The Economics of Land Use

EPS

Berkeley

Sacramento

Denver

University Neighborhood Ordinance
Affordable Housing Fee Update

presented by

Darin Smith

Economic & Planning Systems, Inc.

August 1, 2011

Economic & Planning Systems, Inc.
2501 Ninth Street, Suite 200, Berkeley, CA 94710
510.841-9190 • 510.841-9208 fax

Recap: Abridged History of the UNO Housing Fee

- University Neighborhood Overlay adopted in 2004 as developer option over existing zoning
  - Increased allowable height limits
  - Set design standards for buildings and streetscape
  - Required provision of affordable units or payment of in-lieu fee
    - Most projects have 10% of units at 80% MFI required, plus 10% at 65% of MFI or payment of in-lieu fee at $0.50/net SF
- Over 2,800 housing units built under UNO regulations since 2004, virtually no projects built using base zoning
- No units built at 65% MFI, but over $1 million raised in in-lieu fees
- 2009-2010 – City Council requested an update of the fee to reflect new economic conditions

Goals: Updating the UNO Housing Fee

- Council Resolution 20091210-044: Dec. 2009

  The City Manager is directed to work with stakeholders to ***make recommendations on a potential revision to the calculation of the in-lieu fee*** *for affordable housing in the University Neighborhood Overlay and initiate the necessary code amendments. This potential revision should include a provision to set the in-lieu fee by ordinance with an* ***annual adjustment to reflect current market conditions*** *in a manner and format similar to the in-lieu fees for affordable housing incentives in CBD, DMU, PUD, and NBG zoning districts.*

- Initial stakeholder meetings held in September, 2010

- Economic & Planning Systems retained in February 2011 to assist NHCD with recommendations to update fee

EPS Scope and Process

1. Evaluate economic conditions for development in UNO area
2. Seek stakeholder consensus on “prototypical” development economics
3. Understand the impacts of City requirements on project feasibility
4. Estimate “maximum” in-lieu fee based on subsidies to build appropriate units
5. Recommend a fee level that balances affordable unit subsidy requirements with project feasibility
6. Devise an appropriate methodology for updating the fee over time

NOT revisiting entire UNO ordinance or affordable housing program

– No changes to assumed income levels, percentages of units, “whole building” basis, etc.

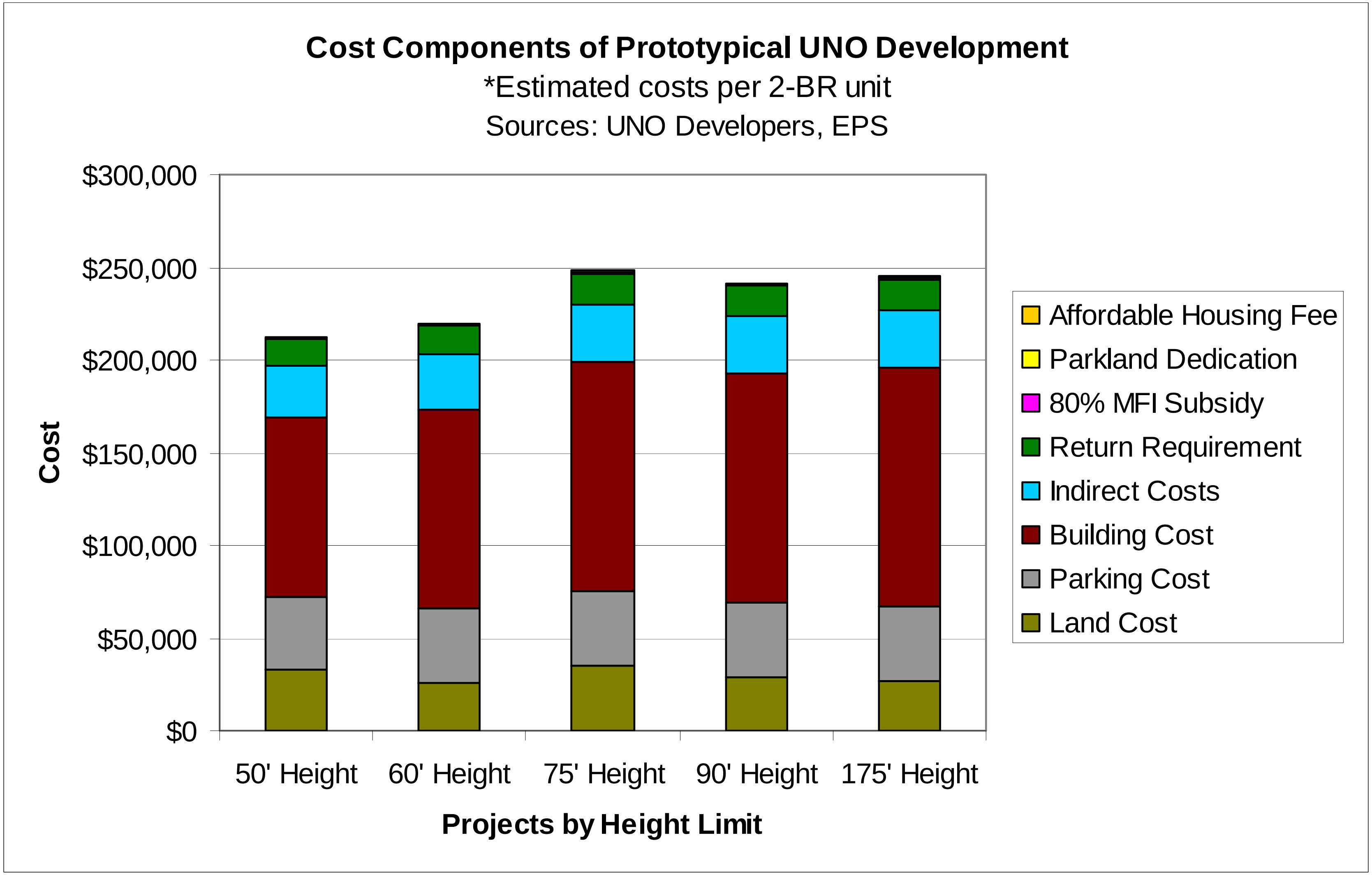
Economic conditions for UNO development

- Long-time pent-up demand for student housing
  - Under base zoning, new projects couldn't achieve values to displace existing uses
- UNO regulations have enhanced the feasibility of development, enabling many new projects
- Property owners have raised expectations regarding values achievable for development sites
- Most "easy" sites are already redeveloped
- Some market for for-sale product, but mostly rental
- Developers offer 80% MFI studios to minimize subsidies

Prototypical development economics

- **Major cost components**: Jointly represent ~97+% of project costs
  - "Fixed" costs that can't be avoided or significantly reduced for most projects
  - Direct costs for buildings and site improvements: ~40-50% of total costs
  - Podium parking: ~10-15%
  - Indirect costs: ~20%
  - Landowner value expectations: ~10-20%
  - Return requirements for developer/lender interest: ~7.5%
- **Minor cost components**: Typically represent <3% of costs
  - SMALL BUT IMPORTANT - directly reduce developer and/or landowners' bottom line
  - UNO Housing Fee: $475 per 2BR (950 SF) unit = ~0.2% of total costs
  - Parkland Dedication Fee: $650/unit = ~0.3%
  - 80% MFI Units: UNO projects are required to provide on-site units
  - Tree Ordinance: Case-by-case

Prototypical development economics



UNO Housing Fee Economics

- **Current fee is $0.50/rentable SF in entire building**
  - Other Austin housing fees: $6/<u>bonus</u> SF for PUD & North Burnet/Gateway, $10/<u>bonus</u> SF in CBD satisfies total affordable housing requirement
  - UNO fee is roughly $1.00/<u>bonus</u> SF due to ~double density, but UNO projects must also build units for 80% MFI
- **Fee “nominally” used as funding for 10% units at 65% MFI**
  - Example: Project with 200 units at 950 SF average rentable SF pays $95K fees
  - UNO requirement = 20 units at 65% MFI
  - $95K fee/20 units = <$5K fee/65% MFI unit required
- **Fee not adequate to fully fund 65% MFI units**
  - Studio (1-person) unit for 65% MFI worth ~$97K
  - Even lowest cost construction with land and profit is ~$115K/Studio unit (350 SF)
  - Actual subsidy required is ~$18K/Studio unit at 65% MFI
    - Larger units require higher subsidies (e.g., $66K for 2 BR)
    - Context: Downtown Plan says average subsidy would be $90K+/affordable unit

65% MFI Studio -- Subsidy Estimation

60' Multifamily with Podium Parking	
Density/Acre	100
Average Gross Unit Size	425
Average Net Unit Size (excluding garage)	350
Average Number of Persons per Household	1
Parking Spaces/Unit	1

Cost Assumptions	
Land/SF	$60
Land/Unit	$26,136
Direct Construction Costs/Gross SF	$110
Direct Construction Costs/Unit	$46,750
Parking Construction Costs/Space	$20,000
Subtotal, Direct Costs/Unit	$66,750
Indirect Costs as a % of Direct Costs	20%
Indirect Costs/Unit	$13,350
Parkland Dedication Fee	$650
Developer Profit at 7.5% of Costs	$8,016
Total Cost/Unit	***$114,902***

Maximum Supported Home Price	
Monthly Rent Price at 65% MFI	$784
Total Rent/Year	$9,402
Parking Revenues/Year	$1,188
Gross Revenues/Year	$10,590
Operating Expenses per Unit/Year	$2,800
Property Taxes	$2,467
Total Expenses/Year	$5,267
Net Operating Income/Year	$5,323
Capitalization Rate	5.50%
Total Supportable Unit Value	***$96,787***

Financing Gap per Unit	-$18,115

UNO Housing Fee Economics

- **Bottom Line:**

1. The UNO Housing Fee at $0.50/SF does not fully subsidize 65% AMI units

2. The *current* UNO Housing Fee is not a significant hardship for developers or impediment to project feasibility
   - $0.50/square foot is ~0.2% of total cost

3. Changes to the Housing Fee *may* impact project feasibility by altering achievable profit margins
   - In competitive market, rents and land prices may not absorb added fee costs

4. Negative impacts on project feasibility may have undesirable consequences for overall affordable housing program
   - Rapid development created many 80% AMI units and fee funding for Co-Ops

UNO Housing Fee Update – Approach to Feasibility Assessment

- Establish “baseline” economics for an average project
  - UNO projects have a mix of Studios through 3+ bedroom units
  - Assumed average unit is a 950 SF, 2-BR unit
  - $200K average development cost
    - Includes land, construction, “indirect” costs, and current City requirements
  - Profit margin target is 7.5% of costs or $15,000

- Assess impact of altered fees on profit margins
  - Assumes land prices and market-rate rents are fixed by competitive market
  - Fee levels that drop profits well below target pose feasibility concerns

Option #1 – CPI Adjustment

- Fee based on existing UNO fees, updated by CPI
  - CPI increased from Dec. 2004 to Feb. 2011 by 17.2%
  - Previous $0.50/SF fee would increase to $0.59 in 2011
- Context: Austin MSA apartment rents increased 17.3% from 2004 to 2010, according to Capitol Market Research
- "Option #1" at $0.59/SF is ~1.2X existing fee
  - Fee for 950 SF unit would increase from $475 to $561
  - $15,000 target profit would reduce to $14,914: <1% difference
  - Profit margin drops from 7.50% to 7.46%
  - No significant feasibility challenge

Option #2 – Maximum Fee

- Maximum Fee is based on the full subsidy to build units affordable at 65% MFI
  - If units not provided in market-rate project, must be provided elsewhere in UNO area
  - Compares affordable unit construction costs and values
  - Assumes affordable units are studios to minimize subsidies
    - Consistent with current UNO practice for 80% MFI units
    - Assumes units are “standard” rather than co-ops, which have higher subsidy requirements

Option #2 – Subsidies for "Maximum Fee"

60' Multifamily with Podium Parking	
Density/Acre	100
Average Gross Unit Size	425
Average Net Unit Size (excluding garage)	350
Average Number of Persons per Household	1
Parking Spaces/Unit	1

Cost Assumptions	
Land/SF	$60
Land/Unit	$26,136
Direct Construction Costs/Gross SF	$110
Direct Construction Costs/Unit	$46,750
Parking Construction Costs/Space	$20,000
Subtotal, Direct Costs/Unit	$66,750
Indirect Costs as a % of Direct Costs	20%
Indirect Costs/Unit	$13,350
Parkland Dedication Fee	$650
Developer Profit at 7.5% of Costs	$8,016
Total Cost/Unit	***$114,902***

Maximum Supported Home Price	
Monthly Rent Price at 65% MFI	$784
Total Rent/Year	$9,402
Parking Revenues/Year	$1,188
Gross Revenues/Year	$10,590
Operating Expenses per Unit/Year	$2,800
Property Taxes	$2,467
Total Expenses/Year	$5,267
Net Operating Income/Year	$5,323
Capitalization Rate	5.50%
Total Supportable Unit Value	***$96,787***

Financing Gap per Unit	**-$18,115**

Option #2 Maximum Fee

- Convert $18K subsidy per affordable unit to fee per total SF
  - Example: 200 unit project X 950 SF/unit = 190K total rentable SF
  - UNO requirement of 10% = 20 units at 65% MFI
  - 20 required units X $18,000 subsidy/unit = $360,000 fee
  - $360,000 fee / 190K SF rentable = $1.89/SF fee
- “Maximum Fee” at $1.89/SF is 3.8X existing fee at $0.50/SF
  - Fee for 950 SF unit would increase from $475 to $1,796
  - $15,000 target profit would reduce to $13,680: 9% difference
  - Profit margin drops from 7.50% to 6.84%
  - <u>Major feasibility challenge</u>

Option #3 – Co-op Subsidies

- Fee based on UNO fee subsidies for actual co-ops
  - Super Co-op received $4,759/bed from UNO funds
  - Eden House seeking $14,286/bed from UNO funds
  - Both projects avoided land acquisition costs and cross-subsidized projects from other properties
- Average of two projects' subsidies/bed ~$9,500
  - EPS used average as proxy, but all projects will have different costs, utilize different subsidy sources, etc.

Option #3 – Co-op Subsidies

- Convert $9,500/bed subsidy to fee per total SF in UNO projects
  - Example: 200 unit project X 950 SF/unit = 190K total rentable SF
  - UNO requirement of 10% = 20 units at 65% MFI
  - 20 required units X $9,500 subsidy/bed = $190,000 fee
  - $190,000 fee / 190K SF rentable = $1.00/SF fee
- "Option #3" at $1.00/SF is 2X existing fee at $0.50/SF
  - Fee for 950 SF unit would increase from $475 to $950
  - $15,000 target profit would reduce to $14,525: ~3% difference
  - Profit margin drops from 7.50% to 7.26%
  - <u>Modest</u> feasibility challenge

Evaluation of Fee Options

- **Option #1: $0.59/net SF** reflects changes in **CPI**
  - Pros: Very modest increase to existing fee maintains feasibility; increases funding marginally
  - Cons: Inadequate funding for desired number of units
- **Option #2: $1.89/net SF** reflects **full subsidy** required for 65% MFI units
  - Pros: Adequate revenues to fund desired units
  - Cons: Extreme increase to existing fee creates large feasibility challenge for developers
- **Option #3: $1.00/net SF** reflects recent subsidies for **co-op projects**
  - Pros: Fee still modest and has little feasibility impact; can subsidize desired number of units under certain conditions
  - Cons: Assumes future affordable projects would have ability to cross-subsidize development
- **EPS recommends Option #3: Update fee to <u>$1.00/net SF</u>**

Ongoing Annual Fee Updates

- Council Resolution 20091210-044: Dec. 2009

  *Set the in-lieu fee by ordinance with an **annual adjustment** to reflect current market conditions in a manner and format similar to the in-lieu fees for affordable housing incentives in CBD, DMU, PUD, and NBG zoning districts.*

- EPS recommends annual updates based on CPI
  - Consistent with other housing fees in Austin
  - Easy to administer
  - Predictable for developers
- Revisit underlying fee calculations every 5-10 years
  - Ensure consistency with ongoing market forces (land, construction costs, etc.) and income limits