Underwriting Review
236 Auburn Street, Newton, MA

Performed by: Daniel R. Gaulin, subcontractor to FinePoint Associates, May 9, 2017
Updated by: Elizabeth Valenta, City of Newton HOME Program Manager, July 6, 2017

I reviewed the proforma and supporting documentation submitted as part of the full proposal from Citizens for Affordable Housing in Newton Development Organization (CAN-DO) to the City of Newton dated April 28, 2017. This analysis follows the underwriting guidelines of the United States Department of Housing and Urban Development and the WestMetro HOME Consortium. *The underwriting was updated based on a revised proforma dated May 18, 2017, submitted by CAN-DO and also to reflect updated HOME per-unit subsidy limits.*

Total Development Costs: **$3,555,595.00**

Project Funding Sources:

Newton CPA Funds	$ 977,700.00
Newton CDBG Funds	$ 1,020,000.00
Newton HOME funds	$ 276,300.90
WestMetro HOME Consortium CHDO-Set Aside	$ 171,599.10
DHCD – Facilities Consolidation Funds (FCF)	$ 659,995.00
Sales Proceeds – Price Center	$ 450,000.00
Total Funding Sources	**$3,555,595.00**

Project Description
CAN-DO purchased 236 Auburn Street, a historic single-family house containing three units located on 18,760 sf lot in a Multi-family 1 zoning district. CAN-DO is proposing to rehabilitate the house into a 3-BR rental unit and build two new structures: a duplex containing one 2-BR and one 3-BR unit and a 5-BR group home for individuals with medically intensive disabilities. The project is seeking Facilities Consolidation Funding from the State and HOME, CDBG and Community Preservation funding from the City of Newton.

Total HOME funding request: **$ 447,900**

HOME Maximum Per-Unit Subsidy Limit:	$ 196,674 - 2 BR
	$ 254,531 - 3 BR
	$ 451,105 Maximum HOME Subsidy

The requested HOME funding is within the current HOME subsidy limits. There will be a total of 2 fixed HOME units (the 2-BR unit and a 3-BR unit) which the developer has proposed to designate as High HOME units. However, the units will set a minimum rent based on the published Low HOME rent limits.

The proposed 5-BR group home will be developed by CAN-DO and sold to The Price Center, a large non-profit that specializes in providing housing support services and residents to disabled.

Market Risk Analyses:
There is negligible market risk. The proposed net rent for the 2-BR is $953/month and the 3-BRs are $1,084/month. These rents are a third of the market rents in Newton.

The proposed group home has a letter of support from the Massachusetts Department of Developmental Services (DDS) which is willing to refer residents to the development as well as a contract for residential services and support. DSS reports it has identified potential residents for the group home.

Developer Risk Analyses:
The project has a complicated development plan that involves three development entities: CAN-DO, Metro West Collaborative Development (MWCD) and The Price Center. The success of the project depends on the ability of each entity to execute its part of the development.

CAN-DO, the project sponsor, was founded in 1994 and has focused on increasing the supply of affordable rental housing in Newton. MWCD, founded in 1991 as Watertown Community Housing, initially focused on the development and preservation of ownership and rental affordable housing in Watertown, but it has recently taken on development and consulting projects in nearby towns (Belmont, Lexington and Weston) as well somewhat further away (Norwell and Medway). CAN-DO owns and operates 39 scattered site units in Newton. Metro West owns and operates 44 units in two developments in Watertown and it has two projects in development outside of Watertown that are projected to add 66 units to their portfolio.

Two years ago, the Board of Directors of CAN-DO began to plan for the retirement of Josephine McNeil, the founding Executive Director. The Board wanted to retain CAN-DO as an organization but to affiliate with MWCD, sharing a board of directors and executive director. CAN-DO entered into a contract for services for MWCD to operate CAN-DO's rental portfolio and provide development project management services for 236 Auburn Street.

CAN-DO now shares an Executive Director with MWCD: Jennifer Van Campen. Ms. Van Campen led Metro West's developments at St. Joseph Hall and Belmont Street which had larger, more complicated, financing than Auburn Street. Metro West also employs Linda Moody, a part-time project manager who is a licensed architect and continues to operate her own architectural firm. The development team is further strengthened by the addition of Daniel J Violi, a consultant in affordable housing financing who has experience in all types of affordable housing, including group homes.

The Price Center is a Newton-based nonprofit provider of services for individuals with intellectual and developmental disabilities and their families, including group homes for the individuals with disabilities. Established in 1977, it has grown into an organization with annual revenue of over $7,000,000 and currently operates four group homes. Its role in the process is to help obtain $659,995 in state financing for the group home and to purchase the completed the group home from CAN-DO for $450,000. The Price Center has a strong track record with the state and it has a strong balance sheet and strong letter of interest from Village Bank to provide mortgage financing for the purchase price. Prior to closing on the HOME/CDBG/CPA funds, Newton should require that The Price Center provide a firm commitment for financing and evidence of sufficient cash to complete the purchase of the group home.

The architect for this project is Terrence Heinlein. Mr. Heinlein specializes in residential construction and has extensive experience with historic preservation and modular construction.

The contractor will be chosen in an open bidding process, managed by the City of Newton Purchasing Dept.

This development team has completed projects of larger size and complexity. Newton should review the final plans and specifications and review the qualifications of the contractor selected in the bid process.

Project Risk Analyses

The project as proposed is not allowed under current zoning. It will need to obtain a comprehensive permit from the City of Newton. There is a chance that the project will not obtain a permit. To mitigate against this risk, the City of Newton should condition its HOME funds on the receipt of a comprehensive permit for the project as proposed.

Sources and Uses

The total development cost is projected to be $3,555,595 ($444,449/unit). The project sources are also projected to be $3,555,595.

CAN-DO purchased the property for $900,000 on December 29, 2016. The acquisition lender, Village Bank, commissioned an appraisal performed by William J. Lanciloti by Village Bank which indicates an as-is Market Value of $950,000 as of September 29, 2016. The appraisal assumed that the building which is currently vacant but was last used as a three-family house could be demolished and replaced with an attached two-family structure. The appraisal considered five comparable sales – four two-family houses and one two-family lot. All sales were within Newton with appropriate adjustments for location, size of the lots and inflation of .5% per month. The adjusted values ranged from $942,000 to $975,000, which provides strong support for the value of $950,000.

The hard costs excluding contingency are projected at $1,782,876.00 or $161.86/sf. The contingency is 8.65% which is a blended rate of 10% for the new group home, 15% for the historic rehabilitation and 5% for the new modular duplex. The estimated hard cost in the proforma is $105,121 (5%) lower than the cost estimate prepared by D G Jones International.

The soft costs are projected at $336,594 or 9.47% of the total development costs. This project has marginally higher than typical soft costs since it requires a comprehensive permit and its architectural fees reflect that there are three distinct projects: a historic rehabilitation, a new group home and a modular duplex. The projected soft costs are reasonable for the size and complexity of the project.

The gross developer fee and overhead and consultant fee is projected at $331,594 or 9.3% of the Total Development costs. This is fee is below the maximum fee allowed under DHCD's Tax Credit Qualified Allocation Plan ($391,308). It is a reasonable fee for the amount of work it takes to put together a transaction of this size and complexity.

There are 6 sources of funds involved in the project:

WestMetro HOME:	$ 447,900
Newton CDBG :	$1,020,000
Newton CPA - Historic:	$ 300,000
Newton CPA - Housing:	$ 677,700
Mass Facilities Consolidation Fund	$ 659,995
The Price Center	$ 450,000

Income and Expenses

All income and expenses are noted on the Operating ProForma submitted with the development proposal on April 28, 2017 and revised May 31, 2017.

The projections for income and expense inflation are reasonable: 2% for affordable rents, 3% for all expenses. The vacancy rate assumption for residential units is a reasonable 5%.

The maintenance and operating budget of the three family units is projected at $30,408 or $10,040/unit/year. This is based on the actual costs in CAN-DO's portfolio and includes $500/unit for supportive services and an estimate of $1,500/unit for property taxes. The Consortium may want to confirm with the City Assessor that the value of the property as restricted by the HOME/ CDBG/ CPA funds is in line with a tax bill of $4,500/year. At Newton's current tax rate of $11.12 per thousand, the development team is estimating an assessed value of $404,675 for the three family units.

Metro West intends to manage the property and the rest of the CAN-DO portfolio utilizing a maintenance service available 24 hours a day and its office staff to collect rent and pay bills. Metro West will re-evaluate this approach after a trial run of 6-12 months and determine whether to continue or seek a property management company to handle all of the management tasks. Since all of CAN-DO's current properties for which Metro West will be responsible have some amount of financing from the City of Newton, the Consortium should monitor Metro West's management performance prior to final commitment.

Cash Flow - Return on Equity

Since there is no debt service on the three family units, a debt service coverage ratio cannot be calculated. We can note that the projected initial cash flow is $5,331 per year represents a cushion of 17.5% above all other expenses.

The proforma does not explicitly identify developer equity; however, two sources totaling $109,436 can be imputed from the proposal. The appraised value of the property is $50,000 higher than carried on the proforma and the developer is taking a $59,436 lower fee than would be allowed under the Massachusetts Tax Credit Allocation Plan, a widely used underwriting benchmark in the state. The projected cash flow results in a modest 4.9% return on imputed equity.

HOME Rental Projects – Underwriting and Risk Assessment Checklist
Source: Franke Consulting Group

	Risk Category – Risk Factor	Acceptable Risk	Reducible Risk	Unacceptable
1	**Market Risk**			
	Market Trends – General market trends (vacancy levels, prices) support the development of the additional units at the proposed pricing	✓		
	Neighborhood market – The immediate project area market conditions are positive and support development of the units at the proposed pricing	✓		
	Community conditions – The physical and social conditions in the immediate environment surrounding the proposed project are suitable for the target audience	✓		
	Target population pool – A sufficient pool of target households exists in the primary geographic market area to support the project; or sufficient primary data (waiting lists or client lists) is presented to support timely occupancy of the development upon completion	✓		
	Affordability – The prices are affordable to a reasonable range of income levels (range = minimum income required to afford: maximum eligibility income)	✓		
	Needs – The project design (unit types, sizes, amenities, services) reflects the apparent needs & desires of the target population	✓		
	Competition – The project's price, location, condition and amenities are reasonably attractive in comparison to other housing choices available to low-income area HHs	✓		

HOME Rental Projects – Underwriting and Risk Assessment Checklist
Source: Franke Consulting Group

	Risk Category – Risk Factor	Acceptable Risk	Reducible Risk	Unacceptable
	Other market risk factors: None	✓		
2	**Borrower Risk**			
	Compatibility – The project is compatible with the mission and strategic focus of the applicant	✓		
	Board capacity – The board (if a nonprofit) is stable and has the skills and experience to oversee development	Merger of two boards results in stronger oversight		
	Staff development capacity – The applicant's staff & development team have the required skills to undertake & complete the project		✓ Developer has reduced risk by hiring a consultant	
	Past performance – The applicant has performed adequately on previous projects of a similar nature	✓		
	Backlog/current project – The current workload will not affect the ability of the applicant to complete this project	✓		
	Equity/pre-dev funds availability – The applicant has the cash needed for its equity contributions, pre-development advances & organizational overhead to support the project during planning and implementation (5 – 10% of TDC)	✓ Developer obtained acquisition and pre-development financing from Village Bank		
	Liquidity/financial ability to absorb overruns/delays – The applicant has sufficient financial strength to absorb reasonable project delays and cost overruns (check current ratio and liquidity of current assets)		✓ Budget contains adequate hard and soft contingency	
	Opportunity costs – The applicant will not be prevented from accomplishing its other key activities as a result of undertaking this development	✓ Proposed project is at the heart of developers mission		

HOME Rental Projects – Underwriting and Risk Assessment Checklist
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	Risk Category – Risk Factor	Acceptable Risk	Reducible Risk	Unacceptable
	project			
	Contingent/portfolio liabilities – The financial obligations of the organization with respect to its portfolio or other programs present no significant risks to the proposed project	✓		
	Ongoing management capacity – The applicant (or its identified management agent) has the capacity to manage the ongoing real estate, and to provide services as proposed		✓ Review Metro West's management performance over the next 6 months.	
	Other Borrower risk factors:		It will be managing the CAN-DO portfolio.	
3	**Project Risk**			
	Development budget cost reasonableness:			
	Acquisition cost – The acquisition cost is supported by appraisal or other evidence of market value, and is reasonable given site remediation, infrastructure and prep costs	✓		
	Hard costs – Construction/rehab costs: ▪ The design incorporates "green principles" for energy-efficiency; ▪ The scope will ensure property standards compliance & economic useful life for at least the compliance period; ▪ Costs are reasonably related to scope; ▪ Costs are final or based on detailed specifications to be considered reliable; and ▪ There is a reasonable contingency provision for construction costs	✓		

HOME Rental Projects – Underwriting and Risk Assessment Checklist
Source: Franke Consulting Group

	Risk Category – Risk Factor	Acceptable Risk	Reducible Risk	Unacceptable
	Soft costs – All non-construction line items are reasonable and supported, and reflect all expected project-related costs	✓		
	Developer/consultant fees – Total fees (including other fees collected by the developer or related parties) are reasonable compared to other projects	✓		
	Reserves – The project has adequate provisions for operating & replacement reserves: ▪ Capitalization of initial operating deficit is sufficient to reflect a reasonable rent-up period ▪ Reserves are capitalized or reasonable annual contributions are in the operating budget Operating budget cost reasonableness: ▪ Rental Revenue – Rents comply with HOME limits and are reasonable compared to market rents; vacancy/collection loss allowance is adequate ▪ Operating Expenses – Total operating expenses (per unit per annum, or month) are reasonable for this type of project; all individual line items are reasonable ▪ Management Expenses – sufficient allowance for management costs for this type of project ▪ Reserve Contributions – Reasonable contributions to operating and replacement reserves (taking into account capitalized contributions to	$15,000 capitalized reserves for 3 units Low HOME are well below market ✓ ✓	✓ Confirm real estate taxes	

HOME Rental Projects – Underwriting and Risk Assessment Checklist
Source: Franke Consulting Group

	Risk Category – Risk Factor	Acceptable Risk	Reducible Risk	Unacceptable
	reserves – see above) ▪ Net Operating Income – NOI and net available for debt service are reasonably calculated to maximum borrowing potential; debt service coverage ratio is reasonable or reflects lender requirements	✓		
	▪ Cash Flow – Cash flow projections are reasonable and not excessive for equity invested (if any)	✓		
	▪ Services – Adequate provision for services to reflect the target population's needs; service revenue sources identified sufficient to cover service expenses (separate from real estate operations)	rents projected to cover service budget of $1,500/yr.		

HOME Rental Projects – Underwriting and Risk Assessment Checklist
Source: Franke Consulting Group

	Risk Category – Risk Factor	Acceptable Risk	Reducible Risk	Unacceptable
	Readiness to Proceed – Project plans are sufficiently advanced to ensure timely commencement of project upon award:			
	▪ Site Control – applicant owns or controls the site	✓		
	▪ Status of Approvals – local approvals are in place or strong support is in evidence		condition of obtaining permit	
	▪ Funds are committed		condition on FCF + Village Bank	commitments
	▪ Project designs are completed		condition of completion	
	Completion Risk – Completion of the project on time and within budgeted resources is likely, taking into account the following risk factors:	✓		
	▪ Site Acquisition – The risk of not being able to complete acquisition of the site or require environmental remediation	Site purchased Clean 21-E		
	▪ Likelihood of Approvals – The risk of obtaining all required approvals to develop the site		condition of obtaining permit	
	▪ Adequacy of Funds – The risk of losing or not being able to finalize all critical funding commitments		condition on FCF + Village Bank	
	▪ Firmness of Budget – The risk that budget estimates are insufficient to cover construction scope or unfunded cost overruns		Condition on Final construction cost within budget	
	▪ Realistic Schedule – The risk of failing significantly behind on the proposed implementation schedule			

HOME Rental Projects – Underwriting and Risk Assessment Checklist
Source: Franke Consulting Group

	Risk Category – Risk Factor	Acceptable Risk	Reducible Risk	Unacceptable
	Viability Risk – The risk that the project, upon completion, will not be able to be maintained as affordable housing for at least the compliance period: ▪ Long-term operating projections (based on reasonable year-to-year rent and expense increases) provide adequate reserve contributions and positive cash flow; ▪ Management & maintenance plans are sufficient to protect physical property long-term	✓ ✓		
4	**Overall Risk Rating & Project Changes**			
	Recommended project changes and conditions for commitment based on risk factors identified:			
	• Review of final plans and spec			
	• Review of contractor once selected			
	• Obtaining comprehensive permit			
	• Review of MetroWest management capacity of CAN-DO's portfolio			
	• Firm commitment of FCF funds			
	• If real estate tax assumption is faulty, consider allowing High HOME rents on 1 or 2 units			

• Final construction budget within projected amount

• Firm commitment of mortgage financing to The Price Center in connection with its purchase of the group home