MEMO

TO: Newton Housing Partnership
Cc: Barney Heath, Lara Kritzer, Shaylyn Davis-Iannaco

FROM: David Rockwell and Chuck Eisenberg, NHP members

DATE: April 24, 2024

RE: 136-144 Hancock Street – recommendation on developer request for waiver of on-site affordable units.

Background

At its March 27 monthly meeting, the Newton Housing Partnership asked us to analyze the developer's request for a waiver of the condition for two onsite affordable units required in the Special Permit approved 24-0 on 12/21/22 by the City Council for 136-144 Hancock Street. This location is part of the former campus of Walker Center for Ecumenical Exchange, an ecumenical conference center dating back to the 1860s with origins as housing for children of missionaries. The Center, whose campus covers 2.2 acres and holds five 2- and 3-story buildings (two of them larger conference buildings and three of them smaller residential buildings; one of the smaller buildings is actually two homes connected by a breezeway) and a parking lot, permanently closed in 2021. In November 2021 the City bought a portion of it -- **137 Hancock and 169 Grove St.**-- two residential buildings totaling 7400sf with land equal to about 40% of the site) for $2.45MM with the stated intention (1) to preserve the buildings for re-use as affordable housing and (2) to reserve adjacent open space for long-term expansion of parking and recreation for the adjacent Williams Elementary School.

The **136-144 Hancock Street** site, which is the subject of the Special Permit, comprises the rest of the Walker Center campus. It is 1.3 acres and was previously zoned SR-3 (single residence 3), but was rezoned in December 2022 to MR2 by City Council in its approval of the Special Permit (see second bullet under Recent History below). It is part of the Auburndale Historic District, but none of the buildings is designated a landmark.

We offer this memorandum as a preliminary statement of our findings and recommendations, for review by Newton planning staff and the NHP.

We start with a brief history of recent developments leading to the current state of the Walker Center site before analyzing the waiver request and offering a recommendation.

Recent History

- *Nov. 2021* – Shortly after the Walker Center closes permanently in 2021, Mayor Fuller announces the City's purchase of 137 Hancock / 169 Grove St., comprising approximately 40% of the 2.2-ac Walker Center site, from the Walker Center, for future use as affordable housing (without tearing down any of the buildings) and extra open space for long-term expansion for the adjacent Williams Elementary School. City takes the property by eminent domain, paying $2,450,000 in damages to the Walker Center, using American Rescue Plan Act (ARPA) funds.

- *Dec. 2022* – City Council (petition #394-22) approves a Special Permit, requested by Civico Inc. for 136-144 Hancock, by a 24-0 vote rezoning it from SR3 to MR2, and allowing development of a 16-unit mixed-income project, as follows:
  - 7 units in the to-be-rehabbed Walker Building, 5 in the to-be-rehabbed Barton Building, and 4 new townhouses to be newly constructed, two each in two newly built detached structures on a portion of the site including the location of an existing house to be demolished.
  - Bedroom mix is two 2BR, eleven 3BR, and three 3BR.
  - Unit sizes range between 979sf and 3,103sf; average unit size is 2,225sf.
  - 2 affordable units – a 3BR and a 2BR, both on 2nd floors – in compliance with the City's Inclusionary Zoning (IZ) ordinance. Developer's IZ plan description of 7/1/22 asserts compliance with IZ requirements related to equivalency* between market and affordable units. One is a 2,495sf 3BR, and one a 1,448sf 2BR. Planning Department memos of 9/16/22 and 12/2/22 do not address IZ compliance; Special Permit states IZ compliance is a condition. Since the project never approached the stage of building permit issuance, the Planning Department never reviewed IZ compliance for the permitted project.
  - 27 at-grade parking spaces (14 open air, 13 garaged).
  - Various minor items of zoning relief from MR2 zoning requirements were granted.
  - A fractional payment to the City of $260,000 is required under the Inclusionary Zoning (IZ) ordinance. (NOTE: 15% of 16u is 2.4; the 4/10ths of a unit translates to $260,000 based on the $650,000/unit payment standard then in effect.)
  - Permit requires LEED Silver Certifiable as the green-building standard.

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* The equivalency tests are: (1) total SF of affordable units must be at least 10% of total project SF; (2) size of each affordable unit must not be less than 80% of the average size of units with the same bedroom count; (3) the affordable units must be locationally dispersed throughout the project, and (4) the affordable units must have access to project amenities that is equivalent to the access enjoyed by the market units.

- *Dec. 2023* – Developer files request (petition #79-24) for Council approval of a waiver of on-site units in favor of a payment-in-lieu of $1,300,000 (total payment would be $1,560,000 including the $260,000 fractional payment).

- *Feb 6, and March 12, 2024*– Land Use Committee holds two public hearings on developer's waiver request, each of which results in motions to hold.
    - The Feb 6 motion to hold was to allow review of the option of keeping only one unit affordable, along with further staff review of the project's compliance of either the 1- or 2-unit plan with the IZ ordinance's equivalency requirements.
    - At March 12 hearing, staff indicated that the 1-unit plan would violate the IZ ordinance equivalency requirements and was not viable. Separately, discussion during the hearing occurred about directing the in-lieu payment to the adjacent city-owned Walker Center parcel (137 Hancock St and 169 Grove St) for an affordable housing development there; staff said this could not be ordered by Land Use Committee, but that the funds could end up there after the required 50/50 distribution to the Newton Housing Authority and Newton Affordable Housing Trust had first occurred.   At the end of the public hearing, the Committee voted unanimously to hold.

- *March 27, 2024*: Staff brings waiver request to NHP for its advisory opinion.
    - At this meeting, Civico's Taylor Bearden indicates the project has gone into financial difficulty since the issuance of the Special Permit due to dramatic increases in costs and interest rates, and remains feasible only if the City waives the requirement for two onsite affordable units and allows the developer to make a payment in lieu of the onsite units.
    - Mr. Bearden indicates that Civico is offering to increase its in-lieu payment by $200,000, from $1,300,000 to $1,500,000, in an effort to better meet the test of "unusual benefit" in the IZ ordinance.
    - At the end of the discussion of this item, NHP assigns us to review the financial feasibility economics of Civico's proposal and have a recommendation ready for the April 30 NHP meeting.

Analysis

- To assess the developer's assertion of financial infeasibility of the project with two onsite affordable units, we requested Civico to provide us with an economic analysis of the project -- its costs, funding sources including the developer's equity investment, and gross and net sales revenue projections -- and to do so with a comparison of the project with and without the two onsite units.

- We received their information on April 9, which was responsive to our request. It showed figures demonstrating their conclusion that the project's return on cost (net profit divided by total project cost) is 15.0% as an all-market project with the payment-in-lieu (hereafter, "PIL") included as a cost, *versus* 12.8% with two on-site units affordable for households at 80% AMI.

- While the margin between these two profit measures may seem narrow, it represents a meaningful $630,000 difference in dollars, and Civico asserts that "it might be the difference between this project moving forward or not". They add that a 15% ROC is "marginal at best", that developers usually look for 20% ROC, and they note that these financial thresholds were met when they acquired the site from Walker Center and sought the permit, before the dramatic rise in construction costs and interest rates.

- We designed our own financial model that allowed us to replicate their ROC calculation, giving us the opportunity to test different economic scenarios in a way that is consistent with their profit margin calculation methodology.

- In our review of Civico's analysis, we discovered that, in our view, their analysis overlooks an element of financial return evident in their pro-forma. On inquiry, we learned that the wife of one of Civico's financial partners is making a "mezzanine" loan to the project of $1,000,000, with an interest rate return of 17%. Mezzanine debt is riskier than bank debt in that it is subordinate to the bank – thus the higher interest rate – and is often used in commercial real estate to fill in part of the gap between financeable debt and a project's cost. It has the impact of reducing direct developer equity and enhancing return. We believe the interest on the mezzanine debt, since it is earned by the spouse of a Civico partner, should be included in the return calculation. Including it, we see the return for the all-market scenario at 17.5% instead of 15.0%, and for the onsite affordable scenario at 15.5% instead of 12.8%.

- We reviewed the developer's estimated project costs, which were based on four detailed bids from contractors, and found them reasonably reflective of construction costs in today's environment.

- In general, we agree with the developer that the project's financial return is on the low side compared to real estate industry standards, especially under the economics of the onsite affordability approach. We believe the project, if constrained by the onsite affordability requirement, might have difficulty obtaining financing in the current market environment, possibly jeopardizing Civico's ability to move it forward.

- We are therefore prepared to recommend that the City accept Civico's waiver request, but subject to a determination, as required by the IZ Ordinance in such cases, that the developer's PIL represents an "unusual net benefit" for the City. To that end, we used our model to identify what we're calling an "optimal PIL" – a payment that still allows the developer a reasonable return but achieves an unusual net benefit that compensates the City for the loss of the affordable units, in the spirit of the IZ ordinance.

- Given that their cost estimates appear reasonable, the key variable driving their profit projections is estimated sales price.
  - We requested a market study backing up their pricing estimates, but they indicated that they have not yet engaged one and were “getting updated data from a local real estate agent”. Without the benefit of a market study, therefore, we conducted our own market inquiry, and, based on this, found Civico’s forecast somewhat conservative.
  - Their average sales price of $679/sf is 39% below the pricing being achieved at the prominent, and fairly comparable, condominium offering in Newton currently on the market -- the 24-unit Bristol Waban Condominium at 20 Kinmonth Road in Waban. It is asking between $1,035 and $1,250 per square foot for their units, all of which are smaller than the Hancock units – there are 1-, 2- and 3-BR units there, and they average just under 1200sf. To date, three units have sold at an average of $1,118/sf, 95% of asking price. Outside of Bristol Waban, the West Newton condominium market appears to consist of units in existing multi-family complexes and 2- and 3-family homes, and they are selling for much less -- $550 to $600/sf.
  - As a new-construction project, the Hancock units will be of much higher quality than those in older buildings. They will clearly share some advantages with Bristol Waban – new construction with modern appliances, attractive, transit-oriented locations near shopping amenities and well-regarded schools, and accessible to the highway system. On the other hand, the larger size of the Hancock units means they will probably sell for less per square foot than the Briston Waban units.
  - Our analysis does not have weight of a professional market study, but since we lack such a study we must make our best determination on this point. Our conclusion is that at $679/sf – 39% below the Bristol Waban price -- Civico appears to be using conservative projections that leave reasonable room for somewhat higher sales forecasts.

- With these considerations in mind, we undertook the following analysis of the economics of the all-market scenario, whose costs include the PIL* and the fractional payment of $274,400.
  - We started by replicating their ROC conclusion of 15.0%, to ensure our calculations were consistent with their analysis.
  - Including the return on mezzanine debt, we found the ROC measure to increase to 17.5%.
  - Adjusting the PIL value/unit from $650,000 to the updated figure of $686,000, ROC dropped slightly to 17.0%.

* A note about the calculation of the PIL: The standard is $686,000/unit, increased during the NHP meeting, based on Planning staff’s findings, from the prior level of $650,000/unit that is in Civico’s analysis. The increase is based on analogous development costs per unit in the marketplace for multi-family housing. The fractional payment also increases – from $265,000 used by Civico prior to the value adjustment to $274,400.

- Increasing the PIL premium by another $200,000, to $400,000, decreased ROC to 16.0%.
- Increasing the sales price/sf by $25 – an increase of only 3.6% above their average sales price projection -- increased ROC to a respectable 20.2%.

Conclusion

Our recommended $400,000 PIL premium brings the developer's PIL to $1,772,000 -- $886,000 per each of the two foregone affordable units. (Adding in the fractional payment of $274,400 brings the total payment to $2,046,000.) We believe $886,000 per unit does represent an unusual net benefit to the City by providing substantial resources for creating affordable housing elsewhere in the City. We further believe that these resources can be put to more efficient use than at Hancock Street, by being part of the financing of affordable housing projects larger than the one Civico is pursuing. We also note that our recommended PIL is 29% higher than the standard PIL requirement in the IZ ordinance – nearly twice the margin offered at the NHP meeting by Civico at 15% above the standard.

Recommendation

We recommend agreeing to Civico's request for a waiver of the on-site affordability requirement in the current Special Permit, conditioned on a total payment-in-lieu of $1,772,000, or $886,000 for each of the two foregone affordable units. (We note that the total payment to the City is actually $2,046,400, including the $274,400 fractional payment required under the IZ Ordinance separate from the developer's payment-in-lieu.) Our recommended payment-in-lieu still allows the developer a reasonable return of at or a little over 20% Return on Cost, while providing a benefit to the City that is 29% greater than the standard requirement in the IZ Ordinance. The $886,000/unit amount represents an unusual benefit to the City in that, in terms of its value for affordable housing efforts elsewhere in Newton, it outweighs the loss of these two affordable units on Hancock Street.