Main Street Innovation Lab Webinar

Upstairs Downtown
Successful Upper-floor Housing Development

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Thom Guzman, Main Street Iowa
Tim Reinders, Main Street Iowa
Linda Sorden, National Trust Loan Fund

Food For Thought

• Almost 100% of Downtowns have upper floor opportunities
• Forefathers expectations
• 40 plus years dependence on 1st floor to economically support multi-level building
• Civilization after civilization got it right until the automobile changed society’s value system
• Increasing energy costs create great opportunities for Downtown!!

Why Live Downtown???

• Freedom
• Cultural Opportunities
• Pedestrian Lifestyle
• Urban Experience
• Sustainability
Why Rehab Upstairs?

Justifications:
- Economic
- Physical
- Social
- Political

Alternative Uses
(Alternatives in order of program complexity)
- Mothball or storage use
- Office space for your own use
- Residential - owner’s apartment
- Residential - rental
- Office - rental
- Retail (very difficult to make work for most retail operations)
- Assembly - theater, meeting hall (adds life safety and structural costs)

Evaluating What You Have
- Size (square footage per floor)
  - Total square footage (exclude basement)
- Structure - usually OK for residential
  - Floor capacity (allowable load in pounds per sq. ft.)
  - Combustible or non-combustible systems and separations
- Architectural
  - Egress (number of stairs)
  - Natural light and ventilation (side windows?)
- Environmental
  - Prior industrial use (check Sanborn maps or abstracts)
  - Asbestos (professional survey required)
  - Lead paint (residential use)
Codes and other Necessities

- Zoning ordinance
  - Parking requirements/Use options
- Building code (International, Existing)
- Life Safety Code-
  - Fire Marshall
- Accessibility Code (ADA)
- Secretary of the Interior’s Standards
Codes and Other Necessities
Residential or Commercial Use

- Light and air analysis
  - Corner building or side windows
  - Mid block building with no side windows
- Two or three stories
- Square footage per floor
  - Under 3,000 sq. ft.
  - Over 3,000 sq. ft. (Higher accessibility requirement)
- Ceiling construction systems and fire separation
- Parking availability (zoning)

Downtown Markets
Four Segments

<table>
<thead>
<tr>
<th>Market Rate</th>
<th>Affordable</th>
</tr>
</thead>
<tbody>
<tr>
<td>Owner Occupied</td>
<td>Owner Occupied</td>
</tr>
<tr>
<td>Rental</td>
<td>Rental</td>
</tr>
</tbody>
</table>
Crucial Variables in successful Rehabilitation

• Market
  • Who is buying/renting
  • Why are they buying/renting
  • How much will they, can they pay
  • What do they want

• “1-3 % Rule”

Crucial Variables in successful Rehabilitation

• Cost
  • Acquisition
  • Rehabilitation
  • Soft costs
  • Holding costs
  • Sales/marketing costs

Crucial Variables in successful Rehabilitation

• Timing
  • Too soon/Too late
  • Holding period
  • Rent-up time
Crucial Variables in successful Rehabilitation

- Physical Characteristics
  - Extent of Rehabilitation
  - Aesthetic/Design elements

- Regulatory
  - Building code
  - Zoning
  - Historic district
  - Secretary’s Standards
  - Tenant Protection laws

- Location
  - Proximity
    - To employment
    - To parking
    - To goods and services
    - To residential areas
    - To “city life”
Cost Saving Design Options

- Leave brick exposed, or paint it
- Cluster plumbing runs
- Use existing floor layout
- Try not to use elevator

- Expose heavy structural elements
- Maintain existing wood or exposed joist ceilings
- Sand existing wood floors
- Install exposed sprinkler systems
- Install exposed ductwork
The Most Expensive Rehabilitation Mistakes

- Paying too much for acquisition
- Spending too much for rehabilitation
- Not controlling rehabilitation costs
- Inadequate analysis of physical structure
- Over improving for likely market
The Most Expensive Rehabilitation Mistakes

- Picking property without “character”
- Not considering initial building layout constraints
- Using contractor not experienced in rehabilitation
- Using other professionals - architect, appraiser, broker, lender - not experienced in rehabilitation
The Most Expensive Rehabilitation Mistakes

- Allowing too little time to:
  - Obtain financing
  - Get required approvals
  - Complete rehabilitation work
  - Rent up property

- Not having early discussions with:
  - Building Inspector
  - Historic Preservation Office
  - Zoning officials

The Most Expensive Rehabilitation Mistakes

- Not using architect
- Diminishing architectural integrity of structure
- Allowing architect to control economic issues
- Not involving architect in marketing decisions

The Most Expensive Rehabilitation Mistakes

- Not Identifying specific likely tenants
- Confusing downtown housing needs with suburban housing demands
- Not controlling costs after completion
Bonus Amenities

- Off-Street Parking - Covered?
- Washer/Dryers
- Outdoor Living Space
- Private Entrance
- Views
- Large Rooms
- Skylights
- Walkability
- Shopping, Employment, Entertainment
TYPES OF FINANCING

Debt Financing - Pre-Development
              Acquisition
              Rehabilitation
              Bridge

Grants - Façade grants
           Hope VI grants (HUD)

Tax Incentives - Federal Historic Tax Credits
                 State Historic Tax Credits
                 New Markets Tax Credits
                 Alternative Minimum Tax Credit
                 Low Income Housing Tax Credits
                 Energy Tax Credits
Crucial Variables in successful Rehabilitation

- Loan to Value
  - Best Use
  - Cost
  - Income
  - Market
  - Location

Good Times vs Economic Downturn
- 80% vs 65% (Estimate) or less

Mixed-Use Development
MacGillivray's Building, Baltimore, MD

- Sources and Uses - Total Project Costs
  - Local Bank - $800,000
  - NTLF - $225,000
  - Investor - $150,000
  - State HTC - $310,000
  - Fed HTC - $316,940
  - Owner Equity - $492,057
  - Def Dev Fee - $398,618
  - Grants - $65,000
  - Liq Lic - $157,270

- Uses
  - Acquisition - $456,600
  - Liq Lic - $157,270
  - Hard Costs - $1,460,000
  - Soft Costs - $740,015

- Project Genesis
  - Concerned neighbors working with CDC
  - 2000 Population of neighborhood - 8,500
Terms to Know

- Pro Forma
- Reserve for Replacement
- Net Operating Income
- Debt Coverage Ratio
- Cash Flow

Operating Pro Forma

<table>
<thead>
<tr>
<th>Income</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross Rent</td>
<td>Rent Collected at 100% Occupancy</td>
</tr>
<tr>
<td>Tenant Contributions</td>
<td>Tenant Contributions towards operating expenses</td>
</tr>
<tr>
<td>(Vacancy/Collection)</td>
<td>Total Income at 100% Occupancy</td>
</tr>
<tr>
<td>Effective Gross Income</td>
<td>Anticipated Cash Actually Collected</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Expenses</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Taxes</td>
<td>Research and negotiate with assessor</td>
</tr>
<tr>
<td>Insurance</td>
<td>Decrease your project with your provider</td>
</tr>
<tr>
<td>Maintenance</td>
<td>Snow removal, window washing, common area</td>
</tr>
<tr>
<td>Utilities</td>
<td>Are utility expenses paid as part of rent?</td>
</tr>
<tr>
<td>Management</td>
<td>Are you going to manage the project or pay someone?</td>
</tr>
<tr>
<td>Reserves</td>
<td>Appliances need to be replaced. Units need repainting</td>
</tr>
<tr>
<td>Net Operating Income</td>
<td>Cash generated by the project</td>
</tr>
<tr>
<td>Debt Service</td>
<td>Interest, principal payments to lender</td>
</tr>
<tr>
<td>Cash Flow</td>
<td>Return to owner</td>
</tr>
</tbody>
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Reasonable Expenditure For Upper Floor Residential Units

<table>
<thead>
<tr>
<th>Monthly Rent</th>
<th>Investment Per Unit</th>
</tr>
</thead>
<tbody>
<tr>
<td>$400</td>
<td>$24,000 - $29,000</td>
</tr>
<tr>
<td>$500</td>
<td>$30,000 - $36,000</td>
</tr>
<tr>
<td>$600</td>
<td>$36,000 - $43,000</td>
</tr>
<tr>
<td>$700</td>
<td>$42,000 - $50,000</td>
</tr>
<tr>
<td>$800</td>
<td>$48,000 - $57,000</td>
</tr>
<tr>
<td>$900</td>
<td>$54,000 - $64,000</td>
</tr>
<tr>
<td>$1,000</td>
<td>$60,000 - $71,000</td>
</tr>
</tbody>
</table>
For more detailed references and sources on the topic of upper floor housing:

1. www.illinoishistory.gov/ps/upperstory.htm

2. Two authoritative Main Street News articles on the topic:
   - Upstairs Downtown: cover article, March 2002
   - Developing Affordable Housing on Main Street: April 2004

Linda Sorden
National Trust Loan Fund
310 N. 5th St.
Lincoln, NE 68502-0524
linda_sorden@nthp.org

deb_ormond@iowalifechanging.com

Thom Guzman
Main Street Iowa
515-242-4733
thom.guzman@mainstreetiowa.org

Tim Reinders
Main Street Iowa
515-242-4762
tim.reinders@mainstreetiowa.org

iowalifechanging.com