



TO: Lisa Mulligan
Brookhaven Industrial Development Agency

FROM: Kevin F. Gremse, Senior Director *KFG*

DATE: February 20, 2019

RE: Town of Brookhaven IDA Application for Financial Benefits
The Arboretum, 510 Horseblock Road, Farmingville, NY

The National Development Council (“NDC”) is a not-for-profit economic development finance advisory company that is retained by the Town of Brookhaven, Office of Economic Development to review and evaluate applications for financial assistance, including those submitted to the Town of Brookhaven Industrial Development Agency (“TOBIDA”). The purpose of this memo is to describe NDC’s project understanding and findings of the above referenced project and application for tax assistance.

PROJECT SUMMARY

Kelly Builders of Farmingville, LLC (the “Developer” or “Applicant”), a single asset entity owned by Michael Kelly and Happy Harbor LLC, has submitted a Uniform Application to the TOBIDA for The Arboretum, a \$118.3 million, 292-unit residential development. The applicant requests payment in lieu of taxes (PILOT) as well as a sales tax and a mortgage recording tax exemption.

The Developer acquired the 65-acre site at 510 Horseblock Road, a former mulch mixing facility, and proposed to construct 292 units and rent them as residential condominiums. The Developer secured zoning changes and land use approvals for the proposed development in Farmingville.

The Developer intends to develop the project as a residential rental development, with 10% of the units set aside as and priced affordably to households earning less than 60% of area median income (AMI). The Developer will also build a sewage treatment plant to support the development. The facility is expected to generate 50,000 gallons per day (gpd) excess capacity to support nearby development nearby. Other civic improvements and contributions from the developer include a 7-acre public park, a 1,200 square foot community building for the Chamber of Commerce, and the donation of a single family to the Historical Society. The he project will include the redemption of 41 Pine Barren Credits.

While a commercial component of the overall development is not included in the application for IDA assistance, the Developer will construct 24,000 square feet commercial space on 3.5 acres on the development site.

The Town of Brookhaven (the “Town”) tax assessor has prepared tentative assessed values for the residential development and reports estimated full taxes at \$1,478,835 upon completion, equivalent to \$5,065 per unit annually. Without a partial tax exemption, the development is not considered feasible, as the Developer would likely not be able to secure permanent financing for the \$118.3 million in development costs or achieve sufficient returns on the investment in order for it to proceed.

NDC has reviewed the development programs, sources and uses and the operating pro forma for the project and presented its findings for sizing the PILOT.

DEVELOPMENT PROGRAM AND SOURCES & USES

The development involves the construction of 292 units. Ten percent, or thirty units, will be "affordable" units under the Town's affordable housing program. There will also be a 7,500sf clubhouse, a pool and an outdoor basketball court constructed for common use and 7-acres of green space land set aside for walking trails.

PROGRAM	Units	Rent	Unit Size	Square Feet	Average Rent	Annual Rent	Rent/SF
Clubhouse				7,500			
Townhomes	77	\$ 2,800	2,100	161,700		\$ 2,587,200	\$ 1.33
Affordables	30	\$ 1,188	1,200	36,000		\$ 427,680	\$ 0.99
Upper Mkt Rent Units 2bdm w Loft n Terrace	67	\$ 2,500	1,650	110,550		\$ 2,010,000	\$ 1.52
Lower Mkt Rent Units 2 BdRm/ Basement&Garage	67	\$ 2,300	1,200	80,400		\$ 1,849,200	\$ 1.92
Cottages	51	\$ 3,400	1,800	91,800		\$ 2,080,800	\$ 1.89
Total	292			487,950	\$ 2,438	\$ 8,954,880	

The Developer is planning to finance the development with a conventional debt (70%) and equity (30%).

USES OF FUNDS	Amount	%	Per Unit	Per SF
Acquisition	\$ 14,600,000	12%	\$ 50,000	\$ 30
Pine Barrens Credit	\$ 3,485,000	3%	\$ 11,935	\$ 7
Sewer Treatment Plant	\$ 10,000,000	8%	\$ 34,247	\$ 20
Site Work	\$ 14,800,000	13%	\$ 50,685	\$ 30
Hard Costs	\$ 42,829,700	36%	\$ 146,677	\$ 88
General Conditions and Overhead	\$ 3,380,009	3%	\$ 11,575	\$ 7
Builder Fee	\$ 6,763,040	6%	\$ 23,161	\$ 14
Hard and Soft Costs Contingencies	\$ 9,216,485	8%	\$ 31,563	\$ 19
Soft Costs	\$ 5,417,837	5%	\$ 18,554	\$ 11
Construction Interest	\$ 7,790,000	7%	\$ 26,678	\$ 16
TOTAL	\$ 118,282,071	100%	\$ 405,076	\$ 242
PERMANENT SOURCES OF FUNDS	Amount	%		
Permanent Loan	\$ 82,797,450	70%		
Developer Equity	\$ 35,484,621	30%		
TOTAL	\$ 118,282,071	100%		

The development cost is considered reasonable at \$118.3 million, or \$405,000 per unit. This per unit cost is considered consistent with to other newly-constructed rental units on Long Island. However, given the size of the units and the extraordinary costs for sewer investment, it is an efficient budget. The Developer will be the general contractor and reports being able to realize efficiencies based upon its dual role.

OPERATING PROFORMA

STABILIZED OPERATING PRO FORMA	With PILOT	Comment	With Full Taxes	Comment	Market Expects
Gross Market Income	\$ 9,379,920	\$2,983 avg. rent	\$ 9,379,920	\$2,983 avg. rent	
Gross Affordable Rent	\$ 470,448	\$1,307 avg. rent	\$ 470,448	\$1,307 avg. rent	
Vacancy	\$ (492,518)	5.00%	\$ (492,518)		
Effective Gross Income (EGI)	\$ 9,357,850		\$ 9,357,850		
Less operating Expenses	\$ (1,401,600)	4,800 per unit	\$ (1,401,600)	4,800 per unit	
Less Annual PILOT	\$ (384,720)	1,318 per unit	\$ (1,538,882)	5,270 per unit	
Net Operating Income (NOI)	\$ 7,571,529		\$ 6,417,368		
Debt Service	\$ (5,855,124)		\$ (5,855,124)		
Cash Flow	\$ 1,716,405		\$ 562,244		
Debt Coverage Ratio	1.29		1.10		> 1.20: 1
Cash on Cash	5%		2%		> 8%
Cash on Cost	6%		5%		> 7%
Internal Rate of Return (IRR)	12%				>12%

The above represents the stabilized operating pro forma. A few comments on the operating pro forma:

- The affordable units (30 total units) will be divided into two equal groups: half (15) designated for households earning 65% of Area Median Income (AMI), or roughly \$75,855 for a family of four, and half (15) designated for households earning 50% of AMI, or earning roughly \$58,350.
- The average monthly market rent per unit is \$2,983, considered reasonable and representative of market rate for a newly constructed two- and three-bedroom apartments in Brookhaven. There is a slight premium due to the large size and amenities of the units.
- The operating expenses are \$4,800 per unit. This is reasonable for a standard rental development. Given the large size of the units and the extensive acreage of the property, the operating expenses are quite low.
- The Town of Brookhaven assessor has estimated taxes for the residential property on an “as-improved” basis at \$1,478,835* or \$5,065 per unit annually. With taxes at full assessment, the development would not be financially feasible, as the financial metrics would fall below standard thresholds for both lender and developer.

* The estimated taxes for the commercial property on an “as improved” basis is \$98,589 annually, bringing the total estimated taxes for the project on an “as improved” basis to \$1,577,424 annually.

FIANCIAL PACKAGDE AND PROPOSED PILOT STRUCTURE

The Developer requested a financial incentive package consisting of a PILOT, sales tax exemption, and mortgage recording tax exemption. The package is summarized as follows.

TAX BENEFIT SUMMARY				
IDA RELATED PROPERTY TAXES		SALES TAX EXEMPTION		
Current Annual Taxes	\$61,804	Construction Cost		\$42,829,700
As Complete Residential Taxes	\$1,478,835	Value of Building Materials	50%	\$21,414,850
As Complete Commercial Taxes	\$98,589	Sales Tax Rate		8.625%
Total "As Complete" Annual Taxes	\$1,577,424	Value of Exemption on Building Materials		\$1,847,031
Multiplier	25.52 /1			
Taxes without PILOT over 15 years	\$24,972,893			
PILOT Savings	(\$10,030,212)			
Taxes and PILOT Paid over 15 Years	\$14,942,681			
MORTGAGE RECORDING TAX				
Mortgage	\$82,797,450			
Mortgage Recording Tax	0.75%			
Value of Exemption	\$620,981			

The 15-year PILOT schedule is shown in Exhibit A. The 15-year PILOT is consistent with TOBIDA’s Uniform Tax Exemption Policy (UTEP) for developments that include affordable housing.

The proposed PILOT, beginning at a 75% abatement, would be phased-in beginning in the second year of construction as residential units become available. The analysis assumes that residential units would be brought into service in equal increments over a four-year period following an initial year of site work. The PILOT, thus, in the first year would equal \$92,427 for an assumed 73 available units, or \$1,266 per unit. The abatement level would remain consistent for four (4) successive years. The abatement would adjust down to 50% in years 6-10, and then to 25% in years 11-15 before terminating in Year 16 when full projected escalated assessment on the residential property would equal \$1,699,883 annually.

The financial package is considered necessary in order to create financial feasibility. Even with the proposed PILOT, the returns are light, with the stabilized yield on cost at 6% (market usually expects 7%) and the levered internal rate of return at 12%, the low end for such return for a comparable development. The financial package is necessary to establish financial feasibility. There is not undue enrichment to the applicant.

The PILOT Schedule and summary of financial benefits are represented in Exhibit A.

COST BENEFIT ANALYSIS

The following demonstrates the net positive benefit from this financial benefit package to incentivize the development of Arboretum.

BENEFIT ANALYSIS	
Total IDA Residential Taxes over 15 years	\$13,241,245
Total Commercial Taxes over 15 Years	\$1,701,436
Clubhouse and Other Civic Improvements	\$2,500,000
Total Aggregate Taxes (Public Benefit)	\$17,442,681
PILOT Savings over 30 years	(\$10,030,212)
Mortgage Recording Tax Exemption	(\$620,981)
Sales Tax Exemption	(\$1,847,031)
Total Tax Benefits (Developer Benefits)	(\$12,498,224)
Net Public Benefit	\$4,944,456

While the project shows a net positive benefit per the above chart, the financial incentive package is also justified on account of the considerable extraordinary costs involved in the development. There is over \$13 million of costs that are not typically involved with the standard residential development, most notably the costs involved with the construction of the sewer treatment facility. The financial incentive package is a means to offset the costs associates with the sewage treatment facility.

EXTRAORDINARY COSTS VS PUBLIC BENEFIT	
Sewer Treatment Facility	\$10,000,000
Pine Barren Credits	\$3,485,000
Extraordinary Costs	\$13,485,000
PILOT Savings over 15 years	(\$10,030,212)
Mortgage Recording Tax Exemption	(\$620,981)
Sales Tax Exemption	(\$1,847,031)
Total Tax Benefits (Developer Benefits)	(\$12,498,224)

Additional public benefits are realized form this development, including;

- 292 units of new rental units in a Town that has a recognized shortage of residential rental units.
- 30 of the units will be deed-restricted as “affordable” and made available through a lottery by the Long Island Housing Partnership.
- Productive reuse of long underutilized land.
- A 7,500 square foot clubhouse, outdoor recreation facilities and donated civic building improvements.
- Provision of 50,000gpd of sewage treatment capacity available to surrounding development.
- Redemption of 41 Pine Barren Credits.
- 3.5 acres (24,000sqft) of mixed-use commercial space expected to generate \$98,589 in additional taxes annually.
- Despite the phase in schedule, the real estate tax increment on the project overall would be considerable generating an estimated increment over current taxes of \$14 million (including commercial) after the completion of the 15-year PILOT.



EXHIBIT A

CURRENT TAXES											
Parcel A											
Parcel B											
Parcel C											
Total Current Taxes											
FUTURE TAXES AT FULL ASSESSMENT											
			Residential	Commercial							
Units			292	24,000 SF							
Assessed Valuation w 292 units			\$450,000	\$30,000							
Assessment Per Unit			\$1,541								
Brookhaven Tax Rate			3.2863	3.2863							
As Complete Taxes at Full Assessment			\$1,478,835	\$98,589							
Units			292								
Taxes/Unit at Full Assessment			\$5,065								
Tax Rate Escalator			1.00%								
Year	Current Taxes	Units Placed In Service	Assessment Per unit	Tax Rate	Full Taxes	Abatement	PILOT	PILOT/UNIT	Savings	Commercial Taxes (no abatement)	Increment Above Current Taxes
Construction	\$61,804						\$61,804				
1	\$61,804	73	\$1,541	3.2863	\$369,709	75.00%	\$92,427	\$1,266	(\$277,282)	\$98,589	\$129,212
2	\$61,804	146	\$1,541	3.3192	\$746,812	75.00%	\$186,703	\$1,279	(\$560,109)	\$99,575	\$224,474
3	\$61,804	219	\$1,541	3.3524	\$1,131,420	75.00%	\$282,855	\$1,292	(\$848,565)	\$100,571	\$321,622
4	\$61,804	292	\$1,541	3.3859	\$1,523,645	75.00%	\$380,911	\$1,304	(\$1,142,734)	\$101,576	\$420,684
5	\$61,804	292	\$1,541	3.4197	\$1,538,882	75.00%	\$384,720	\$1,318	(\$1,154,161)	\$102,592	\$425,509
6	\$61,804	292	\$1,541	3.4539	\$1,554,270	50.00%	\$777,135	\$2,661	(\$777,135)	\$103,618	\$818,949
7	\$61,804	292	\$1,541	3.4885	\$1,569,813	50.00%	\$784,907	\$2,688	(\$784,907)	\$104,654	\$827,757
8	\$61,804	292	\$1,541	3.5234	\$1,585,511	50.00%	\$792,756	\$2,715	(\$792,756)	\$105,701	\$836,653
9	\$61,804	292	\$1,541	3.5586	\$1,601,366	50.00%	\$800,683	\$2,742	(\$800,683)	\$106,758	\$845,637
10	\$61,804	292	\$1,541	3.5942	\$1,617,380	50.00%	\$808,690	\$2,769	(\$808,690)	\$107,825	\$854,712
11	\$61,804	292	\$1,541	3.6301	\$1,633,554	25.00%	\$1,225,165	\$4,196	(\$408,388)	\$108,904	\$1,272,265
12	\$61,804	292	\$1,541	3.6664	\$1,649,889	25.00%	\$1,237,417	\$4,238	(\$412,472)	\$109,993	\$1,285,606
13	\$61,804	292	\$1,541	3.7031	\$1,666,388	25.00%	\$1,249,791	\$4,280	(\$416,597)	\$111,093	\$1,299,080
14	\$61,804	292	\$1,541	3.7401	\$1,683,052	25.00%	\$1,262,289	\$4,323	(\$420,763)	\$112,203	\$1,312,689
15	\$61,804	292	\$1,541	3.7775	\$1,699,883	25.00%	\$1,274,912	\$4,366	(\$424,971)	\$113,326	\$1,326,434
16	\$61,804	292			\$1,699,883	0.00%	\$1,699,883	\$5,822	\$0	\$114,459	\$1,752,538
	\$988,861				\$23,271,457		\$13,241,245		(\$10,030,212)	\$1,701,436	\$13,953,820