Memo

To: Anchorage Community Development Corporation and other interested parties

From: Shanna Zuspan, Agnew::Beck Consulting

Date: February 1, 2023

Re: **Improvements to Statute: Economic Development Property Tax Incentives**

Why Can't We Build More Housing?

Communities across Alaska struggle to develop new housing due to economic and financial feasibility obstacles. This is especially true for rental projects that support our workforce, including single households, aging seniors, and the younger workforce. Similarly, new office and retail projects, especially in already developed downtowns and commercial corridors, struggle to achieve industry returns necessary to attract private investment. Without the ability to secure market returns, private capital looks elsewhere for less risky, higher return investment opportunities leaving our communities without the benefit of new housing for our workforce and new buildings for jobs and businesses.[1]

Example projects. Since 2015, Agnew::Beck has prepared, or reviewed, approximately 30 different real estate pro formas to test the financial feasibility of building new workforce multi-family rental housing and/or commercial uses, such as office and retail. We have studied the market in Anchorage, Bethel, Kodiak and Fairbanks. To date, none of the housing projects we have analyzed, or reviewed, have been fully built. Instead, the pro forma results show substantial financial feasibility limitations. Simply put these projects do not pencil. One client, who is a private landowner with capital to invest, stated, "I can make more at night when I sleep," than by building new rental housing. Another developer with options in multiple locations outside of Alaska choses to invest in other locations. Many developers in addition to private landowners are looking for ways to invest their capital or better utilize their land holdings. However, without financially feasible projects, great housing ideas stall out. The financial feasibility obstacles are too substantial. We are losing out on new private investment in Alaska.

How much is the gap? The cost to build new commercial grade buildings far exceeds the value of the rental stream that is produced. The number is evolving due to the high cost of construction post-Covid. Generally speaking, pro forma analysis indicates a financial feasibility gap of about $120,000 per workforce housing unit or about 45 percent of the total development cost of a project.[2]
As Alaskans, we see this everywhere we look. New workforce market rate apartments do not come to fruition. Downtowns remain opportunities for redevelopment with very few new residential or commercial projects being built. People continue to ask, "where will my adult children live?," or "can I find housing back in my hometown?" and "are there options for me as a I age?" As the State of Alaska grapples with out-migration, the stakes for not addressing these questions grows.

The Solution: Improved Property Tax Incentives

Alaska is not alone in seeing financial feasibility challenges that prevent housing and commercial development. Communities across the country face similar financial challenges when redeveloping their downtowns and trying to add new workforce housing to their neighborhoods. Many communities use tax increment financing (TIF) or have implemented property tax exemptions to help make projects pencil. In Alaska, TIF is not available, but we have the option of **property tax exemption incentives** as enabled by state statute to help close the gap. The optional economic development property tax exemption (AS 29.45.050(m)) offers the most compelling and flexible tool for local communities to incentivize new housing and new development.

In 2017, the State legislature passed SB 100, which improved the optional economic development property tax incentive. SB 100 gave local governments the authority to make their own decisions on the length of time to set a property tax incentive. These improvements went a long way toward establishing local control over the use of optional property tax incentives. In Anchorage, the community quickly passed Assembly Ordinance 2019-12 as amended (AMC 12.60) to offer 12 years of property tax incentive for housing projects in downtown Anchorage with at least four new units. Soon after, Anchorage passed Assembly Ordinance 2020-103, as amended (AMC 12.70), allowing for 12 years of tax exemption for workforce housing and 15 years of exemption for income restricted affordable housing in areas within a transit supported corridor. Anchorage was careful and strategic in implementing local ordinances; policy leaders did not want to give away more than was necessary to improve feasibility. The number of exemption years is limited, and certain performance measures must be met, such as requiring at least four new units in downtown or requiring housing to be within a transited supported corridor.

Once these incentives were adopted in Anchorage, private pro formas were revised and the results showed projects were headed toward feasibility. In Anchorage, developers and policymakers began to understand that the property tax incentive of 12 or 15 years moves projects about half of the way toward feasibility, but deeper incentives are needed. In a 40-unit downtown example, the property tax incentive takes a gap of $120,000 per unit and cuts it down to $70,000 per unit. Closing the gap will require additional incentives. Anchorage's updated Downtown Comprehensive Plan (see page 30 also pasted at the end of this memo)

Statute Fix

Current statute allows flexibility to local government to craft a property tax incentive that meets the needs of their community, in terms of length of the incentive (number of years). However, under current statute, the required local contribution to schools cannot be exempted and must be collected. This prohibits communities from implementing a full property tax incentive based on what is needed in their community for their strategic redevelopment goals. SB77 and HB84 will not change the amount of the School district allocationin a municipality is required to pay. SB77 and HB 84 also adds an additional tool for the Municipalities allowing them to encourage Blighted Property owners to develop their property.

[1] Note: income restricted affordable housing with federal funds, such as low income housing tax credits have been successfully developed in many parts of Alaska. This memorandum focuses on workforce housing that is not income restricted nor is it built with luxury level amenities but is targeted to instead to our workforce, which is typically those earning between 80 and 120 percent of area median income. Households do not have to income qualify by being under a certain income to become a resident.

[2] We measure financial feasibility a number of ways. 1) Return on cost or cash-on-cash. Our pro formas indicate that returns are coming in less than industry targets at more like two percent return on cost and four percent cash-on-cash (or return on equity). This is hard to justify in the private sector when mutual funds with less risk yield higher returns. 2) A 2nd way to measure financial feasibility is discounted cash flow analysis and/or use of cap rate to value the net operating income and compare that to the total development costs. A real estate project should generate at least as much value as the cost to construct or its generally considered a non-economical or non-feasible project. Most pro formas we analyze show the cost of construction far outweighing the value of the income stream 3) A third way to assess financial feasibility is the ability to raise the full capital stack – how much does the bank invest
given the value of the income stream? Given cap rates and appraisals of existing projects, banks can typically finance only about 50 percent of the total development costs leaving the rest of the capital stack to be raised through private equity; with low returns on equity, this is a substantial equity raise that often cannot be completed.

What Does it Cost to Develop Housing in Anchorage?

Key Findings Agnew::Beck Pro Forma Study: The Agnew::Beck pro forma has been used for several years and has tested the feasibility of multi-family rental housing in five different areas of Anchorage. The results indicate that regardless of location in Anchorage, market rate rental housing faces financial feasibility challenges, despite a strong demand for multifamily housing.

When we use realistic rents given existing market conditions in Anchorage and compare the capitalized value of the income stream to the total development costs, a financing gap results. This is consistent with economic findings of the *2007 Downtown Plan* where financial feasibility was identified as an issue. Construction, infrastructure, and land costs are too high relative to the rents that can be achieved.

Figure #2 indicates the results of five hypothetical projects throughout Anchorage with one in Downtown. As shown, a 40-unit rental housing project costs roughly $10 million to construct and yields $4 million in capitalized value, resulting in a $5.8 million funding gap. Some developers who are also their own general contractor can construct a project for less cost, but the financial feasibility gaps still exist. The 4-unit Downtown Housing Tax Incentive reduces the gap by roughly 50 percent, but additional solutions are still required to make projects pencil.

New Housing Summary (2007-Present)

New housing built by Cook Inlet Housing Authority (CIHA) includes *Elizabeth Place* (50 units) and *Qanchi Place* (30 units). The Alaska Railroad Corporation (ARRC) partnered with the Petersen Group to build The Downtown Edge (35 units). Two projects by ACDA include the mixed-use 6th Avenue Hotel project, projected to add a substantial number of hotel (156) and housing (32) units, and the Block 96 Flats on 8th Avenue proposed with (44) market rate studio and one-bedroom apartments. A public/private partnership was required for all of these projects to make them financially feasible.

GAP PER UNIT

Project	NO INCENTIVE	12-YEAR TAX INCENTIVE	12-YEAR + $2M Patient Capital + Land Write Down	25-YEAR + Some Land Write Down
Current DT Project	**$120,000**	**$70,000**	**No Gap**	**No Gap**
40 units on 1/2 acre. Surface parked at .50 spaces per unit. Density: 80 DUA. All Stick Built.				
Block 102 – 8th & F	**$110,000**	**$60,000**	**$20,000**	**No Gap**
150 Units on .96 acres: North Parcel Only. Parking = .05 per unit. 40% parking onsite surface and remaining in adjacent lots or garages. Density: 155 DUA. All Stick Built.				
Block 28 – 3rd & H	**$90,000**	**$50,000**	**$20,000**	**No Gap**
200 Units on .80 acres: North parcel only. Parking = .05 per unit. 40% parking onsite surface and remaining in adjacent lots or garages. Density: 249 DUA. All Stick Built.				

Figure #2: Project Financing Gaps Key Findings-Three Downtown Anchorage Examples

Downtown Plan 2021 Housing Target

Identifying and communicating a housing target in this plan is a policy choice many other cities have made to bolster downtown housing development. This plan empowers our community leaders to champion the housing target and incentives that are needed to support new housing in Downtown Anchorage. 4700 housing units are possible Downtown. **A target of 1400 market rate housing units is proposed in the next 5-8 years.** We need to do the following to get there:

- Tax Incentive Amendments.
- Establishment of a GAP Housing Trust Fund.
- ACDA is appointed as the lead agency for redevelopment Downtown.
- Coordinated utilites and infrastructure development.

Housing is Economic Development
"Housing is the foundation on which Anchorage can build a stronger economic future. Lack of affordable, available, and livable housing has been cited by many local businesses as a challenge to attracting and retaining employees in Anchorage