

Apartment Economics Primer

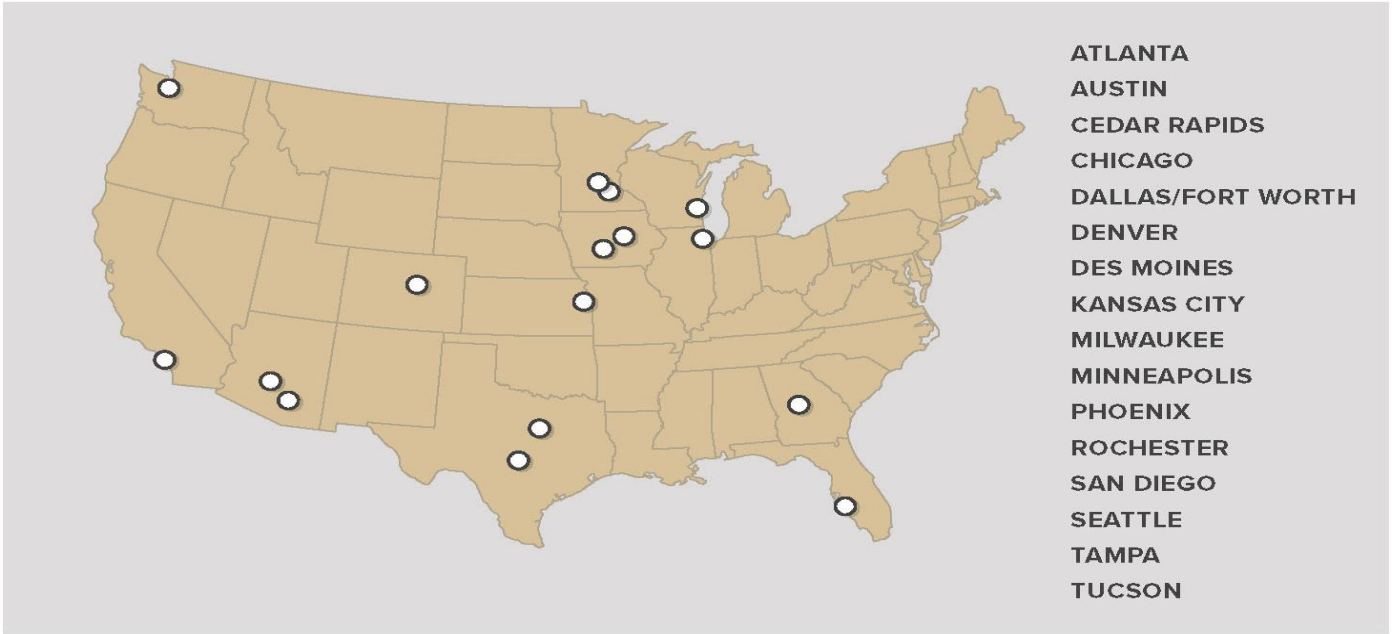
Policy Action To Address The Twin Cities Housing Crisis

January 2022

About Ryan



FOUNDED 1938	PROJECTS DELIVERED IN NEARLY EVERY STATE	SERVICES DEVELOPMENT ARCHITECTURE + ENGINEERING CONSTRUCTION CAPITAL MARKETS REAL ESTATE MANAGEMENT
2020 REVENUE \$3.2 BILLION	1,600+ EMPLOYEES	
.73 MOD RATE	HEALTHCARE INDUSTRIAL RETAIL SENIOR LIVING MULTIFAMILY BUILD-TO-SUIT	BUILDING PORTFOLIO UNDER MANAGEMENT 19M+ SF



Completed Multifamily Projects



The Flats at West End
ST. LOUIS PARK, MN

- Completed: April 2013
- 181,000 SF, 119 Units, Multifamily
- Terrace with pool, bocce ball & rooftop deck



222 Hennepin
MINNEAPOLIS, MN

- Completed: August 2013
- 580,000 SF, 286 Units, Multifamily
- 39,000 SF, Whole Foods Grocery
- LEED Silver



Vintage on Selby
ST. PAUL, MN

- Completed: November 2015
- 420,000 SF, 210 Units, Multifamily
- 39,000 SF Whole Foods Grocery
- Urban neighborhood



Edition
MINNEAPOLIS, MN

- Completed: July 2016
- 182,466 SF, 195 Units, Multifamily
- Retail at ground level
- Skyway connected to Central Business District



Maverick
MINNEAPOLIS, MN

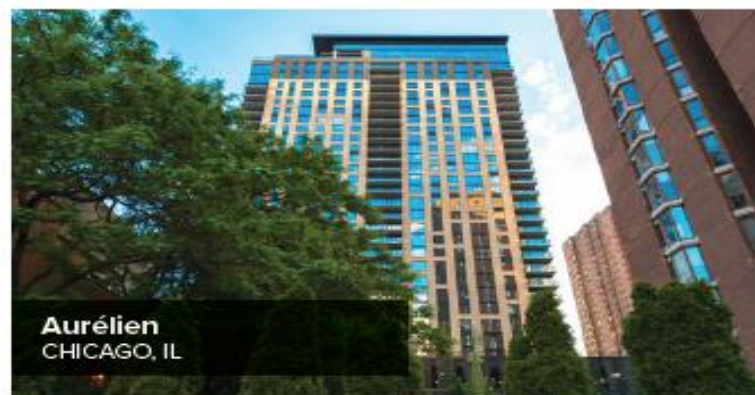
- Completed: February 2017
- 201,423 SF, 159 Units, 13 Walk-Up Townhomes, Multifamily
- Ground floor coffee shop
- 2017 Award of Excellence — NAIOP-MN



The Reserve at Springdale
AUSTIN, TX

- Completed: April 2017
- 330,000 SF, 292 Units, Affordable Housing

Completed Multifamily Projects



Aurélien
CHICAGO, IL

- Completed: May 2017
- 453,000 SF, 368 Units, 32 Stories, Multifamily
- Chicago's "Gold Coast"
- Rooftop Pool



Pierside Apartments
OCEANSIDE, CA

- Phase I Completed: October 2016
- 149,264 SF, 176 Units, Multifamily
- Phase II Completed: October 2018
- 246,948 SF, 156 Units, Multifamily



Circa Central Avenue
PHOENIX, AZ

- Completed: December 2018
- 283,000 SF, 227 Units, Multifamily
- Five two-story town homes & two office suites
- Prime urban location — across the street from Phoenix Art Museum and Burton Barr Central Library



Uptown at Kirkland Urban
KIRKLAND, WA

- Completed: September 2019
- 1,200,000 SF Master Development
- 185,000 SF, 185 Units, Multifamily
- 400,000 SF, Class A Office
- 170,000 SF, Grocery - Anchored Retail



Daymark Uptown Apartments
MINNEAPOLIS, MN

- Completed: March 2020
- 335,000 SF, 318 Units, Multifamily
- 16,000 SF, Class A Office
- 7,000 SF, Retail



Harper Apartments
ST. PAUL, MN

- Completed: March 2020
- 194,000 SF, 164 Units, Multifamily
- 4,000 SF, Restaurant
- 2,000 SF, Co-Working Space

Summary

- The housing crisis stems from **increased demand** from people who want to live & work in the Twin Cities. Supply has not kept up and rents have increased. The only way to decrease prices is to **increase the supply of housing at all income levels**.
- We **don't have the political will** to publicly finance all MN housing needs. Politics aside, there is simply not enough public capital at the city, state, and regional level.
- New housing developed with **private funding from outside investors** must be better leveraged to positively impact this crisis.
- We are competing on a Global basis for capital from investors who are **seeking yield**. Local land use regulation, taxes, and impact fees make development less compelling in MN than in other regions. We must identify policies that **ease process and improve investment yield** to encourage outside private capital to support new housing projects.

The Crisis in Metrics

Market Rate Housing Sources and Uses

Impacts and Inflation

Taking Action

Great jobs, culture, and amenities have led to rapid growth in the Twin Cities Metro area. This has led to an increase in population which has led to an increase in demand for all types of housing.



When housing demand increases, housing supply must also increase, otherwise housing prices will rise faster than inflation.

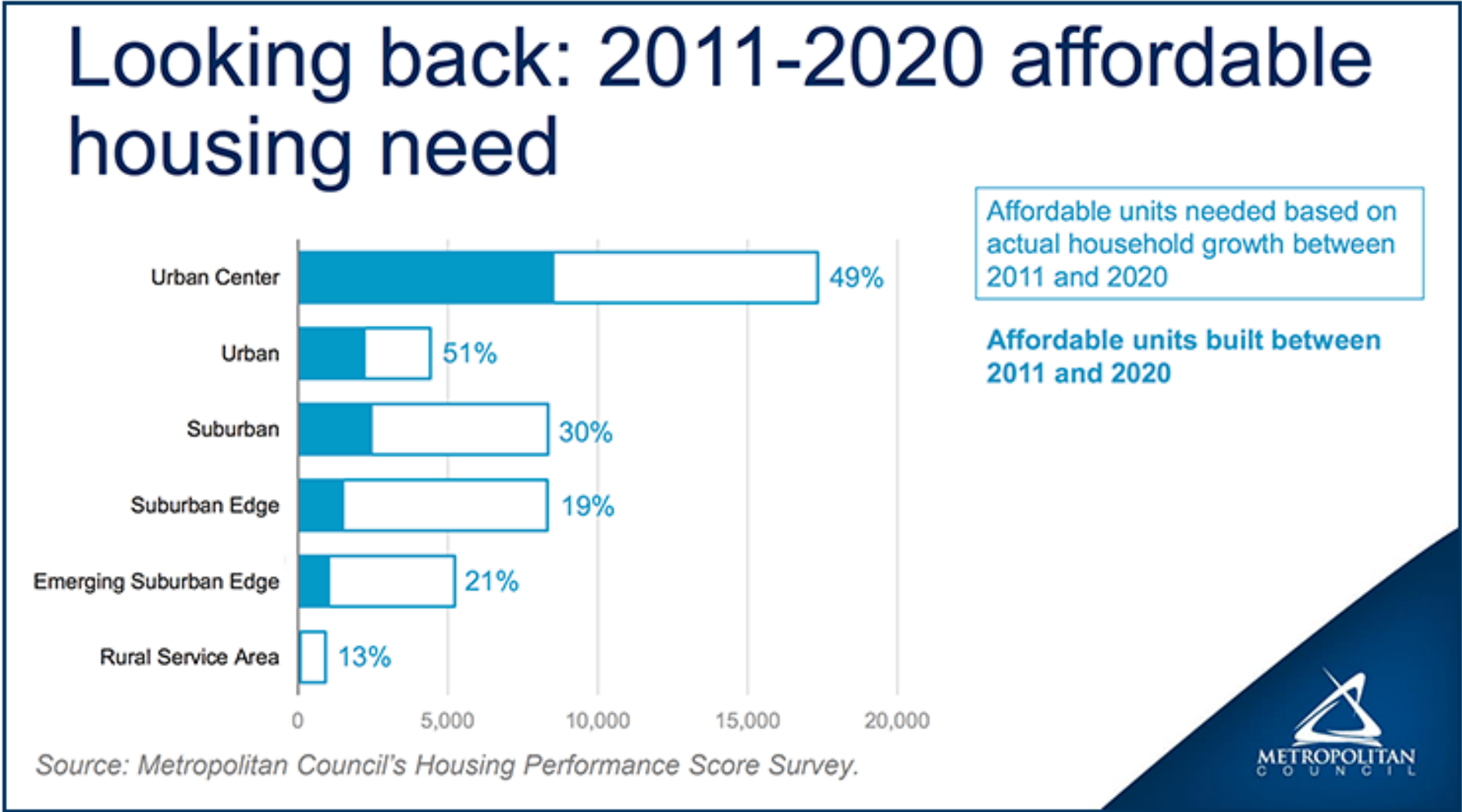
Vacancy Rates

Increased demand and constrained supply have led to:

Historically Low Vacancy Rates

- Lowest rental vacancy rate of major metro markets in the US
- 0% vacancy for 30% AMI
- Less than 2% Class C* apartment vacancy rate
- Investors are purchasing NOAH properties
- With healthy housing supply, rents should grow in-line with inflation (2-3% annually)
- For a healthy rental growth rate, market vacancy needs to be in the range of 5% or more

* Class C denotes older vintage apartment buildings which would generally be naturally occurring affordable housing.



Last decade, we underbuilt AH by 25,000+ units in the Metro Area.

The Crisis in Metrics - MN Housing partnership – 2021 report

- **More affordable housing needed.** In Minnesota, there is critical need for housing particularly for extremely low-income renters, or renter households that earn at or under 30% of area median income (AMI). There are approximately 169,585 renter households in the state fall into this category; yet, there are only 64,238 affordable and available units at this income level across the state. This leaves a gap of 105,347 units needed for extremely low-income renters.
- **Homeownership disparities persist.** Racial disparities in Minnesota are among the worst in the nation. While 77 percent of all white households own their home, 60 percent of Asian, 50 percent of Hispanic, 49 percent of Native American, and just 25 percent of Black households own their homes.
- **Housing costs are increasing.** Housing costs continue to increase disproportionately to income. Between 2000 and 2019, the median renter income in Minnesota increased by just 1 percent, while median gross rent for the state increased by 14 percent.
- **Cost burden disparities magnified.** The cost-burden disparity for renters and homeowners of color is stark. In Minnesota, 44 percent of white renters are cost burdened; in contrast, 58 percent of Black renters — 82,364 renter households — pay more than they can afford on housing.
- **Wages are not keeping up with housing costs.** Of the top five in-demand jobs in the state, three do not earn enough for quality housing to be affordable. Relatively low-earning positions central to the healthcare industry, particularly home health and personal care aides and nursing assistants, are expected to see some of the largest increases in demand over the next ten years.

The Crisis in Metrics – December 2021 Ramsey County Affordable Housing

In Ramsey County, more than 37,000 families live at or below 30% AMI, said County Board Chair Toni Carter. The county estimates that it needs 15,000 new affordable units.

- 15,000 units at \$300,000 per unit is **\$4.5 BILLION** (recently announced of \$74M funding)
- Metro area needs 3 times this amount – **\$13.5 BILLION** of housing to meet current demand
- With project level debt only able to cover 30% of costs, **\$9+ BILLION** needs to come from public sources.

Without a significant increase in overall housing supply, this crisis will only get worse.

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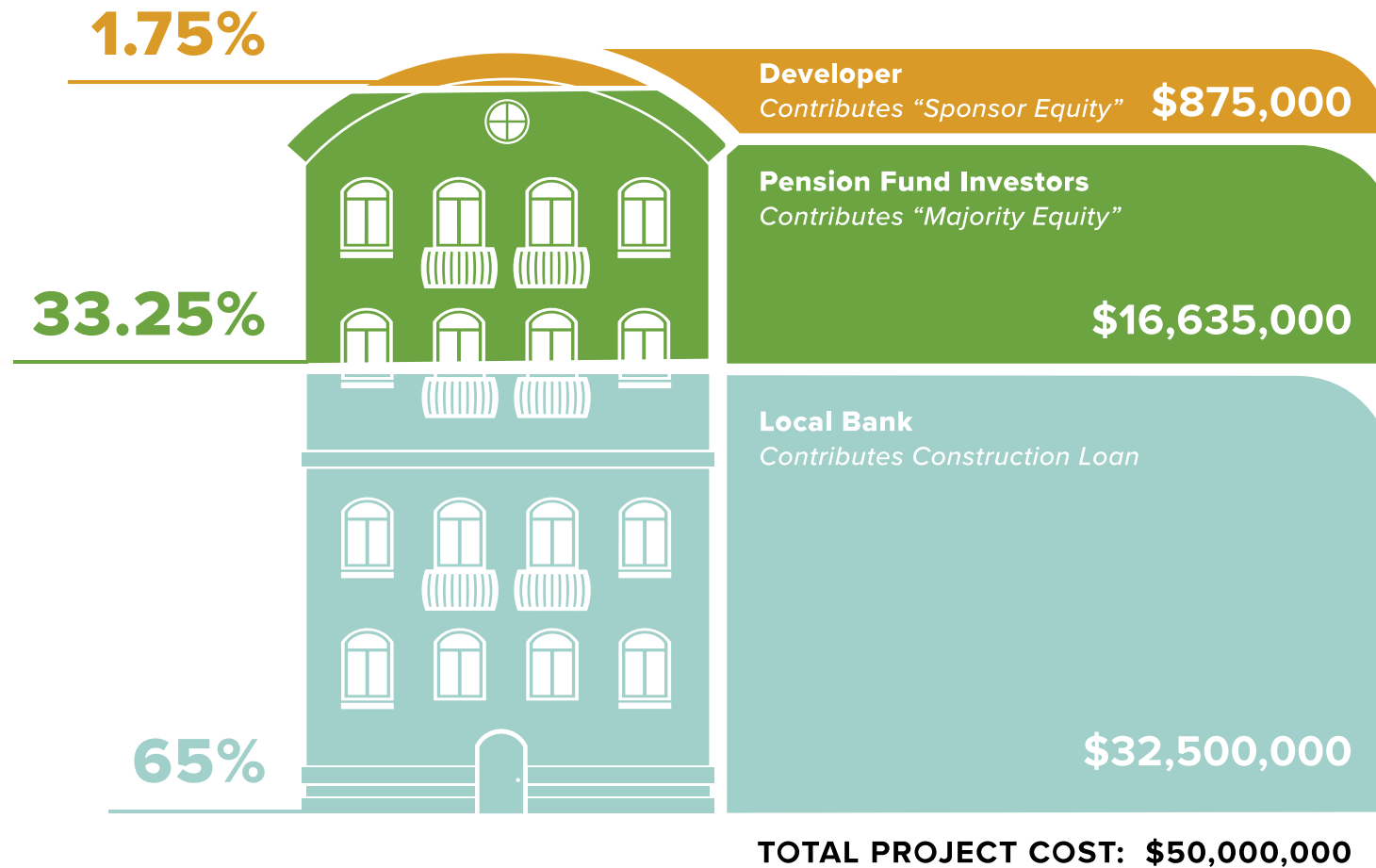
A new unit of housing costs +/- \$300,000.

Takes 24-48 mos. to complete a MF Development

The cost to build a unit of Affordable Housing costs about the same as unit of Market Rate

Ryan – Example Development – 175 Unit Building

Funding Sources - How a New Market Rate Project is Funded



Harper Apartments, Saint Paul – 65% Associated Bank; 33.25% State Retirement System; 1.75% Developer (Ryan)

Ryan – Example Development – 175 Unit Building

Investor Profile, Priorities, & Risk Tolerance:



Local Bank –

- **Profile:** Very risk adverse. Regulated by Federal Reserve & OCC. Banks require borrower to demonstrate ability to maintain positive cash-flow under multiple scenarios to ensure payback.
- **Project Risk:** Will not close without proof of equity and project fully approved. Will take 60-70% of value of project with rates 2-3% over an index.



Fund Investors:

- **Profile:** Takes calculated risks to get a good risk adjusted return that will grow the pension on behalf of the pension holders. Open to wide range of investments and geographies.
- **Project Risk:** Closes after entitlements are complete and full Budget is set.

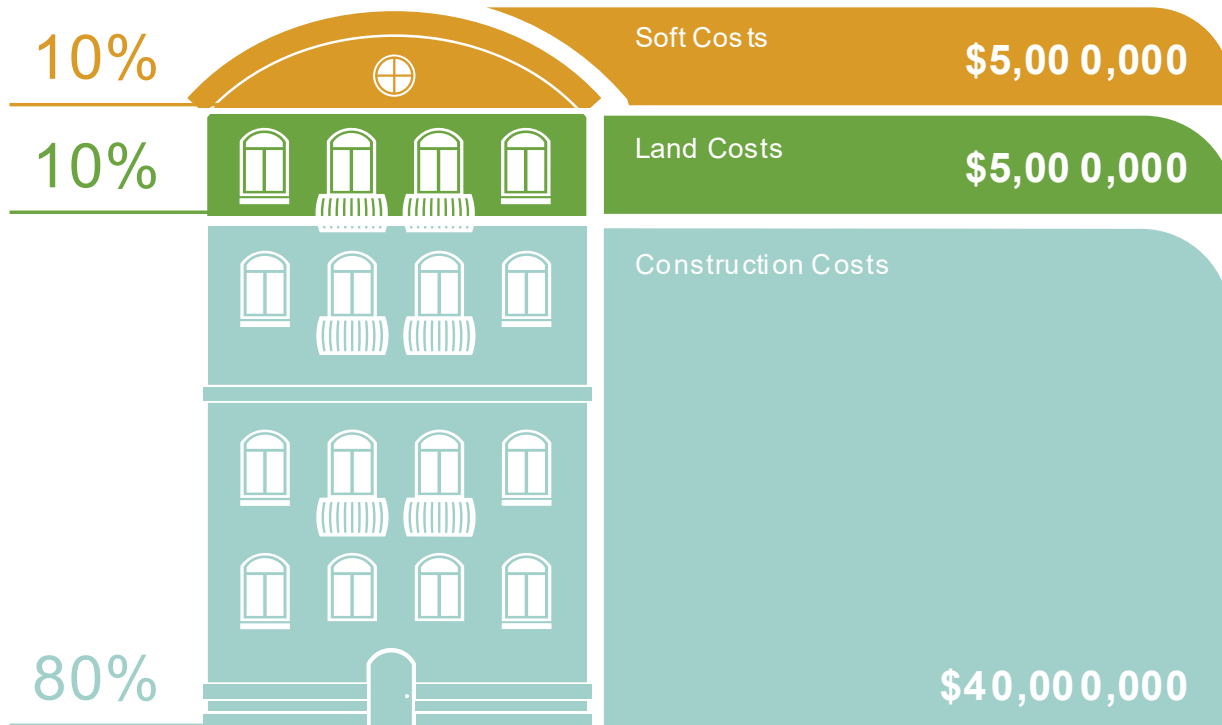


Local Developer(Ryan):

- **Profile:** Wants to build more projects locally. Tries to identify local projects that will attract investment from Banks & Investors. Cannot build without funding from outside sources.
- **Project Risk:** Funds all pursuit costs. Takes entitlement & GMP risk pre-closing. Construction risk, loan guarantee risk, and project cash-flow risk post-closing.

Ryan – Example Development – 175 Unit Building

Funding Uses - What are the Project Costs?



Soft Costs - \$5MM

- **\$1MM** to City & County: SAC/WAC Fees, Park Dedication Fees, Entitlements & Permitting
- Other Soft Costs: Legal, Design, Due Diligence, Environmental Surveying, Property Taxes, etc.
- Development Fee - typically 3% of project costs

Land Cost - \$5MM

- Land side acquisition, paid to the landowner

Construction Costs - \$40MM

- ~\$20MM(50%) is spent on Union Labor
 - Ex: Local 563, Local 49, Local 633, IBEW 110, Carpenters 322, Roofers 96, Teamsters 346, etc.
- ~\$20MM (50%) is spent on Building Materials
 - Lumber, Concrete, Steel, Glass, Copper, etc.

Funding Supply

What is Yield?

Investors analyze the '**Yield**' of a development project to assess the potential return on their investment

- High Yield = Good Investment & High Investor Interest ↑
- Low Yield = Bad Investment & Low Investor Interest ↓

$$\text{Yield} = \frac{\text{Net Operating Income}}{\text{Total Project Cost}}$$

Apartment projects require a yield of 6-7% in order to be financed

Competing for Investment Dollars

Outside investors have many different investment options

- **Equity Markets (Dow Jones & S&P 500)**
- **Fixed Income Assets (Bonds & Securities)**
- **Alternative Assets (Hedge Funds & Private Equity Funds)**
- **Other U.S. Real Estate**
 - Other Mid-Size Cities: Seattle, Portland, Austin, Atlanta
 - Other Midwestern Cities: Chicago, Kansas City, Milwaukee, Indianapolis

Investors will go where they can find the best yield based on risk.

Addressing Market Supply

We need to increase the supply of all housing types



Class A

- Brand New Construction
- Most Expensive



Class B

- 10-25 Years Old
- Less Expensive

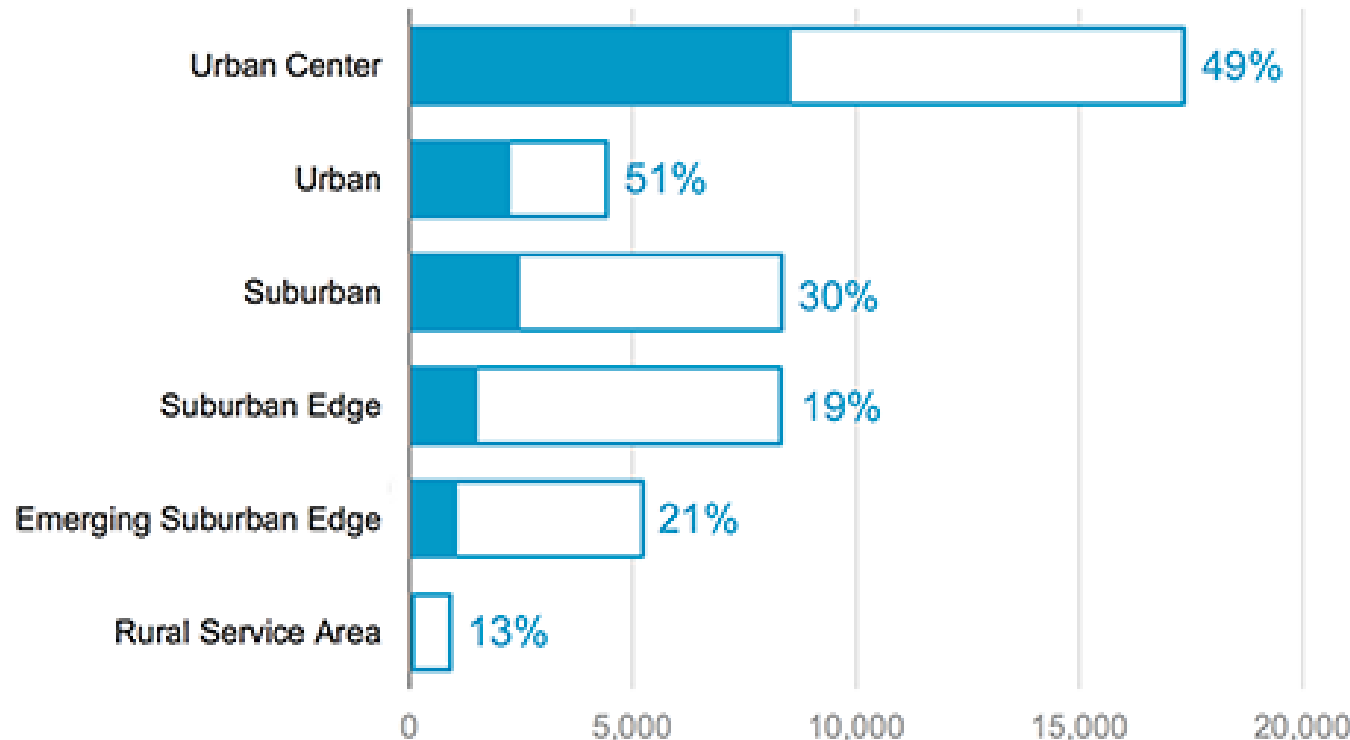


Class C

- 25+ Years Old
 - Least Expensive(NOAH)

Delivery of Class A today is delivery of Class B & C tomorrow

Looking back: 2011-2020 affordable housing need



Affordable units needed based on actual household growth between 2011 and 2020

Affordable units built between 2011 and 2020

Source: Metropolitan Council's Housing Performance Score Survey.

The Crisis in Metrics

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Inflationary Pressure on Housing

Cost Inflation – 6 story wood frame Market Rate Multifamily

- Budget in September 2020 = \$214 per square foot
- Budget for April 2022 start = \$272 per square foot
- Cost increase 27% in 20 months

Snapshot of commodity increases

- Insulation went from \$1.51 SF to \$3.00 SF - + 98%
- Residential composite windows went from \$2.90 SF to \$3.80 SF - + 31%
- Appliances went from \$3.30 SF to \$3.60 SF - +10%
- Lumber went from \$44.12 SF to \$75.06 SF - + 70%

Inflation Impacts on Housing Production Costs



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There is not political will to sufficiently fund an adequate supply of Affordable Housing. There is ample, and relatively inexpensive private capital available for housing, however local tax structure and regulatory environment do not make an attractive place to invest. (We are losing to other states.)

With the AH dollars we have:

- 1) **Aggressively fund AH vouchers** – this quickly gets subsidy into the hands of our neighbors that need it most.
- 2) **Gap fund NOAH purchases!** - New construction is lengthy and the most expensive form of housing

Immediately and Aggressively subsidize the construction of all types of housing, especially market rate housing as it leverages outside private capital.

When considering policies, we need to make sure that our policies do not impact investment yield. If new policies negatively impact the yield, they will negatively impact the ability to increase the housing supply, leading to increased rental rates and further shortage of AH units - **IZ and Rent Control DON'T WORK!**

Rent Control – unintended consequences

- Capital won't invest
- Developers and builders will shift to more predictable locations and asset types
- Will further impact supply, exacerbating gentrification, providing near term savings for some, but long term increases to housing costs.

Questions?