University Neighborhood Ordinance Affordable Housing Fee Update

presented by

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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 roughly $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" market-rate housing development economics
3. Understand the impacts of UNO affordable housing and other City requirements on project feasibility
4. Estimate a "maximum" in-lieu fee based on subsidies required to build appropriate units
5. Build consensus on 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

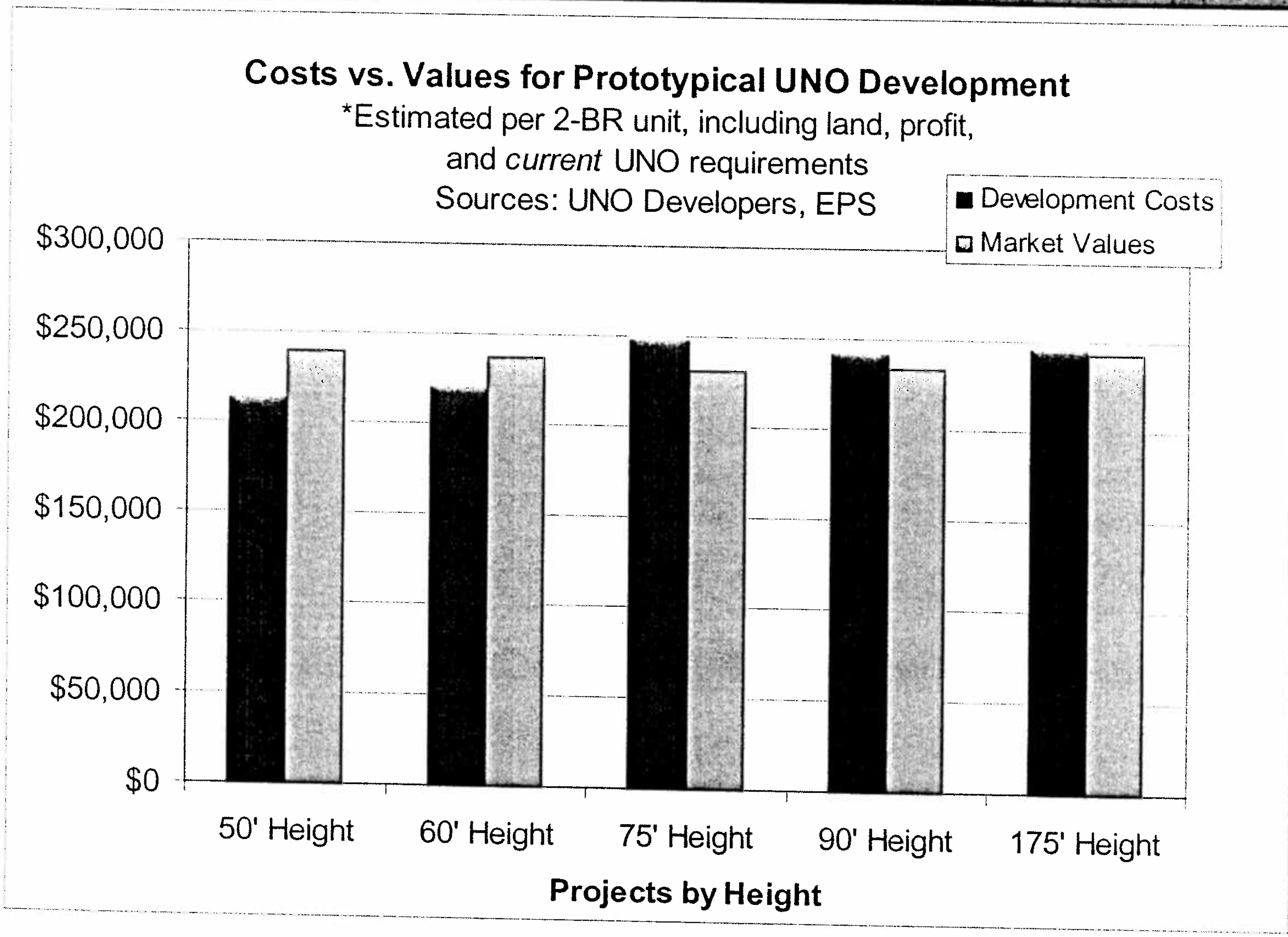
Economic conditions for UNO development

- 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

Prototypical development economics

- Current achievable rents are roughly $1.70-$2.00/SF for 1 & 2 BR
- Development costs per square foot generally increase with height
  - Woodframe construction costs < concrete/steel costs
- To maximize densities, most recent projects have podium parking
  - Podium parking costs < underground costs
- Smaller lots pose unique challenges due to parking circulation, efficient floorplates, etc.
- 75'+ height limits challenging because can't use woodframe construction but don't have current market support to achieve significant rent premiums

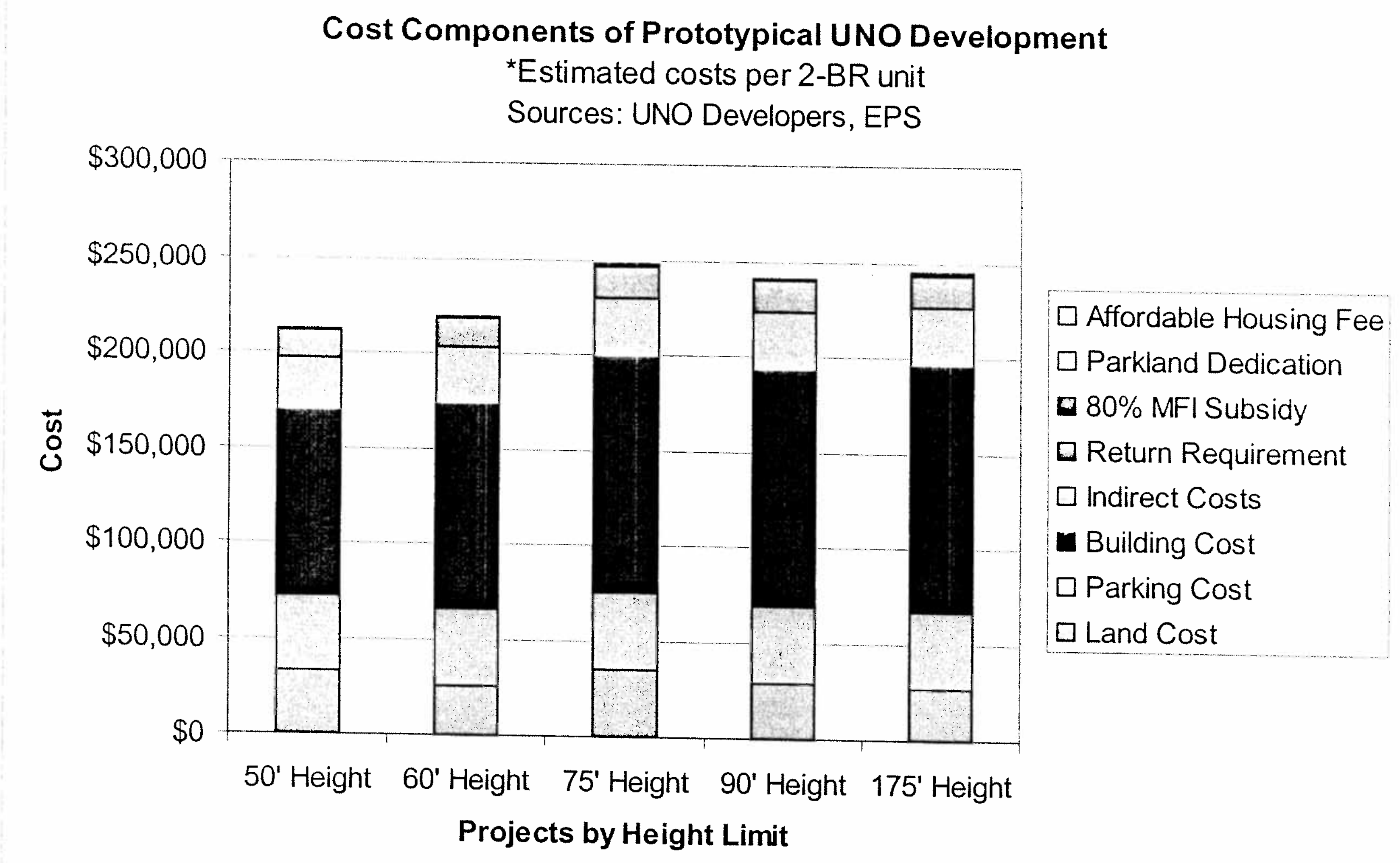
Prototypical Development Economics



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: Subsidies or opportunity costs to provide units at lower price points
  - 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 ~$114K/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
Total Cost/Unit	***$106,886***

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***
less Developer Profit at 7.5% of Costs	-$8,016
Financing Gap per Unit	**-$18,115**

UNO Housing Fee Economics

- Housing Fee is a small fraction of total development costs
  - UNO Housing Fee: ~$475/2BR unit = ~0.2% of total cost
  - Fee cost can be recovered by charging ~$2.00 more per month for a 2BR unit (e.g., $1,602 vs. $1,600)
- **Bottom Line:**
  1. The UNO Housing Fee at $0.50/SF does not fund the same number of 65% AMI units as required if constructed
  2. The UNO Housing Fee *itself* is not a significant hardship for developers or impediment to project feasibility

Total City Requirement Economics

- **Housing fee is not the only City-imposed cost**
  - **Parkland dedication fee:** $650/unit
  - **Tree ordinance:** case-by-case, but limits building footprint and adds costs on most development sites
  - **Construction of 80% MFI units:**
    - Maximum rent for units may or may not be less than market rates
    - Many projects satisfy 80% MFI requirements with smaller units that lose less money or may be profitable
      - 2-BR unit at 80% MFI is $1,378/mo. max, 15% less than market rate
        - » 80% MFI rents capitalize at $54K less than market rate units
      - Studio units max ~$964/mo. or ~$2.50+/SF, not a deep discount if any
        - » 80% MFI rents allow studios to break even in lower-cost prototypes
    - Still may be an opportunity cost – could potentially yield more profits with larger, market-rate units

Comparative Value of Affordable 2-BR Units

Item	2-BR Units by Affordability Level		
	Market-Rate	***80% MFI***	***65% MFI***
Rent/Unit [1]	$1,625	$1,378	$1,119
Cap Rate	5.5%	5.5%	5.5%
Capitalized Gross Rent	$354,436	$300,567	$244,211

[1] Assumes average units are 2 BR, rents are $1.71/SqFt for market-rate units, NHDC max rents for 4-person HH for affordable units

Sources: UNO area property listings; Austin NHDC; EPS.

80% MFI Studio – Costs vs. Values

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
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Subtotal, Direct Costs/Unit	$66,750
Indirect Costs as a % of Direct Costs	20%
Indirect Costs/Unit	$13,350
Parkland Dedication Fee	$650
Total Cost/Unit	***$106,886***

Maximum Supported Home Price	
Monthly Rent Price at 80% MFI	$964
Total Rent/Year	$11,572
Parking Revenues/Year	$1,188
Gross Revenues/Year	$12,760
Operating Expenses per Unit/Year	$2,800
Property Taxes	$2,467
Total Expenses/Year	$5,267
Net Operating Income/Year	$7,493
Capitalization Rate	5.50%
Total Supportable Unit Value	***$136,237***
less Developer Profit at 7.5% of Costs	-$8,016
Surplus Profit per Unit	**$21,334**

Overall Assessment of Current Feasibility

- Low-rise projects (50-60’) on suitable sites should be feasible under current market conditions and UNO requirements
- Mid-rise projects (75-90’) face feasibility challenges in current market *with or without* in-lieu fee and other UNO requirements
- High-rise projects (175’) are marginally feasible, may be most affected +/- by changes to UNO fee
- Question: Will land owners respond to market realities and City requirements by lowering asking prices?
  - Typically occurs in competitive vacant land supply situation, but UNO properties have existing uses with intrinsic values

Option #1 – CPI Adjustment

- Fee based on existing UNO fees, updated by CPI
  - CPI has increased from Dec. 2004 to Feb. 2011 by 17.2%
  - Previous $0.50/SF fee would increase to $0.59 in 2011
- Context: Average apartment rent increases since 2004, according to Capitol Market Research
  - Austin MSA rents up 17.3%
  - "Downtown" rents up 44.9%
- "Option #1" at $0.59/SF is ~1.2X existing fee
  - Fee for 950 SF unit would increase from $475 to $561
  - Even if no off-set in land prices/other costs, profit margin would decrease very little
    - $15,000 target profit would reduce to $14,914: <1% difference

Option #2 -- Setting a Maximum Fee

- Maximum Fee is based on the full subsidy to build affordable units in UNO area
  - If units not provided in market-rate project, must be provided elsewhere in UNO area
  - Compares affordable unit construction costs and values
  - "Co-op" model assumes builder has stand-alone project
    - Must acquire property for development site
    - Does not have cross-subsidies available from other projects
  - "Private" model assumes units built in market-rate project

Option #2 Maximum Fee – Co-op Model

Super Co-op FY 09-10	
Gross Income	$1,116,798
Building Expenses	$455,172
Shared Expenses	$285,000
NOI	$376,626
Beds	176
NOI/Bed	$2,140
Cap Rate	5.5%
Value/Bed	$38,908
Development Costs (excl. land)	$15,134,566
Costs/Bed	$85,992
Subsidy/Bed (excluding land)	-$47,084
Land Value/Land SF	$100
Land SF	16,000
Total Land Value	$1,600,000
Land Value/Bed	$9,091
Subsidy/Bed with Land	**-$56,175**

Option #2 Maximum Fee – Private Model

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
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Direct Construction Costs/Gross SF	$110
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Subtotal, Direct Costs/Unit	$66,750
Indirect Costs as a % of Direct Costs	20%
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Parkland Dedication Fee	$650
Total Cost/Unit	***$106,886***

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***
less Developer Profit at 7.5% of Costs	-$8,016
Financing Gap per Unit	**-$18,115**

Option #2 Maximum Fee

- In this example, assumed private model because it yields lower subsidy for studio unit than does co-op model
  - $18K for private studio vs. $56K for co-op
- Subsidy must be converted to fee per total net SF
  - Example: 200 unit project with avg. of 950 SF/unit, total 190K SF rentable
  - 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
- "Option #2 Maximum Fee" at $1.89/SF is 3.8X existing fee at $0.50/SF
  - Max fee would be ~1% of costs for projects with typical 7.5% margins
  - If no off-set in land prices/other costs, profit margin would decrease substantially
    - $15,000 target profit would reduce to $13,675: 9% difference

Option #3 – Co-op Subsidies

- Fee based on UNO fee subsidies received for actual student/co-op housing
  - 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

Option #3 – Co-op Subsidies

- $9,500/bed subsidy must be converted to fee per total net SF
  - Example: 200 unit project with avg. of 950 SF/unit, total 190K SF rentable
  - UNO requirement of 10% = 20 units at 65% MFI
  - 20 required units X $9,500 subsidy/unit = $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 would be ~0.5% of costs for projects with typical 7.5% margins
  - If no off-set in land prices/other costs, profit margin would decrease marginally
    - $15,000 target profit would reduce to $14,525: 3% difference

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 to construct 65% MFI units
  - Pros: Adequate revenues to fund desired units
  - Cons: Extreme increase to existing fee creates largest feasibility challenge for developers
- Option #3: **$1.00/net SF** reflects subsidies for **co-op projects** *with* other subsidies
  - 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