

On September 1st MPT Alter forwarded staff an email from Brian Rodgers regarding the market value of the Statesman property. The numbers from Mr. Rodgers' email are below.

MPT Alter asked staff to please explain the difference between the EPS approach and what Mr. Rodgers calculated below? Please also provide any relevant critiques of Mr. Rodgers' calculations. And can someone please explain how EPS incorporates anticipated income / rent streams into its shortfall calculation?

Staff asked Darin Smith from EPS to provide a response and it is also provided below.

The numbers from Mr. Rodgers' email:

Cost \$1,875,800,000 THIS IS NOT THE MARKET VALUE. THIS IS COST TO BUILD.
Size 3,510,000 square feet
Cost \$534/square foot

Value Estimated by Brian Rodgers using Heimsath and market rents plus 40 years of commercial real estate darn good sense:

Office: 1,495,000 square feet x \$66 annual NNN rents = \$98,670,000 net rent / 6% capitalization rate = \$1,644,500,000

Retail: 150,000 sf x \$100 annual rents = \$15,000,000 net rent / 6% capitalization rate = \$250,000,000

Condos: 1,645,000 square feet x \$1,000/sf = \$1,645,000,000

Hotel: 220,000 sf x \$669/sf (used same sf price as Hotel Van Zandt which sold for \$246 million) = \$147,180,000

Total Value = \$3,686,680,000

Minus Cost = \$1,875,800,000

Profit = \$1,810,880,000

Darin Smith's Response:

EPS strongly disagrees with the assertion that we are "pretending that construction cost equals the value of the development." We clearly note the difference between costs and values in our memorandum and presentation material from the 7/26/22 Council discussion, citing the extent to which "value-side metrics" vs. "cost-side metrics" have escalated in recent years, and comparing the estimated project value to the estimated project cost to assess project feasibility. We note that ECONorthwest, the previous consultants who evaluated the SCW Vision Plan and Statesman development feasibility, made similar and consistent distinctions.

We do agree that the general approach suggested by Mr. Rodgers below is reasonable, and is in fact consistent with the approach that ECONorthwest and subsequently EPS are using to estimate the value of the proposed development. For "income properties," meaning those that rent their space (like apartments, retail, office, and hotels), the calculations estimate the value of the buildings based on the income that the building can generate through annual operations, less the cost of those operations, to generate a Net Operating Income that is then divided by a market-driven capitalization rate to estimate

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the price that an informed buyer would be willing to pay for that building, assuming it can be expected to perform in a similar way in the future. For condominiums, the value is simply the prices at which the units can be sold to future homebuyers.

However, we do not agree with all of the assumptions used by Mr. Rodgers in applying this methodology. Some specific differences I can quickly note between Mr. Rodgers's calculations and those of the City's consultants include:

1. Mr. Rodgers cites the same \$1.87B cost figure that ECONorthwest derived in 2019 as if it were still the correct cost estimate. Applying cost escalators since that time, EPS estimates the 2022 cost figure would range from \$2.39-2.55B today, as noted in our memorandum and previous presentation.
2. Mr. Rodgers applies the rent and value figures to the entire (gross) building square footage, while the rents and corresponding values are only applicable to the net leasable square footage. For the residential buildings, the ratio of net to gross square footage is typically around 80%, meaning that the value of those buildings would be reduced by 20% from Mr. Rodgers' estimates, all else being equal. Office and mixed-use retail space is typically about 94-95% net-to-gross, so these would have some downward value adjustments as well.
3. Mr. Rodgers also does not overtly account for deductions to gross operating revenues, such as operating expenses and vacancy losses. Even in strong markets like Austin, some proportion of buildings tends to be unleased at any given time, which reduces the building's income compared to its maximum potential income. Likewise, even for properties leased on a "triple-net" basis (in which tenants pay the lease rate PLUS a pro rata share of insurance, maintenance, and taxes), as suggested by Mr. Rodgers below, the building owners have some level of expenditure that is not directly paid by tenants. Adjusting for these revenue reductions and expenditures would reduce the buildings' estimated values.
4. Mr. Rodgers further assumes that all of the residential development is "condos," when in fact over 80% of the residential program is rental apartments. Accordingly, ECONorthwest and by implication EPS used a similar income valuation approach for the apartments as suggested by Mr. Rodgers for the other income properties (capitalized value of net operating revenue), which results in a lower value per square foot for the apartments than for the condos. As a result, Mr. Rodgers' value estimates for the overall residential program is likely overstated, even on a per leasable square foot basis. While we concur that \$1,000/SF for for-sale condos is reflective of market conditions, we believe it overstates the value of apartments. To achieve capitalized values at \$1,000/SF as suggested by Mr. Rodgers, apartments would have to rent for over \$6.00 per square foot on average, after accounting for operating costs and standard vacancy losses. Currently, the average market-rate rent for Downtown Austin high-rise apartments constructed since 2020 is \$4.12/SF, according to CoStar.
5. The rents assumed by Mr. Rodgers for the office and retail components are aggressive. He assumes that retail will achieve \$100/SF rents, which is roughly 3X the 2022 YTD asking rents achieved for Downtown Austin retail properties according to CoStar. Similarly, he assumes office rents are \$66/SF, nearly 50% higher than \$46/SF average rents being achieved by the newest Downtown Class A office buildings (those constructed since 2017) according to CoStar. The ECONorthwest figures, inflated by EPS based on market changes since 2019, are

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more similar to the Downtown averages for comparable recent buildings than they are to Mr. Rogers' rent assumptions.

6. While his rent and value numbers are understandably broad, it is not clear that Mr. Rodgers accounts for any affordable housing or affordable commercial space in his calculations. These affordable spaces, offered at something less than market-rate rents, derive less value per square foot than similar spaces offered at market rates. The ECONorthwest modeling and, by extension, EPS updates do account for the proportion of space offered at below market rents.

The result of these adjustments to inputs and assumptions – inflating the outdated cost estimates; reducing leasable and saleable square footage; adjusting for vacancies and operating expenses; adjusting for rental apartments rather than condos; reflecting less aggressive market rent assumptions; and incorporating affordability impacts – would produce a different mathematical result than Mr. Rodgers's calculations below, even using the same methodological approach, which again we agree is appropriate.