

The Economics of Land Use

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# University Neighborhood Ordinance Affordable Housing Fee Update

*presented by*

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PC C+D  
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ITEM D-2

## 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

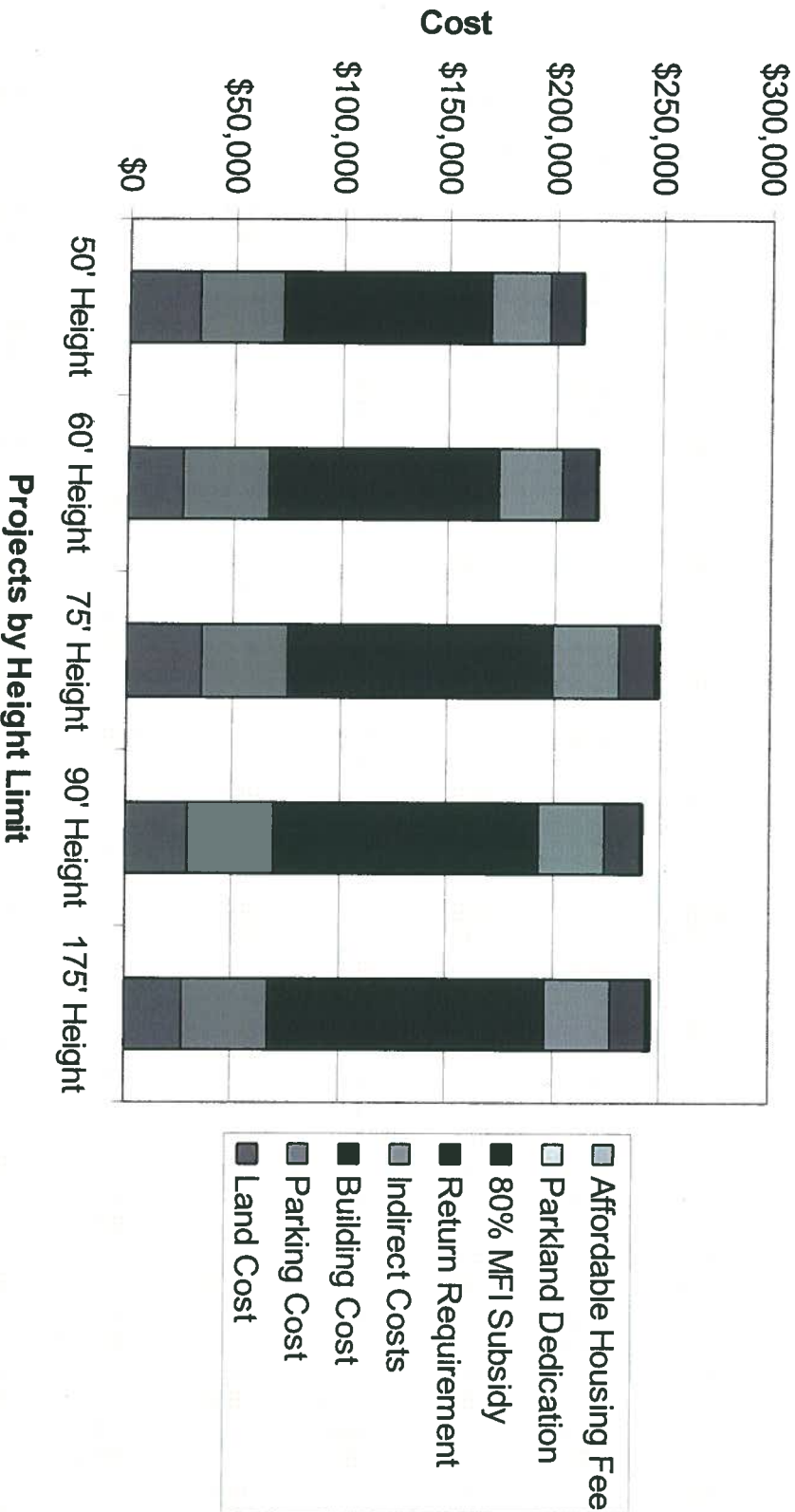
- **Major cost components:** Jointly represent ~97+% of project costs
  - “Fixed” costs that can’t be avoided or significantly reduced for most projects
  - Direct costs for buildings and site improvements: ~40-50% of total costs
  - Podium parking: ~10-15%
  - Indirect costs: ~20%
  - Landowner value 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

## Cost Components of Prototypical UNO Development

\*Estimated costs per 2-BR unit

Sources: UNO Developers, EPS



# UNO Housing Fee Economics

- **Current fee is \$0.50/rentable SF in entire building**
  - Other Austin housing fees: \$6/bonus SF for PUD & North Burnet/Gateway, \$10/bonus SF in CBD satisfies total affordable housing requirement
  - UNO fee is roughly \$1.00/bonus 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
<b>Total Cost/Unit</b>	<b>\$114,902</b>

## Maximum Supported Home Price

Monthly Rent Price at 65% MFI	\$784
Total Rent/Year	\$9,402
<u>Parking Revenues/Year</u>	<u>\$1,188</u>
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%
<b>Total Supportable Unit Value</b>	<b>\$96,787</b>

**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
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## Maximum Supported Home Price

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Total Rent/Year	\$9,402
<u>Parking Revenues/Year</u>	<u>\$1,188</u>
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%
<b>Total Supportable Unit Value</b>	<b>\$96,787</b>

## 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%
  - Major feasibility challenge

## 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%
  - Modest 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 \$1.00/net SF**

## 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

# EXTRA SLIDES

- EXTRAS

## 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

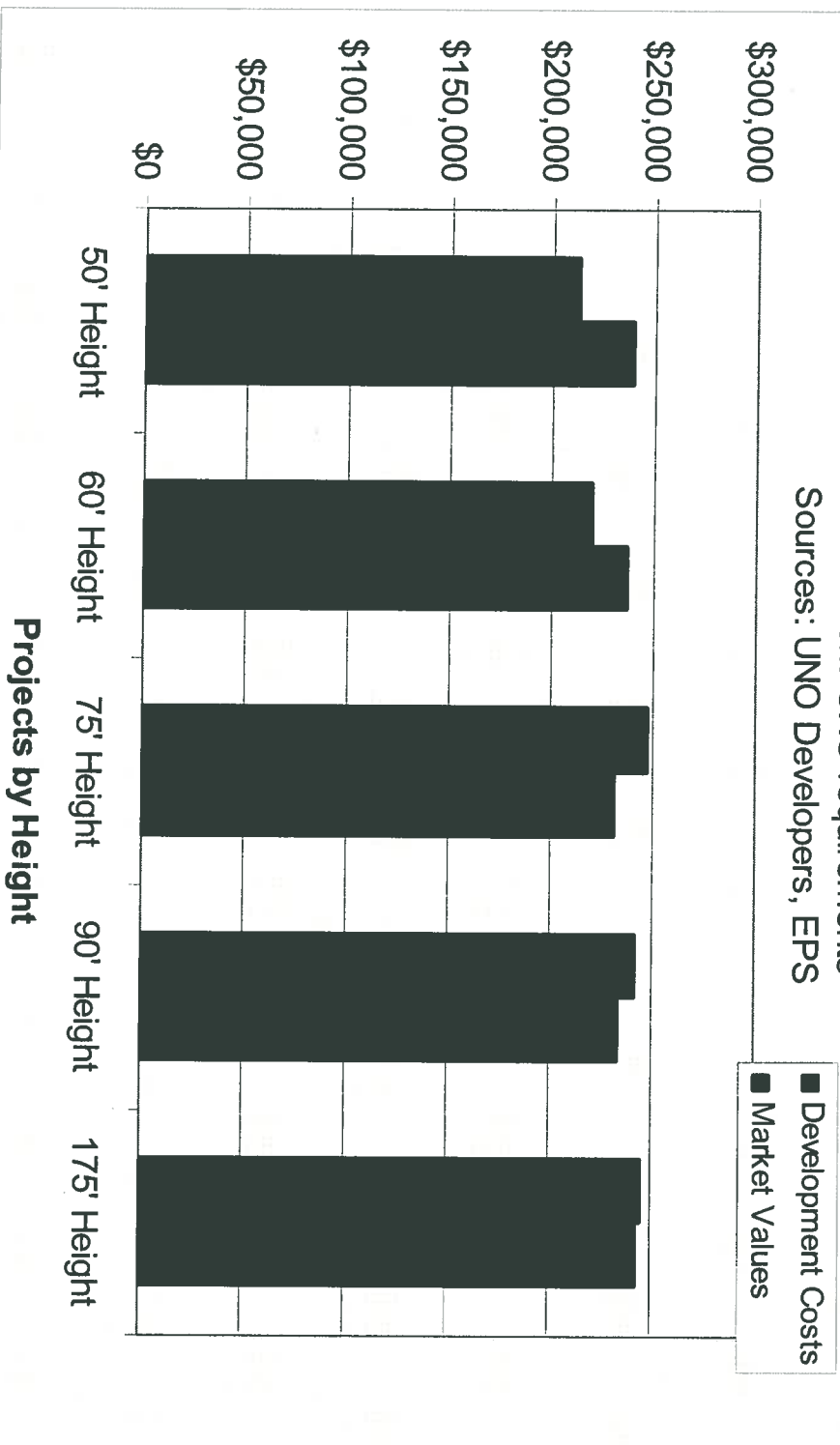
# Prototypical Development Economics

## Costs vs. Values for Prototypical UNO Development

\*Estimated per 2-BR unit, including land, profit,

and *current* UNO requirements

Sources: UNO Developers, EPS



# 80% MFI Studio – Subsidy/Surplus Estimation

<b>60' Multifamily with Podium Parking</b>	
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

<b>Cost Assumptions</b>		<b>Maximum Supported Home Price</b>	
Land/SF	\$60	Monthly Rent Price at 65% MFI	\$964
Land/Unit	\$26,136	Total Rent/Year	\$11,572
Direct Construction Costs/Gross SF	\$110	<u>Parking Revenues/Year</u>	<u>\$1,188</u>
Direct Construction Costs/Unit	\$46,750	Gross Revenues/Year	\$12,760
Parking Construction Costs/Space	\$20,000	Operating Expenses per Unit/Year	\$2,800
Subtotal, Direct Costs/Unit	\$66,750	Property Taxes	\$2,467
Indirect Costs as a % of Direct Costs	20%	Total Expenses/Year	\$5,267
Indirect Costs/Unit	\$13,350	Net Operating Income/Year	\$7,493
Parkland Dedication Fee	\$650	Capitalization Rate	5.50%
Developer Profit at 7.5% of Costs	\$8,016	<b>Total Supportable Unit Value</b>	<b>\$136,236</b>
<b>Total Cost/Unit</b>	<b>\$114,902</b>		

<b>Surplus Value per Unit</b>	<b>\$21,334</b>
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# 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

<b>Subsidy/Bed with Land</b>	<b>-\$56,175</b>
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## "Affordability by Bedroom"

- Student housing often rents per bedroom or per bed, rather than as whole units
- Current UNO program effectively encourages all affordable units as studios, to minimize developers' subsidies
- Converting program from "per unit" to "per bedroom" would alter economics
  - Maximum rent for 1-person household at 65% MFI = \$784
  - 2 X \$784 = \$1,568 : above market rate for 1-BR units (~\$1,400), just below market-rate for 2-BR units (~\$1,625)
- Allowing "per bedroom" affordability would encourage developers to build the units, because little or no subsidy is required
  - May not actually result in units below market rate
  - Would reduce fee-based funding for other, more affordable projects