

Affordable Housing in Washington County, UT

An analysis of multi-family development and the
underlying assumptions

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While the rest of the United States and the Wasatch Front have seen multi-family development recover, expand, and peak, Washington County has failed to build a single unit of market rate multi-family housing in a configuration over 20 units. Even with rising rents and record low vacancies, development lags. This analysis considers the reasons for sluggish developer demand and proposes solutions to ensuring there are more affordable housing options in the St. George area in the future.

Historical Background

As single family homes continue to appreciate, affordability is becoming a concern. The residential real estate market heated up from 2004 to 2007 and left many struggling to find affordable housing options. During this period, the St. George Area started an important conversation about the need for affordable housing. The concern was that home ownership was out of reach for many working families and that there were few options for individuals starting families or relocating from out of the area for work.

The discussion ended when the housing peak turned into a housing led recession. Many homes became available for rent. The cycle also resulted in vacancy rates of over 20% in our multi-family sector and created significant downward pressure on rents. The good news was that the affordability problem was solved. The bad news was we had a housing led recession that devastated construction, real estate and finance, banking, retail, and other sectors of the economy.

It has been ten years since housing affordability was last debated in Washington County. Residential housing markets are nearing their pre-recession peaks. Although appreciation isn't as aggressive as it was prior to 2007, home prices are on the rise and affordability is becoming an issue once again. Median home prices are now \$250,000 with the average home sold coming in over \$292,000 (See Exhibit A).

With interest rates at 4.25% as of this writing, the \$250,000 median home payment will be just over \$1,100 per month, assuming they can qualify at 90% down. Private mortgage insurance, property taxes, homeowners' insurance, and HOA fees can bring that total to nearly \$1,500 per month. Adding utilities and basic maintenance a family should budget \$1,750/month to afford this home.

Population Growth

Driving around the area, it appears as though the entire county is under construction. Homes, schools, and commercial being built almost everywhere. Some may think that this surge of construction is unusual. For those who know the growth history of Southern Utah, this is normal.

From 1975 to 2007, population growth averaged more than 6% per year. Population growth is natural increase (births minus deaths) plus net migration (move-ins minus move-outs). From 2010 to 2015 population estimates ranged from 1.56%-2.64%. The 2016 numbers just came in at 3.7%, a full percentage point higher than any time during the past five years¹. While natural increase has been relatively constant at about 1,000 people per year, net migration is the driver with only 126 net move-ins to Washington County in 2010 compared with estimated 4,900 move-ins in 2016 alone.

The result is that during the slow growth years of 2010 – 2016, the Washington County population increased by 22,000 people. For the full table showing population changes by county for the State of Utah between 2010 and 2016, please see Exhibit B. If we would have maintained the historical growth rate of 6% prior to the recession, the county would have grown by more than 50,000 people. Of all the factors that could impact our local economy, changing population is the most significant. More than any

¹ Source: Utah Population Estimates Committee: <http://gardner.utah.edu/state-and-county-level-population-estimates/>

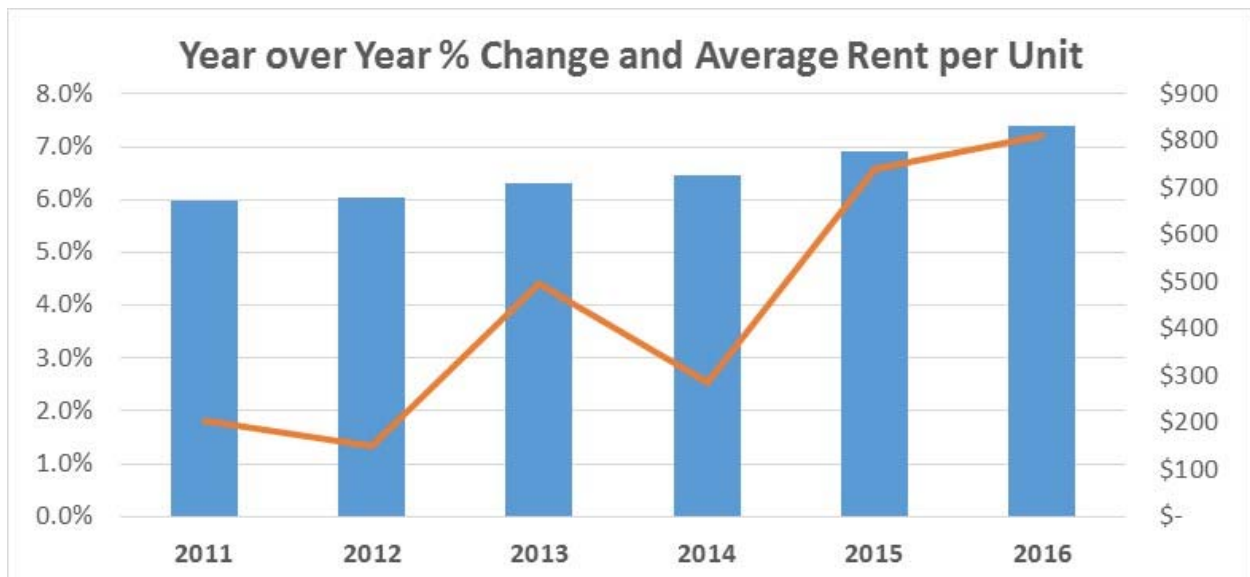
other number, population growth will tell the story for economic development, employment, quality of life, and affordability in our community.

Apartment Rents are on the Rise

Historically, our Multi-family housing markets offered a safe haven from rising housing costs--until now. With 2015 and 2016 rent increases of 6.6% and 7.2% respectively and vacancies below 1% for a full year, without new rental supply, this asset class will offer no reprieve from rising rents.

The problem is not too much demand. Across the United States and along the Wasatch Front, multi-family has seen explosive development. While our community has grown by more than 22,000 residents since 2010, we have added one senior subsidized housing project of 54 units and one student housing building. We have a shortage of rental housing. Vacancy rates below 1% confirm this. Other assets like single family residential, office, retail, industrial, and schools have kept up with the increase in population by adding to supply. Multi-family has not.

Without new supply, rents will continue to rise. Average rent is \$832 per month or \$0.86/SF but a 3 bedroom, 2 bath apartment unit will cost approximately \$1,050 per month at the beginning of 2017—approaching the cost of the mortgage payment referenced above.



Coming Projects

Rising rents have created some interest from developers, but primarily student housing and where there are government incentives. The Vintage at Dixie State and Rocky Vista's student housing are currently under construction. Downtown, the proposed City View project contemplating 100 units in a mixed-use project with a hotel and retail space are in planning stages. The City View project benefits from a Community Development Area downtown that reduces property taxes for the project as an incentive.

Bach Homes' 244 unit Greyhawk apartments at Mall Drive anticipated for 2017 is seeking zoning approval after their initial approval from 18 months ago lapsed because they did not break ground on the development. Riverwalk Village a 55 unit subsidized housing project also at Mall Drive, is anticipated to start construction in 2017.

Developer Constraints

Why no new supply and so few projects in the pipeline, particularly for market rate products? There are only four options:

- 1) Rents are too low to generate a meaningful return.
- 2) Construction costs are too high, wiping out returns.
- 3) Land is too expensive.
- 4) The use is constrained through zoning.

In performing the sensitivity analysis, we started with a base case scenario using current market conditions. Those market conditions are summarized below and fully described in Exhibit C.

	Base Case
SF/Unit	1,000
# Units	200
Rent/Unit	\$ 860
OpEx as a %	32.5%
Construction Cost/SF	\$95
Impact Fees/Unit	\$13,946
Land Cost/Unit	\$ 10,000
Density/Acre	20
Vacancy Rate	4%

We assumed the project would be a combination of two and three bedroom units with an average of 1,000 square feet. The project consists of 200 units with rent at \$.86 per square foot. Operating expenses are assumed at 32.5% of effective rental income and construction costs are estimated at \$95 per square foot inclusive of land improvements, vertical construction costs, and soft costs like engineering and architectural fees.

Impact fees, including city and water conservancy impact fees and permitting costs, are estimated at \$14,000 per door. Note that this is for St. George City. Other municipalities are higher in Washington County as of this writing. Land costs are estimated at \$10,000 per door with a density of 20 units per acre. Vacancy rates are estimated at 4%, which is reflective of stabilized conditions and not the extraordinarily low vacancy rates associated with current market conditions.

From this base case, an investment analysis was constructed. Given the assumptions above, we can determine the financial feasibility. Project costs include land costs, impact fees, and construction costs. The estimate is \$119,000 per door. Income can be estimated, adjusted for vacancy, operating expenses subtracted, and net operating income projected. The result is a 5.62% return in our current scenario.

Land Cost	\$	2,000,000
Impact Fees		\$2,789,200
Construction Cost	\$	19,000,000
Total Cost	\$	23,789,200
Cost/Unit	\$	118,946
Rental Income	\$	2,064,000
Vacancy	\$	(83,000)
Net Rental Income	\$	1,981,000
Operating Expenses	\$	(644,000)
Net Operating Income	\$	1,337,000
CAP Rate		5.62%

The 5.62% capitalization rate (CAP Rate) is too low to justify investment in Southern Utah. With typical debt at 70% loan to value, the project has a cash on cash return of only 4.8%. These economics are discouraging for prospective developers.

Breakeven Analysis

In determining what would need to change to incentivize developers, we targeted a 6.25% CAP Rate and a 7% cash on cash return. We then tested the key assumptions to calculate at what level the investment metrics would meet the above criteria.

Rents must increase by 11% to reach breakeven. Rents have been too low to justify the investment given the costs of construction, land, and permitting. They have increased over the past two years by 14%, still the breakeven lease rate is 11% higher than current rent levels. This would put rents at \$957 for a 1,000 SF apartment or \$.96 per SF.

Construction costs would need to fall by 13%. This reflects all the costs of construction, exclusive of impact fees. On site improvements, soft costs, and vertical construction are all included in this number. In calculating the break even, significant cost reductions would be material to the analysis; unfortunately, construction costs are rising instead of falling. We assumed a base case of \$95 per square foot in construction costs—not including land or impact fees. The costs would have to fall to \$83 per square foot to meet the breakeven criteria. This is probably the most unrealistic scenario of those considered.

Even if the land were free, it would not hit breakeven. At \$10,000/door, land costs represent 1/2 of the cost of the impact fees. If land prices were \$0/door, it still wouldn't represent enough of an adjustment to incentivize developers with the current economic assumptions.

Impact fees would have to fall to \$2,000 per unit. They currently range between \$14,000 and 19,000 per door, plus permitting costs. This fee includes the city impact fee, the water conservancy district fee, and other permitting costs. If impact fees were to fall to \$2,000 it would justify the project economics.

Some say these numbers are unreasonable, but consider the impact fees published in the Spectrum on December 12, 2016 comparing St. George and Washington City to other municipalities in the State.

These impact fees for St. George and Washington City are not inclusive of the Water Conservancy District fee of \$3,800, which by itself is approximately the same as the other municipalities below.

Unit	St. George	Washington	American Fork	Draper	Ogden	Provo	Salt Lake City
3000 SF Home	\$ 11,253	\$ 16,800	\$ 3,200	\$ 5,343	\$ 3,800	\$ 4,000	\$ 3,459
1800 SF Home	\$ 11,253	\$ 16,800	\$ 3,200	\$ 5,343	\$ 3,800	\$ 4,000	\$ 3,459
1100 SF Condo	\$ 10,163	\$ 14,750	\$ 3,000	\$ 3,645	\$ 3,400	\$ 3,500	\$ 3,284

Source: The Spectrum, "Area Housing Prices Squeeze Middle Class" Monday December 12, 2016

In 2016, Salt Lake City set a precedent by waiving impact fees for a full year to incentive development². It has been said that impact fees can't be reduced, but Salt Lake City showed that they clearly can. At a minimum, consideration should be given for some of the key differences between multi-family units and single family units.

- 1) They don't consume as much water per unit.
- 2) They don't require as much road infrastructure per unit.
- 3) They don't need the same storm drainage per unit.
- 4) They don't consume as much electricity per unit.
- 5) They don't produce as much sewer or garbage per unit.

In considering the breakeven analysis, we are really considering opportunity cost. If investment capital can be deployed in Salt Lake City, Las Vegas, Phoenix, Denver, Boise, or St. George. All things equal, the investment capital will follow the returns. In the case of multi-family development, the development has lagged significantly in St. George because the economics don't justify the investment.

Zoning and Land Use

Even if all of the other assumptions meet developer standards, if a project does not have the proper zoning, then it is not feasible. Zoning remains a problem in Washington County. R-3 and R-4 designated land is rare. Instead, the municipalities are relying on planned development (PD) zoning to grant approval for density.

The motivation for this strategy is to protect the neighboring property owners and community from poorly thought out projects. While understandable, the unintended consequence is that no neighborhood wants multi-family development and every project sees significant opposition from

² The Salt Lake Tribune: "Salt Lake City Exploring Moratorium on Development Fees" published September 24, 2015 and Salt Lake Tribune: "Impact Fee Cash Piles Up Even as Salt Lake City Faces Budget Squeeze" June 6, 2016.

neighbors. If the economics work but the land use doesn't, we still don't have multi-family development.

Honestly, what are we afraid of? The concern raised in public comment sections is increased crime implying undesirable neighbors. The truth is that most of us have lived in apartments during our lives for many of good reasons. The claims of many that prejudice multi-family development are based in unfounded fears and not reality.

There are many reasons individuals are tenants instead of owners. It could be the stage in their lives or lack of savings. It could be that they aren't planning to stay in the same place for a long time. It could be that they don't have faith in the housing market. It could be that they don't need very much space and are comfortable in a smaller footprint. It could be that this is the best location for their work or school needs. It could simply be that this is the best space they can afford.

We have stigmatized affordable housing options by not setting aside land zoned for them. Instead of frustrating both neighbors and developers with the planned development approval process, the municipalities should consider setting aside land for multi-family development and designating its use as such through the zoning power vested in the municipality.

Recommendations

Our community can take action that will align incentives resulting in more proposals resulting in actual development. Following are specific recommendations:

Temporary Impact Fee Reduction

A municipality or the water conservancy district could offer a reduction in the impact fee cost for a specific amount of time for a limited number of units. For example, instead of waiving impact fees, offer a reduction in impact fees first 250 or 500 units that would sunset six months from the effective date. In addition, require construction to be complete within a specific timeframe or the permits expire. This prevents permits getting pulled that won't be built, it allows the municipality to control the dollar value of the incentive offered, and it prevents the incentive from staying on the market longer than necessary.

Zoning Certainty

It is expensive to contract for land, create a development plan with engineered drawings and architectural renderings, evaluate environmental and geotechnical conditions, go through staff reviews, and then not be able to move forward because of public clamor. While our community generally does well in managing these dynamics, projects that have less entitlement risk are more desirable than projects with more entitlement risk. Parcels identified in the General Plan as high density residential developments could proactively be zoned as such. Provide as much certainty and transparency up front as possible to eliminate risk of failure. R-3 and R-4 zoning is more desirable than PD because of the ability for a large, unexpected turnout from the public to derail a project.

Density Considerations

Given height restrictions, circulation, setbacks, and landscaping requirements, density can be a thorny issue. There are examples where making exceptions are appropriate. Codify those scenarios and offer increased density as the rule instead of the exception. In considering all the constraints, it is uncommon

for the density contemplated in the code to be feasible without some kind of variance. Higher densities drive the per door cost of the land down, and lower densities drive the cost per door of the land up.

Conclusion

The outlook for multi-family is clear. Either costs will fall or rents will rise. The stage is set for a 11% increase in rents. If construction costs continue to rise, then rents will have to push even higher to compensate. At a time when affordability is becoming an important issue again, the rental market is preparing to clear via higher rates.

Over the past six years, the local population has grown by 22,000 people. We are building nearly 1,500 homes per year. The median home price is \$268,000 as of December 2012. Yet there has been no construction of market rate apartments. Given that three out of the four proposed projects require direct government support to move forward, we should recognize that changing the incentives is an integral part of the affordable housing solution. The affordable housing debate was tabled 10 years ago. It is time to restart the conversation.

Exhibit A: Washington County Housing Market December 2016



HIGHLIGHTS:

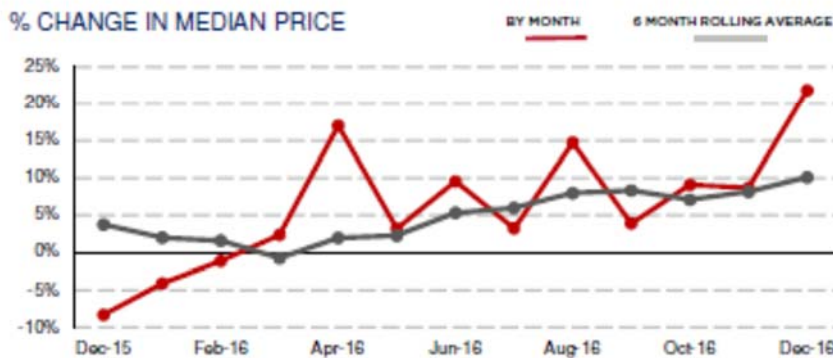
- Closed Sales jumped 34.3% from previous December to 360 units.
- Inventory continues a downward trend, falling 16.8% from December 2015.

MARKET REPORT - January 2017 WASHINGTON COUNTY

Year-Over-Year		
-6.8%	34.3%	-16.8%
Change in New Listings	Change in Closed Sales	Change in Inventory



	12 MONTH COMPARISON			6 MONTH AVG	
	December 2015	December 2016	+ / -	Last 6 Months	+ / -
New Listings	310	289	-6.8%	424	-2%
Pending Sales	228	263	15.4%	340	11%
Closed Sales	268	360	34.3%	350	18%
Median Sales Price	\$220,000	\$268,000	21.8%	\$248,411	10%
Average Sales Price	\$249,882	\$294,097	17.7%	\$283,658	10%
List to Sale Price Ratio	95.8%	97.2%	1.5%	97.5%	-3.8%
Days on Market	79	63	-20.3%	74	-14%
Inventory of Homes for Sale	1433	1192	-16.8%	1256	-14%
Months Supply of Inventory	5.3	3.3	-38.1%	3.6	-28%
Building Permits	76	111	46.1%	139	12%



The source of the data for this report is the MLS, Local Association of Realtors and Construction Monitor.

Exhibit B: Utah Population Estimates by County 2010-2016

**Table 1
State and County Population Estimates: 2010-2016**

County	April 1, 2010										Cumulative Change*	
	Census	July 1, 2010	July 1, 2011	July 1, 2012	July 1, 2013	July 1, 2014	July 1, 2015	July 1, 2016	Absolute	Percent		
Beaver	6,629	6,643	6,658	6,670	6,754	6,661	6,710	6,782	153	2.3%		
Box Elder	49,975	50,067	50,640	51,155	51,794	52,280	52,971	54,038	4,063	8.1%		
Cache	112,656	113,307	115,004	116,404	117,598	118,872	121,855	123,907	11,251	10.0%		
Carbon	21,403	21,419	21,505	21,590	21,340	21,201	21,164	21,188	-215	-1.0%		
Daggett	1,059	1,078	1,109	1,114	1,157	1,113	1,113	1,103	44	4.1%		
Davis	306,479	307,625	313,280	318,476	324,407	329,833	336,091	342,645	36,166	11.8%		
Duchesne	18,607	18,721	19,020	19,696	20,283	20,577	20,821	20,608	2,001	10.8%		
Emery	10,976	11,012	11,128	10,964	10,945	10,844	10,659	10,573	-403	-3.7%		
Garfield	5,172	5,171	5,203	5,226	5,220	5,194	5,164	5,190	18	0.3%		
Grand	9,225	9,238	9,395	9,529	9,550	9,626	9,757	9,933	708	7.7%		
Iron	46,163	46,221	46,955	47,311	47,621	48,191	49,406	50,742	4,579	9.9%		
Juab	10,246	10,280	10,380	10,485	10,604	10,824	11,071	11,541	1,295	12.6%		
Kane	7,125	7,116	7,200	7,302	7,321	7,266	7,271	7,581	456	6.4%		
Millard	12,503	12,535	12,706	12,816	12,956	13,023	13,104	13,291	788	6.3%		
Morgan	9,469	9,518	9,714	10,049	10,418	10,776	11,080	11,522	2,053	21.7%		
Piute	1,556	1,555	1,576	1,585	1,603	1,593	1,631	1,604	48	3.1%		
Rich	2,264	2,278	2,291	2,277	2,300	2,323	2,353	2,355	91	4.0%		
Salt Lake	1,029,655	1,031,697	1,046,461	1,060,336	1,070,799	1,080,874	1,094,650	1,108,872	79,217	7.7%		
San Juan	14,746	14,771	15,037	15,448	15,573	15,772	15,902	16,302	1,556	10.6%		
Sanpete	27,822	27,907	28,351	28,485	28,631	28,705	29,088	29,489	1,667	6.0%		
Sevier	20,802	20,814	20,893	21,053	21,020	21,101	21,238	21,517	715	3.4%		
Summit	36,324	36,562	37,396	37,936	38,212	38,677	39,278	40,050	3,726	10.3%		
Tooele	58,218	58,358	59,151	60,131	61,367	62,182	63,262	65,285	7,067	12.1%		
Uintah	32,588	32,760	33,943	35,047	36,145	36,979	37,396	36,580	3,992	12.3%		
Utah	516,564	518,872	532,753	544,892	554,401	567,208	585,694	603,362	86,798	16.8%		
Wasatch	23,530	23,652	24,484	25,542	26,389	27,342	28,613	29,995	6,465	27.5%		
Washington	138,115	138,579	141,797	144,061	147,058	150,500	154,602	160,359	22,244	16.1%		
Wayne	2,778	2,782	2,766	2,773	2,748	2,740	2,725	2,718	-60	-2.1%		
Weber	231,236	231,833	233,819	236,391	237,918	239,582	242,737	245,672	14,436	6.2%		
State	2,763,885	2,772,373	2,820,613	2,864,744	2,902,131	2,941,858	2,997,404	3,054,806	290,921	10.5%		

Sources: U.S. Census Bureau (April 1, 2010); Utah Population Committee, Kem C. Gardner Policy Institute (2010-2016)

* Change calculated from April 1, 2010 Census Decennial Count to July 1, 2016 UPC Estimate

Note: Revised building permit data for 2013 and 2014 resulted in revisions to the historical 2014 and 2015 population and net migration estimates released in June, 2016.

Exhibit C: Sensitivity Analysis for Multi-family Development

	Assumption Change for 6.25% Capitalization Rate				
	Base Case	Rent Chg	Cost Chg	Impact Fee Chg	Land Chg
SF/Unit	1,000	1,000	1,000	1,000	1,000
# Units	200	200	200	200	200
Rent/Unit	\$ 860	\$ 957	\$ 860	\$ 860	\$ 860
OpEx as a %	32.5%	32.5%	32.5%	32.5%	32.5%
Construction Cost/SF	\$95	\$ 83	\$ 83	\$95	\$95
Impact Fees/Unit	\$13,946	\$13,946	\$13,946	\$ 2,000	\$13,946
Land Cost/Unit	\$ 10,000	\$ 10,000	\$ 10,000	\$ 10,000	\$ -
Density/Acre	20	20	20	20	20
Vacancy Rate	4%	4%	4%	4%	4%
Land Cost	\$ 2,000,000	\$ 2,000,000	\$ 2,000,000	\$ 2,000,000	\$ -
Impact Fees	\$2,789,200	\$2,789,200	\$2,789,200	\$400,000	\$2,789,200
Construction Cost	\$ 19,000,000	\$ 19,000,000	\$ 16,600,000	\$ 19,000,000	\$ 19,000,000
Total Cost	\$ 23,789,200	\$ 23,789,200	\$ 21,389,200	\$ 21,400,000	\$ 21,789,200
Cost/Unit	\$ 118,946	\$ 118,946	\$ 106,946	\$ 107,000	\$ 108,946
Rental Income	\$ 2,064,000	\$ 2,296,800	\$ 2,064,000	\$ 2,064,000	\$ 2,064,000
Vacancy	\$ (83,000)	\$ (92,000)	\$ (83,000)	\$ (83,000)	\$ (83,000)
Net Rental Income	\$ 1,981,000	\$ 2,204,800	\$ 1,981,000	\$ 1,981,000	\$ 1,981,000
Operating Expenses	\$ (644,000)	\$ (717,000)	\$ (644,000)	\$ (644,000)	\$ (644,000)
Net Operating Income	\$ 1,337,000	\$ 1,487,800	\$ 1,337,000	\$ 1,337,000	\$ 1,337,000
CAP Rate	5.62%	6.25%	6.25%	6.25%	6.14%