 FAR	1.3 FAR	1.0 FAR
Parking Spaces	285 spaces	288 spaces	250 spaces	313 spaces	250 spaces	188 spaces	125 spaces
Unit Mix							
% Studios *(500 SF)*	20%	20%	5%	20%	20%	20%	20%
% 1BR *(750 SF)*	50%	50%	40%	50%	50%	50%	50%
% 2BR *(1,000 SF)*	25%	25%	45%	25%	25%	25%	25%
% 3BR *(1,200 SF)*	5%	5%	10%	5%	5%	5%	5%
Weighted Average Unit Size (NSF)	755 NSF	755 NSF	935 NSF	755 NSF	755 NSF	755 NSF	755 NSF

APPENDIX | MODEL INPUTS (DEVELOPMENT ASSUMPTIONS)

	Core			Strong		Transitional	
Building Typology	Mid-rise New Construction	High-rise New Construction	Mid-rise For-sale	Mid-rise New Construction	Mid-rise Rehab	Mid-rise New Construction	Mid-rise Rehab
Development Costs							
Land Costs *(per Land SF)*	$80/SF	$80/SF	$80/SF	$50/SF	$50/SF	$20/SF	$20/SF
Total Land Cost	$4,765,121	$4,159,541		$3,700,980	$3,552,941	$2,131,765	$1,776,471
Vertical Hard Cost per GSF *(excl. parking)*	$206 /NSF	$265 /NSF	$206 /NSF	$206 /NSF	$155 /NSF	$206 /NSF	$155 /NSF
Soft Costs per NSF	$41 /NSF	$53 /NSF	$41 /NSF	$41 /NSF	$39 /NSF	$41 /NSF	$39 /NSF
Parking Cost	$25,000 /space	$25,000 /space	$25,000 /space	$25,000 /space	$25,000 /space	$25,000 /space	$25,000 /space

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Operating Revenues + Expenses *(escalated annually at 2.5%)*							
Market Rent/Sale Price PSF	$2.35/SF	$2.75/SF	$425.00/SF	$2.15/SF	$2.05/SF	$2.05/SF	$1.95/SF
Parking Rent PSF	$150 /Mo	$150 /Mo	$0 /Mo	$75 /Mo	$75 /Mo	$25 /Mo	$25 /Mo
Vacancy	5%	5%	5%	5%	5%	5%	5%
OpEx per Unit *(excl. RE taxes)*	$5,500 /unit	$5,500 /unit	$0 /unit	$5,500 /unit	$5,500 /unit	$5,500 /unit	$5,500 /unit
Full RE Taxes	$4,355 /unit	$5,577 /unit	$0 /unit	$3,566 /unit	$3,242 /unit	$3,094 /unit	$2,772 /unit

APPENDIX | MODEL INPUTS (FINANCING ASSUMPTIONS)

	Core			Strong		Transitional	
Building Typology	Mid-rise New Construction	High-rise New Construction	Mid-rise For-sale	Mid-rise New Construction	Mid-rise Rehab	Mid-rise New Construction	Mid-rise Rehab
Construction Loan							
Loan to Cost	65%	65%	65%	65%	65%	65%	65%
Total Fees	2.00%	2.00%	2.00%	2.00%	2.00%	2.00%	2.00%
Rate	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%
Permanent Financing							
Debt Service Coverage Ratio (DSCR)	1.25	1.25	1.25	1.25	1.25	1.25	1.25
Loan-to-Value	65%	65%	65%	65%	65%	65%	65%
Lender's Points	1.00%	1.00%	1.00%	1.00%	1.00%	1.00%	1.00%
Mortgage Recording Tax	1.65%	1.65%	1.65%	1.65%	1.65%	1.65%	1.65%
Loan Closing Costs	1.00%	1.00%	1.00%	1.00%	1.00%	1.00%	1.00%
Perm Loan Interest Rate	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%
Term	30 years	30 years	30 years	30 years	30 years	30 years	30 years

APPENDIX | MODEL INPUTS (TIMING ASSUMPTIONS)

	Core			Strong		Transitional	
Building Typology	Mid-rise New Construction	High-rise New Construction	Mid-rise For-sale	Mid-rise New Construction	Mid-rise Rehab	Mid-rise New Construction	Mid-rise Rehab
Construction Period	18 Mo.	24 Mo.	18 Mo.	18 Mo.	18 Mo.	18 Mo.	18 Mo.
Lease-Up Period	12 Mo.	12 Mo.	12 Mo.	12 Mo.	12 Mo.	12 Mo.	12 Mo.
Exit	Year 10	Year 10	Year 10	Year 10	Year 10	Year 10	Year 10
Construction Period	18 Mo.	24 Mo.	18 Mo.	18 Mo.	18 Mo.	18 Mo.	18 Mo.

APPENDIX | MODEL INPUTS (RETURN METRICS)

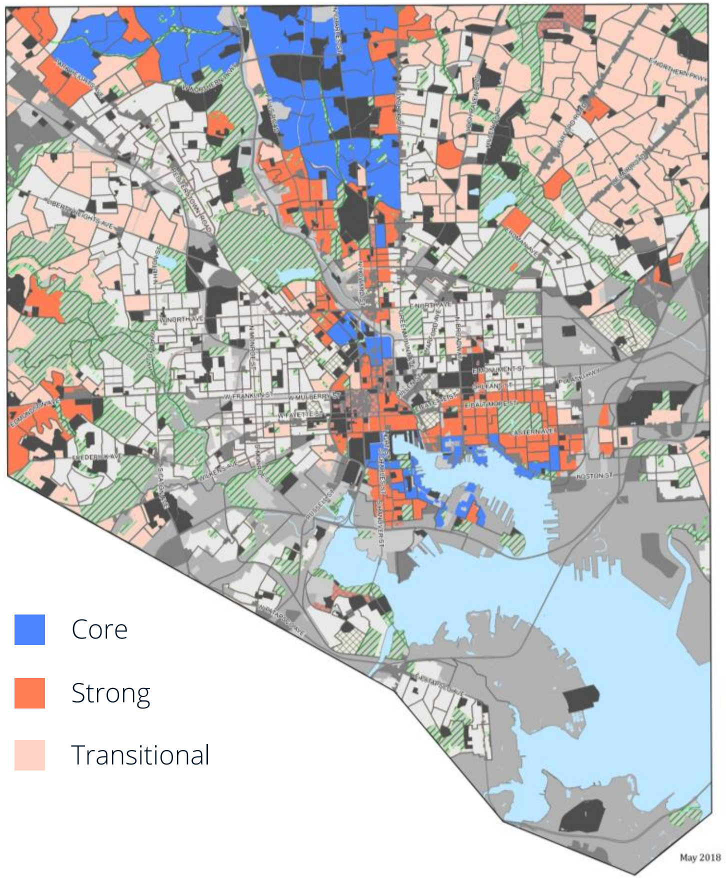
	Core			Strong		Transitional	
Building Typology	Mid-rise New Construction	High-rise New Construction	Mid-rise For-sale	Mid-rise New Construction	Mid-rise Rehab	Mid-rise New Construction	Mid-rise Rehab
Cap Rate	4.75%	4.75%		5.25%	5.25%	5.75%	5.75%
Yield on Cost Premium	1.25%	1.25%		1.25%	1.25%	1.25%	1.25%
Target Yield on Cost/Equity Multiple	6.00%	6.00%	2.00x	6.50%	6.50%	7.00%	7.00%

Note: Yield on cost is calculated as the average annual NOI after stabilization (deflated to Year 1 dollars) over the 10-year cashflow divided by the net cost. The target yield on cost is calculated as 125 basis points above the cap rate.

APPENDIX | MARKET TYPOLOGIES

Using Baltimore's Housing Market Typology as a base for understanding conditions, the Team defined three submarkets for evaluating market strength to support new market-rate development.

Market Typologies based on Baltimore's Housing Market Typology



Source: Baltimore Housing Market Typology

- **Core Submarket** areas represent locations where the majority of new market rate development is occurring today, prices are highest, and includes areas along the harbor and adjacent to Downtown.
- **Strong Submarket** areas are the remaining markets in Baltimore that could potentially to support new market rate development.
- **Transitional Submarket** areas are maturing and could possibly support market rate development in the future.

Targeting specific geographies allows the City to capture affordable housing in locations best positioned to support feasibility, without compromising development potential in locations where the margins for financial feasibility are thinner.

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