WEAVER BUILDINGS

TO: The City of Austin Design Commission

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FROM: Jen Weaver, AIA RID LEED AP MRED

RE: Density Bonus Fee Calibration Recommendation

DATE: July 19, 2021

EXECUTIVE SUMMARY

The City of Austin Land Development Code team engaged ECO Northwest to consult on the fee calibration of the Downtown Density Bonus program. The current program is widely implemented as a requirement to develop projects downtown, but problematic assumptions yield no new actual Affordable housing downtown and increased costs to developers, who must include these fees in their costs. This causes increase rents or sales to end users as developers must meet minimum yields to cover their costs of financing. We recommend slowing down the process, creating two-way conversation with developers delivering product in areas where the City would like to see Affordable housing and market-rate housing, and evaluating the ultimate goal: fees or missing middle housing delivery to the market (although they are not mutually exclusive solutions.)

Context: The City of Austin Land Development Code team engaged ECO Northwest, an independent consulting firm based in Oregon to advise on the fee calibration of the existing affordable housing density bonus program. The existing LDC-related affordable housing density bonus programs (areas) are the Downtown Density Bonus Program (including Rainey and the University Neighborhood Overlay.) The analysis was of in-lieu fees that capture a portion of the upside without discouraging developers from delivering product and is focused on calibrating in-lieu fees only. The stated exclusions are: recalibration of the affordable housing bonus incentives, or affordable housing performance requirements in the bonus areas which could change the target incomes or set aside requirements. This developer additionally notes that feedback from the developers responsible for financing these fees was not assessed. Critical feedback from two-way communication could include: 1) the challenges in the developer's business model to cover fees and projected increases in fees, 2) effects on land acquisition 3) challenges in implementing on-site affordability 4) hurdles for market-rate (rather than luxury) housing.

Problems in Assessing Success: The City of Austin Land Development Code department cites the current program as a success noting that many developers participate in the program. Currently, the City of Austin requires more fees up front, encouraging developers to develop luxury product with a higher margin of safety to covers fees and the cost to finance fees a successful project. In short, increasing costs by various fees causes the developer to charge higher rent or sell at a higher cost / sf to cover the minimum required Debt Service Coverage Ratio (DSCR.) The Affordable Housing fund is only one of four large fees the developer encounters in the entitlement process. Without the entitlement, the developer cannot close their financing rounds – so its another required project cost, essentially, just like brokers fees etc. to move forward. **Is a more accurate measure of success market-rate units that can be delivered, or fees paid on luxury units to the Affordable housing fund, skipping the missing middle?**

Problematic Methodology & Assumptions:

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- Non-disclosure State & Residual Land Value (RLV): The methodology assumes inputs into a proforma by the economists driving the study, and after they completed their analysis they reported to compare their findings to CoStar. Texas is a non-disclosure state, and CoStar often reports incorrect prices and ownership. As well, this would exclude land contributed as equity, which is also a common real estate practice. As a developer, I can report none of CoStar's reports on my projects are correct, and they even report me to own properties I have never touched. Developers will not disclose costs due to potential exposure to litigation for mismanagement. This is not likely an accurate costs basis analysis.
- Parking: In the recommendations from EcoNorthwest, they note that residential fees could be higher if parking maximums in the draft code are adjusted. They then note that according to condominium sales, one and a half stalls per unit are reported, which is higher than the proposed maximum in the draft code of one stall per unit. Left to their own devices, developers will prefer more parking because it is cheaper financing and the space also creates potential cash flow during operations. In practice, only 60% of parking spaces are utilized at some residential buildings downtown that I specifically have data from a large brokerage. If policy wants to incentivize housing and livability over cars in a now urbanized city – this is a great source of potential funds for housing, especially now that one multifamily has in 2021, eight years after policy allowed no parking for DMU, successfully financed a project.

Density Bonus Program Problems in Practice: To receive credit for on-site Affordable Housing, the design requirements and underwriting most comply with those set forth by the US Department of Housing and Urban Development. To be competitive in an urban environment for anything less than luxury product, developers are having to be more innovative than ever to hit market-rate consumers. This may mean stacking washers & dryers (prohibited by HUD,) having roommates (only allowed in NYC by HUD for household calculations,) or having an urban-scaled room like a 9' x 10' (10' x 10' is the HUD minimum.)

- On-site For-Sale: In on-site for sale housing, HOA fees are reduced for on-site affordable units, which could be problematic for HOA democracy and fair treatment within the building. While it would be illegal to not offer unequal treatment, HOAs are operated by a board untrained in Fair Housing or any type of professional real estate training, and it is not uncommon to have allegations and lawsuits for specific enforcement (discrimination based on unequal treatment against an party not of a protected class.) As well, an increased value on the exit for an individual unit holder is capped at 2%: this creates a negative investment for the participant in the Affordable Housing program and does not help the owner escape s cycles of poverty. It challenging to fit all the factors that go into the value of real estate into a simple escalation clause.
- On-site Rentals: For Affordable housing, on-site rentals require a property manager who is HUD certified for appropriate income qualification reporting and compliance, tax credit compliance, or the entire tax credit benefit would be unwound. Many market-rate property managers won't touch Affordable housing reporting – it's a specialty property management. Pending on code requirements for the on-site management – best efforts could be required or mixed-income rent restrictions – but it's certainly a challenge for market-rate developer to incorporate. And in the UNO district developed for dormitory housing, it leads only to fee-in-lieu participation.
- Fee in Lieu: The fee in lieu program is under scrutiny due to the great amount of funds collected and lack of transparency about how the dollars are used. The program is generally understood to pay for housing vouchers for existing affordable housing programs. Effectively, developers providing housing are subsidizing the debt service of other developers who are participating in the affordable housing program and already receive discounted financial mechanisms, property tax discounts, and potentially grants. This also increases the

cost, aka hurdles, for developers to bring market-rate residential product to market by reducing their safety margin. Instead, we see more luxury product downtown to provide a financeable development. We do not see Affordable housing product delivered downtown.

- <u>All future developments will be full blocks only.</u> In the all areas of the downtown density bonus program utilize the Tiered Downtown Density Bonus program are utilized, many projects developed would be the full block, only. Landowners are incented to hold out for the highest and best offer, which would only be developers pursuing full-block projects, which are the minimum financing size for the cheapest financing available (mutual funds, etc.) The missing middle exists in financing too – between the friends and family raise, private family office and institutional debt and equity. Ultimately, this reduces urban infill developments in a market in which only large-scale developers are able to compete.

<u>Case Study Example:</u> Based on the last draft of the density bonus fee schedule, my high-density workforce housing, which offers rents at 80% AMI, would be charge nearly the same amount as a low-density luxury building 4x its height. This is due to the FAR adopted for each respective property, and the assumed fees to reach the highest and best use.

- Fifth & West, a 39-story luxury condo building, participated in the affordable housing density bonus program. Fifth & West (SP-2013-0454C for reference) **paid $499,860 into the affordable housing fund** (and also did not follow any recommendations from Design Committee.) The product is the second home for many residents and most of the residential floors only have 4 units per floor for a total of 162 units.
- Shoal Cycle, a workforce housing project I am developing is in the Northwest District, a downtown neighborhood that is on their third draft of the Northwest Ordinance which would allow affordable housing density bonus but it has not yet been adopted. The neighborhood initially said that they would support my project for DMU-60 + density bonus to achieve a height of 90'. This obviously was not able to move forward as proposed because the Northwest Ordinance has not been adopted, but the fee impact to my project would be $10 / sf over the 60' the neighborhood agreed to zone, which would be **$354,375 into the affordable housing fund** + financing to cover the fees, so let's say $500k to cover this up-front cost. This fee and associated financing cost for the fee would be the equivalent almost 2% of my hard cost – this is why people modify their product to luxury instead of market-rate affordable.

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