




MEMORANDUM

TO: Mayor and City Council

FROM: Gregory I. Guernsey, AICP
Director of Planning 

DATE: December 5, 2014

RE: Economic Evaluation of Rainey St. Density Bonus Program

On September 25, 2014, under [Resolution No. 20140925-083](#), the Austin City Council directed the City Manager to analyze the economic and financial aspects of the density bonus program for the Rainey Street Subdistrict of the Waterfront Overlay, as amended by Ordinance No. 20140227-054 and codified in City Code Sections 25-2-586 (Downtown Density Bonus Program) and 25-2-739 (Rainey Street Subdistrict Regulations).

Staff performed an initial analysis of the revised density bonus program for the Rainey Street district and prepared a draft Memorandum summarizing that analysis and making recommendations. Staff then retained Economic & Planning Systems, Inc. (EPS) to conduct a peer review of analysis. City staff's initial memorandum and EPS's peer review memorandum are contained in "Exhibit A" attached to this memo. After review of EPS recommendations, staff initiated revisions to the draft memo and finalized recommendations contained herein. This memo responds to the Council direction as stated above.

EXECUTIVE SUMMARY

City Council modified the Downtown Density Bonus Program in February 2014, including changes to the Rainey Street District, specifically requiring term limits for on-site affordable units and that the total square footage of those units equal 5% of the residential square footage with a similar bedroom mix for projects requesting an FAR of 8:1.

Staff used Envision Tomorrow, a return-on-investment (ROI) tool, to analyze the effect of the changes to the on-site affordability requirements by modeling three residential scenarios that reflected Downtown and Rainey Street projects and one hotel scenario. For each residential scenario, staff modeled the current affordability requirements, previous affordability requirements, and no affordability requirements.

Using a sample Rainey Street parcel, construction costs from local sources, and an underground-parking assumption, *all* ROIs projected a financial performance *at or above* industry performance measures. While affordability requirements do lower the rate of return, the reduction – a half percent for the

internal rate of return – is not significant enough to render projects financially infeasible. Reductions could also be offset by adjustments to parking.

Staff also considered hotel and office uses and found that the choice to develop such projects would largely be driven by market demand and not by the affordability requirements of residential uses. Additionally, affordability requirements in other parts of the city are being met that are more than equivalent to the Rainey Street District requirements, as detailed in the section on Affordable Units in the University Neighborhood Overlay.

Staff's analysis suggests that Council's February 2014 code amendments did not render residential projects financially infeasible, so staff does not believe that amendments to the on-site affordability requirements of the Rainey Street district in the Density Bonus Program are needed.

BACKGROUND

City Council adopted the basic framework of the Downtown Density Bonus Program in June 2013 ([Ordinance No. 20130627-105](#)), and expanded the Program via code amendments in February 2014 ([Ordinance No. 20140227-054](#)). The 2014 code amendments expanded the Program into the Rainey Street District (previously ineligible for the Program) and set up a two-tiered application of the Program: projects seeking additional density up to an FAR of 8:1 participate in the program previously created by the Waterfront Overlay; projects seeking density above an FAR of 8:1 participate in the Downtown Density Program for the FAR above 8. These 2014 amendments also made three changes to the pre-existing Waterfront Overlay program as it applied in the Rainey Street District:

1. An affordability "term" was added to affordable units created under the program, mandating that they be maintained at affordable levels: 40 years for rental housing and 99 years for ownership housing.
2. The on-site affordable units requirement was **modified** from 5% of the dwelling units to 5% of the square footage.
3. The bedroom count mix for the on-site affordable units must now be proportional to the overall bedroom count mix within the overall development. I.e., if the bedroom count ratio for the market rate units is 25% studio units, 40% one-bedroom units; 20% two-bedroom units, and 15% three-bedroom units, then the same bedroom count mix must be provided for the affordable units.

Subsequent to the February 2014 amendments to the Density Bonus Program, some questions were raised as to whether these changes to the rules that applied in the Rainey Street District might have the effect of dis-incentivizing residential projects, thereby producing the unintended consequence of reducing the creation of affordable housing units. On September 25, 2014, the City Council directed the City Manager to study the situation and report back to Council with its findings.

ANALYSIS

Staff used the Envision Tomorrow (ET) tool to develop several return-on-investment (ROI) models to analyze the financial viability of projects meeting the Rainey Street on-site affordability requirements. This analysis was conducted for a sample project with a FAR of 8:1, using average construction costs derived from several local sources. Four base scenarios were developed using a mix of units, rental rates, and use that reflected the following types of projects:

- Downtown: mixed-use residential with ground floor retail with average downtown unit mix and rental rates (provided by a developer working in the Rainey Street district, Endeavor);
- Skyhouse: mixed use residential with ground floor retail with a unit mix and rental rates reflecting the Skyhouse, a Rainey Street project that opened at the end of 2013;
- Millenium: mixed-use residential with ground floor retail with a unit mix reflecting the Millenium project currently under construction in the Rainey Street area. Rental rates are not yet available, so similar per-square-foot rental rates from the Skyhouse were used; and
- Hotel: hotel use assuming a default occupancy rate of 75% and a conservative rate of \$200 per-night rate based on downtown hotel rates. The operating costs were assumed to be 50% of gross income.

For each of the three residential scenarios, a ROI model was developed for each of the following cases:

- Current Rainey Street on-site affordability requirements, 5% of square footage with a similar unit mix;
- On-site affordability requirements that assume 5% of total units are affordable; and
- No on-site affordability requirements.

An additional ROI model with a much larger percentage of studios was also developed for the Downtown scenario in order to understand the impact of the affordability requirements on unit mix.

As a reference point for the ability of the Austin market to absorb affordability requirements, staff also surveyed projects with a similar high-rise construction in the University Neighborhood Overlay for the number of affordable units provided and the corresponding square footage.

Envision Tomorrow tool

The [Envision Tomorrow Tool](#) was originally developed by Fregonese Associates and was significantly enhanced during the HUD-funded Sustainable Places Project by Dr. Arthur C. Nelson at the University of Utah. He is co-director of the Master of Real Estate Development Program and has published widely on planning and real estate development. Staff used the [Return-on-Investment App](#), also referred to as the Prototype Builder. This tool is much like industry pro forma and models the financial aspects of a proposed project based on physical and financial inputs.

Sample parcel

Staff used a sample parcel with the following characteristics based on information provided by Endeavor, a developer working in the area:

Site area	32,000 sf	0.73 acres
FAR	8:1	256,000 sq.ft
Residential use	96.875%	<i>based on square footage provided = 248,000 sf/ 256,000 sf</i>
Retail use	3.125%	<i>based on square footage provided =8,000 sf/ 256,000 sf</i>
Land costs	\$2,449,271	(\$77/sf) <i>based on TCAD values</i>

Additional inputs

Construction costs per gross square foot are based on the average of several sources: local values from an on-line constructions data source ([RS Means](#)) and input from three local real estate industry professionals working in Austin.

Constructions costs	Average used	Reference Values		
		RS Means	Local sources	
Residential hard costs \$/ gross sf	\$172/sf	<u>\$119-\$166/sf*</u>	high-rise rental \$165	high-rise rental \$145-165 high-rise rental \$190
Commercial hard costs \$/ gross sf	\$172/sf		\$75/sf + tenant improvement	\$100-200/sf \$75/sf + tenant improvement
Parking below grade \$ per space	\$35,000		\$30,000- \$35,000	\$75-100/sf ~\$19,500- 26,000/ space \$25,000

** for Apt 8-24 stories in 78701 zip code, 15-story Ribbed Precast Concrete Panel / Steel Frame*

While there are no parking requirements for properties zoned CBD, parking was presumed to be provided. Underground parking was assumed with the following parking ratios:

- 1 space / dwelling unit
- 2.5 spaces per 1,000 sf of retail space

The retail leasing rate used was \$30/square foot (annual, triple net).

The residential unit mix, unit size, and rental rate varied in each set of ROI models. The Downtown rates were based on information provided by Endeavor, a developer working in the Rainey Street area. The Skyhouse and Millenium models were based on site plans and [ALN data](#) for the Skyhouse from October 2014 (attached). This data did reflect that effective rental rates were the same as market rental rates.

The Windsor, another residential rental project in the Rainey Street district, was not used in this analysis because it was built in 2008 and contains particularly large units that are not typical of today's market.

The property's monthly rental rates are especially high because of the larger unit size, but its rental rates on a per-square foot basis are lower than more recently built projects. The ET tool uses average per-square-foot rental values and average square-foot unit size.

For each of the three scenarios, a ROI model was created for each of the following situations: the current affordability requirements (5% of the square footage with a unit mix mirroring the unit mix of market-rate units); an affordability requirement for 5% of the total units; and no affordability requirements. In order to understand the effect of the current affordability requirements on the unit mix, an additional ROI model was created for the downtown rates and assumed a higher percentage of studios and no three-bedroom units.

Residential units	Downtown rates				Skyhouse rates			Millenium rates		
	5% sf, similar unit mix	5% units	no afford-able	5% sf, more studios	5% sf, similar unit mix	5% units	no afford-able	5% sf, similar unit mix	5% units	no afford-able
Avg. size, sf	959	959	959	793	791	791	791	878	878	878
Avg. rent \$/sf	\$2.76	\$2.78	\$2.84	\$2.82	\$2.70	\$2.71	\$2.77	\$2.72*	\$2.72*	\$2.80*
Studio	19.7%	15.8%	20.8%	38.0%	22.56%	18.8%	23.8%	0.0%	0.0%	0.0%
1 bedroom	43.1%	45.4%	45.4%	42.8%	46.91%	49.4%	49.4%	79.9%	79.1%	84.1%
2 Bedroom	29.8%	31.4%	31.4%	14.3%	20.19%	21.3%	21.3%	15.2%	16.0%	16.0%
3 bedroom	2.3%	2.4%	2.4%	0.0%	5.34%	5.6%	5.6%	0.0%	0.0%	0.0%
Affordable units	5.0%	5.0%	0.0%	5.0%	5.0%	5.0%	0.0%	5.0%	5.0%	0.0%
Total affordable units	10	10	0	13	13	13	0	12	12	0
Total units	217	217	217	262	263	263	263	237	237	237

*The Millenium is still under construction, so no rental rates were available. Per- square-foot rates similar to the Skyhouse were assumed.

Outputs

Given the physical inputs described above, each model produced the following gross square footage

- 247,892 residential gross square feet
- 7,997 retail gross square feet

These results closely match the desired square footage of 248,000 and 8,000 for residential and retail respectively.

The Envision Tomorrow tool produces several measures of financial viability, including those listed below with accompanying target rates:

Financial Performance Measures	Target
IRR (unleveraged return)	11-12%
Cap Rate (yield to costs)	>9%
Cash-on-cash (after year 3)	10.0%
IRR on Investor Equity (leveraged return before tax)	18-25%
Debt Service Coverage Rate (year 3)	1.25

Each of the scenarios described performed according to the rates below:

Financial Performance	Downtown rates				Skyhouse rates			Millenium rates		
	5% sf, similar unit mix	5% units	no afford-able	5% sf, more studios	5% sf, similar unit mix	5% units	no afford-able	5% sf, similar unit mix	5% units	no afford-able
IRR (unleveraged return)	12.4%	12.5%	12.9%	12.2%	11.5%	11.5%	11.9%	11.9%	11.9%	12.4%
Cap Rate (yield to costs)	9.86%	9.93%	10.15%	9.78%	9.38%	9.41%	9.62%	9.60%	9.61%	9.88%
Cash-on-cash (after year 3)	10.5%	10.7%	11.5%	10.2%	8.8%	8.9%	9.6%	9.6%	9.6%	10.5%
IRR on Investor Equity (Leveraged Return before Tax)	20.5%	20.8%	21.6%	20.2%	18.6%	18.8%	19.6%	19.5%	19.5%	20.6%
Debt Service Coverage Rate (year 3)	1.58	1.59	1.64	1.56	1.49	1.49	1.53	1.53	1.53	1.58

No ROI model performed below the target rates, including those meeting the current affordability requirements in the Rainey Street districts, indicating that these requirements do not make residential projects with a FAR of 8:1 infeasible.

On-site affordability requirements generally reduced the Internal Rate of Return (IRR) by half a percentage, but not to an extent as to make a project financially infeasible.

The downtown ROI model using a unit mix with more studios produced an IRR of 12.2%, which is slightly lower than the more balanced mix of 12.4%. Despite having more total units, with the accompanying increase in income, the project must also provide more parking spaces, which does not provide income as modeled in these scenarios.

In general, the affordability requirements for a project could be offset by providing less parking, charging a monthly parking fee, or using less-expensive above-grade parking structures. In the case of the Skyhouse scenario, a monthly parking fee of \$50 would increase the IRR for a project meeting the current on-site affordability requirements from 11.5% to 11.9%, the same rate achieved for a project that did not provide on-site affordable units. Alternatively, for the same scenario, using above-grade parking (\$20,000 per space, 57% cheaper than underground parking) would produce a similar rate of return of 11.9%.

For additional information on project costs, net operating income and new cash flow, please see the attached table.

Hotel Use

A ROI model was also developed for a hotel use with the same parcel size, FAR, and land cost characteristics.

Financial Performance	Hotel	A daily room rate of \$200 with 75% occupancy and a construction cost of \$300 per gross square foot, based on local data from RS Means of \$140 per square foot building shell cost plus additional improvement costs of \$160 per square foot, were assumed. Average room size was assumed to be 400 net square feet and the operating costs to be 50% of gross income.
IRR (unleveraged return)	15.4%	The hotel ROI far outperformed the mixed-use residential ROIs, indicating that a decision to develop a hotel would be largely driven by the ability of the market to absorb additional hotel product. There are several downtown hotels currently under construction with three located in or adjacent to the Rainey Street district for a total of 1,610 rooms: the Fairmont (1,060 rooms) at Cesar Chavez and Red River, one of the Waller Park Place towers (200 rooms) on Cesar Chavez and Red River, and the Hotel Van Zandt (350 rooms) at 605 Davis Street.
Cap Rate (yield to costs)	10.5%	
Cash-on-cash (after year 3)	28.0%	
IRR on Investor Equity (Leveraged Return before Tax)	28.0%	Typically developers specialize in either hotel or residential use and land held by a residential developer for investment may need to be sold before a hotel could be developed.
Debt Service Coverage Rate (year 3)	2.05	

Office Use

A ROI model for an office use was not modeled for this analysis. Due to a number of factors (the lack of proximity to local and state government offices, limited transportation options, etc.) the Rainey Street district does not lend itself to an office use, as evidenced by the lack of office buildings in the area.

Comparative Approach

In general, all scenarios used the same base inputs of parcel size, FAR, land costs, etc. Within each of the mixed-use residential scenarios, all inputs were kept the same except those testing affordability requirements: unit mix, unit size as related to affordable housing, and the resulting average rental rate. The default residential rate of 10% of income for operating costs was used, which may be low, but because it was used in all of the residential scenarios, a higher rate would still yield the same relative difference between no affordability requirements and meeting the current affordability requirements – that is a 0.5% lower return on the IRR when meeting affordability requirements.

Affordable Units in the University Neighborhood Overlay (UNO)

Staff also reviewed several recent projects using similar high-rise construction in UNO to gauge the ability of the Austin market to absorb on-site affordability requirements. Projects in this area must provide 10% of the units at affordable rates in order to obtain bonus provisions. To date there are 33 properties in the UNO district that include on-site affordable housing, four of which are concrete construction multifamily properties that meet or exceed the 5% square footage requirements found in Rainey:

Property Name	Stories	FAR	Total Units	Affordable Units	% of Total Square Footage that is Affordable
The Quarters at Nueces	8	4.8	235	23	9.4%
21 Rio	21	15.4	158	16	7.8%
The Quarters at Grayson	8	5.7	100	10	7.6%
Twenty-Two Fifteen	8	5.8	156	16	5.9%

While land values in the UNO are not typically as high on a per square foot basis as the Downtown and Rainey markets, achievable rents are also significantly lower than downtown and Rainey.

UNO is an area near Downtown, with similar construction, with a more rigorous affordability requirement, and the market is producing quite a few projects; thereby, indicating that residential projects remain feasible notwithstanding affordability requirements more rigorous than those in the Rainey District.

CONCLUSION

Rainey District projects meeting on-site affordability requirements are financially feasible according to this analysis. An analysis of the current Rainey Street on-site affordability requirements yielded a typical reduction of half a percent on the IRR, a reduction that did not cause projects to dip below a target IRR of 11% and above.

Projects seeking to offset the costs of on-site affordability requirements could choose to adjust parking provisions, including reducing the number of parking spaces, charging for parking spaces, or using above-grade parking structures.

Other uses, such as hotel and office, would likely be considered as a result of market demand and not because of on-site affordability requirements for residential use. An office use does not appear to be well-suited to the area. A hotel use would be very profitable, much beyond that of a residential use, with or without affordability requirements. Given the amount of hotel construction in and around the Rainey Street district, there may no longer be as strong a market for this use – a market study would be needed to understand this possibility in further detail.

Higher affordability requirements in exchange for bonus provisions in other parts of Austin (i.e., University Neighborhood Overlay) are being absorbed by the market for similar types of construction, despite lower revenues. The production of these affordable units would indicate that the Rainey Street requirements can also be absorbed by the market.

Given this analysis, staff does not recommend amendments to the on-site affordability requirements of the Rainey Street district in the Density Bonus Program.

CC:

Marc Ott, City Manager
Sue Edwards, Assistant City Manager
Marie Sandoval, Executive Assistant, CMO
Betsy Spencer, Director of Neighborhood Housing and Community Development
Matthew Lewis, Assistant Director, PDRD
Jim Robertson, Manager, Urban Design, PDRD
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Sylvia Leon Guerrero, Urban Design, PDRD
Elizabeth Smith, Urban Design, PDRD
Jessi Koch, NHCD

Skyhouse Austin **NEW! County Tax page for this property**78 Rainey St [Y-Map](#) [G-Map](#) [B-Map](#)

Austin TX 78701-4309

(512) 961-6968

MGT CO: Simpson Property Group LP

LSE TERM: 6-12

PARKING: Parking Garage (+40)

PETS: <70#/\$600 (300 NR)/\$20mo/2 Max

AREA:

CE4

MAP:

SCHOOL DIST:

Austin

CENSUS TRACT:

0011.00

UNITS:

320

YR BLT/RENO:

2013

OCCUPANCY:

62

COUNTY:

Travis

ELECTRIC:

RESIDENTIAL

APP FEE:

\$100

LOC COMMISSION: ☒ \$2000 Flat Fee Eff, 1&2Brs 6-12m/100%

3Brs 6-12m

Name on App

[More Pictures & Plans](#)
[Historical Report](#)
[Including 5-Year](#)
[Historical Chart](#)
AMENITIES:

- | | | | |
|---|--|---|--|
| <input checked="" type="checkbox"/> Pools (1) | <input checked="" type="checkbox"/> BBQ Grill | <input checked="" type="checkbox"/> Self-Clean Oven | <input type="checkbox"/> Pantry |
| <input type="checkbox"/> Laundry | <input type="checkbox"/> Playground | <input type="checkbox"/> Cont-Clean Oven | <input type="checkbox"/> Ceiling Fan |
| <input type="checkbox"/> Tennis | <input checked="" type="checkbox"/> Fitness Center | <input type="checkbox"/> Double Oven | <input checked="" type="checkbox"/> Patio/Balcony |
| <input type="checkbox"/> Water V-ball | <input checked="" type="checkbox"/> 24-Hour Fitness Room | <input checked="" type="checkbox"/> F.F. Refrig | <input checked="" type="checkbox"/> Extra Storage |
| <input type="checkbox"/> Volleyball | <input checked="" type="checkbox"/> Jogging Trail | <input checked="" type="checkbox"/> Ice Maker | <input checked="" type="checkbox"/> Garden Tubs |
| <input type="checkbox"/> Basketball | <input checked="" type="checkbox"/> Access Gates | <input checked="" type="checkbox"/> Dishwasher | <input type="checkbox"/> Mini-Blinds |
| <input type="checkbox"/> Racquetball | <input checked="" type="checkbox"/> On-Site Mgmt | <input checked="" type="checkbox"/> Disposal | <input type="checkbox"/> Private Alarms |
| <input type="checkbox"/> Jacuzzi | <input type="checkbox"/> Corporate Rates | <input checked="" type="checkbox"/> Microwave | <input checked="" type="checkbox"/> Monitored Alarms |
| <input type="checkbox"/> Sauna | <input type="checkbox"/> Short Term Leases | <input type="checkbox"/> Crown Molding | <input checked="" type="checkbox"/> Vaulted Cell |
| <input checked="" type="checkbox"/> Clubhouse | <input checked="" type="checkbox"/> Near Transit | <input checked="" type="checkbox"/> High Speed Internet | <input checked="" type="checkbox"/> Walk-In Closet |
| <input checked="" type="checkbox"/> Business Center | <input type="checkbox"/> Income Restricted | <input type="checkbox"/> Commercial Electric | <input type="checkbox"/> Wall-Wall Carpet |
| <input type="checkbox"/> All Bills Paid | <input type="checkbox"/> Accepts Section 8 | | |

NOTES: Hardwood Flooring With Carpet In Bedrooms.**UNIT INFORMATION**

MIX	DESC	W/D	FP	SQFT	MKT. RENT	\$/SF	EFF. RENT	EFF \$/SF	DPST	NR FEE	MKT ANN INC
19	EFF	FP		544	\$1,625	\$2.99	\$1,625	\$2.99	300	250	\$370,500
16	EFF	FP		585	\$1,710	\$2.92	\$1,710	\$2.92	300	250	\$328,320
3	EFF	FP		585	\$1,685-\$1,705	\$2.90	\$1,685-\$1,705	\$2.90	300	250	\$61,020
19	1/1	FP		593	\$1,535-\$1,625	\$2.66	\$1,535-\$1,625	\$2.66	300	250	\$360,240
19	EFF	FP		618	\$1,760-\$1,780	\$2.86	\$1,760-\$1,780	\$2.86	300	250	\$403,560
1	1/1	FP		655	\$1,950	\$2.98	\$1,950	\$2.98	300	250	\$23,400
18	1/1	FP		655	\$1,820-\$1,915	\$2.85	\$1,820-\$1,915	\$2.85	300	250	\$403,380
19	EFF	FP		672	\$1,715-\$1,830	\$2.64	\$1,715-\$1,830	\$2.64	300	250	\$404,130
37	1/1	FP		679	\$2,060-\$2,070	\$3.04	\$2,060-\$2,070	\$3.04	300	250	\$916,860
14	1/1	FP		691	\$2,015-\$2,025	\$2.92	\$2,015-\$2,025	\$2.92	300	250	\$339,360
5	1/1	FP		691	\$1,990-\$2,010	\$2.89	\$1,990-\$2,010	\$2.89	300	250	\$120,000
19	1/1	FP		724	\$2,080-\$2,090	\$2.88	\$2,080-\$2,090	\$2.88	300	250	\$475,380
19	1/1	FP		729	\$1,960-\$2,025	\$2.73	\$1,960-\$2,025	\$2.73	300	250	\$454,290
19	1/1	FP		760	\$1,945-\$1,970	\$2.58	\$1,945-\$1,970	\$2.58	300	250	\$446,310
1	1/1	FP		762	\$2,135	\$2.80	\$2,135	\$2.80	300	250	\$25,620
3	1/1	FP		900	\$2,365	\$2.63	\$2,365	\$2.63	300	250	\$85,140
3	1/1	FP		948	\$2,365	\$2.49	\$2,365	\$2.49	300	250	\$85,140
31	2/2	FP		1,029	\$2,780-\$2,830	\$2.73	\$2,780-\$2,830	\$2.73	400	250	\$1,043,460
3	2/2	FP		1,029	\$2,735-\$2,755	\$2.67	\$2,735-\$2,755	\$2.67	400	250	\$98,820
34	2/2	FP		1,079	\$2,695-\$2,770	\$2.53	\$2,695-\$2,770	\$2.53	400	250	\$1,114,860
2	3/3	FP		1,217	\$3,345	\$2.75	\$3,345	\$2.75	500	250	\$80,280
1	3/3	FP		1,346	\$3,315	\$2.46	\$3,315	\$2.46	500	250	\$39,780
1	3/3	FP		1,346	\$3,310	\$2.46	\$3,310	\$2.46	500	250	\$39,720
4	3/3	FP		1,382	\$3,520	\$2.55	\$3,520	\$2.55	500	250	\$168,960
2	3/3	FP		1,391	\$3,470	\$2.49	\$3,470	\$2.49	500	250	\$83,280
4	3/3	FP		1,449	\$3,620	\$2.50	\$3,620	\$2.50	500	250	\$173,760
2	3/3	FP		1,451	\$3,505	\$2.42	\$3,505	\$2.42	500	250	\$84,120
2	3/3	FP		1,509	\$2,645	\$1.75	\$2,645	\$1.75	500	250	\$63,480
320	TOTALS			253,102	\$691,098		\$691,098				\$8,293,170
	AVERAGES			791	\$2,160	\$2.73	\$2,160	\$2.73			

SPECIALS: 6wks Free East Facing Units, 1mo Free West Facing Units 12mo.Ls

Information obtained from sources deemed reliable, but is not guaranteed.
ALN Apartment Data. • 972/931-2553 or 800/643-6416 • www.alndata.com

Last Update: 2014/09/16

HISTORY REPORT FOR Skyhouse Austin

Month	Ave. Rent	Eff. Rent	Occupancy		Month	Ave. Rent	Eff. Rent	Occupancy
Sep 14	\$2,159.68	\$2,159.68	62.0		Mar 14	\$2,142.16	\$2,118.64	27.0
Aug 14	\$2,146.47	\$2,146.47	58.0		Feb 14	\$2,126.13	\$2,102.62	19.0
Jul 14	\$2,199.51	\$2,199.51	60.0		Jan 14	\$2,143.08	\$1,875.28	13.0
Jun 14	\$2,200.71	\$2,200.71	41.0		Dec 13	\$2,147.75	\$1,969.50	0.6
May 14	\$2,177.33	\$2,153.71	35.0		Nov 13	\$2,144.69	\$1,966.63	n/a
Apr 14	\$2,142.79	\$2,142.79	42.0		Oct 13	\$2,144.69	\$1,966.63	n/a

SPECIALS/CONCESSIONS

Sep 14: 6wks Free East Facing Units, 1mo Free West Facing Units 12mo.Ls

Aug 14: 6wks Free East Facing Units, 1mo Free West Facing Units 12mo.Ls

Jul 14: 6wks Free East Facing Units, 1mo Free West Facing Units 12mo.Ls

Jun 14: 6wks Free East Facing Units, 1mo Free West Facing Units 12mo.Ls

May 14: 6wks Free 3Brs 12mo.Ls; 1mo Free East Face Units 12mo.Ls

Apr 14: East Facing Units 1mo Free 12mo.Ls

Mar 14: East Side 1mo Free 12mo.Ls

Feb 14: 6wks Free 3Brs 12mo.Ls

Jan 14: 6wks Free 12mo.Ls

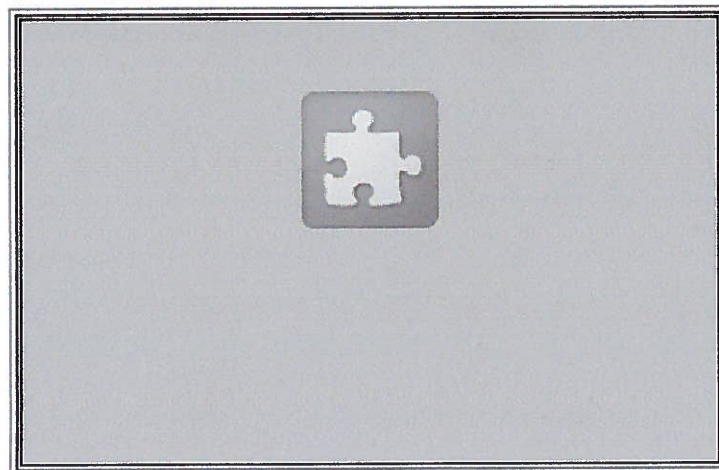
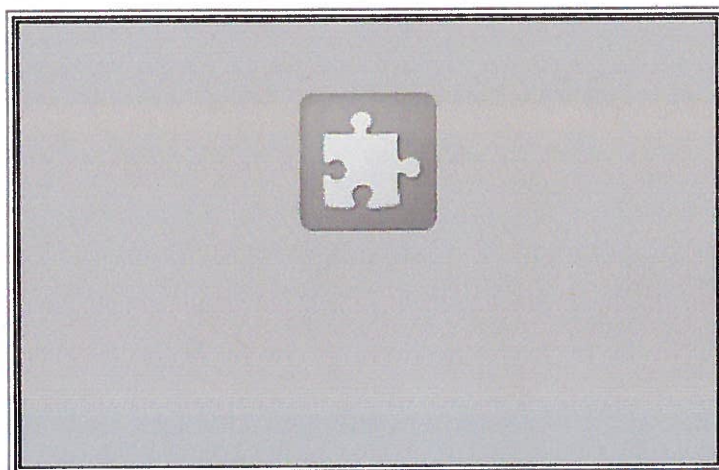
Dec 13: Pre-leasing For Jan 20th Move Ins; 1m Free 12mo.Ls by Jan 20th

Nov 13: Pre-leasing For Jan 20th Move Ins; 1m Free 12mo.Ls by Jan 20th

Oct 13: Pre-leasing For Dec 16th Move Ins; 1m Free 12mo.Ls by Nov 15th

Sep 13: Pre-leasing For Dec 16th Move Ins; 1st Mo Free 12mo.Ls

Aug 13: 2wks Free 12mo.Ls.



Information from sources deemed reliable but is not guaranteed
 ALN Apartment Data. • 972/931-2553 or 800/643-6416 • www.alnsystems.com

Envision Tomorrow Modeling of Rainey Street Affordability Requirements in the Density Bonus Program											
Unit Mix	Downtown rates				Skyhouse rates			Millenium rates			Hotel
	5% sf, similar unit mix	5% units	no afford-able	5% sf, more studios	5% sf, similar unit mix	5% units	no afford-able	5% sf, similar unit mix	5% units	no afford-able	
Avg. size, sf	959	959	959	793	791	791	791	878	878	878	400
Avg. rent \$/sf	\$2.76	\$2.78	\$2.84	\$2.82	\$2.70	\$2.71	\$2.77	\$2.72	\$2.72	\$2.80	\$200/night
Studio	19.7%	15.8%	20.8%	38.0%	22.56%	18.8%	23.8%	0.0%	0.0%	0.0%	
1 bedroom	43.1%	45.4%	45.4%	42.8%	46.91%	49.4%	49.4%	79.9%	79.1%	84.1%	
2 Bedroom	29.8%	31.4%	31.4%	14.3%	20.19%	21.3%	21.3%	15.2%	16.0%	16.0%	
3 bedroom	2.3%	2.4%	2.4%	0.0%	5.34%	5.6%	5.6%	0.0%	0.0%	0.0%	
Affordable units	5.0%	5.0%	0.0%	5.0%	5.0%	5.0%	0.0%	5.0%	5.0%	0.0%	
Total affordable units	10	10	0	13	13	13	0	12	12	0	
Total units	217	217	217	262	263	263	263	237	237	237	423
Financial Performance											
IRR (unleveraged return)	12.4%	12.5%	12.9%	12.2%	11.5%	11.5%	11.9%	11.9%	11.9%	12.4%	15.4%
Cap Rate (yield to costs)	9.86%	9.93%	10.15%	9.78%	9.38%	9.41%	9.62%	9.60%	9.61%	9.88%	10.5%
Cash-on-cash (after year 3)	10.5%	10.7%	11.5%	10.2%	8.8%	8.9%	9.6%	9.6%	9.6%	10.5%	28.0%
IRR on Investor Equity (Leveraged Return before Tax)	20.5%	20.8%	21.6%	20.2%	18.6%	18.8%	19.6%	19.5%	19.5%	20.6%	28.0%
Debt Service Coverage Rate (year 3)	1.58	1.59	1.64	1.56	1.49	1.49	1.53	1.53	1.53	1.58	2.05
Predevelopment costs (due diligence, land carry, land entitlement, professional fees, raw land)	5,235,812	5,235,812	5,235,812	5,315,013	5,316,189	5,316,189	5,316,189	5,270,589	5,270,589	5,270,589	6,182,170
Building construction costs	52,301,838	52,301,838	52,301,838	53,885,869	53,909,374	53,909,374	53,909,374	52,997,376	52,997,376	52,997,376	71,228,995
Indirect costs (impact fees, building permits, insurance)	984,117	984,117	984,117	1,059,584	1,060,704	1,060,704	1,060,704	1,017,254	1,017,254	1,017,254	1,450,763

[illegible]

EXHIBIT A

MEMORANDUM

To: Gregory Guernsey and Jorge Rousselin
From: Darin Smith
Subject: Peer Review of Rainey Street Density Bonus Analysis;
EPS #141163
Date: December 4, 2014

The Economics of Land Use



Economic & Planning Systems, Inc. (EPS) has been retained as a consultant to the City of Austin (City) to conduct a peer review of analysis of the economic implications of the revised density bonus program for the Rainey Street district. The City Council adopted the amendments in February 2014, requiring projects seeking a density bonus in the Rainey Street district to provide five percent of the total residential square footage as affordable units, and that such units must be the same mix of unit types (by number of bedrooms) as the project overall. Previously, the City had allowed a density bonus if developers provide five percent of the total number of units in their projects as affordable housing, with no specifications for unit sizes.

Certain developers have suggested that these changes have diminished the feasibility of housing development in the Rainey Street district and may lead to more properties being developed as commercial office or hotel uses rather than residential, thus diminishing the Council-desired primarily residential character of the district. City staff has conducted research and analysis of this issue, and a developer has offered commentary and suggestions regarding Staff's analysis. In this memorandum, EPS provides a high-level peer review of these analyses, and provide recommendations for additional analyses or assumption adjustments that may improve the work done to date.

Summary of Findings

EPS's analysis has yielded the following findings:

1. The general modeling approach taken by City staff to evaluating the economic implications of the amended density bonus appears sound, as it reflects direct financial considerations for developers as well as policy considerations regarding the character of Rainey Street.

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2. While many of the assumptions in the Envision Tomorrow modeling appear sound and potentially even conservative, there remain unsettled questions regarding several key issues including achievable market-rate rents, operating costs, and appropriate feasibility thresholds.
3. The analysis conducted for hotel development feasibility appears to be incorrect and should be reconsidered.
4. "Spot-check" auditing of the Envision Tomorrow financial model suggests that it is working as designed, irrespective of the merits of certain assumptions.
5. While many assumptions can be debated, the staff and developer analyses agree on the fundamental fact that the amended density bonus program is likely to reduce financial returns for residential development, relative to those achievable under the previous density bonus provision. The extent and implication of this negative effect is not yet in agreement.
6. City staff and developers have clearly invested energy into providing a meaningful analysis of this important issue, and continuing their dialogue prior to taking action on the density bonus program may yield better information and stronger outcomes for Rainey Street.

Review of Methodology

To evaluate whether and the extent to which residential development feasibility and certain policy goals will be negatively impacted under the amended density bonus requirements, City staff has attempted to estimate the expected return on investment for various development projects under various assumptions. This approach directly addresses the central concern expressed by the developers – that the amended density bonus program will alter the economics of development and reduce the feasibility of residential projects. This approach also indirectly addresses a key policy consideration – whether the amended density program will reduce residential development in the Rainey Street district, thereby reducing the amount of affordable housing delivered and potentially encouraging other uses (such as hotels or office buildings) that would change or undermine the desired residential nature of the district.

To conduct this analysis, City staff utilized the "Envision Tomorrow" model that aims to calculate returns on investment based on development cost inputs (land acquisition, labor and materials, "soft costs" such as design and financing) and expected revenues (net operating income from rents less operations). Staff ran multiple building scenarios on a sample site, including one using a mix of units (1 BR, 2BR, etc.) typical of Downtown development and two others based on the unit mixes found in the SkyHouse and Millenium projects in the Rainey Street district. The primary difference among these scenarios was the mix of units by bedroom count; otherwise, the site dimensions and overall building size were equivalent among these scenarios, assuming an 8:1 FAR on a 32,000 square foot site. In addition, staff ran analyses of the amended density bonus program (primarily, with 5 percent of all leasable square footage being affordable), the program as it would have previously applied (primarily, with 5 percent of all units being affordable), and a scenario in which no affordable housing was required.

In addition to these multiple residential scenarios, staff has evaluated the potential return on investment of a hotel development on the same example site. This analysis is intended to illustrate whether a hotel development may offer financial returns that are superior to those under residential development, and therefore may be a preferred outcome for developers and landowners, thus reducing the amount of residential development achieved in the district.

EPS believes that the general approach to evaluating the economic implications of the density bonus program is appropriate, as it addresses the primary financial and policy issues for consideration and aims to reflect actual practices and choices to be made by developers. A less complex approach might also have been possible, such as estimating the implied subsidy for the affordable units under the previous density program and those under the amended program. For instance, such an approach would simply compare the gross lease revenues achievable for a given building program (unit mix) under the various affordability requirements, and capitalize that difference as an indicator of the economic impact of the amended density program, rather than incorporating complex development cost and operating cost assumptions as in City staff's analysis. However, such an approach, while more simple, may not have addressed the fundamental question of whether development remains feasible under the amended program. The mere fact of a reduction in profitability is not sufficient to determine that a regulation makes development infeasible.

Review of Assumptions

City staff has provided EPS active Excel files containing the Envision Tomorrow models used for staff's analysis. The usefulness of the Envision Tomorrow financial model, like all models, depends on the appropriateness of the assumptions and inputs. City staff clearly has made efforts to utilize defensible inputs, citing published sources in several cases as well as seeking information from developers active in Downtown Austin. However, the letter received from Endeavor Real Estate Group on November 18, 2014 reveals several concerns regarding the assumptions used in the financial modeling. EPS's review of the models has revealed some similar concerns, as well as a level of comfort with other assumptions. Below, EPS discusses several aspects of the financial model assumptions.

Project Unit Mixes

As noted above, the staff analysis included multiple residential development programs, each with roughly 208,000 square feet of leasable residential space and roughly 7,000 square feet of leasable retail space. However, the number of residential units in each scenario varies from 217 to 263, based on the mix of studios, 1 BR, 2BR, and 3BR units assumed. These unit mixes are meant to mirror the unit mixes of "typical" downtown developments (as provided to staff by Endeavor), as well as actual projects built or under construction in the Rainey Street district (SkyHouse and Millenium).

The Endeavor letter suggests that the analysis should also have included a scenario similar to the existing "Windsor on the Lake" project in Rainey Street, which has larger unit sizes (and lower rents per square foot) on average than those under the tested scenarios. The Windsor on the Lake project was a relatively early project in Rainey Street (2008), and may have oversized its units in an effort to attract residents to a then-unproven market and/or to keep overall costs lower, as larger units tend to be less expensive to build per square foot due to more square footage over which to spread expensive features like kitchen and bathroom plumbing and fixtures.

Regardless of the reasons for Windsor on the Lake's particular unit mix, EPS believes the staff analysis has made a reasonable effort to represent a range of project types that may be of interest to developers in Rainey Street. While EPS understands the interest in running still more scenarios with different unit mixes and would be curious to know how that analysis might change

the results, we do not have reason to believe the project descriptions used in the analysis thus far are inadequate or would lead to results that misrepresent the basic economic dynamics of the amended density bonus program.

Parking Program

In each scenario, the analysis assumes one parking space per residential unit, irrespective of the size of those units. This may be allowable under the City's development regulations, but may present a marketing challenge for the developers, as the occupants of larger units may in fact have more than one vehicle. EPS believes it would be prudent to determine through market comparables whether a single space per unit is marketable in Rainey Street or similar downtown Austin locations. This is not to say that the assumption of one space per unit is inaccurate or unachievable, only that parking ratios tend to be important considerations in development economics and are worthy of attention.

The financial model assumes that these parking spaces will be provided in underground spaces. With underground spaces typically costing significantly more than above-ground structures, EPS believes this is meant to be a conservative assumption that yields higher costs (and thus lower financial returns) than might otherwise be assumed. With a site assumed to be 32,000 square feet total, it may be physically possible to accommodate all the parking in three or four levels underground, although the Rainey Street location near the Lake and Waller Creek may present water table issues that constrain the ability to provide parking below grade. EPS is not certain that this parking program assumption warrants reconsideration, but merely points out the possibility that it may be challenging to realize.

It is worth noting that the Endeavor letter did not indicate concern regarding the parking program assumptions for the staff analysis.

Development Costs

The financial model assumes land acquisition costs based on the current appraised value of the four parcels comprising the example site. This seems to be a reasonable assumption, and is held constant for all scenarios, including the hotel scenario, so no advantage or disadvantage is conferred to any scenario.

The "hard" development costs (labor and materials) for the building (excluding parking) are assumed at \$172 per square foot in all residential scenarios. This figure is shown as the average of several unnamed developer sources provided to the City, and is also above the cost estimates published in RS Means, an industry standard source. However, the analysis applies this figure to all residential scenarios, irrespective of their unit mix. As noted above, it is typical that development costs per square foot are higher for smaller units. As such, EPS would anticipate that the scenarios with fewer units (217) would have lower costs per square foot than scenarios with more units (263). No such adjustment has been made in the Envision Tomorrow modeling, and may be critical to understanding the subsidies implicit in providing affordable housing as required under the amended density bonus program, given its requirements based on building square footage and unit mixes.

The parking costs are assumed to be \$35,000 per space for underground construction. This figure is at the top of the range provided by local developer sources, and thus is also considered reasonable and potentially conservative, notwithstanding the notes above regarding the marketability of a modest parking ratio and the potential challenges of underground parking at this particular location.

All-in costs, including land acquisition, hard costs, parking costs, and "soft costs" (design, permitting, financing, etc.) are assumed to be around \$66-68 million in the residential scenarios, with the variation primarily attributable to the number of parking spaces required based on the number of units. These all-in cost figures amount to roughly \$260 per gross buildable square foot, and is roughly 10 percent higher than the figure provided in the Endeavor letter (\$236/GSF). As such, EPS believes the development cost assumption used by staff is reasonable and potentially conservative. However, as noted above, differentiating costs by unit type or size may have a substantive impact on the findings, given the focus of the analysis on these factors as they relate to the affordable housing requirements.

Operating Costs

The Envision Tomorrow modeling assumes that operating costs for the rental residential units equal 10 percent of the gross potential rent, excluding property taxes. EPS believes there are two concerns about this assumption: 1) it appears very low, and 2) it decreases operating expenses when more affordable units are in the project. EPS typically sees operating expenses of at least 20 percent and potentially as high as 30 percent of gross potential income for market-rate rental residential projects. Furthermore, EPS is aware that operating costs typically bear some relationship to achievable rents, but the same building should have the same operating costs (marketing, maintenance, utilities, reserves, etc.) whether X or Y units are offered as affordable units. To the extent that operating costs are underestimated in the Envision Tomorrow model, net operating income and thus unit values and financial returns will be overestimated. Endeavor flagged this issue in their letter, and EPS concurs that it is of concern.

Market-Rate Lease Rates

The Envision Tomorrow modeling assumes different lease rates for the market-rate units, ranging from an average of \$2.77 per square foot per month to \$2.84. City staff has indicated that these rents reflect rates provided by Endeavor for downtown apartments generally, as well as the asking rents at SkyHouse on Rainey Street, as provided in October 2014 by ALN, an apartment data provider. Interestingly, the Envision Tomorrow modeling assumes higher per-square-foot rents for the development programs with larger units than those with smaller units, which runs counter to EPS's experience as well as ALN data showing that smaller units typically command higher rents per square foot.

Endeavor's letter further states that the rents assumed are higher than should be expected, based on market comparables. Endeavor provides a November 2014 ALN report for SkyHouse indicating that the project's average "asking rent" may be \$2.65 per square foot (though still not the \$2.77 assumed in the Envision Tomorrow modeling), but the project's "effective rent" after concessions to attract residents is only \$2.43 per square foot. Given that SkyHouse only began leasing in 2013, EPS is not certain that concessions will be required as a structural component of effective rent. ALN data for Windsor on the Lake, which opened in 2008, indicates that asking rent and effective rent are now the same, and a broader November 2014 ALN report on Austin apartment market conditions indicates that only 11 percent of stabilized Austin apartment complexes are offering concessions and that overall market "effective rents" are essentially equal to "asking rents."¹ As such, EPS does not agree with Endeavor's assertion that concessions should be incorporated as a significant permanent reduction on asking rents.

¹ <http://public.alndata.com/marketreview/AUS7d4a5dbdd3.pdf>

Still, the November ALN data for SkyHouse does suggest that the market-rate rents assumed in the modeling may be aggressive. This, in combination with the likely underestimation of operating costs, would yield a net operating income figure that overstates the probable revenue and value of the units, and thus their return on investment.

Affordable Lease Rates

Consistent with affordable housing practices, the Envision Tomorrow modeling assumes that affordable unit rents are based on standards for different categories of units (studios, 1 BR, etc.) rather than the actual square footage of those units. Consistent with the amended density bonus program, the model appears to apply affordable rent limits based on incomes at 80 percent of Area Median Income for various household sizes. Interestingly, the affordable rents applied in the model are somewhat lower than those that might be allowed for households earning 80 percent of AMI under the State's Housing Trust Fund program. For example, the Envision Tomorrow modeling is assuming that an affordable 1 BR unit would lease for \$986 per month, whereas the State's worksheet suggests the rent could be as high as \$1,132.² EPS understands that the rent limits were provided by NHCD using the City's standard ratios (28 percent of gross household income), but if higher rents could be allowed than are being modeled, the model may overestimate the subsidy required for the affordable units and thus underestimate the projects' financial returns. Clarification on this issue should be sought, so that stakeholders and City staff and policymakers can be assured of what rent levels will be allowed.

Condominium Pricing

While the Envision Tomorrow modeling conducted by staff and the analysis provided by Endeavor have focused on rental housing, the Endeavor letter asserts that the amended density program will have an even more negative effect on for-sale housing opportunities in Rainey Street, because condominiums are typically built with somewhat more square footage per number of bedrooms than are apartments. To EPS's knowledge, no analysis has been conducted by staff or Endeavor on the feasibility implications of the amended ordinance on for-sale housing, and thus there is no material for EPS to review and critique. However, it does not seem obvious to EPS that the amended density bonus would have a more deleterious effect on for-sale housing development, given that any for-sale affordable units would be priced at 120 percent of AMI rather than 80 percent for rental units. If this issue is important to the policy discussion, it deserves to be evaluated explicitly rather than subject to unsubstantiated (though not necessarily incorrect) assertions.

Financial Return Thresholds

The Envision Tomorrow modeling produces several metrics that indicate the financial returns from the projects, and compares those returns to thresholds meant to reflect development and investment industry standards. For example, the model produces an unleveraged "Internal Rate of Return (IRR)" metric, and asserts that a result reaching 12 percent or greater should be considered feasible. For reasons that are unclear to EPS, the staff report suggests that an 11 percent IRR would be acceptable. While this may be reasonable, the discrepancy between the model and the staff report regarding acceptable thresholds bears further consideration, as the results of multiple scenarios fall between 11 and 12 percent IRRs.

² <http://www.tdhca.state.tx.us/pmcomp/irl/index.htm>

Endeavor has asserted that, while an IRR calculation is one metric of financial returns, many developers and investors base their decisions on an expected "yield on costs," or the ratio of net operating income in an early year of stabilized operations to the total costs of the project. EPS is aware that this metric is indeed used as the primary consideration for many developers and investors, particularly those who may choose to retain ownership of the building for the long-term rather than selling it. EPS is also aware that seemingly small changes in the expected performance on any of these or other financial metrics can represent significant deterrents to development and investment.

Given what appears to be some unsettled debate regarding both the type of return metrics to be used and the appropriate thresholds for those metrics, EPS believes it is worth continuing that discussion to pursue consensus. However, we would caution that investment return thresholds are subject to numerous factors, including the global financial market and achievable returns from alternative investments as well as more local and regional factors. For example, investors always compare alternative investments based on risk and return thresholds, and at times when stock market or other typical investment returns are high, they may require a higher return on their real estate development investment to justify the entitlement, construction, and market risks. As such, it may be possible to achieve consensus regarding appropriate metrics and thresholds at a given point in time, but those should be regarded as "snapshots" rather than permanent indicators.

Hotel Modeling

The staff analysis has provided an estimate of the financial returns achievable through a hotel development in Rainey Street, with the intention of comparing the attractiveness of hotels vs. residential developments under the amended density bonus program. The analysis provided indicates that a hotel development would achieve extraordinary returns and profitability which, if it is to be believed, would suggest that no sensible developer would choose to build residential projects in Rainey Street until the hotel market is clearly in great decline. While hotel development may in fact be an attractive investment, the calculations in the Envision Tomorrow modeling effort do not appear realistic. In EPS's opinion, based on reviews of other hotels proposed and built in downtown Austin and elsewhere, the assumed development costs and operating costs appear far too low, leading to greatly inflated return estimates. For full-service hotels, for example, EPS has seen development costs as high as \$286K per room (vs. \$120,000 in the Envision Tomorrow modeling) and operating costs as high as 78 percent of gross income (vs. 25 percent in the modeling). EPS recommends that the hotel modeling be wholly reconsidered if it is to be an important factor in evaluating the merits of the density bonus program for residential projects. The Endeavor letter provides a summary of their own modeling of both a hotel and an office development scenario which, despite not providing great detail on their assumptions and calculations, appears to have resulted in much more realistic results than were achieved in the Envision Tomorrow modeling.

Review of Accuracy

EPS has conducted some "spot check" auditing of the actual calculations (not assumptions) in the Envision Tomorrow model. This included tracking the linkages and reviewing the formulae for several calculations of development costs, revenues, and financial returns. EPS did not discover any issues regarding the accuracy of the calculations in the model.

The Endeavor letter indicates confusion about why the City's summary table regarding the staff analysis shows a scenario with unit mixes adding up to 105 percent of units (rather than 100 percent). EPS has reviewed the actual modeling associated with that scenario and agrees that the representation in the summary table is both confusing and inconsistently provided,³ but we have confirmed that the modeling does indeed correctly reflect 100 percent of the units, not a greater amount.

Conclusions and Suggestions

The staff modeling and Endeavor's modeling (summarized but not explicitly provided in their letter) agree on one important conclusion: the affordable housing requirements in the amended density bonus program for Rainey Street reduce the financial returns from residential development compared to the previous affordable housing requirements. The extent of that reduction, and its implications for continuing development of housing in Rainey Street, are not yet in agreement. By both accounts, it is financially advantageous for developers to be able to provide 5 percent affordable units in the most cost-effective manner, rather than having those units necessarily mirror the mix and size of market-rate units. However, there may be valid policy arguments for diversifying the mix and size of affordable units. The ability of a given project to absorb those added costs will depend as much or more on dynamic factors beyond the scope of this analysis or control of the City Council (such as achievable market-rate lease rates, land acquisition and development costs, interest rates on construction loans, investors' return expectations, etc.) than they rely on the size or mix of market-rate and affordable units.

Given the importance of this issue in achieving the City's stated goal of encouraging residential development in the Rainey Street district, EPS believes it is worth at least a modest level of continued analysis and discussion. It may not be possible to achieve full concurrence on all assumptions and scenarios for the modeling, and it may also not be possible to determine with certainty whether the potential negatives are outweighed by the potential positives from the amended density bonus program. But staff's concerted effort to provide objective and defensible analysis, combined with the level of interest and engagement displayed by developer stakeholders, suggest that additional discussion among these parties may prove fruitful in assuring that the Rainey Street density bonus program achieves its multiple objectives.

³ In some scenarios, "affordable units" are shown as separate from the number of studios, 1 BRs, etc. but are not differentiated by the type of affordable unit. These examples sum to 95 percent for the market-rate units differentiated by type, plus 5 percent for the affordable units, and thus 100 percent overall. In other scenarios, the mix of unit sizes includes the affordable units, so adding the "affordable units" figure would yield greater than 100 percent.



MEMORANDUM

TO: Mayor and City Council

FROM: Marc Ott, City Manager

DATE: 14 November 2014

RE: Economic Evaluation of Downtown Density Bonus Program

On September 25, 2014, under Resolution No. 20140925-083, the Austin City Council directed the City Manager to analyze the economic and financial aspects of the density bonus program for the Rainey Street subdistrict of the Waterfront Overlay, as amended by Ordinance No. 20140227-054 and codified in City Code Sections 25-2-586 (Downtown Density Bonus Program) and 25-2-739 (Rainey Street Subdistrict Regulations). This memorandum responds to that direction.

EXECUTIVE SUMMARY

City Council modified the Downtown Density Bonus Program in February 2014, including changes to the Rainey Street District, specifically requiring term limits for on-site affordable units and that the total square footage of those units equal 5% of the residential square footage with a similar bedroom mix for projects requesting an FAR of 8:1.

Staff used Envision Tomorrow, a return-on-investment (ROI) tool, to analyze the effect of the changes to the on-site affordability requirements by modeling three residential scenarios that reflected downtown and Rainey Street projects and one hotel scenario. For each residential scenario, staff modeled the current affordability requirements, previous affordability requirements, and no affordability requirements.

Using a sample Rainey Street parcel, construction costs from local sources, and an underground-parking assumption, *all* ROIs projected a financial performance **at or above** industry performance measures. While affordability requirements do lower the rate of return, the reduction – a half percent for the internal rate of return – is not significant enough to render projects financially infeasible. Reductions could also be offset by adjustments to parking.

Staff also considered hotel and office uses and found that the choice to develop such projects would largely be driven by market demand and not by the affordability requirements of residential uses. Additionally, affordability requirements in other parts of the city are being met that are more than equivalent to the Rainey Street District requirements.

Given this analysis, staff does not recommend amendments to the on-site affordability requirements of the Rainey Street district in the Density Bonus Program at this time.

BACKGROUND

City Council adopted the basic framework of the Downtown Density Bonus Program in June 2013 (Ordinance No. 20130627-105), and expanded the Program via code amendments in February 2014 (Ordinance No. 20140227-054). The 2014 code amendments expanded the Program into the Rainey Street District (previously ineligible for the Program) and set up a two-tiered application of the Program: projects seeking additional density up to an FAR of 8:1 participate in the program previously created by the Waterfront Overlay; projects seeking density above an FAR of 8:1 participate in the Downtown Density Program for the FAR above 8. These 2014 amendments also made three changes to the pre-existing Waterfront Overlay program as it applied in the Rainey Street District:

1. An affordability "term" was added to affordable units created under the program, mandating that they be maintained at affordable levels: 40 years for rental housing and 99 years for ownership housing.
2. The on-site affordable units requirement was **modified** from 5% of the dwelling units to 5% of the square footage.
3. The bedroom count mix for the on-site affordable units must now be proportional to the overall bedroom count mix within the overall development. I.e., if the bedroom count ratio for the market rate units is 25% studio units, 40% one-bedroom units; 20% two-bedroom units, and 15% three-bedroom units, then the same bedroom count mix must be provided for the affordable units.

Subsequent to the February 2014 amendments to the Density Bonus Program, some questions were raised as to whether these changes to the rules that applied in the Rainey Street District might have the effect of dis-incentivizing residential projects, thereby producing the unintended consequence of reducing the creation of affordable housing units. On September 25, 2014, the City Council directed the City Manager to study the situation and report back to Council with its findings.

ANALYSIS

Staff used the Envision Tomorrow (ET) tool to develop several return-on-investment (ROI) models to analyze the financial viability of projects meeting the Rainey Street on-site affordability requirements. This analysis was conducted for a sample project with a FAR of 8:1, using average construction costs derived from several local sources. Four base scenarios were developed using a mix of units, rental rates, and use that reflected the following types of projects:

- Downtown: mixed-use residential with ground floor retail with average downtown unit mix and rental rates (provided by a developer working in the Rainey Street district).
- Skyhouse: mixed use residential with ground floor retail with a unit mix and rental rates reflecting the Skyhouse, a Rainey Street project that opened at the end of 2013.
- Millenium: mixed-use residential with ground floor retail with a unit mix reflecting the Millenium project currently under construction in the Rainey Street area. Rental rates are not yet available, so similar per-square-foot rental rates from the Skyhouse were used.

- Hotel: hotel use assuming a default occupancy rate of 75% and a conservative rate of \$200 per-night rate based on downtown hotel rates.

For each of the three residential scenarios, a ROI model was developed for each of the following cases:

- Current Rainey Street on-site affordability requirements, 5% of square footage with a similar unit mix.
- On-site affordability requirements that assume 5% of total units are affordable.
- No on-site affordability requirements.

An additional ROI model with a much larger percentage of studios was also developed for the Downtown scenario in order to understand the impact of the affordability requirements on unit mix.

As a reference point for the ability of the Austin market to absorb affordability requirements, staff also surveyed projects with a similar high-rise construction in the University Neighborhood Overlay for the number of affordable units provided and the corresponding square footage.

Envision Tomorrow tool

The [Envision Tomorrow tool](#) was originally developed by Fregonese Associates and was significantly enhanced during the HUD-funded Sustainable Places Project by Dr. Arthur C. Nelson at the University of Utah. He is co-director of the Master of Real Estate Development Program and has published widely on planning and real estate development. Staff used the [Return-on-Investment App](#), also referred to as the Prototype Builder. This tool is much like industry pro formas and models the financial aspects of a proposed project based on physical and financial inputs.

Sample parcel

Staff used a sample parcel with the following characteristics based on information provided by a developer working in the area:

Site area	32,000 sf	0.73 acres
FAR	8:1	256,000 sq.ft
Residential use	96.875%	<i>based on square footage provided = 248,000 sf/ 256,000 sf</i>
Retail use	3.125%	<i>based on square footage provided =8,000 sf/ 256,000 sf</i>
Land costs	\$2,449,271	(\$77/sf) <i>based on TCAD values</i>

Additional inputs

Construction costs per gross square foot are based on the average of several sources: local values from an on-line constructions data source ([RS Means](#)) and input from three local real estate industry professionals working in Austin.

Constructions costs	Average used	Reference Values			
		RS Means	Local sources		
Residential hard costs \$/ gross sf	\$172/sf	<u>\$119-\$166/sf*</u>	high-rise rental \$165	high-rise rental \$145-165	high-rise rental \$190
Commercial hard costs \$/ gross sf	\$172/sf		\$75/sf + tenant improvement	\$100-200/sf	\$75/sf + tenant improvement
Parking below grade \$ per space	\$35,000		\$30,000- \$35,000	\$75-100/sf ~\$19,500- 26,000/ space	\$25,000

** for Apt 8-24 stories in 78701 zip code, 15-story Ribbed Precast Concrete Panel / Steel Frame*

Underground parking was assumed with the following parking ratios:

- 1 space / dwelling unit
- 2.5 spaces per 1,000 sf of retail space

The retail leasing rate used was \$30/square foot (annual, triple net).

The residential unit mix, unit size, and rental rate varied in each set of ROI models. The Downtown rates were based on information provided by a developer working in the Rainey Street area. The Skyhouse and Millenium models were based on site plans and [ALN data](#).

The Windsor, another residential rental project in the Rainey Street district, was not used in this analysis because it was built in 2008 and contains particularly large units that are not typical of today's market. The property's monthly rental rates are especially high because of the larger unit size, but its rental rates on a per-square foot basis are lower than more recently built projects. The ET tool uses average per-square-foot rental values and average square-foot unit size.

For each of the three scenarios, a ROI model was created for the current affordability requirements (5% of the square footage with a similar unit mix), 5% of the total units, and no affordability requirements. In order to understand the effect of the current affordability requirements on the unit mix, an additional ROI model was created for the downtown rates and assumed a higher percentage of studios and no three-bedroom units.

Residential units	Downtown rates				Skyhouse rates			Millenium rates		
	5% sf, similar unit mix	5% units	no afford-able	5% sf, more studios	5% sf, similar unit mix	5% units	no afford-able	5% sf, similar unit mix	5% units	no afford-able
Avg. size, sf	959	959	959	793	791	791	791	878	878	878
Avg. rent \$/sf	\$2.76	\$2.78	\$2.84	\$2.82	\$2.70	\$2.71	\$2.77	\$2.72	\$2.72	\$2.80
Studio	19.7%	15.8%	20.8%	38.0%	23.8%	18.8%	23.8%	0.0%	0.0%	0.0%
1 bedroom	43.1%	45.4%	45.4%	42.8%	49.4%	49.4%	49.4%	79.9%	79.1%	84.1%
2 Bedroom	29.8%	31.4%	31.4%	14.3%	21.3%	21.3%	21.3%	15.2%	16.0%	16.0%
3 bedroom	2.3%	2.4%	2.4%	0.0%	5.6%	5.6%	5.6%	0.0%	0.0%	0.0%
Affordable units	5.0%	5.0%	0.0%	5.0%	5.0%	5.0%	0.0%	5.0%	5.0%	0.0%
Total affordable units	10	10	0	13	13	13	0	12	12	0
Total units	217	217	217	262	263	263	263	237	237	237

Outputs

Given the physical inputs described above, each model produced the following gross square footage

- 247,892 residential gross square feet
- 7,997 retail gross square feet

These results closely match the desired square footage of 248,000 and 8,000 for residential and retail respectively.

The Envision Tomorrow tool produces several measures of financial viability, including those listed below with accompanying target rates:

Financial Performance Measures	Target
IRR (unleveraged return)	11-12%
Cap Rate (yield to costs)	>9%
Cash-on-cash (after year 3)	10.0%
IRR on Investor Equity (leveraged return before tax)	18-25%
Debt Service Coverage Rate (year 3)	1.25

Each of the scenarios described performed according to the rates below:

Financial Performance	Downtown rates				Skyhouse rates			Millenium rates		
	5% sf, similar unit mix	5% units	no afford-able	5% sf, more studios	5% sf, similar unit mix	5% units	no afford-able	5% sf, similar unit mix	5% units	no afford-able
IRR (unleveraged return)	12.4%	12.5%	12.9%	12.2%	11.5%	11.5%	11.9%	11.9%	11.9%	12.4%
Cap Rate (yield to costs)	9.86%	9.93%	10.15%	9.78%	9.38%	9.41%	9.62%	9.60%	9.61%	9.88%
Cash-on-cash (after year 3)	10.5%	10.7%	11.5%	10.2%	8.8%	8.9%	9.6%	9.6%	9.6%	10.5%
IRR on Investor Equity (Leveraged Return before Tax)	20.5%	20.8%	21.6%	20.2%	18.6%	18.8%	19.6%	19.5%	19.5%	20.6%
Debt Service Coverage Rate (year 3)	1.58	1.59	1.64	1.56	1.49	1.49	1.53	1.53	1.53	1.58

No ROI model performed below the target rates, including those meeting the current affordability requirements in the Rainey Street districts, indicating that these requirements do not make residential projects with a FAR of 8:1 infeasible.

On-site affordability requirements generally reduced the Internal Rate of Return (IRR) by half a percentage, but not to an extent as to make a project financially infeasible.

The downtown ROI model using a unit mix with more studios produced an IRR of 12.2%, which is slightly lower than the more balanced mix of 12.4%. Despite having more total units, with the accompanying increase in income, the project must also provide more parking spaces, which does not provide income as modeled in these scenarios.

In general, the affordability requirements for a project could be offset by providing less parking, charging a monthly parking fee, or using above-grade parking structures. In the case of the Skyhouse scenario, a monthly parking fee of \$50 would increase the IRR for a project meeting the current on-site affordability requirements from 11.5% to 11.9%, the same rate achieved for a project that did not provide on-site affordable units. Alternatively, for the same scenario, using above-grade parking (\$20,000 per space, 57% cheaper than underground parking) would produce a similar rate of return of 11.9%.

For additional information on project costs, net operating income and new cash flow, please see attached.

Hotel Use

A ROI model was also developed for a hotel use with the same parcel size, FAR, and land cost characteristics.

Financial Performance	Hotel
IRR (unleveraged return)	44.9%
Cap Rate (yield to costs)	36.76%
Cash-on-cash (after year 3)	111.7%
IRR on Investor Equity (Leveraged Return before Tax)	109.0%
Debt Service Coverage Rate (year 3)	7.19

A daily room rate of \$200 with 75% occupancy and a construction cost of \$140 per gross square foot, based on local data from RS Means, were assumed.

The hotel ROI far outperformed the mixed-use residential ROIs, indicating that a decision to develop a hotel would be largely driven by the ability of the market to absorb additional hotel product. There are several downtown hotels currently under construction with three located in or adjacent to the Rainey Street district for a total of 1,610 rooms: the Fairmont (1,060 rooms) at Cesar Chavez and Red River, one of the Waller Park Place towers (200 rooms) on Cesar Chavez and Red River, and the Hotel Van Zandt (350 rooms) at 605 Davis Street.

Typically developers specialize in either hotel or residential use and land held by a residential developer for investment may need to be sold before a hotel could be developed.

Office Use

A ROI model for an office use was not modeled for this analysis. Due to a number of factors (the lack of proximity to local and state government offices, limited transportation options, etc.) the Rainey Street district does not lend itself to an office use, as evidenced by the lack of office buildings in the area.

Affordable Units in UNO

Staff also reviewed several recent projects using similar high-rise construction in the University Neighborhood Overlay (UNO) to gauge the ability of the Austin market to absorb on-site affordability requirements. Projects in this area must provide 10% of the units at affordable rates in order to obtain bonus provisions. To date there are 33 properties in the UNO district that include on-site affordable housing, four of which are concrete construction multifamily properties that meet or exceed the 5% square footage requirements found in Rainey:

Property Name	Stories	FAR	Total Units	Affordable Units	% of Total Square Footage that is Affordable
The Quarters at Nueces	8	4.8	235	23	9.4%
21 Rio	21	15.4	158	16	7.8%
The Quarters at Grayson	8	5.7	100	10	7.6%
Twenty-Two Fifteen	8	5.8	156	16	5.9%

While land values in the UNO are not typically as high on a per square foot basis as the downtown and Rainey markets, achievable rents are also significantly lower than downtown and Rainey.

CONCLUSION

Projects meeting on-site affordability requirements are financially feasible according to this analysis. An analysis of the current Rainey Street on-site affordability requirements yielded a typical reduction of half a percent on the IRR, a reduction that did not cause projects to dip below a target IRR of 11%.

Projects seeking to offset the costs of on-site affordability requirements could choose to adjust parking provisions, including reducing the number of parking spaces, charging for parking spaces, or using above-grade parking structures.

Other uses, such as hotel and office, would likely be considered as a result of market demand and not because of on-site affordability requirements for residential use. An office use does not appear to be well-suited to the area. A hotel use would be very profitable, much beyond that of a residential use, with or without affordability requirements. Given the amount of hotel construction in and around the Rainey Street district, there may no longer be as strong a market for this use – a market study would be needed to understand this possibility in further detail.

Higher affordability requirements in exchange for bonus provisions in other parts of Austin are being absorbed by the market for similar types of construction, despite lower revenues. The production of these affordable units would indicate that the Rainey Street requirements can also be absorbed by the market.

Given this analysis, staff does not recommend amendments to the on-site affordability requirements of the Rainey Street district in the Density Bonus Program at this time.

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Envision Tomorrow Modeling of Rainey Street Affordability Requirements in the Density Bonus Program											
Unit Mix	Downtown rates				Skyhouse rates			Millenium rates			Hotel
	5% sf, similar unit mix	5% units	no afford-able	5% sf, more studios	5% sf, similar unit mix	5% units	no afford-able	5% sf, similar unit mix	5% units	no afford-able	
Avg. size, sf	959	959	959	793	791	791	791	878	878	878	400
Avg. rent \$/sf	\$2.76	\$2.78	\$2.84	\$2.82	\$2.70	\$2.71	\$2.77	\$2.72	\$2.72	\$2.80	\$200/night
Studio	19.7%	15.8%	20.8%	38.0%	23.8%	18.8%	23.8%	0.0%	0.0%	0.0%	
1 bedroom	43.1%	45.4%	45.4%	42.8%	49.4%	49.4%	49.4%	79.9%	79.1%	84.1%	
2 Bedroom	29.8%	31.4%	31.4%	14.3%	21.3%	21.3%	21.3%	15.2%	16.0%	16.0%	
3 bedroom	2.3%	2.4%	2.4%	0.0%	5.6%	5.6%	5.6%	0.0%	0.0%	0.0%	
Affordable units	5.0%	5.0%	0.0%	5.0%	5.0%	5.0%	0.0%	5.0%	5.0%	0.0%	
Total affordable units	10	10	0	13	13	13	0	12	12	0	
Total units	217	217	217	262	263	263	263	237	237	237	423
Financial Performance											
IRR (unleveraged return)	12.4%	12.5%	12.9%	12.2%	11.5%	11.5%	11.9%	11.9%	11.9%	12.4%	44.9%
Cap Rate (yield to costs)	9.86%	9.93%	10.15%	9.78%	9.38%	9.41%	9.62%	9.60%	9.61%	9.88%	36.76%
Cash-on-cash (after year 3)	10.5%	10.7%	11.5%	10.2%	8.8%	8.9%	9.6%	9.6%	9.6%	10.5%	111.7%
IRR on Investor Equity (Leveraged Return before Tax)	20.5%	20.8%	21.6%	20.2%	18.6%	18.8%	19.6%	19.5%	19.5%	20.6%	109.0%
Debt Service Coverage Rate (year 3)	1.58	1.59	1.64	1.56	1.49	1.49	1.53	1.53	1.53	1.58	7.19
Predevelopment costs (due diligence, land carry, land entitlement, professional fees, raw land)	5,235,812	5,235,812	5,235,812	5,315,013	5,316,189	5,316,189	5,316,189	5,270,589	5,270,589	5,270,589	4,589,978
Building construction costs	52,301,838	52,301,838	52,301,838	53,885,869	53,909,374	53,909,374	53,909,374	52,997,376	52,997,376	52,997,376	39,385,155
Indirect costs (impact fees, building permits, insurance)	984,117	984,117	984,117	1,059,584	1,060,704	1,060,704	1,060,704	1,017,254	1,017,254	1,017,254	1,116,403

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