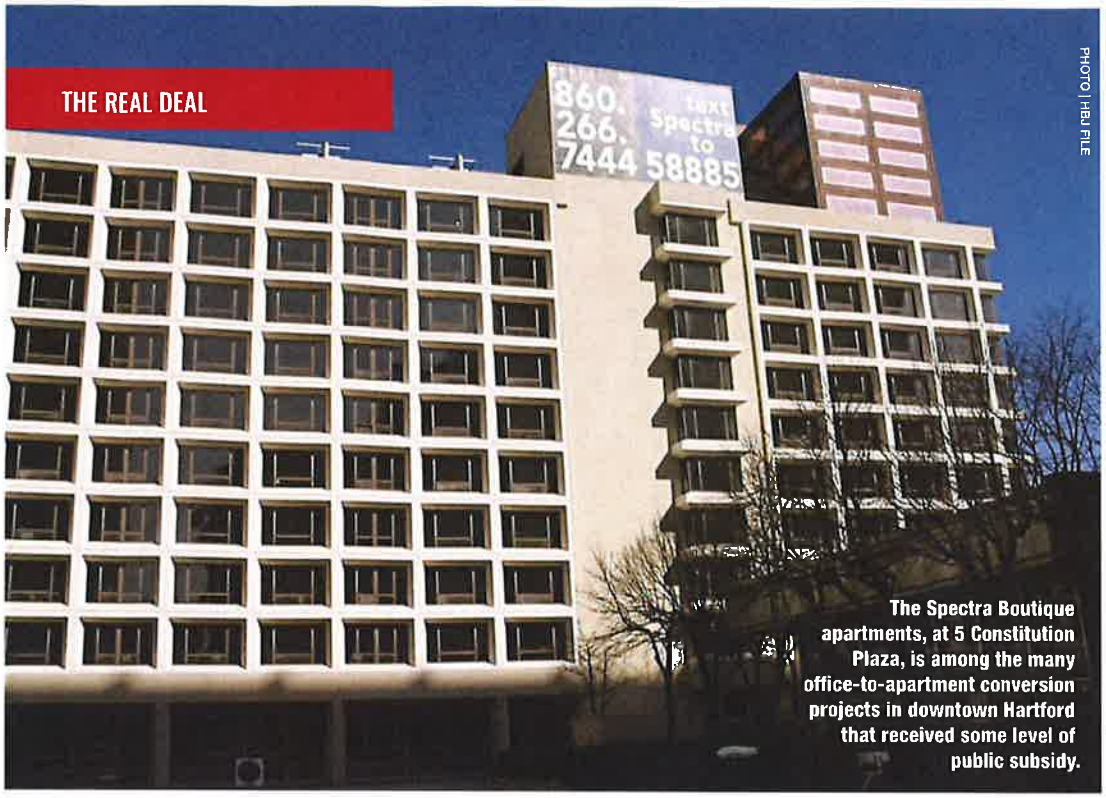
THE REAL DEAL



The Spectra Boutique apartments, at 5 Constitution Plaza, is among the many office-to-apartment conversion projects in downtown Hartford that received some level of public subsidy.

Why public subsidies are critical to new downtown Hartford housing construction

By Joe Cooper
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Some taxpayers scoff when a wealthy real estate developer secures a public subsidy to fund new housing construction in downtown Hartford.

But that support is necessary if the city wants to see more apartments sprout in and around the central business district, according to a new study by East Hartford real estate advisory firm Goman+York Property Advisors LLC.

In fact, taxpayer dollars are crucial in supporting new apartments because high construction costs and operating expenses make it difficult, if not impossible, for developers to achieve a 12% to 18% return on investment (essentially the minimum ROI most would accept to do a project) based on the market rents that can be charged downtown, the study said.

The Goman+York study — which was commissioned by the Capital Region Development Authority (CRDA), a quasi-public financier of most downtown Hartford projects — provides two hypothetical examples of a typical housing project to demonstrate why a subsidy is needed.

In the first example, the project has development costs of $250 per square foot, monthly market rents of $2.35 per square foot (that equates to a 650-square-foot apartment having monthly rents of about $1,527), and annual operating expenses of $9.87 per square foot.

The net rent ($9.87 in annual operating costs subtracted from $28.20 in annual rents) is $18.33 per square foot.

That project's return on investment, without subsidies, is 7.3% ($18.33/$250), far below what it would take to entice a developer, the study says.

Using that same hypothetical example and providing a $100-per-square-foot public subsidy, which equates to 40% of the overall development costs, bumps up the return on investment to 12.22%.

If you're thinking that's a significant public subsidy it is, but CRDA, which largely offers low-interest loans, isn't providing all of it.

State Department of Economic and Community Development (DECD) loans/grants, various state and federal tax credits, brownfield loans, and city tax abatements are among other financing sources developers use to hit their minimum-required return on investment, the study said.

Why public subsidies are needed

Here are the numbers and math of a hypothetical Hartford multifamily development without subsidies and why it wouldn't attract a private developer.

Required return on investment (ROI)	**12% – 18%**
Development costs	**$250 per square foot**
Market rents	**$2.35 psf/month – $28.20 psf/year**
Operating expenses	**$9.87 psf/year**
Net rents	**$18.33 psf/year**
Actual ROI with no subsidies	**($18.33/$250) = 7.33%**

Source: Goman+York market studies and project research

For example, the $24-million Spectra Boutique Apartments at 5 Constitution Plaza, which debuted in 2015 with 190 studio, one- and two-bedroom units in the former Sonesta Hotel, received $9.6 million in state and federal historic tax credits, a combined $6 million in loans from DECD and CRDA, and a favorable tax assessment for blighted properties, the study said.

Spectra Boutique, developed by New York's Girona Ventures and Wonder Works Development and Construction Corp., is currently 94% occupied and charges monthly rents ranging from about $1,100 to $1,900, the study says.

The study didn't reveal the developer's estimated ROI.

R. Michael Goman, principal of Goman+York, said public financing will be needed to encourage adaptive re-use of non-residential buildings in Hartford for at least the next five years, or as long as Connecticut's population continues to decline or flatline.

Goman said an increase in population would drive greater demand for housing and increase rents, which would lessen the need for public subsidies on new housing construction.

R. Michael Goman, Principal, Goman+York Property Advisors LLC

"Until we see that change, I think you need the government to step in and incentivize new housing product," he said. "CRDA is a vehicle in which we do that, and you can see that on the street."

The ROI issue, Goman says, is common in most small cities, especially in the Northeast, where construction-cost growth has outpaced rents at aging residential buildings for decades.

"Virtually any project that we have looked at, particularly in downtown areas, ... in order to make the numbers work, the community needs to participate," Goman said. "This isn't something specific just to Hartford."

Deal Roundup

A 17,600-square-foot shopping center in Wallingford has changed hands for $1.6 million, brokers say.

Northern Star CT Inc., led by principal Ed Lin, recently acquired the retail property at 200 Church St. from New Haven attorney Edward A. Renn. Tenants include a printing/marketing company, and several restaurants and retail stores, among others.

Broker O,R&L Commercial LLC said it represented the buyer and seller in the deal.

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Yale University has acquired an industrial complex in Hamden for more than $1.2 million.

Yale bought the 25,534-square-foot industrial facility, which has several existing tenants, at 105 Leeder Hill Dr., from Stengel & Tomasulo Realty LLC.

Hamden's Press/Cuozzo Realtors represented both parties in the transaction.

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Joe Cooper is HBJ's web editor and real estate writer. He pens "The Real Deal" column about commercial real estate.