City of Providence

Inclusionary Zoning:

Financial Feasibility Analysis

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EXECUTIVE SUMMARY

Scope of Work

The scope of this analysis is to determine the financial feasibility resulting from incorporating inclusionary zoning requirements into the City of Providence's zoning ordinance. RKG Associates Inc. (RKG) constructed a financial feasibility model to evaluate a range of scenarios for/approved by the City of Providence. The importance of this analysis cannot be understated, as setting the appropriate parameters for an inclusionary zoning ordinance is key to ensuring housing development accommodates various income levels across the city while minimizing impact on existing development activity.

Process

This process is a follow on to the Housing Master Plan provided by RKG Associates Inc. to the City in 2022. This effort was collaborative and included engaging City staff, local and regional housing developers, local debt and equity investors, and other real estate professionals to understand the market dynamics and performance indicators unique to Providence. RKG utilized information gained from the original Housing Master Plan, updating market research and conducting interviews to construct an adaptable financial model to measure the feasibility of implementing an inclusionary zoning policy within Providence.

Summary Findings

An IZ policy can only work with financial support.

Applying an inclusionary zoning policy will have a negative fiscal impact on financial returns, especially long-term viability. To supply income-controlled housing through an IZ policy, new construction development will require layering of financial incentives such as tax stabilization, financial inducements, and Federal programs.

Development feasibility is limited to the strongest market areas within the City (Greater East Side and Downtown).

Rental rates and sale prices differ across the City causing variations in development feasibility by location. Market data shows that locations within Greater East Side and Downtown Providence perform the strongest financially. New real estate development in areas north, south, and west of the City's downtown is challenging to create a feasible project. Rental rates cannot outpace the operating and construction costs involved when developing a multifamily project.

Construction costs in Providence are disproportionally high to achievable revenue potential.

The combination of high construction costs and low revenue levels disproportionately impacts development. Both the empirical data collected and feedback from residential developers indicate construction costs within Providence are high. These costs have negatively impacted financial

feasibility within the City by setting prices that exceed what the City's current market rent levels can support.

State regulations will frame the City's IZ policy.

Based on our analysis, if Providence's inclusionary zoning policy follows the State's 15% minimum set aside, the City would need to target between 80% - 100% area median income for rental projects and between 120% - 150% area median income for ownership projects. If the City wants to aim for a lower than the 15% set aside, then it would require the State to change its policy or provide financial relief.

In sum, the introduction of an inclusionary zoning policy, specifically looking at applying a 15% set-aside, can be achievable Downtown under the conditions that the development receives a combination of public subsidies. These subsidies can range at the local, state and/or federal level (e.g., LIHTC, tax abatements) and from additional City investments (e.g., housing trust, direct investment).

Federally subsidized projects have a different financial reality.

Market rate and mixed-income projects (without subsidy assistance) have a different financial reality than projects that receive local, state, and federal assistance. These projects, particularly those that receive federal Low Income Housing Tax Credits (LIHTC) assistance, are less encumbered with cost-revenue challenges and location-based challenges (both described above). To this point, development activity for heavily subsidized projects is not impacted the same as projects that rely exclusively (or heavily) on private-sector profit-motivated investors.

Providence's real property tax rate adversely affects feasibility.

Providence's current real property tax rate for multifamily housing development is $35.10 per $1,000 in value. In comparison, Boston's real property tax rate is $25.27 per $1,000 in value. Based on the financial feasibility analysis, developments that do not receive 8% Tax or Tax Stabilization have real property tax payments that equate to 20%-25% of potential gross income. This is substantially higher than RKG's experience in other communities throughout New England where real property taxes typically account for 8%-12% of potential gross income. This disparity results from the combination of Providence's comparably lower revenue levels and its comparably higher tax rate. This situation is contributing to the financial feasibility challenges for new multifamily development that is not heavily subsidized with local, state, and/or federal money.

Proposed Fiscal year 2026 Budget - Residential Tax Rate

	Existing	Proposed
Owner occupied single-family home	$10.46	8.40
Owner occupied 2-5 unit home	$10.46	$7.55
Non-owner occupied single-family home	$18.35	$14.60
Non-owner occupied 2-5 unit home	$18.35	$14.00
6-10 unit	$35.10	$26.00
11+ unit residential	$35.10	$28.50
Commercial	$35.10	$29.50

INTRODUCTION

The City of Providence Department of Planning and Development has sought to assess the financial implications of implementing an inclusionary zoning policy for new housing development. The City of Providence hired RKG to build a financial feasibility model to evaluate approaches and the financial impacts towards incorporating an inclusionary zoning policy.

RKG Associates is a multi-disciplinary real estate, planning, and economic development consulting firm with more than 40 years of experience advising public-sector and private-sector clients on real estate development and financial feasibility. The RKG analysis relied on conducting market research, interviewing stakeholders, and working with the City to test a series of development typologies to understand the financial sensitivity of introducing inclusionary zoning.

Inclusionary zoning is a way in which communities can generate affordable housing through traditional market developments. Inclusionary zoning policies are typically based on a specific percentage applied to new housing development. For example, if the City of Providence implements an IZ policy that requires residential developers to allocate 20% of all units in the development as income-controlled housing units, a multifamily developer seeking to construct a new 100-unit apartment building would have to set aside 20 units (20% of 100 rental units) to be priced at a monthly rate deemed "affordable" to a household at the prescribed income level. The U.S. Department of Housing and Urban Development (HUD) defines affordable as paying less than 30% of gross income for rent and essential utilities. Consequently, those 20 income-controlled units would generate lower rental revenues than the remaining market-rate units.

Traditionally, local housing authorities are responsible for providing housing to households at 30% of AMI. For inclusionary zoning, having a lower AMI requirement results in a greater reduction in financial return for a developer because costs are harder to recoup due to lower revenue streams.

The following analysis details the approach RKG used to test if the City were to adopt an inclusionary zoning ordinance, results of the analysis, and recommendations to minimize financial impacts of such changes. At the end of this report, a glossary of terms provides an explanation of terminology used throughout this analysis.

MODEL

Model

To perform the analysis, RKG Associates developed a financial feasibility model that estimates a real estate developer's potential financial return. While there are several return metrics used to assess financial feasibility, the Providence financial feasibility model focuses on estimating the Internal Rate of Return (IRR) and the Return on Cost (ROC). IRR is a standard quantitative metric used to predict the financial performance of a potential real estate investment over time. This measure is a standard approach to understanding the potential performance of a real estate investment as it accounts for the construction, operation, and eventual sale of a real estate investment. Real estate development is a risk-based venture that requires an investor to guarantee a sum of money in exchange for the potential revenue and value created by that investment. Developers seek to reduce the risk of a project (i.e., development duration and cost overruns) while maximizing the revenue potential (i.e., rent payments and reversion for a rental project and sales pricing for an ownership project).

IRR calculations are presented as percentages. A higher percentage indicates the property will provide a greater return for the investor. IRR is compared against an investor's desired return rate (or discount rate) to determine if an investment meets the perceived risk level. IRR calculations are much more detailed than overall return calculations, and account for inflation, projected income escalators and the reversion (or sale) of the property at the end of the study period (or hold period).

ROC is a point-in-time measure comparing the financial performance (Net Operating Income) against the total cost of construction. ROC measures the value of the development against market conditions. The model was created in Microsoft Excel to allow for the greatest functional flexibility and analysis transparency.

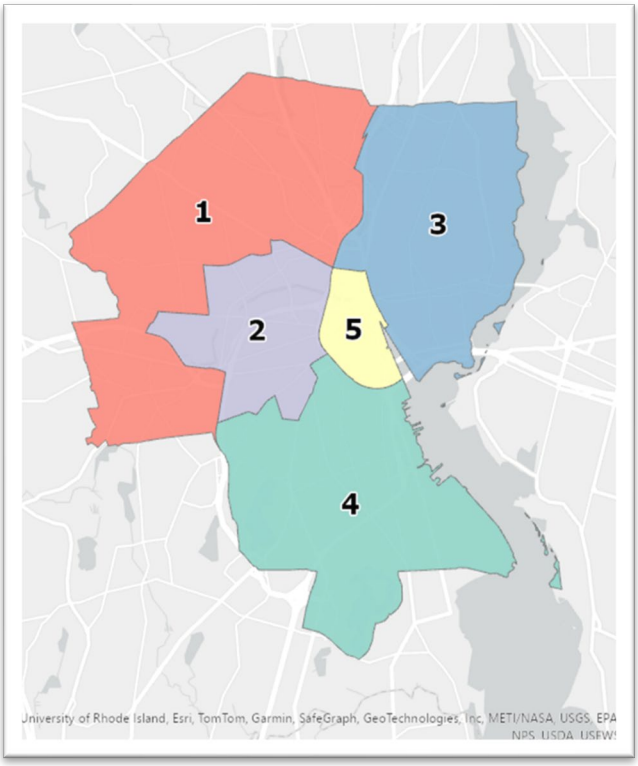
The capitalization rate is a valuation metric that is used to estimate the potential return for a real estate investment. It is calculated by dividing a property's net operating income (NOI) by its current market value. Capitalization rates have an inverse relationship to financial performance, therefore a higher cap rate reflects a lower value for a income-producing property.

There is no universally accepted return rate to judge the return-risk of a real estate project. These market thresholds are established in each market based on several factors including current and projected demand, existing market supply, current and projected employment levels, and risk tolerances of local investors. For this project, Providence area development industry average standards for a desired IRR were set at 25% for new ownership construction and 13.50% for new residential rental construction. RKG used 25.00% and 13.50%, respectively, because those are more industry standard returns, and should be a measure to determine whether a project receives public incentives.

Subareas

Location within Providence has an impact on the financial performance of a proposed new construction real estate development. For example, market rate rents vary throughout the City. Rents tend to be higher closer to downtown and east of the Providence River (nearest Brown University). As a result, location within the City was a primary factor for modeling the financial performance of a real estate investment under a hypothetical Inclusionary Zoning policy. To this extent, the City is divided into five subareas: 1) Greater Northwest 2) Central West 3) Greater East Side 4) South Side and 5) Downtown. This effort considered several financial, market, physical, land use, and socioeconomic factors to define the submarket boundaries to use for this analysis. A limiting factor was the availability of data, which limited the creation of the subarea boundary lines to follow along U.S. Census designations (block groups). Testing multiple different scenarios by location allows the City to assess the impacts of financial returns for developments subjected to various hypothetical inclusionary zoning policies.

Providence Subareas



Map 1. Providence Subareas

MODELING INPUTS

Methodology

As stated, all financial feasibility modeling is based upon the following principal components: construction costs, operational revenues, operational costs, and financial market indicators. Each component utilizes locally derived inputs to accurately reflect the City's market conditions and effectively design realistic development scenarios. To this point, RKG conducted a comprehensive analysis of all components of financial feasibility of residential development in the City of Providence.

CONSTRUCTION COSTS

To determine hard costs for building and parking construction, RKG interviewed several for-profit and non-profit developers, as well as utilizing RSMeans to build out customized per square foot construction costs for stick, stick over podium, and steel frame construction typologies.

Similarly, RKG collected information on construction costs for three types of parking costs: surface parking, aboveground structured parking, and underground parking.

Lastly, a land cost analysis was conducted by RKG on recently completed residential projects to understand the land price per unit developers have paid. RKG used interview data from for-profit and non-profit developers to verify the research.

OPERATING REVENUES

As the name suggests, operational revenues include any income generated by the property. Rent revenues generated by tenants is the most substantial income source. However, other sources including parking fees, laundry fees, and vending income are included in operational revenues.

For the purposes of this analysis, RKG calculated rent rates for both market rate and income-controlled apartments. These rates vary by bedroom count (e.g., efficiency (studio), one-bedroom, and two-bedroom apartments) and whether an apartment is market rate or income-controlled.

RKG Associates used HUD Fair Market Rent (FMR) income levels for Providence, which are part of the 'Providence-Fall River' region, to calculate corresponding rent levels. The adjoining table indicates the income thresholds ranging from 30% AMI to 150% AMI for the City. As stipulated by HUD, the maximum affordable rent would be 30% of a household monthly income. For instance, an 80% AMI household living in a 2-bedroom unit in Providence-Fall River HUD region earns $72,130. The monthly payment for this income to avoid being cost burdened (30% of this income) calculates out to be $1,803.

Table 1. Providence HUD Income Thresholds

Income Thresholds by Bedroom Count

Providence-Fall River, RI-MA HUD Metro FMR Area

AMI	Studio	1 Bedroom	2 Bedrooms	3 Bedrooms	4 Bedrooms
30% AMI	$22,266	$23,866	$27,049	$30,216	$33,073
40% AMI	$29,688	$31,821	$36,065	$40,288	$44,098
50% AMI	$37,110	$39,776	$45,081	$50,360	$55,122
60% AMI	$44,532	$47,731	$54,097	$60,432	$66,146
70% AMI	$51,954	$55,686	$63,113	$70,504	$77,171
80% AMI	$59,377	$63,641	$72,130	$80,577	$88,195
90% AMI	$66,799	$71,597	$81,146	$90,649	$99,220
100% AMI	$74,221	$79,552	$90,162	$100,721	$110,244
110% AMI	$81,643	$87,507	$99,178	$110,793	$121,269
120% AMI	$89,065	$95,462	$108,195	$120,865	$132,293
130% AMI	$96,487	$103,417	$117,211	$130,937	$143,317
140% AMI	$103,909	$111,372	$126,227	$141,009	$154,342
150% AMI	$111,331	$119,328	$135,243	$151,081	$165,366

Source: RKG Associates Inc, 2024

OPERATING COSTS

In addition to the cost of developing a project, property owners will incur costs while owning and operating the project. Understanding the impact of traditional operating expenses (OpEx) is critical to determine financial returns. Costs including marketing, property maintenance, management, and real property taxes are part of the OpEx for a project.

FINANCIAL MARKET INDICATORS

Development financing is the most essential element of any real estate deal. Several types of financing are available depending upon the scale of the project. Through interviews with for-profit and non-profit developers, RKG gained an understanding around debt, operational costs, and vacancy assumptions used in developer proformas.

Additionally, RKG Associates obtained information on financial return expectations through interviews. This information was used as a benchmark for the financial feasibility model to understand the impact policy changes may have on a project's returns.

Construction Costs

Hard and soft construction costs were collected through interviews with local for-profit and non-profit developers.

The financial feasibility model applied each of these hard costs based on the type of construction material used: wood-frame (stick), wood-frame over concrete and steel (stick over podium), and steel frame construction. The costs of stick construction can vary for ownership developments, especially single-story townhome units. As indicated in Table 2 below, soft costs, such as engineering and architectural fees, average around 18% of hard costs as learned through interviews with local developers. Interviews were conducted between January and April 2024.

Table 2. Construction costs

Hard Construction Costs (PSF)	Apartment	Condo/Townhouse
Stick (Ownership)	$200	$200
Stick	$245	$245
Stick Over Podium	$275	$275
Steel Frame	$350	$350

Table 3. Soft costs

Soft Costs (% of Hard Cost)	
Soft Costs	18.00%

Other construction costs include the cost to build requisite parking. RKG Associates collected data for three distinct types of parking: surface, structured aboveground, and structured belowground. Surface parking is the least expensive option for parking at approximately $4,000 per space to build. Structured Belowground parking, the most expensive parking option, costs approximately $50,000 per space to build, will typically be incorporated into areas that are more land constrained (historically downtown). Public parking garages tend to offer a variety of parking spaces, which can function as a development incentive to not have to include parking costs.

Table 4. Parking costs

Parking (Per Space)	Average Costs
Surface	$4,000
Structured Aboveground	$30,000
Structured Belowground	$50,000

The amount of money a developer can pay for a piece of land is a critical component to the financial feasibility of a project. The higher the land value, the more a developer needs to offset their costs through things like higher density, lower parking rates, or increased sales prices and rents.

When RKG did the analysis, land costs vary within the City. It was noted that multifamily development is financial challenging, making land acquisition unpredictable from project to project. For example, interviews revealed that projects requiring structured parking cannot meet financial expectations and pay for land. The adjoining table illustrates land acquisition costs for "unencumbered" projects that do not have unique development challenges (e.g., demolition, rock blasting).

Table 5. Land costs per housing type

Housing Type	Average Citywide Land Cost
Condominium	$60,000/Unit
Townhome	$90,000/Unit
Apartment	$25,000/Unit

Operating Costs

Following the construction of the actual development, property owners accrue costs related to marketing, maintaining, and managing rental property. These costs are known as operating expenses which can include, but are not limited to utility, labor, and cleaning-related costs.

Operating costs do not vary for market rate or income-controlled units, as costs do not change dramatically based on a tenant. Therefore, operating expenses accounted for 23.00% of total rental revenues generated from both market-rate and income-controlled units.

Vacancy and collection loss data for new construction projects are consistent throughout Providence, with most uncollected rent due to turnover. Turnover is the time when a unit is marketed until a tenant occupies it. The operating expenses and vacancy and collection loss are consistent with most New England communities. In contrast, the real property tax rate for apartments in Providence is substantially higher than most New England communities. For example, Boston, MA is $25.27/$1,000 and Worcester, MA is $28.61/$1,000.

Table 6. Operating costs

Operating Costs (As a % of Rental Revenue)	
Vacancy & Collection Loss	5.00%
Operating Expenses (less real property taxes)	23.00%
Real Property Taxes (Commercial)	$35.10/$1,000

Financial Market Inputs

The most common approaches towards financing residential development are through equity investment and debt financing.

Equity is the initial out-of-pocket amount a developer contributes towards a real estate investment. Developers will pay less in out-of-pocket costs if they can secure financing from other sources. This is preferable to developers, since the overall project return is expected to be greater, and less investment risk is involved. Per interviews with local developers, RKG Associates set the equity requirement to 30% for both ownership and rental developments.

Securing long-term debt financing at affordable rates has become increasingly challenging. Recent widespread increases in interest rates, accelerated by the COVID-19 pandemic, have adversely impacted the financial performance of new residential development. Based on developers' interviews and national data, RKG Associates set the expected interest rate to a 7% average.

Table 7. Financial costs

Financing Costs	
Interest Rate	7.00%
Equity Required	30.00%
Capitalization Rate	8.57%

Operating Revenues

RKG collected rental rate data for new developments built over the previous 5 years that included efficiency (studio), one-bedroom, two-bedroom, and three-bedroom apartments. The rental revenue inputs for each of the bedrooms consists of per square foot averages based on the rates of new developments.

The market rental rates seen below in Table 8 were used as a baseline for the analysis and were compared to the information obtained from developer survey responses. Excluding studio floorplans, a new construction rental unit, depending on location and bedroom size, varies in monthly rates between $1.95 and $3.75 per square foot citywide.

Table 8. Monthly rental rates by subarea

Subarea	Studio	1BR	2BR	3BR
Subarea 1	$3.16	$3.08	$2.87	$2.48
Subarea 2	$3.42	$3.15	$3.00	$2.50
Subarea 3	$3.29	$3.40	$3.34	$3.13
Subarea 4	$2.04	$2.00	$1.97	$1.95
Subarea 5	$4.25	$3.75	$3.55	$3.38

RKG collected commercial rental rate data for new developments within the past 5 years to model the feasibility of a mixed-use project. The rental revenue inputs for each commercial option consists of annual per square foot averages based on the rates of the developments.

Across all subareas in Providence, average annual rent for new construction commercial space is approximately $23 per square feet. The data shows that rents do not vary between retail and office, with restaurant space having the highest annual asking rents at $40 per square feet.

Table 9. Commercial rental rates

Commercial	Rent	Construction Cost
Retail	$28.00	$200
Restaurant	$40.00	$300
Office	$24.00	$250

Real estate industry standards track rents differently for residential and non-residential uses. The industry convention for residential is to track rent levels on a per month basis and for non-residential on a per year basis. This analysis reflects that convention.

Financial Assistance

Included in the model are different forms of state and federal financial funding programs such as HUD's Section 8 Housing Voucher Program, Low-Income Housing Tax Credits (LIHTC), HOME Investment Partnership Program (HOME), and tax stabilizations.

Section 8 Housing Voucher Program is a federal housing funding program provided by the HUD department. RIHousing serves as the authority of the program, while being administered by local public housing authorities. In the City's case, the Providence Housing Authority (PHA) oversees the housing vouchers and distribution of funds. The purpose of the program is to assist low-income individuals and families with a 'voucher' that subsidizes their rent and utilities. Typically, an individual or family on a voucher program pays approximately 30% of their rent, while the remaining 70% is paid for by HUD to the developer.

HUD uses three distinct types of rent calculations for voucher payments: Fair Market Rents (FMRs), 110% of Fair Market Rents, and Small Area Fair Market Rent (SAFMR). FMRs are fixed rents by bedroom size set by HUD for real estate developments that include affordable rental units. SAFMR are estimated fair market rents adjusted spatially by zip codes household incomes and typically are higher than FMRs. This enables developers and property managers to have the ability to apply for SAFMRs, which provides the most financial relief than the other HUD calculations. Included in the table below are the most recent HUD calculations for fair market rental rates and small are fair market rental rates for Providence. The PHA has adopted the use of SAFMRs to calculate payment standards for Section 8 Housing Vouchers program.

Table 10. Providence HUD Fair Market Rents

Fair Market Rents (Providence)					
	Efficiency	**1BD**	**2BD**	**3BD**	**4BD**
Fair Market Rent	$1,289	$1,398	$1,693	$2,047	$2,536
110% of FMR	$1,418	$1,538	$1,862	$2,252	$2,790
SAFMR	$1,389	$1,504	$1,823	$2,203	$2,730

LOW-INCOME HOUSING TAX CREDITS (LIHTC)

The LIHTC Program is a federal program that provides funding for real estate developments incentivizing affordable rental housing. There are two types of LIHTC fundings: 4% LIHTC and 9% LIHTC. The main difference between the two is the 9% LIHTC program offers substantially more funding and has competitive qualifications, while the 4% LIHTC program is non-competitive. Both non-profit and for-profit developers are eligible to qualify for LIHTC funding. For a development to qualify, at least 20% of the total units must be set aside at 50% of AMI or 40% of the total units must be set aside at 60% of AMI or below and maintained for a minimum of 30 years. RIHousing administers the State's LIHTC program. Within Providence, Rhode Island's LIHTC program has a funding limit set at $30M annually per project.

HOME INVESTMENT PARTNERSHIP PROGRAM (HOME)

The HOME Investment Partnership Program is a federal program that provides funding to newly constructed affordable rental housing. Both non-profit and for-profit developers are eligible to qualify for HOME funding. To qualify for HOME funding, all proposed HOME units must be at no more than 60% of AMI or at least 20% of the total HOME units must be set aside at 50% of AMI. Generally, HOME funding is limited to approximately $50,000 to $90,000 per unit.

In addition to the programs already discussed, RKG modeled the potential for other financial contributions coming from local resources. These can range from type, variety, and timing. Tax abatement programs reduce the overall tax of a development at a specified percentage over a set number of years.

8% TAX - AFFORDABLE HOUSING TAX RATE

The State of Rhode Island's 8% Tax found under § 44-5-13.11 of Rhode Island's General Laws is a program intended to provide real property tax relief. It is calculated by multiplying the property's previous years' effective gross income for rental units by 8%. This becomes the real property tax payment to the municipality. The program is only available to developments that provide income-controlled housing and are deed restricted as such. The 8% Tax program is different from the City's current tax stabilization incentive.

TAX PREDICTABILITY FOR COMMERCIAL AND MULTIFAMILY RESIDENTIAL PROPERTY

The City of Providence's Tax Predictability for Commercial and Multifamily Residential Property is a graduated tax abatement that incrementally increases the tax amount owed year by year until it reaches full taxation at year 15 – See table 11 below.

Table 11. City of Providence's Multifamily Tax Predictability tax schedule

Year	Schedule
1	$0/Base tax (if applicable)
2	Base tax and/or base land tax
3	Base tax and/or base land tax
4	Base tax and/or base land tax
5	Base tax and/or base land tax + 5% of increase to assessed valuation
6	Base tax and/or base land tax + 10% of increase to assessed valuation
7	Base tax and/or base land tax + 20% of increase to assessed valuation
8	Base tax and/or base land tax + 30% of increase to assessed valuation
9	Base tax and/or base land tax + 40% of increase to assessed valuation
10	Base tax and/or base land tax + 50% of increase to assessed valuation
11	Base tax and/or base land tax + 60% of increase to assessed valuation
12	Base tax and/or base land tax + 70% of increase to assessed valuation
13	Base tax and/or base land tax + 80% of increase to assessed valuation
14	Base tax and/or base land tax + 90% of increase to assessed valuation
15	Full taxation

Modeling Limitations

Feasibility modeling requires use of several development, operational, financing, and market assumptions when calculating financial proformas. We understand that each project is different and will carry costs and revenues that can vary greatly, even within a single market. Unfortunately, one of the limitations of modeling is having to create a policy that covers various development types, scale, and locations. RKG does its best to account for unique issues (e.g., wood frame costs versus concrete and steel costs), but we are limited in being able to model every potential permutation. There are three approaches to this type of analysis:

Best-Case Planning – This is where the modeling uses the most beneficial assumptions that results in an aggressive IZ policy.

Worst-Case Planning – Opposite of best-case, this is where the modeling uses the most challenging development assumptions to understand how a policy decision would impact the weakest project.

Mid-Point Planning – As it sounds, use means and medians to model to the 'middle of the pack', trying to find a balance point between production and financial impact.

There are benefits and drawbacks to all three approaches. Best-Case Planning is based on the most financially beneficial development examples, leading to the most aggressive IZ policy thresholds (set aside requirements and target AMIs). However, it is the most financially punitive to all but these ideal projects and can adversely impact residential development potential.

Conversely, the Worst-Case Planning approach focuses on the most difficult financial projects, thus leading to lower set-aside rates and/or higher AMI targets. While the worst-case approach ensures financial feasibility impact is minimized—or even eliminated—it yields the least amount of housing price diversity and does not capture the full potential of stronger projects. RKG Associates' uses the 'mid-point' analysis approach, balancing potential impact and price diversity delivery as fair as possible.

Regardless of which approach used, any individual project will likely differ somewhat from the model. This is why for-profit and non-profit organizations are interviewed, and locally-based data sources are used in the model's creation.

It is important to acknowledge that the financial performance of a project is one of many factors developers and investors consider when looking at a deal. Developers also assess project risk and feasibility based on ease of process and permitting, flexibility in zoning, location and amenities, strength of the market, and strategic value. Given the variability and difficulty of assessing all these additional factors, the model focuses primarily on the financial aspects of the project.

FINANCIAL SENSITIVITY ANALYSIS

Development Variables

The financial sensitivity analysis conducted by RKG Associates provides key insights regarding the relative impact on financial feasibility resulting from several developmental scenarios. RKG Associates modeled several development scenarios to understand the impacts on developers' return expectations for rental and ownership housing. Each scenario incorporates multiple variables, including, but not limited to:

Project Size – The total number of units for a rental development. While the model can test for infinite number of units, the following analysis evaluates the impacts on returns based on the typical size of projects within the City of Providence. For rental developments, RKG Associated modeled projects at 25 units and ownership developments modeled projects at three and six units.

Household Income Level – The household income level is a percentage of the City of Providence's Area Median Income (AMI) as defined by the U.S. Department of Housing and Development (HUD). AMI levels can range between 30%-150% of the city's Area Median Income, with 30% AMI representing the lowest earning income generating households. RKG Associates modeled projects at different AMI levels to understand the relationship between financial returns and providing a proportion of income-controlled housing units.

Percentage Set Aside – The percentage set aside is the proportion of income-controlled units in relation to market-rate units. By increasing the percentage set aside, financial returns are expected to be lower.

Financial Assumptions

The financial assumption table below presents the expected financial returns for the City with comparisons to data reflected for the New England region and nearby comparable cities. The average acceptable market expectations for an IRR to be considered financially feasible is 13.50%. The average acceptable market expectations for a ROC to be considered financially feasible is 6.50%.

Table 12. Financial Assumptions

Category	Input		
	Low	Avg.	High
Return Expectations			
Rental			
IRR	12.5%	13.5%	15.0%
ROC	6.0%	6.5%	7.0%
Ownership			
IRR	20.0%	25.0%	30.0%
Cap Rate (Rental)			
Providence	8.0%	8.5%	9.0%
New England (Range)	5.0%	6.0%	9.0%
Rent Prices (PSF)			
Providence	$2.00	$3.00	$3.75
Lynn, MA	$3.50	$4.25	$5.00
Boston, MA	$5.50	$7.00	$9.00
Purchase Price (PSF)			
Providence	$209.00	$287.00	$373.00
Providence County	$226.00	$251.00	$279.00

Rental Analysis

The financial analysis conducted by RKG provides key insights regarding the relative impact of introducing an IZ policy on new construction rental and ownership development finances. Both the rental and ownership analyses focused on subareas with the strongest market conditions that are most likely to be capable of absorbing an IZ policy in the near future without leading to financial development challenges. To this end, data collection results yielded that market conditions in subareas three and five are the strongest financially performing locations within Providence.

The following results focus on the IRR and ROC return metrics for a proposed 25-unit wood frame residential rental development. The average acceptable IRR to be considered financially feasible is 13.50%. The average acceptable ROC to be considered financially feasible is 6.00%. Each slide contains a visual, reporting the results of each metric. The X-axis reflects the percentage of units to be set aside (with 0% equating to the current market value). The Y-axis reflects the percentage of Area Median Income ranging from 40% to 80%. Each visual reflects a color indicating if the financial return is above market expectations (green), market expectations (yellow), or below market expectations (red) – See table below for reference.

Table 13. Interpreting model results

	Below Market	Market Expectations	Above Market
Rental			
IRR	< 12.50%	12.50% - 15.00%	> 15.00%
ROC	< 5.75%	5.75% - 6.25%	> 6.25%
Ownership			
IRR	< 20.00%	20.00% - 30.00%	> 30.00%

SUBAREA 3 – GREATER EAST SIDE
25-UNIT MULTIFAMILY (STICK) RENTAL DEVELOPMENT

The first round of scenario testing was conducted in subarea three. Data collection efforts proved subarea three is the second strongest financially performing submarket to develop real estate in Providence, under current market conditions. Subarea three's boundary is located east of downtown Providence, with the north border going up I-95, going as far east following along the edge of City's boundary along the Seekonk River, and following along I-195 for its south border. RKG analyzed four different scenarios. These scenarios include:

- Return analysis with no subsidies
- Return analysis with 8% Tax
- Tax subsidy needed to reach an IRR of 13.50%
- Impact of 4% LIHTC subsidy

RETURN ANALYSIS WITH NO SUBSIDIES

The first scenario measures the financial impact of market rate development, and the impact of a proposed inclusionary zoning would have on a project that is not receiving any form of subsidy. Table 14 presents the results of the analysis below. Instances where this scenario returns a lower IRR indicates an IZ policy creates a financial disincentive, while instances where this scenario has a higher IRR than the target return scenario indicates the policy creates a positive financial impact. The market-based assumptions under the current market yielded an IRR of -1.51% and a ROC of 5.46% based on an average land acquisition price of $25,000 per unit. This return is well below the expected IRR of 15.00% for rental projects, and slightly below ROC market expectations of 6.00%. Returns only weaken as the set aside goes up and AMI thresholds go down. In other words, the current market is not strong enough to support a market rate only project with no subsidy.

Table 14. Return analysis with no subsidy

IRR		Set Aside				
		0.00%	10.00%	15.00%	20.00%	25.00%
AMI	40.0%	-1.51%	-6.18%	-6.75%	-12.61%	-18.21%
	50.0%	-1.51%	-5.63%	-5.98%	-10.73%	-14.88%
	60.0%	-1.51%	-5.09%	-5.23%	-9.08%	-12.24%
	70.0%	-1.51%	-4.57%	-4.52%	-7.59%	-10.03%
	80.0%	-1.51%	-4.06%	-3.82%	-6.25%	-8.12%

ROC		Set Aside				
		0.00%	10.00%	15.00%	20.00%	25.00%
AMI	40.0%	5.46%	4.91%	4.84%	4.44%	4.15%
	50.0%	5.46%	4.97%	4.92%	4.57%	4.30%
	60.0%	5.46%	5.03%	5.00%	4.69%	4.45%
	70.0%	5.46%	5.08%	5.08%	4.81%	4.60%
	80.0%	5.46%	5.14%	5.16%	4.93%	4.76%

RETURN ANALYSIS WITH 8% TAX

The second scenario measures the impacts of applying the 8% Tax stabilization across the development project. This was performed to better understand whether a standalone tax abatement is sufficient enough to provide financial relief to lay ground for an inclusionary zoning policy without providing further subsidies. Table 15 presents the results of the scenario below. In comparison to the first scenario, tax stabilization improves overall financial performance, yielding an IRR of 8.68% for market rate projects but long-term viability is still infeasible. However, it is important to note that financial performance in Greater East Side is not uniform across its market. There are stronger development opportunities on College Hill compared to the northern portion of the study area, such as the student market around Brown University.

Table 15. Return analysis with 8% Tax

IRR	Set Aside				
AMI	0.00%	10.00%	15.00%	20.00%	25.00%
40.0%	8.68%	5.01%	4.52%	1.26%	-1.48%
50.0%	8.68%	5.42%	5.09%	2.31%	0.00%
60.0%	8.68%	5.82%	5.65%	3.31%	1.37%
70.0%	8.68%	6.22%	6.20%	4.26%	2.65%
80.0%	8.68%	6.62%	6.75%	5.17%	3.86%

ROC	Set Aside				
AMI	0.00%	10.00%	15.00%	20.00%	25.00%
40.0%	7.08%	6.42%	6.33%	5.86%	5.50%
50.0%	7.08%	6.49%	6.43%	6.01%	5.68%
60.0%	7.08%	6.56%	6.53%	6.15%	5.87%
70.0%	7.08%	6.63%	6.62%	6.30%	6.05%
80.0%	7.08%	6.70%	6.72%	6.45%	6.24%

TAX RATE STABILIZATION TO REACH MINIMUM RETURNS

The third scenario examines a new hypothetical tax rate percentage required to meet the minimum range of market expectations for an IRR return of 13.50%. The calculation is the same as the current 8% Tax stabilization where the stabilization is applied to the property's previous years' gross scheduled rental income. Table 16 presents the results below. The negative IRRs illustrates that in order for a proposed new real estate development to build income-controlled units at a range from 40%-80% AMI, the development requires a full tax abatement and additional subsidies to meet market return expectations.

Table 16. New tax rate stabilization to reach minimum IRR

IRR	Set Aside				
AMI	10.00%	15.00%	20.00%	25.00%	30.00%
40.0%	-10.44%	-11.70%	-17.59%	-23.21%	-28.22%
50.0%	-9.51%	-10.40%	-15.51%	-20.36%	-24.61%
60.0%	-8.61%	-9.12%	-13.50%	-17.63%	-21.18%
70.0%	-7.71%	-7.87%	-11.56%	-15.02%	-17.93%
80.0%	-6.83%	-6.65%	-9.68%	-12.52%	-14.84%

4% LIHTC

The fourth scenario measures the financial impact that 4% LIHTC funding would have on financial returns. This scenario focuses on the baseline development meeting the qualifications for LIHTC funding using the 20/50 rule. The 20/50 rule is defined as 20% of the units must be set aside at 50% AMI. The 4% LIHTC program is non-competitive, meaning anyone who qualifies and is approved will receive the funding. The 9% LIHTC program is competitive, meaning not everyone who qualifies will receive the funding. Developments that allocate more set aside and/or lower AMIs will be prioritized over other qualified developments. Results displayed in Table 17 below show that baseline

scenario for 4% LIHTC funding results to be financially infeasible under current market conditions (e.g., high construction costs, low rental rates).

Table 17. Return analysis with 4% LIHTC

IRR	Set Aside				
AMI	10.00%	15.00%	20.00%	25.00%	30.00%
40.0%					
50.0%			-1.44%	-5.77%	
60.0%					
70.0%					
80.0%					

SUBAREA 5 – DOWNTOWN
25-UNIT MULTIFAMILY (STICK) RENTAL DEVELOPMENT

The second round of scenario testing was conducted in subarea five. Data collection efforts proved, under current market conditions, subarea five is the strongest financially performing submarket to develop real estate in Providence. Subarea five's west boundary follows up along I-95 to Smith Street, its south boundary goes past the Jewelry District until it reaches I-195, and its east boundary follows along the Providence River up north until it reaches Smith Street. RKG analyzed five different scenarios for subarea five. These scenarios include:

- Return analysis with no subsidies
    - Podium construction typology
- Return analysis with 8% Tax
- Return analysis with multifamily tax predictability
- Tax subsidy needed to reach an IRR of 13.50%
- Impact of 4% LIHTC subsidy

RETURN ANALYSIS WITH NO SUBSIDIES

The first scenario examines a return analysis for the baseline development that is not receiving any financial subsidies. It measures the financial feasibility of market rate development, and the impact of a proposed inclusionary zoning would have on a project that is not receiving any form of subsidy. Table 18 presents the results of the return analysis below. Under current market conditions, market rate development yielded an IRR of 2.84% and a ROC of 6.03% based on an average land acquisition cost of $25,000 per unit. This return is well below the minimum expected IRR of 12.50% for market rental projects. The scenario does meet minimum ROC market expectations, reflecting an annual point in time measure, meaning the development can retain its investment if it were to sell at the end of the year. Table 19 presents the results for the same baseline development using podium construction. Due to the high costs involved with acquiring concrete materials, financial returns take a significant drop. For example, for a market rate development with no income-controlled units, the IRR drops to -1.66% and the ROC to 5.44%. In other words, the current market is not strong enough to support a market rate only project assuming there is no subsidy, therefore the impact of allocating for income-restricted units lowers the financial returns.

Table 18. Return analysis with no subsidies

IRR	Set Aside				
AMI	0.00%	10.00%	15.00%	20.00%	25.00%
40.0%	2.84%	-1.12%	-2.29%	-6.27%	-9.73%
50.0%	2.84%	-0.68%	-1.66%	-4.97%	-7.78%
60.0%	2.84%	-0.25%	-1.04%	-3.77%	-6.06%
70.0%	2.84%	0.18%	-0.45%	-2.66%	-4.51%
80.0%	2.84%	0.59%	0.14%	-1.61%	-3.09%

AMI \ ROC	Set Aside 0.00%	10.00%	15.00%	20.00%	25.00%
40.0%	6.03%	5.43%	5.26%	4.87%	4.56%
50.0%	6.03%	5.49%	5.35%	5.00%	4.72%
60.0%	6.03%	5.55%	5.43%	5.13%	4.88%
70.0%	6.03%	5.61%	5.52%	5.26%	5.40%
80.0%	6.03%	5.67%	5.60%	5.39%	5.20%

Table 19. Return analysis with no subsidies for podium style construction

AMI \ IRR	Set Aside 0.00%	10.00%	15.00%	20.00%	25.00%
40.0%	-1.66%	-6.20%	-7.57%	-13.44%	-19.01%
50.0%	-1.66%	-5.68%	-6.81%	-11.54%	-15.65%
60.0%	-1.66%	-5.17%	-6.07%	-9.88%	-13.00%
70.0%	-1.66%	-4.68%	-5.36%	-8.39%	-10.79%
80.0%	-1.66%	-4.19%	-4.68%	-7.04%	-8.89%

AMI \ ROC	Set Aside 0.00%	10.00%	15.00%	20.00%	25.00%
40.0%	5.44%	4.90%	4.76%	4.40%	4.12%
50.0%	5.44%	4.96%	4.83%	4.51%	4.26%
60.0%	5.44%	5.01%	4.91%	4.63%	4.40%
70.0%	5.44%	5.07%	4.99%	4.74%	4.55%
80.0%	5.44%	5.12%	5.06%	4.86%	4.69%

RETURN ANALYSIS WITH 8% TAX

The second scenario measures the impacts of applying the 8% Tax stabilization to the development project. Table 20 presents the results of the stabilization below. Tax stabilization improves financial performance overall. For example, a market rate project yielded an IRR of 12.23% meaning there is long-term viability for market-rate deals but is still financially infeasible when adjusting for income-controlled units. Return on costs results are strong and meet the return expectations at higher set asides and at lower AMI thresholds. However, long-term viability remains infeasible in current market conditions due to costs outpacing revenues. Additionally, cap rates remain weak for Providence at an average of 8.57%.

Capitalization rates, or cap rates, are a measure of property value based on perceived risk. In short, income producing properties, which are perceived to be low risk investments, will have a lower capitalization rate. This translates to a higher value of that cash flow than an investment perceived to be riskier. The City's cap rate for multifamily is comparably high to other New England markets, where cap rates between 5.5% and 7.5% are typical. The effect of a high cap rate adversely affects

financial feasibility due to the impact of lower sales values. Effectively, the investment market perceives multifamily investment in Providence as a higher risk, lowering rates of return compared to other, less risky markets. Tax relief, whether the 8% Tax or the City's tax stabilization program, increases cash flow through lowering tax bills. The higher cash flow results in a higher value which creates a net positive impact on financial feasibility.

Table 20. Return analysis with 8% Tax

IRR	Set Aside				
AMI	0.00%	10.00%	15.00%	20.00%	25.00%
40.0%	12.23%	8.68%	7.64%	5.04%	2.64%
50.0%	12.23%	9.06%	8.17%	5.96%	3.89%
60.0%	12.23%	9.43%	8.69%	6.84%	5.08%
70.0%	12.23%	9.80%	9.21%	7.69%	6.20%
80.0%	12.23%	10.17%	9.72%	8.51%	7.28%

ROC	Set Aside				
AMI	0.00%	10.00%	15.00%	20.00%	25.00%
40.0%	7.82%	7.09%	6.89%	6.43%	6.05%
50.0%	7.82%	7.17%	6.99%	6.59%	6.24%
60.0%	7.82%	7.24%	7.10%	6.74%	6.43%
70.0%	7.82%	7.32%	7.20%	6.90%	6.63%
80.0%	7.82%	7.39%	7.30%	7.05%	6.82%

RETURN ANALYSIS WITH MULTIFAMILY TAX PREDICTABILITY

The third scenario measures the financial impact of applying the City's current Tax Predictability for Commercial and Multifamily Residential Property. It is a graduated tax abatement program that incrementally increases the taxes owed year by year over a fifteen-year period, until it reaches full taxation. Table 21 presents the results below. Based on current market conditions, market rate projects resulted in an IRR of 14.31% and an ROC of 8.74%. This performance level meets return market expectations for both financial returns. Similarly, to the previous scenarios, long-term viability becomes financially challenging to support the development of income-controlled units when introducing an inclusionary zoning policy.

Table 21. Return analysis with multifamily tax predictability

AMI	IRR \ Set Aside	0.00%	10.00%	15.00%	20.00%	25.00%
	40.0%	14.31%	9.55%	7.27%	6.87%	3.79%
	50.0%	14.31%	10.03%	8.03%	7.81%	5.16%
	60.0%	14.31%	10.51%	8.78%	8.72%	6.45%
	70.0%	14.31%	10.99%	9.51%	9.60%	7.67%
	80.0%	14.31%	11.46%	10.23%	10.44%	8.84%

AMI	ROC \ Set Aside	0.00%	10.00%	15.00%	20.00%	25.00%
	40.0%	8.74%	7.76%	7.34%	7.27%	6.77%
	50.0%	8.74%	7.86%	7.48%	7.43%	6.98%
	60.0%	8.74%	7.95%	7.62%	7.60%	7.20%
	70.0%	8.74%	8.05%	7.76%	7.76%	7.41%
	80.0%	8.74%	8.14%	7.90%	7.92%	7.62%

Both tax stabilization programs offer benefits and drawbacks. When measuring financial returns, the timing of revenues and costs impacts overall financial performance. This called the "time value of money." In short, financial feasibility increases when revenues are front loaded and/or costs are delayed. The inverse is true for reducing financial feasibility as well. The time value of money is sensitive to the hold period of a property, when comparing The City's multifamily tax predictability to the State's 8% Tax. The multifamily tax predictability creates benefits by providing a greater discount on the amount of property taxes owed at the front end/initial years of operating. If the intention is to hold on to and then sell the property within a short period of time (e.g., 10-years, 15-years), the time value of money provides greater financial relief to the developer thus creating greater financial returns. A drawback is that the tax stabilization program expires after 15-years, meaning the property is subject to full taxation. In comparison, the 8% Tax program benefits from its longer lifespan (e.g., 30-years) which becomes more favorable for owners who intend on holding the property longer.

TAX RATE STABILIZATION TO REACH MINIMUM RETURNS

The fourth scenario examines what a new hypothetical tax rate percentage would need to be to meet the minimum market IRR return expectations of 12.50%. The calculation mirrors the same process as the 8% Tax by applying the stabilization to the property's previous year's gross scheduled rental income. Table 22 presents the results below. This analysis illustrates that for a proposed new real estate development to build income-controlled units at a range from 40%-80% AMI, the development requires beyond a full tax abatement meaning it will need additional subsidies to increase feasibility to meet market return expectations.

Table 22. New tax rate stabilization to reach minimum IRR

IRR	Set Aside				
AMI	10.00%	15.00%	20.00%	25.00%	30.00%
40.0%	-2.32%	-4.70%	-9.46%	-14.56%	-19.35%
50.0%	-1.50%	-3.52%	-7.60%	-12.02%	-16.13%
60.0%	-0.69%	-2.36%	-5.81%	-9.60%	-13.07%
70.0%	0.11%	-1.22%	-4.08%	-7.27%	-10.16%
80.0%	0.89%	-0.10%	-2.40%	-5.03%	-7.39%

4% LIHTC

The fifth scenario measures the financial impact of 4% LIHTC funding would have on financial returns. Assuming the development meets qualifications for LIHTC funding using the 20/50 rule. The 20/50 rule is defined as 20% of the units must be set aside at 50% AMI. The 4% LIHTC program is non-competitive, meaning anyone who qualifies and is approved will receive the funding as described. The 9% LIHTC program is competitive, meaning not everyone who qualifies will receive the funding. Developments that allocate more set aside and/or lower AMIs will be prioritized over other qualified developments. Results displayed in Table 23 below show that qualified developments under the 20/50 rule for 4% LIHTC funding yielded an IRR of 5.12% thus making those projects infeasible in current market conditions.

Table 23. Return analysis with 4% LIHTC

IRR	Set Aside				
AMI	10.00%	15.00%	20.00%	25.00%	30.00%
40.0%					
50.0%			5.12%	1.13%	
60.0%					
70.0%					
80.0%					

Ownership Analysis

The ownership analysis uses a baseline development project for a new construction three- and six-unit condominium. To understand financial sensitivity of an inclusionary zoning policy toward ownership projects, RKG evaluated the financial impact of setting aside one income-controlled unit for both the three- and six-unit condominium development and two units for a six-unit condominium. RKG assessed these development scenarios across different AMI thresholds ranging from 60% to 150%. The financial assumptions for ownership differ from rental developments. The minimum expected IRR return is 25% compared to 15% for rental developments.

SUBAREA 3 – GREATER EAST SIDE
3-UNIT AND 6-UNIT OWNERSHIP DEVELOPMENT

Using the baseline development mentioned above, Table 25 presents the results of the financial performance in subarea three, also known as Greater East Side. A market rate project for three-unit project yielded a 52.92% IRR and a six-unit development yielded a 53.85% IRR, both above market return expectations making those projects feasible.

Additionally, Table 25 shows that the sensitivity of including an affordable unit has a substantial impact due to the price difference between how much the development can earn from a market rate unit compared to an income-controlled unit. Requiring one income-controlled unit for a three-unit development is feasible targeting at 150% AMI unit. For a six-unit development, the most feasible AMI target range drops to 120% AMI. The data indicate that targeting below 150% AMI creates challenges for feasibility without the assistance of additional financial subsidies or relief elsewhere in the project.

Table 24. Ownership return analysis

IRR		Set Aside				
		3 Units	3 Units (1 Aff)	6 Units	6 Units (1 Aff)	6 Units (2 Aff)
AMI	60.0%	52.92%	-27.93%	53.75%	-9.31%	-41.00%
	80.0%	52.92%	-13.10%	53.75%	0.96%	-25.31%
	100.0%	52.92%	1.82%	53.75%	12.20%	-9.53%
	120.0%	52.92%	16.83%	53.75%	24.56%	6.34%
	150.0%	52.92%	39.51%	53.75%	45.59%	30.32%

SUBAREA 5 – DOWNTOWN
3-UNIT AND 6-UNIT OWNERSHIP DEVELOPMENT

Using the baseline ownership development scenario, Table 26 reveals how inclusionary zoning could impact smaller ownership housing development projects in Downtown Providence. A market rate project yielded a 79.36% IRR assuming $60,000 land value per unit. The return is more than triple the expected market average return of a 25% IRR.

Subarea five (Downtown) modeled similarly to the results in subarea three (Greater East Side). At 150% AMI threshold, all project scenarios meet above market return expectations thus making those projects feasible. The impact of an IZ policy performed financially best at 120% AMI for a six-unit development. Setting aside one income-controlled unit yielded above average market return expectations at 28.41% IRR making the project feasible.

Table 25. Ownership return analysis

	IRR	Set Aside				
		3 Units	3 Units (1 Aff)	6 Units	6 Units (1 Aff)	6 Units (2 Aff)
AMI	60.0%	79.36%	-18.23%	80.11%	0.80%	-29.10%
	80.0%	79.36%	-5.81%	80.11%	9.34%	-15.97%
	100.0%	79.36%	6.67%	80.11%	18.52%	-2.77%
	120.0%	79.36%	19.21%	80.11%	28.41%	10.49%
	150.0%	79.36%	38.14%	80.11%	44.77%	30.50%

POLICY CONSIDERATIONS/RECOMMENDATIONS

Approach

Introducing an Inclusionary Zoning policy into a community for the first time is complex. At a base level, regulatory requirements that reduce project revenue have a negative impact on financial feasibility. Communities with challenging development markets run the risk of slowing or stagnating their development pipeline by making returns untenable.

Further, financial feasibility is one of several considerations a community must address when attempting to materially change their regulations and policies. An Inclusionary Zoning policy has broader reaching impacts to a community than financial feasibility for developers. Focusing solely on the financial feasibility aspect of implementing an IZ policy, this analysis indicates the residential rental development market in Providence is currently not well-positioned to absorb the financial impacts.

However, there are actions, investments, and policy options available to the City that can expedite the feasibility of an IZ policy and better position the City to address housing affordability needs with or without an IZ policy.

The following section provides recommendations for the City to consider as it advances its efforts to promote new residential development obtainable across the income spectrum. These recommendations are organized into three categories:

- Inclusionary Zoning specific recommendations
- Resource recommendations
- General Policy recommendations

Within each category, recommendations are organized by timing of implementation. Short-term recommendations should be considered within the next year, with many beginning immediately. Mid-term recommendations should be considered over the next few years, building upon the short-term efforts. Long-term recommendations should be considered aspirational, with an undefined timeline contingent upon market conditions.

Recommendation #1: **Lobby state for municipal IZ policies**

Rhode Island legislature recently passed a revised inclusionary zoning policy (effective January 1, 2025) that requires developers to set aside 15% of the total unit affordable to households earning 80% of Area Median Income (AMI) for projects that include 10 or more units, if a municipality within the State decides to adopt an IZ policy. Depending on municipal market conditions, the impact of a 15% minimum will vary on the feasibility of new development projects. In the case of Providence, new construction market rate developments are already financially challenging. **Under the current State parameters for creating an inclusionary zoning policy, RKG does not recommend implementing**

an Inclusionary Zoning policy. The City should consider lobbying so that a municipality can create an IZ policy custom to their community but does not exceed State minimums.

Recommendation #2: **Partial Unit Rule**

A proposed new construction development subject to an IZ policy may yield a fraction of a unit because of the set aside percentage. For example, a proposed development with 52 rental units subjected to a percentage set aside of 10% would result in 5.2 income-controlled rental units. The project may still deliver five total income-controlled units, and the City can decide how to handle the remaining 0.2 of a rental unit by establishing a Partial Unit Rule. RKG recommends for Providence to set up standards on how to address partial unit calculations by utilizing the following five approaches: Round Up, Round Down, Round up at 50%, Round Up/Round Down, and Partial Unit Payment.

Round Up - Yields the most units out of a development project. In the case of the example above, this approach would round the 0.2 of a unit to a full unit. This would force a developer to pay for an additional rental unit, thus having to provide six income-controlled units in total instead of five. However, this approach decreases financial performance for a development project, therefore this can create behavioral incentives for developers to decrease a project's total number of units to maintain profitability (e.g., only building 50 units to avoid the 6th IZ unit).

Round Down - Yields the fewest number of units for a development project and is the most financially beneficial option for a developer. In the case above, the City would remove the requirement to build a full unit or cash payment in lieu and round 0.2 units to zero, thus the developer only having to provide five total IZ units.

Round Up at 50% - A hybrid approach involving the round up approach OR a partial unit payment, depending on the size of a proposed project and percentage set aside. If a partial unit exceeds half (0.5 unit) or more of an income-controlled unit, the developer would be required to 'round up,' and provide an additional income-controlled unit. For instance, a developer proposes a 76-unit project under a citywide IZ policy that requires 10% of units to be controlled. This would equate to 7.6 income-controlled units, or 0.6 of a total unit. In this case, the developer would be required to provide eight income-controlled units. In contrast, a partial unit payment would be imposed on the developer if the partial unit were less than half of a total income-controlled unit. For instance, a 74-unit at a 10% set aside would generate 7.4 income-controlled units, or 0.4 of a total unit.

Round Up/Round Down - If the partial unit is greater than or equal to 0.5, then the developer would have to build the full unit. If the partial unit is less than or equal to 0.49, then the developer would not have to build the unit nor a cash payment in lieu.

RKG recommends yielding a pro rata share of the partial unit and receiving cash payments in lieu. This approach is considered most fair to developers and least harmful to smaller scale developments.

Partial Unit Value Calculation

Based on the approach the City established for how partial units are treated, the value for that partial unit needs to be calculated for situations where the developer must make a cash payment. Using the 76-unit example above, the 0.6 of a unit would require the developer to make a cash payment valued at 60% of a full unit. In these situations, the monies typically go toward a Housing Trust Fund or other housing assistance program. That value is typically calculated using one of two methods: Value Gap approach and the Construction Cost approach. In Rhode Island, a third option is available, a value defined by the state (currently set at $356,199).

Value Gap Calculation – The Value Gap reflects the value difference between a market rate unit and an income-controlled unit. For rental housing, the value gap is determined by capitalizing the difference in net operating income using market capitalization rate. For ownership housing it is simply the difference in sales value. In other words, the value gap calculates the lost value to a developer as the result of having to price that income-controlled unit at a lower price. The upside of this approach is it truly reflects the financial gain a developer gets by not having to lower the price for an income-controlled unit. The challenge of this approach is the Value Gap does not reflect the actual cost to build an income-controlled unit.

Construction Cost Calculation – This approach focuses on the costs to build a housing unit regardless of the price point. This includes land acquisition, land development and soft costs (e.g., design and engineering), approval process, and the hard construction costs for development. Inverse to the Value Gap approach, the benefit of this approach captures a greater cash payment because it does not reflect value change. From a negative perspective, this approach could be financially punitive because the cost will exceed the value gained by the developer by not having to deliver the income-controlled unit.

Because of this, RKG Associates recommends using the Value Gap approach for calculating the partial unit value. This option presents the value difference between a market rate unit to an income-controlled unit as the most financially neutral to the developer. The Construction Cost approach and the State fee were calculated to create disproportionate financial infeasibility.

Recommendation #3: **Payment In Lieu**

A payment in lieu strategy addresses situations where the City or the developer would prefer to contribute a cash payment instead of delivering an onsite income-controlled unit. This may happen for several market, financial, and strategic reasons (e.g., an area has a surplus of income-controlled housing). In these cases, a cash payment is made to a housing trust fund or another housing assistance program and that unit can be priced at market rate.

Payment in lieu policies can be controversial. Most housing advocates prefer residential developments to be inclusive and diverse (e.g., mixed-income projects). Being able to buyout allows a project to be more exclusive. Further, the housing values vary in the City. A static buyout price will incentivize payments in high-cost development areas of the City, which likely are already unobtainable to low-

and moderate-income households. As a result, the payment in lieu would further limit choice in areas that need options.

RKG does not recommend allowing payment in lieu. If the City wishes to implement a payment in lieu strategy, then RKG recommends the following approaches:

- Use the construction cost valuation approach because the developer would receive the full value of those units. In addition, the partial value calculation will not provide sufficient resources to replace that income-controlled unit elsewhere.
- Approval by the City should be required. If the developer wants to seek a payment in lieu option, they should have to put in a request to be determined by the City.

Recommendation #4: **Offsite Development**

An offsite development strategy allows a developer to build their required income-controlled units on a different site than the proposed project in question. Communities use this strategy for several reasons, including instances where a developer cannot fit the units on the proposed site, where they are getting a greater income-controlled unit yield at another location, or the offsite location is strategically beneficial for low- and moderate-income households (e.g., along a mass transit line). In communities where offsite development is allowed, developers can request to build the required income-controlled units at a different location within the community.

If Providence opts to implement an offsite policy, considerations for the policy include:

- Proximity – The offsite policy needs to determine how far the offsite units need to be from the proposed development site. Simply put, the community needs to determine specific distance from the proposed development site for reasons of keeping it in the same neighborhood or at a proximate distance (e.g., within a quarter mile).
- Offsite requirement – Some communities that implement offsite, require additional income-controlled in exchange for approving the offsite strategy. For example, a project that owes five income-controlled units may be subject to providing an additional 20% bonus (or one additional unit) for allowing the offsite development. This is typically used to capture the full value of those units.
- Need/Reason – The community should define specific circumstances for it to consider an offsite request. Generally, not wanting to deliver units is not an acceptable reason. Circumstances such as an opportunity to increase yield or finding a more suitable location should be included in the consideration process.
- Value equivalency – Using the Value Gap or Construction Cost approach, the community can determine the value of those units and require proof that the developer is investing that amount (or more) at the offsite location. This ensures the community receives the full of the IZ requirement.

An offsite provides certain benefits including greater flexibility for tough to build properties, can streamline the construction process, reduce overall costs to the developer, and potentially deliver more/better located income-controlled units.

A drawback of this approach is the potential to concentrate the production of offsite income-controlled units into areas where affordability is already concentrated and reduce the ability to develop mixed-income projects. If the City establishes an offsite strategy, RKG recommends considering partnership opportunities with non-profit housing organizations that lead to offsite requirements for building income-controlled units, while actively avoiding development in most revenue rich areas.

Recommendation #5: **Density Bonus**

A density bonus is a common incentive strategy used to encourage developers to build more income-controlled units. This program works by increasing the number of total units allowed than would be allowed in exchange for a developer providing income-controlled units. In fact, the State enabling IZ legislation requires municipalities to offer a density bonus. This incentive allows developers to build more market rate units in exchange for providing income-controlled units which reduces the financial burden that a traditional IZ policy would have on feasibility by mitigating costs and maximizing the economic use of a property.

RKG calculated the ratio of density bonus (number of market units to income-controlled units) for the City. Results from the model showed an approximate ratio of 7 market rate units to 1 affordable unit (7:1) for a density bonus to have an impact that increases feasibility for new construction developments located in subareas 1, 2, and 5. In subarea 3, the ratio slightly changes to 6:1 market rate/affordable units. Development in subarea four is infeasible regardless of the bonus density.

Based on the findings above, a density bonus incentive does not work under an IZ policy in Providence because it requires too many market rate units for each affordable unit. A density bonus ratio of 6:1 and 7:1 is high compared to ratios that are typical in the industry (e.g., 2:1 or 3:1). Additionally, a 6:1 or 7:1 ratio would make physically accommodating the bonus units challenging given the current density allowances in Providence.

The market analysis indicates a required density bonus program will render a local IZ policy as infeasible. To this point, Providence should lobby the state to remove the density bonus requirement. In the meantime, Providence can offer a limited density bonus (e.g., two market rate units for every one income-controlled unit delivered) to mitigate the financial impact, but that will not fully compensate the developer. Long term, RKG recommends density bonus to be implemented as an overlay district rather than an addition to existing zoning. Using an overlay district will provide the City with greater flexibility to meet the local growth/development vision without having to materially change the existing zoning code.

Recommendation #6: **Subsidies**

The analysis indicates that implementing an IZ policy will have a negative financial impact on a development project in a community where market rate development is already financially challenging. As a result, any IZ policy within Providence will require financial assistance to reach financial feasibility. The following strategies and tools can be used by the City in partnership with the goal of increasing housing choice through new development. For a 25-unit wood-frame residential development that is subject to the State IZ requirements of setting aside 15% of the units as income-controlled, the table below reflects the financial gap necessary to be closed to reach average market expectations at different AMI thresholds. Further increasing the percentage set aside will increase the amount of subsidy needed per project to reach market expectations.

Table 26. Cash calculations to reach minimum financial feasibility for 25-unit rental development

Closing the Financial Gap

Subsidy Needed to Reach Financial Feasibility

AMI	@15% Set Aside
40% AMI	$3,150,000
50% AMI	$3,020,000
60% AMI	$2,890,000
70% AMI	$2,760,000
80% AMI	$2,630,000

Low-Income Housing Tax Credits – LIHTC is a federal program that provides funding for real estate developments incentivizing affordable rental housing. Both non-profit and for-profit developers are eligible to qualify their project for LIHTC funding. Projects can qualify for two types of funding: a 4% credit or a 9% credit. The differences between the two credits are the equity generated, and competitive (9%) vs. non-competitive (4%). A project receiving 9% LIHTC typically generates a tax credit equivalent to approximately 70% of the development cost for the income-controlled units, while 4% LIHTC generates a tax credit valued at approximately 30%. Because of this, the demand for 9% credit far outweighs the supply available therefore making it competitive to qualify. For a development project to qualify, at least 20% of the total units must be set aside at 50% of AMI or 40% of the total units must be set aside at 60% of AMI or below and maintained for a minimum of 30 years.

In addition to the federal LIHTC allocation provided to the state, the Rhode Island legislature recently passed a $30 million State LIHTC fund to augment the federal monies. It is aimed at closing the financing gaps for awarded projects to help streamline development quicker. The program is set to expire in 2028.

LIHTC is an effective tool for projects that meet the minimum requirements to qualify. However, the 9% credit is challenging to acquire at the minimum thresholds. Further, the market analysis illustrated that the 4% credit is not sufficient to create feasibility for projects at a set aside of 20% targeting

household at 80% AMI. That said, the 4% credits are beneficial and can be used in coordination with other state and local subsidy programs to reach financial feasibility.

HOME Program – The HOME Investment Partnership Program is a federal program that provides funding to newly constructed affordable rental housing. Both non-profit and for-profit developers are eligible to qualify for HOME funding. To qualify for HOME funding, all proposed HOME units must be at no more than 60% of AMI or at least 20% of the total HOME units must be set aside at 50% of AMI. HOME funding is limited to approximately $50,000 to $90,000 per unit per project. This option can be used in conjunction with LIHTC and other subsidies as part of the capital stack.

Section 8 Housing Vouchers – Section 8 Housing Voucher Program is a federal housing funding program provided by the HUD department. The purpose of the program is to assist low-income individuals and families with a 'voucher' that subsidizes their rent and utilities. Typically, an individual or family on a voucher program pays approximately 30% of their rent, while the remaining 70% is paid for by HUD to the developer. There are three ways that HUD calculates the value of a housing voucher: Fair Market Rent (FMR), 110% of FMR, and Small Area Fair Market Rent (SAFMR). Fair Market Rents are fixed rents by bedroom size set by HUD for real estate developments that include affordable rental units. SAFMR are estimated fair market rents adjusted spatially by zip codes household incomes. This allows developers/property managers the flexibility ability to apply for SAFMRs which provides the most financial relief than the other calculations.

RKG learned that FMRs and SAFMRs per unit are approximately equal to HUD regional rents between 70% - 90% AMI threshold range, meaning only developments targeting household incomes at or below 60% of AMI will receive a financial benefit from the use of a housing voucher. That said, the challenge of qualification and compliance for housing voucher units may make use of this tool unattractive to for-profit developers and/or smaller projects. As market rate rents continue to escalate faster than HUD defined FMRs, this tool may be a more viable option.

Local Investment – Providence and its implementation partners already invest in housing choice and housing price diversity. As with every other community, resources are not sufficient to meet all housing demand. A strategy for consideration is additional financial investment in housing development, particularly under an IZ policy. At a base level, the City can increase its commitment of general fund resources toward an IZ policy. Another approach involves dedicating a tax millage on real property to the IZ program. In this instance, the City would commit a tax millage (e.g., three mills) onto existing tax rates. This additional assessment would be earmarked for new housing development under the IZ policy. Setting this rate needs to be considered against the City's other financial needs.

Tax classification change – Currently, Providence has two different tax rates. One for fee-simple residential, and one for commercial/industrial. The residential rate is $17.80 per thousand dollars of value, while the commercial tax rate is $35.10 per thousand dollars of value. Multiunit residential buildings with more than five units are assessed at the commercial tax rate. The analysis shows that the commercial tax rate being applied to market rate multifamily development makes projects infeasible in most in Providence. On this point, the City should consider implementing a third tax

classification for larger multiunit projects at a more commensurate rate with the existing residential rate. This change would improve the feasibility for market rate projects and potential IZ projects.

Tax Stabilization – The analysis indicates that Providence's existing tax stabilization agreement program is not sufficient to support the creation of projects that require income-controlled units. Simply put, providing an 8% Tax stabilization just for the income-controlled units does not create enough financial benefit to offset the losses from the income-controlled units. At market rate, the 8% Tax is viable when applied to the entire building. Incorporating income-controlled units requires further subsidies to reach feasibility. If the City chooses to pursue an IZ policy, additional financial resources (e.g., Trust Fund grants) will be necessary in addition to the current tax stabilization agreement.

Tax Predictability – In comparison to the 8% Tax stabilization, which reduces the tax bill to a percentage (8%) of the property's effective gross income, the tax predictability program performs better for the reasons: a) the property's tax bill is front-loaded, receiving a larger discount in earlier years, and b) it benefits the developer by providing a lower overall tax payment to the City over a 15-year period. The analysis indicates applying the tax predictability abatement is sufficient to support market rate projects. Like results from the 8% Tax stabilization scenario, it is more challenging to support the creation of income-controlled units and requires additional financial resources if the City were to implement an IZ policy.

GLOSSARY OF TERMS

Capitalization Rate – Ratio between the net operating income of a property and its sales value

Discount Rate – The interest rate used in discounted cash flow analysis to determine the present value of future cash flows

Density Bonus - A ordinance mechanism allowing a developer to build a greater number of units than the existing underlying zoning dictates in exchange for the creation of additional affordable units

Equity – Initial out-of-pocket investment on the part of developer that is required to obtain financing

Effective Gross Income – Gross income minus the vacancy collection loss

Fee-in-Lieu – Payment made to City to account for fractional affordable unit not built.

Internal Rate of Return - Annualized rate of return sought by a developer based on the project discounted cashflow

Net Operating Income – Net income after deducting operating expenses from potential gross income

Net Present Value – Net value of the initial investment and cashflows generated from a project, discounted back to the current year

Operating Expenses – Expenses related to operating the building such as maintenance, salaries, and repairs

Other Income – Income generated from the property aside from rent, this income is parking revenues for leased spaces

Potential Gross Income – Potential income generated from rental income or sale of a property. Calculated by multiplying the number of units and rent for each unit

Land Value - The price a developer pays for a piece of land

Vacancy and Collection Loss – Percent of rent that is uncollectable

Value Gap – Difference in value between a market rate unit and affordable unit