Final Risk Assessment and Underwriting Review
Myrtle Village, Newton, MA
Updated: October 9, 2014

Performed by: Daniel Gaulin, subcontractor to FinePoint Associates

In order to complete this assessment, I reviewed the Development and Operating Proformas submitted by the developer, Myrtle Village LLC, and its consultant, the Newton Community Development Foundation. I also reviewed the appraisals and other information located on the City of Newton's website.

Project Summary:

The project consists of the converting two existing occupied houses (a single family at 12 Curve Street and a duplex at 18-20 Curve Street) into seven units. The construction work will be a mix of renovation to the existing structures and construction of additional space onto the existing structures. The final unit configuration will be 1 1BR, 4 2 BRs and 2 3-BRs.

The HOME request is $339,000. The developer is proposing 2 low HOME units: a 1-BR and a 3-BR. The maximum amount of HOME that could into the project with this unit configuration is $391,756 – the requested HOME is less than the maximum allowable.

Market Risk Analyses:

The developer correctly indicates gross low HOME rents of $917 for the 1BR and $1,271 for the 3-BR. The Newton Housing Authority issued a new utility allowance schedule on October 1, 2014 which will result in reductions of $1 to $2 dollars per month in net rent. This slight change has no effect on the marketability of the units.

The five non-HOME units in the complex are projected at the following gross rents:
2 2-BRs @ $1,334 (this is the Local Initiative Program limit for a 2-BR based on 70% of median income)
2 2-BRs @ $1,552 (restricted by the Community Preservation funds to a maximum of $1,864 based on 85% of median)
1 3-BR @ $1,671 (restricted by the Community Preservation funds to a maximum of $2,017 based on 85% of median)

Curve Street is located in the village of West Newton. There is an active rental market in Newton including apartments in condominiums, single-families and duplex houses. The appraisal dated 9/26/13 performed by William J. Lanciloti, Jr. of Suburban Appraisal Services of the duplex at 18-20 Curve Street indicated that the market rent for the current unrenovated 3-BR unit is $1,700/month. A review of the rentals offered on the Multiple Listing Service on October 5, 2014 indicates that 1-BRs range from $1,250 to $2,100 and 2BRs range from $1,600 to $3,000. Newton is a desirable community for rentals due to its reputation for safety and good schools and its proximity to jobs in Boston and along Route 128. All of the proposed units will be offered at rents at or lower than market rents and will be of much better quality due to the proposed renovation; therefore, there is little market risk.

Developer Risk Analyses:

This developer is the Myrtle Village Limited Liability Company (MVLLC) formed by members of the Myrtle Baptist Church as an outgrowth of their Affordable Housing Committee. Its purpose is the conversion of the former church parsonage and a recently purchased adjacent building into affordable rental housing. The sole member of the LLC is the Myrtle Baptist Church and its sole Manager is Shelby

Robinson. Ms. Robinson is a registered nurse who has been an active member of the Affordable Housing Committee since its inception in 2011. MVLLC has chosen to hire a local community development corporation, the Newton Community Development Foundation (NCDF) as a development consultant and upon completion, as the property manager. NCDF has a strong track record in affordable housing development and management. It has developed 5 rental projects containing 231 units and one 10-unit ownership project. In addition, it manages two other affordable developments on behalf of other non-profits.

While there is always a risk with the first project undertaken by a new entity, there are factors that mitigate that risk in this case. The Affordable Housing Committee/MVLLC has chosen to start with a relatively small project involving two structures and seven units. Most importantly, it has demonstrated skill and sound judgment in its actions to date: the acquisition of 12 Curve Street, the hiring of an architect with affordable housing experience, and the hiring of NCDF as consultant and property manager. Although its track record is short, it is positive and it is not unreasonable to expect that the MVLLC will continue to exercise sound judgment in the future.

The renovation work will be under the supervision of the project architect, Angelo Kyriakides. Mr. Kyriakides has over 35 years of architectural experience including many award-winning HOPE VI projects which are among the largest and most complicated of affordable housing developments.

Project Risk Analyses:

Permitting

There is a degree of permitting risk as the MVLLC will be applying for a Comprehensive Permit under Chapter 40 B. This risk is considered to be low since MVLLC is applying under the Local Initiative Program which requires a formal endorsement of the municipality’s chief elected official and the financing includes $1,853,858 of municipality-controlled funds. MVLLC completed the first step of the process when the Massachusetts Department of Housing and Community Development approved MVLLC’s application for a Project Eligibility Letter on September 26, 2014. The next step is to schedule a hearing with the Newton Zoning Board of Appeals (ZBA). In the unlikely event that the ZBA either denies the permit or approves it with uneconomic conditions, the MVLLC would have the ability to appeal the decision to the state Housing Appeals Committee which often overturns ZBA decisions.

Sources and Uses

The total development cost for the project is projected to be $3,077,604. This project costs include the acquisition value of the properties, the construction work to renovate and expand the structures and the related soft costs. The sources are developer equity, a loan from the Village Bank, a grant from Newton Community Preservation, deferred payment loans from the Community Development Block Grant and HOME program. The sources and uses are in balance and the proforma provides sufficient detail of all financing and all project costs.

The acquisition cost is carried at $1,032,000 which is $113,000 lower than the appraised values determined by William Lanciloti on 9/26/13.

The construction is estimated at $1,310,950 with a 10.5% construction contingency. This is a reasonable estimate at this stage of the design development and the 10.5% contingency is appropriate given the project’s mix of renovation with large new additions.

The soft costs total $445,635 14.5% of the total development costs which includes architectural and project management costs, legal, title, temporary relocation, NCDF development consulting fee and a soft cost contingency.

The developer fee and overhead is carried at $151,526 or 5.2% of all other development costs. This is a modest figure for a development of this size and complexity. Since the MVLCC is bringing $632,000 of equity to the project, the net equity is $480,474 ($632,000 less the fee and overhead of $151,526).

Income and Operating Expenses

The operating proforma projects all income and expenses over a 10 year period. The proforma assumes rents will increase at 2% per year while expenses will increase at 3% and taxes at 2.5%. These are reasonable assumptions and result in slowly increasing positive cash flow over the 10 year period. Projecting these figures over years 11 through 20 also shows a slowly increasing positive cash flow.

The operating budget of this project is $6,523/unit/year which includes a $300/unit/year replacement reserve. This is a reasonable overall budget. The City may wish to increase the replacement reserve to $350/unit/year to bring it in line with most state-financed projects. The project was underwritten with a 7% vacancy allowance which is appropriate in a smaller development that lacks the ability to spread the collection/vacancy risk over more units. There will be three rent tiers targeting renters at below 50% of median; below 80% of median and below 100% of median. The rents have been calculated to be affordable to households at a range of incomes below those maximum limits.

Cash Flow - Return on Equity

The proposed loan has a debt coverage ratio of 1.21 and a year one cash flow of $8,916. The cash-on-cash return on the net equity of $480,474 is 1.9% which is within HUD and Consortium HOME standards. The projected cash flow increases slowly, the cash-on-cash return in year 10 is projected at 3 % and in year 20 at 4.3%.

Recommendation

This project has been well-conceived as a first project for a newly formed LLC and the LLC has made good choices in putting together its development team. While there are some risks identified; there are measures that can be taken to mitigate the risks. In the key area of financial feasibility, the project is considerably less risky than most, due to the strong rental market in Newton and the conservative development and operating assumptions.

The permitting risk of the project can be mitigated by not expending any HOME funds until a comprehensive permit is issued by the Newton ZBA.

The developer risk of the project can be mitigated by the City of Newton retaining the right to approve any changes to the development team. If there are no changes, it is reasonable to expect that the proposed team will deliver a good project and will operate it well over time. Should a change become necessary for any reason, the City would want to ensure that the new team member be at least as experienced as the existing members are.