



99 Hudson Street, 3rd Floor, New York, NY 10013-2815
T: 212-977-5597 | F: 212-977-6202 | www.hraadvisors.com

MEMORANDUM

To: City of Austin, Texas, Planning and Development Review Department - Urban Design Division

From: HR&A Advisors, Inc.

Date: June 24th, 2013

Re: Downtown Austin Density Bonus Fee Recalibration – **DRAFT**

In April of 2013, The City of Austin's Planning and Development Review Department ("PDRD") retained HR&A Advisors, Inc. ("HR&A") to recalibrate the fee-in-lieu payment structure that HR&A originally calculated in 2009 and was also recommended for implementation as part of the Downtown Austin Plan (the "Plan"), adopted on December 8, 2011. This memo summarizes HR&A's methodology and recommendations regarding the recalibration of that fee structure.

Summary of Recommendations

HR&A recommends that the City of Austin implement a program of fee-in-lieu payments to the Affordable Housing Trust Fund for the right to develop a property with a bonused floor area at a density that exceeds the as-of-right zoning (also known as the Primary Entitlement) in Downtown. The size of the recommended fee varies based on development type and location of development. HR&A's recommendations are as follows:

Residential Uses: HR&A recommends that the City of Austin implement a fee-in-lieu payment to the Affordable Housing Trust Fund for the right to develop residential properties in Downtown. As detailed in HR&A's 2009 recommendations and the Plan, this fee is to serve as an alternative payment if a project's developer does not choose to include on-site affordable housing. Based on a thorough analysis of the economics of residential development and ownership, HR&A recommends this fee be set at \$10 per square foot of bonused floor area in the Core/Waterfront district; \$5 per square foot of bonused floor area in the Lower Shoal Creek and Rainey Districts; and \$3 per square foot of bonused floor area within all other districts of Downtown. This recommendation for a graduated scale of fees based on geography is a result of the economic analysis, which found that residential developments receiving a bonus gain sufficient value to support a public benefit, particularly those developments which result in increased height where price premiums can be gained. The graduated fee scale also reflects the range of relative residential real estate values in each of the Downtown districts.

Non-Residential Uses: HR&A's economic analysis of the development and ownership of non-residential uses in Downtown found that the development of additional floor area beyond the as-of-right zoning for non-residential buildings does not provide adequate incremental returns at this time to allow for a fee-in-lieu payment to be paid by a developer to the City. As a result, HR&A recommends that the fee be set at \$0 per square foot of bonused floor area on non-residential development in the all Downtown districts.

Fee Recalibration and Interim-Period Growth: The density bonus program should be carefully calibrated to maintain the Downtown's competitive position within the Austin region. HR&A recommends that the fee-in-lieu payment program be recalibrated every five years so that it can accurately reflect the economics of development on ownership in Downtown. HR&A further recommends that the size of the fee-in-lieu be tied to a local market indicator so that it reflects current conditions in a dynamic marketplace and can remain proportional to changing real estate values in the years between recalibration exercises. For example, annually adjusting the size of the fee to the proportional shift in appraised value of properties in each district, will enable the fee to most closely evolve in proportion to overall market dynamics.

Project Goals

A density bonus is an incentive-based tool, which permits developers to increase the maximum allowable floor area on a property in exchange for helping the community achieve public policy goals. Density bonuses are used by municipalities across the country, in conjunction with their zoning ordinances, to achieve a wide range of community benefits, including preservation of historic buildings and sensitive environmental resources, provision of affordable or special-needs housing, higher levels of urban design, provision of public open space, arts and cultural uses and special amenities, etc. Typically, a density bonus program is tied to clear public objectives, providing specific quantities of additional floor area above an established maximum, in return for prescribed community benefits.

Increased density in a downtown is an amenity in and of itself. Density allows for a more efficient use of publicly funded infrastructure, supports pedestrian based activity, and provides space for the attraction and support of commercial and civic activity that would otherwise not be conducted.

As a foundational principle, for a density bonus fee-in-lieu payment system to work effectively, the fee needs to be calibrated so that there is sufficient incremental value produced for a private developer, over and above any fee that is charged, to incentivize the additional development in light of the increased risk and costs associated with development of a project with greater density. Or, more simply, Downtown density should be encouraged, not penalized. The benefits of additional density should be shared between the community who has granted the right to build beyond the as-of-right zoning and the project's developers and investors who will benefit from the project's improved economic returns.

In addition to establishing a program that encourages rather than discourages increased density in Downtown and allows for a public/private sharing of the benefits of the increased density, HR&A recommendations are crafted in light of these overall guidelines, which were articulated in the Plan.

- Existing zoning should be retained as the base for the density bonus program.

- High quality urban design should be required for all projects seeking additional density.
- There should be one, administrative and predictable pathway to a density bonus.
- Additional density should be allowed only where appropriate and compatible.

Recalibration Methodology

Development Massing and Locations: In 2009, in concert with PDRD, McCann Adams Studio, and Studio 8 Architects, HR&A tested the form and economic implications of potential density bonuses for three different building types (residential, office, and hotel) on nine different sites – three in each of three different districts of the Downtown (the Core, the Uptown and Northwest Districts). The sites include all of the principal zoning designations of the Downtown (e.g., CBD, DMU, CS, GO). For the 2013 recalibration, HR&A again tested the economics of both a bonused scenario and the as-of-right base scenario (“base”) for the same sites using the same massing scenarios and the same building types.

Stakeholder Outreach: To accurately model the economics of building development and ownership, HR&A re-examined the Downtown Austin real estate economy: land costs, construction costs, soft costs, financing, other development costs, revenues (rents, sales prices, etc.), operating costs, returns, etc. HR&A interviewed nearly 20 area stakeholders including developers, brokers, land owners, building operators, contractors, investors, planners, and affordable housing advocates. Interviewees represented a wide array of interest and provided insight into market dynamics, regional competitiveness and the economics of each asset class (residential for sale and rental, commercial office, and hotel). Interviewees also represented a broad understanding of the nuances of the Austin real estate market on both a regional level and a Downtown district/neighborhood level.

Market Research: To supplement and verify the findings of the Stakeholder Outreach, HR&A surveyed a wide array of public and proprietary real estate data sources. These sources of market data include:

- **CoStar**, a third party real estate database, was used to aggregate and analyze downtown real estate market transactions and provide market reports for commercial real estate activity customized to the geography of the Downtown district.
- **ESRI**, a third party demographic and economic search tool, enabled HR&A to produce detailed reports on homeownership rates, resident income levels, and other key demographic metrics for customized geographies that matched each Downtown District.
- **Capital Market Research**, an Austin-based real estate market analytic and consulting firm, provided research on specific real estate development economics and area real estate transactions.
- **Austin Investor Interests**, a local third-party market research firm, provided rent, occupancy, and absorption data for specific Downtown multifamily properties.
- **Smith Travel Research (STR)**, provided hotel performance data on both a regional market and downtown submarket level. Data provided included historic and current occupancy rates, average daily room rates (ADR) and revenue per available room (RevPAR).

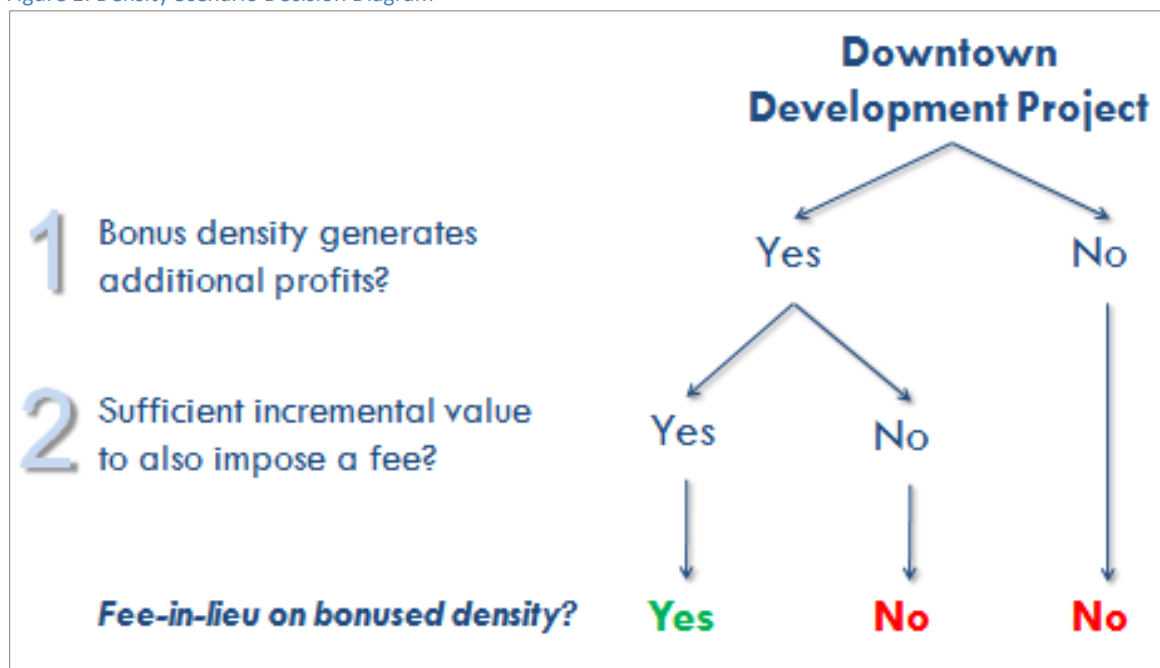
- **Area Publications**, including the *Austin Business Journal*, the *Austin Statesman*, and the *Austin Chronicle* provided confirmation of planned and rumored projects in downtown as well as up to date reporting on the regional economy.

Development Proforma Overview: To accurately test the economic implications of the proposed density bonus as compared to the base scenarios, HR&A created detailed development proforma models for the base and bonused scenarios on each of the nine sites. HR&A structured its modeling to accurately and thoroughly include all line items that would be included on the “uses” side of a development’s sources and uses model. For income-producing assets, HR&A estimated a stabilized-year net operating income based on projected revenues and expenses. The annualized cash flows were then compared to total project costs to arrive at a stabilized-year yield on cost (equal to net operating income divided by total project cost.) For residential condominium projects, HR&A compared net sales proceeds (gross revenue from unit sales, less selling expenses) to total project costs in order to quantify net profits and return on project cost (equal to net profits divided by total project cost.) This analysis was conducted for both the base scenario and a bonused scenario to determine if total project returns were improved in the bonused scenario.

Density Bonus Fee Recalibration Analysis

Density Scenario Context: In general terms, HR&A’s analysis to determine if a bonused development could support a fee asked two basic questions. 1) Does a density bonus generate an incremental profit for that project’s developers and investors at a level that is beyond the level of returns produced in the base scenario of development? And, 2) is that incremental return of a size that would allow for a fee-in-lieu payment to be paid to the City without negatively impacting the overall project’s economics? Only a scenario where the analysis answered “yes” to both questions could a project support a fee-in-lieu.

Figure 1: Density Scenario Decision Diagram



HR&A's market analysis identified scenarios in which a fee-in-lieu payment would be supported, specifically in residential development. The analysis also indicated that greater density does not always mean greater value. The ability to develop with increased or bonused density does not always generate incremental value to a developer sufficient to incentivize the additional development. There can be a number of reasons that a private developer may not be able to achieve a sufficiently higher return utilizing a density bonus to justify the increased risk or cost taken on to build a larger building. These reasons include:

- Higher per unit costs due to a change in construction type (i.e., change from mid-rise to high-rise) outweigh the additional returns provided through increased density.
- Longer construction and absorption/lease-up periods increase the carry costs associated with construction financing.
- A project's operational returns are hindered by additional space (this is especially true in hotels where additional hotel rooms that are not rented hamper that project's returns)
- Exposure to additional types of construction and market risk can reduce project returns.

Because of these inherent risks associated with increased density, many recent development projects have not sought or will not utilize a full density bonus as granted through the CURE program. A review of the densities of twelve recent development projects in downtown Austin for which HR&A was provided detailed zoning and density information shows that only one of the twelve projects utilized the full density bonus and that five others used only a portion of the density bonus. The five remaining projects either were built to the maximum as-of-right density or below the as-of-right density limit. **Figure 2** details the floor to area ratio (FAR) of each of the twelve projects.

Figure 2: Built and Planned Downtown Developments Project Density Bonus

Project	Base FAR	Base+ Bonus FAR	Designed or Built FAR	Built Bonus Area
<u>Used Full Bonus</u>				
W Block 21	8.00	12.00	12.00	50%
<u>Used Portion of Bonus</u>				
Austonian	8.00	25.00	18.30	129%
Spring	5.00	12.00	11.06	121%
Block 52	8.00	12.00	11.00	38%
Ashton	8.00	12.00	9.60	20%
360 Condos	8.00	10.00	9.36	17%
Legacy Town Lake	8.00	12.00	9.01	13%
<u>Did Not Use Bonus</u>				
Monarch	8.00	8.00	5.39	-33%
Four Seasons Residences	8.00	8.00	5.70	-29%
Commerica Bank	8.00	8.00	6.37	-20%
Block 51	8.00	8.00	7.14	-11%
Frost Bank	8.00	12.00	7.86	-2%

Detailed Proforma Modeling: To understand the economic implications of the proposed density bonus scenarios, HR&A created test pro-forma models for the base and bonused scenarios on each of the nine sites. This process involved the following:

- **Generating the usable and built envelope for each site and its bonus alternative.** This was calculated by multiplying the lot size by the appropriate Floor Area Ratio (FAR) estimate. **Figure 3** details the building sizes used in the analysis of three development types, in three districts on nine sites.

Figure 3: Analyzed Development Densities

Development Type	Downtown District	Base Density	Bonus Density
Residential	Core	202,410 SF	303,615 SF
	Uptown	178,200 SF	305,600 SF
	Northwest	34,525 SF	94,100 SF
Office	Core	350,100 SF	525,150 SF
	Uptown	106,375 SF	159,563 SF
	Northwest	78,300 SF	117,450 SF
Hotel	Core	147,380 SF	231,800 SF
	Uptown	22,575 SF	87,300 SF
	Northwest	53,700 SF	209,700 SF

- **Determining total development costs** through a combination of information gathered from developer interviews and baseline construction cost estimates provided by Studio 8 architects of different construction types corresponding with different building types. In addition to development construction costs, or hard costs, HR&A included in the development budget analysis the soft costs of project design, professional fees, development management, local permitting and impact fees, construction financing interest costs, and land acquisition costs. HR&A calibrated these costs for each site's location within Downtown and the associated development typology and construction type.

Figure 4: Total Development Costs by Product Type and Scale

Product Type	Scale	"All-In" Development Costs Range
Residential Condo	Mid rise	\$215-220 / SF
	High rise	\$285-315 / SF
Residential Rental	Mid rise	\$200-210 / SF
	High rise	\$280-305 / SF
Office*	Mid rise	\$260-265 / SF
	High rise	\$375-395 / SF
Hotel	Mid rise	\$230-260 / SF
	High rise	\$315-320 / SF

*Office costs are inclusive of higher parking to built-area ratios than in other product types as well as the costs associated with Tenant Improvements (TIs).

- **Calculating net operating income (NOI) through a stabilized year cash flow analysis.** HR&A calculated each scenario's stabilized year gross income through information gathered

through stakeholder interviews and market data research. HR&A then subtracted operating expenses from the gross income to determine the project's NOI on a per square foot basis. This approach was used for residential rental products, office, and hotel. Because of the non-recurring returns of condo developments, for-sale residential condo project returns were analyzed by confirming market-validated per-unit sale prices for a range of condo product types and locations.

Figure 5: Modeled Returns by Product Type

Product Type	Return Type	Scale	Range of Returns
Residential Condo	Sale Price	Mid rise	\$375 / SF
		High rise	\$490-\$572 / SF
Residential Rental	Monthly Rents	Mid rise	\$2.25-2.30 / SF
		High rise	\$2.75-3.02 / SF
Commercial Office	Annual Rents (Net Lease)	Mid rise	\$22 / SF
		High rise	\$25-32 / SF
Hotel	Average Daily Rate (ADR)	Limited Service	\$120-135 / Room
		Full Service	\$165-250 / Room

- **Base Scenario Development Returns.** After establishing the total development costs and NOI for each development scenario, HR&A then calculated the project return on cost by dividing the total costs by the stabilized year's NOI. HR&A performed this analysis for each site for the base scenario to determine if the base scenario development met a market-validated anticipated yield on cost.

Figure 6: Anticipated/Expected Threshold Returns by Product Type

Product Type	Return
Residential Condo	30% return on total project costs
Residential Rental	6.75% annual yield on total cost
Commercial Office	8.0% annual yield on total cost
Hotel	8.5% annual yield on total cost

- **Bonus Scenario Development Returns.** HR&A then performed the same analysis for each site's bonus scenario to determine if a density bonus **both** improved overall project returns **and** that those incremental returns exceeded the market validated anticipated yield on cost. If the project met both of those requirements, HR&A determined that returns were sizeable enough to accommodate a fee-in-lieu on the square footage of the density bonus. HR&A then sized the fee-in-lieu recommendations in proportion to the test returns for each product type in each district.

Figure 7: Achieved Returns for Bonused Scenarios

District	Product Type	Achieved Yield on Cost in Bonused Scenario
Core	Residential Condo	41.1%
	Residential Rental	6.9%
	Commercial Office	5.9%
	Hotel	6.6%
Outer Districts (Uptown and Northwest)	Residential Condo	31.0% - 38.0%
	Residential Rental	6.5% - 6.6%
	Commercial Office	4.9% - 5.7%
	Hotel	6.5% - 7.7%

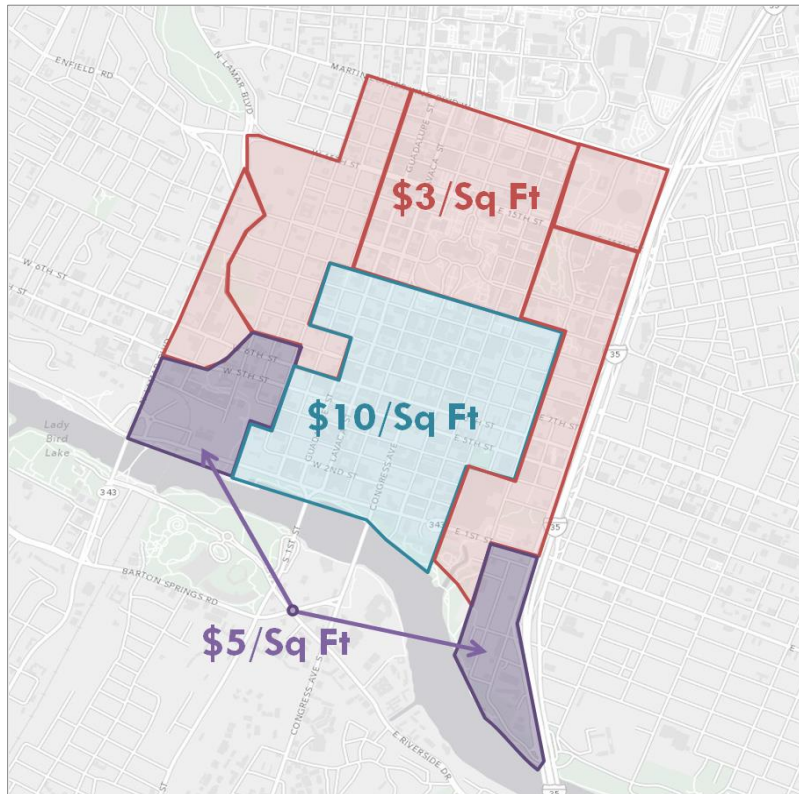
Recalibration Findings

Based on the analysis detailed above, HR&A's findings are as follows:

Residential development supports a fee-in-lieu. Residential developments receiving a density bonus appear to gain sufficient incremental value to support a fee-in-lieu payment in each downtown district. This is due largely to the added value of high-floor residential units as well as strong market demand for urban rental and for-sale residential products.

For residential projects, the incremental value created varies by district within downtown and resultantly the level of supportable fee varies accordingly, with residential development in the Core/Waterfront districts producing the highest value and supporting the largest fee. The analysis suggests that residential projects in the Core/Waterfront could support a fee-in-lieu of \$10 per bonused square foot; residential projects in the Lower Shoal Creek and Rainey Districts could support a fee-in-lieu of \$5 per square foot of bonused floor area; and all other Downtown districts could support a fee-in-lieu of \$3 per square foot. Within Downtown, development returns and costs vary on a finely grained level, sometimes block by block. As a result, the level of fee that could be supported by a project could be more finely tuned to address the micro-nuances of location. However, HR&A does not recommend instituting a complex fee schedule based on those nuances and instead recommends a more simple and efficient graduated three-tier scale of fees based on the general economics of each larger district within Downtown. **Figure 8** identifies the recommended fee-in-lieu per square foot of bonused residential floor area per district.

Figure 7: Recommended Residential Fee-In-Lieu Per Bonused Square Foot



Impact of fee-in-lieu payment on end users. Just as a fee-in-lieu on bonused floor area should be calibrated so as to not adversely impact a project's feasibility, the fee-in-lieu payment should also not have a significant detrimental impact on the economics of home ownership or apartment rental for the end users of those products, Downtown residents. To understand the impact of the fee on the end users, HR&A tested the impacts of the fee on for-sale residential condo product in the Core, the district which is recommended to have the highest per-square-foot fee. HR&A's analysis found that if the total impact of a \$10 fee on the bonused density is passed on to the end user and distributed amongst all units in a building, the purchase price of a unit will rise, on average, by \$3,300. This incremental increase equates to approximately 0.5% to 0.75% of the total purchase price of a unit priced between \$400,000 and \$650,000. Assuming standard financing terms available for residential product, this increase would result in an additional monthly mortgage payment of roughly \$14 per month. It is HR&A's opinion that this increase in costs will not have a detrimental impact on project marketability and that the increased ownership costs are outweighed by the project and neighborhood amenities that increased density generates.

Commercial and hotel development does not support a fee-in-lieu. At this time, commercial development **does not** produce sufficiently high incremental returns on additional building area that could be gained through a density bonus to justify charging a public benefit fee. Office product does not command sufficiently higher rents for additional density to produce significant incremental value, and hotel programs are not easily amenable to scaling, which would be required to take advantage of bonused areas.

Furthermore, density bonuses that result in a more expensive construction type (i.e., shifting from mid-rise to high-rise) typically do not yield additional returns high enough to justify their usage. In some cases, however, additional density makes a project feasible where it was not feasible under base zoning. This is particularly the case for commercial (office and hotel) developments outside of the Core and Waterfront districts, which depend on a sufficient density to support the construction of parking. However, the increased density does not improve project returns to a level sufficient enough to support a fee-in-lieu payment. By providing a bonus without an accompanying public benefit in these cases, the City is incentivizing the commercial development as a goal in and of itself.

Appendix

To receive a copy of this report's detailed appendix, please contact Erica Leak in the City of Austin Planning and Development Review Department via email at erica.leak@austintexas.gov.