October 28, 2016

Planning and Sustainability Commission
1900 SW 4th Avenue, Suite 7100
Portland, OR 97201

Via email: psc@portlandoregon.gov

RE: Proposed Inclusionary Housing Policy

Chair Schultz and Members of the Planning and Sustainability Commission:

Thank you for the opportunity to testify before the Commission regarding the proposed Inclusionary Housing Policy being considered for the City of Portland. As a longtime mixed use developer in Portland, we have taken a close look at the proposed policy both to analyze the impacts it would have had on recently completed projects, and on projects we have in our pipeline or are considering for development.

We have included with this testimony a case study on the Muse Apartments which we completed three weeks ago and is a 100% market rate building, which formed the basis of our conclusions.

Our high level observation from analysis of the numbers is that implementation of the policy as proposed will significantly impede housing development for at least several years, which will undermine the city's goal of producing 120,000 new units over the next 20 years.

As written, the PHB policy will have the following effects:

- It will require either significant compromises in the quality, design and/or sustainability of the product that gets built in our city
- As demonstrated in the attached analysis "Effect of proposed policy on Muse if built now" ***it will require market rents to increase significantly, in fact by $543/ per month or between 20-25%*** thereby exacerbating affordability issues for the large majority of renters not who are not eligible for the IZ-subsidized unit, **this will clearly stop new development until market rate rents rise enough to pay for the subsidized units**
- It will encourage developers to build in the far suburban reaches of Portland, encouraging suburban sprawl

Gerding Edlen recently joined the local LOCUS affiliate and has been participating in discussions about the proposed alternative that LOCUS has advanced. While we are largely in favor of a more modest IZ proposal, we are

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not convinced that the LOCUS proposal will not have similar negative incomes, albeit less severe. As I stated in my testimony, we believe the bond route is the more appropriate funding mechanism unless a portion of the objective is to slow or stop new construction.

We strongly encourage the city to take more time to analyze potential outcomes and possible unintended outcomes of the adoption of such a policy, as well as to look at ways to make the policy more flexible for developers. For instance, a viable in-lieu fee should be a part of the policy, at least in the first 3-5 years of the program. Portland Housing Bureau has structured the proposed in-lieu fee to be punitive which, especially in the early years of such a policy being implemented, is a mistake.

We also believe that a credible off-site option should be a part of the initial policy, and the city has yet to present an off-site option that makes any sense. Developers should be able to form reasonable partnerships to deliver units off site and the program should allow for flexibility and creativity, including allowing developers to take "credit" for surplus affordable units being developed as part of other projects. The current proposal for offsite units is unrealistic and rigid.

When one seriously considers the impact of this policy we believe that it will encourage low cost, low quality product as the impact will be to "tax" high cost, high quality projects more significantly than it will be for low cost, low quality projects. This is due to the fact that the affordable rents will be the same whether it be in a low cost stick frame building with low grade finishes as it would be in a high quality type I constructed high rise in the central city thereby rewarding the low cost, low quality project and penalizing the high cost, high quality project.

Again, we appreciate the opportunity to provide our analysis and testimony to the Planning and Sustainability Commission about this proposed policy, and are grateful that Commission members are taking a thoughtful approach to analyzing the potential impacts on the adoption of such a proposal. Gerding Edlen is supportive of increasing the affordable housing supply in the City of Portland and recognizes the extreme need and in fact we are currently in the process of developing three affordable projects in the City, but we cannot support a policy that will have what we view as negative unintended consequences on the City's growth, density and sustainability goals overall.

Sincerely,

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Impacts of Proposed Inclusionary Zoning Policy

Case Study with recently completed multifamily development

Gerding Edlen project name: Muse

- Completed October 2016
- 58 units, 5 over 1 podium construction
- Zoning: EX(d) (Central Employment)
- Base FAR: 3:1 (30,000 sf on a 10,000 sf lot)
- Max Height: 65 feet
- Max FAR with residential bonus: 6:0 (60,000 sf on a 10,000 sf lot)
- Actual building GSF: 51,898 sf
- Parking: 31 stalls (0.53 stalls/unit)

PHB recommendation for Projects in Zones with Base FAR below 5.0

1) 20% at 80% MFI with
   a. Density bonus of 3.0 FAR
   b. 10-year tax exemption on affordable units only
   c. CET exemption on affordable units only

OR

2) 10% at 60% MFI with
   a. Density bonus of 3.0 FAR
   b. 10-year tax exemption on affordable units only
   c. CET and SDC waivers on affordable units only

Effect of proposed policy on Muse, inclusive of incentives:

	Baseline Project - Muse	20% at 80% - PHB Proposal	Variance	10% at 60% - PHB Proposal	Variance
Yield	5.55%	4.85 %	-0.70%	5.12%	-0.43%
Unlevered IRR Year 11	9.93%	8.04%	-1.89%	8.85%	-1.08%
Yield Year 11	7.46%	6.30%	-1.16%	6.79%	-0.67%

The impact of the policy as written to project returns are such that it would not attract financing capital without either a significant increase in income – meaning higher rent on the market rate units – or a significant cost savings – meaning either reduced construction costs or land costs. The following two options look at the necessary changes to achieve the same yield, assuming 20% at 80% MFI.

Option 1: Increase income

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With 20% at 80% MFI, the net operating income (NOI) decreases by 11%. In order to get back to the baseline yield (NOI/cost), rents would have to **increase by $183 per unit, per month**. That means, with current rents at $2.79 per square foot, they would need to increase to $3.06 today, which is above market and unachievable.

Option 2: Decrease cost

Since we are unlikely to capture this increased rental income, we look to decreasing costs. The costs would have to **decrease by $33 per square foot** on construction cost (an 11% or **$1.7 million reduction** overall), or the **land price would have to decrease 100%** from $170 per square foot of land to $0.

In order to decrease construction costs, considerations include:

- less expensive cladding (design review issue)
- less expensive envelope (energy code issue)
- fewer amenities and lower quality finishes (market issue)

This previous example showed a multifamily building that has already been completed. If we were to build the same building of the same quality **now**, it is even more extreme, as construction and land costs have increased dramatically. For this same building in similar location, construction costs have increased 9% per year, and land price in the area has risen 27% per year.

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Effect of proposed policy on Muse if built now, inclusive of incentives:

	Baseline Project - Muse	20% at 80% - PHB Proposal	Variance	10% at 60% - PHB Proposal	Variance
Yield	4.64%	4.01%	-0.63%	4.26%	-0.38%
Unlevered IRR Year 11	7.72%	5.78%	-1.94%	6.61%	-1.10%
Yield Year 11	6.24%	5.22%	-1.02%	5.65%	-0.59%

As it is, doing the same quality project is not feasible in today's market and would not attract financing capital. With the policy as written, additional financial burdens are imposed. To make the project feasible with 20% at 80% MFI, the NOI would need to increase by 26%, **increasing rents by $543 per unit, per month**. The costs would have to **decrease by $99 per square foot** on construction cost (a 26% or a **$5.2 million reduction** overall), or the **land price would have to decrease 100%** WITH an additional **reduction of $49 per square foot in construction costs**.

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