Resolution 20230720-132
Next Steps for 1215 Red River & 606 East 12th Streets

Housing & Planning Committee
September 6, 2023

Agenda

- Status Update
- Community Engagement Highlights
- Market Overview by Economic & Planning Systems
- Capital Market Overview by JLL
- Staff Recommendations
- Discussion

Status Update

- September 14, 2023 Council Meeting: Council authorizing contract for site demolition to expedite redevelopment options and eliminate the annual maintenance cost of the unusable facility.
  - Demo commences in January 2024
- Council Direction in Resolution 20230720-132
  - Retain City ownership (lease property)
  - Redevelop as mixed-use, mixed-income project serving residents at or below 60% MFI
  - Provide affordable housing scenarios on site and within Palm District Plan
  - Explore AHFC and AEDC as lead negotiators
  - Provide comprehensive report on market feasibility of site redevelopment and recommend next steps

Community Engagement August 2023

- ✓ Palm District Plan Stakeholder Reports
  Review findings and recommendations

- ✓ August 4-31 Speak Up Austin survey 416 participants provided 484 comments

- ✓ August 9 Downtown Austin Neighborhood Association Board meeting

- ✓ August 22 Neighborhood Roundtable
  – Austin Economic Development Corporation
  – Central Health
  – Downtown Austin Alliance
  – Innovation District Steering Committee
  – Red River Cultural District
  – The University of Texas
  – Travis County Sobering Center
  – Waller Creek Local Government Corporation
  – Waterloo Greenway

Speak Up Austin – Remarkable Response

Project Engagement

VIEWS	PARTICIPANTS	RESPONSES	COMMENTS	SUBSCRIBERS
2,059	416	2,612	484	1

What three community uses would you be excited to see on this site?

75%	Affordable housing	298 ✓
51%	Local retail/restaurants	201 ✓
38%	Cultural/entertainment spaces	151 ✓
35%	Plaza/open space	140 ✓
16%	Other	62 ✓

396 Respondents

Council wants this site to create more affordable housing downtown. Who would you like it to serve?

72%	Hospitality, healthcare, and service industry workers	276 ✓
56%	Teachers	215 ✓
46%	Families	179 ✓
36%	Older adults	138 ✓
26%	Single adults	100 ✓
18%	Students	71 ✓
12%	Other	47 ✓

385 Respondents

Community Engagement Highlights

Affordable Housing

- Serve broader range of incomes (50-80% MFI)
- Target downtown workers with focus on hospitality, healthcare, service industries, and education
- 1-2 bedroom apartments, not condos
- Mixed results on serving families

Other Priorities

- Local retail/restaurants for residents & area workers
- Cultural spaces and community rooms
- Open spaces that complement Waterloo Park
- Public parking to serve residents & visitors enjoying Waterloo Greenway and attending Red River Cultural District events

Market Context and Indicators, EPS

Darin Smith, Principal
Economic & Planning Systems, Inc.

DEVELOPMENT PROJECTS FACING FEASIBILITY CHALLENGES

SINCE 2019, DEVELOPMENT COSTS HAVE RISEN FASTER THAN VALUES

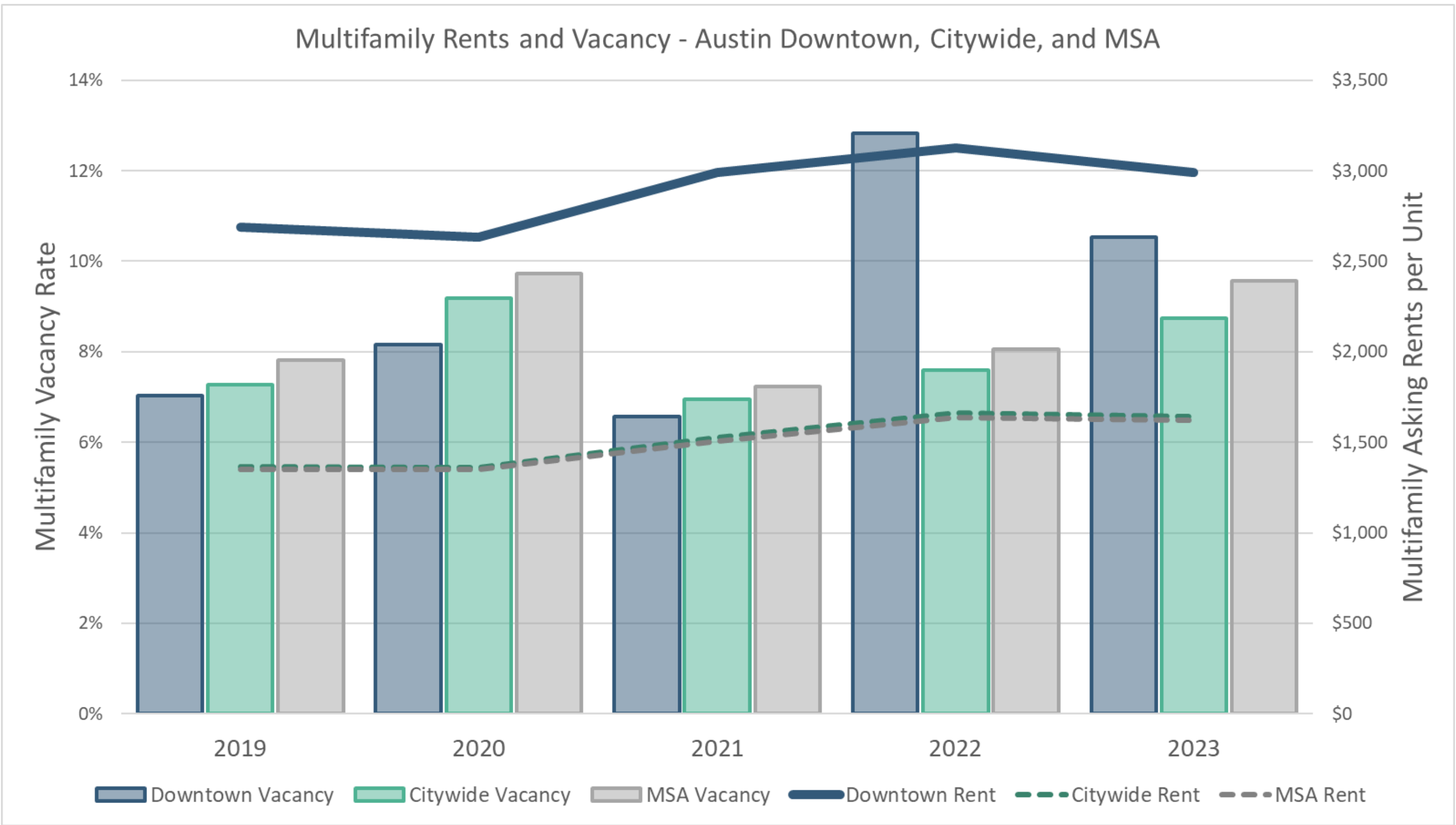
Description	2019	2023 YTD	'19 - '23 % Chg.	
Cost Indices				
Construction Cost Index (CCI)	11281	13425	**19%**	Cost Increases
Building Cost Index (BCI)	6136	8180	**33%**	
30-Yr. Fixed Rate Mortgage Avg.	3.9%	6.5%	**65%**	
Value Indices				
Downtown Austin Office Rents (per SF)	$37.40	$39.07	**4%**	Value Increases
Downtown Austin Multifamily Rents (per DU)	$2,692	$2,969	**10%**	

Source: ENR; Federal Reserve Economic Data; CoStar Group; Economic & Planning Systems

Residential

Downtown Austin residential rents have grown since 2019 but more slowly than in the broader region.

Downtown Vacancy peaked in 2022 due to an increase in supply but is returning to pre-pandemic levels.



Source: CoStar Group, EPS

Residential

MULTIFAMILY MARKET HAS GROWN QUICKLY, BUT DOWNTOWN RENTS HAVE EXHIBITED SLOWER GROWTH THAN RENTS CITYWIDE

Q4 2019 TO TODAY:

DOWNTOWN APARTMENT MARKET HAS SEEN:

30+% supply increase

Vacancy up from 9.5% to 9.8%

Rents up ~10%

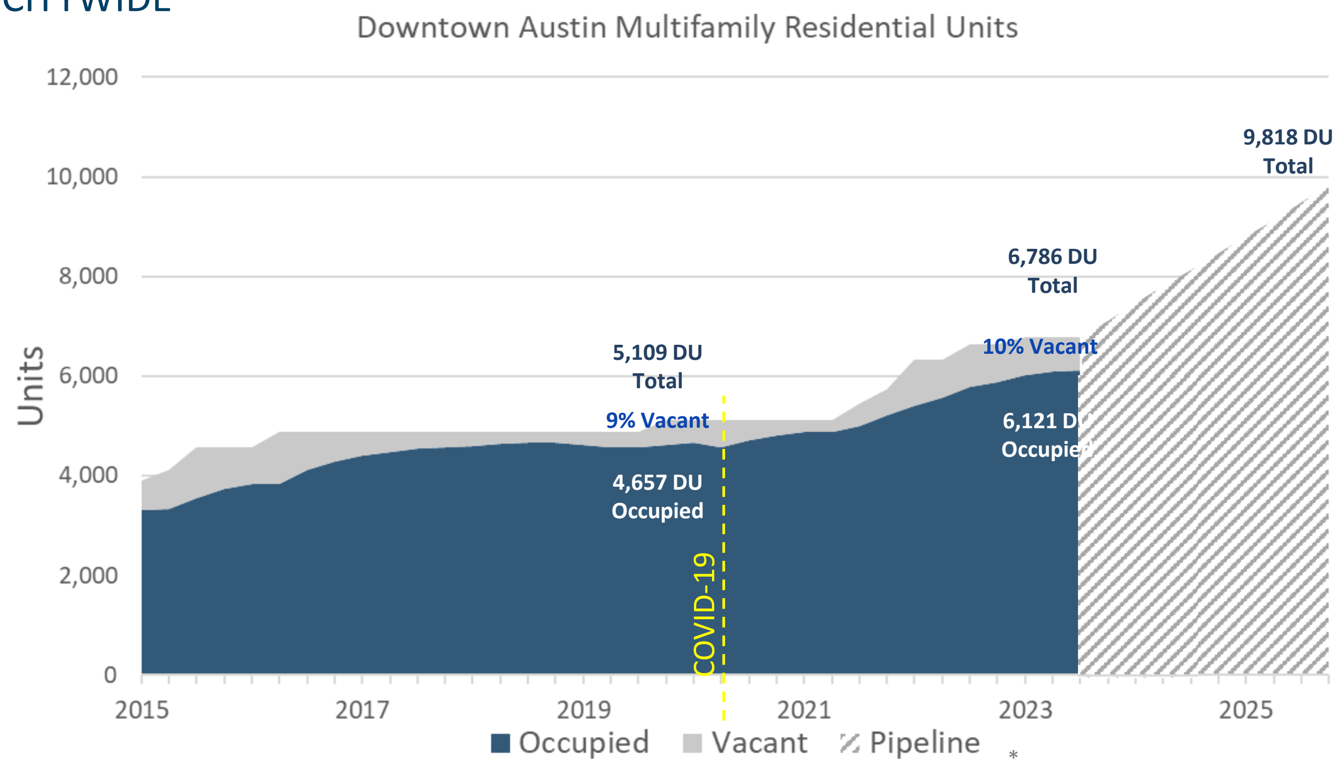
CITYWIDE APARTMENTS:

15% supply increase

Vacancy up from 8% to 9%

Rents up 19%

CONTRAST SUGGESTS DOWNTOWN MARKET PRICING IS LAGGING DUE TO ABSORPTION DEMANDS

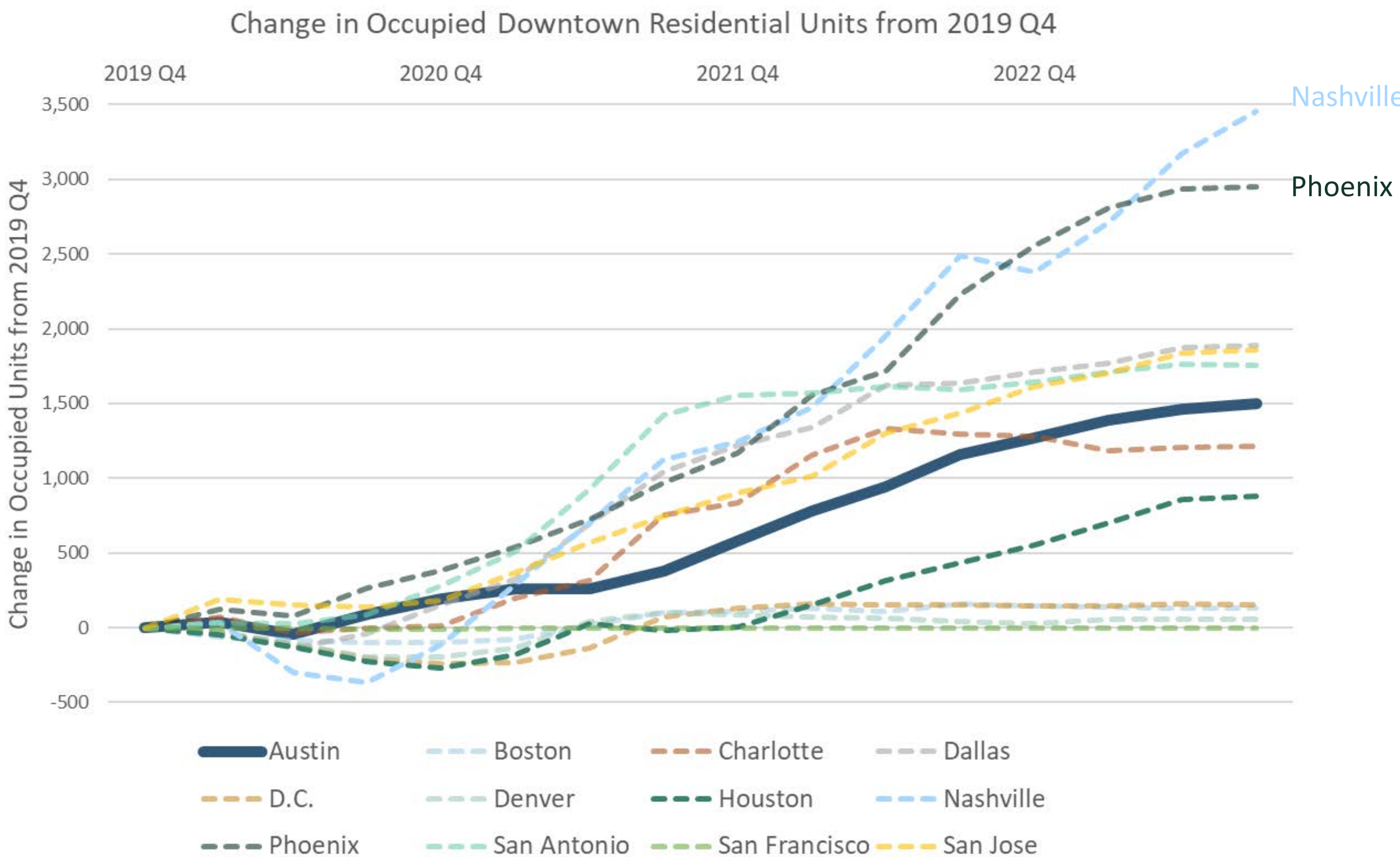


*Pipeline includes all 3,032 multifamily units under construction downtown, assuming full buildout by Q4 2025 with a linear rate of delivery.

Source: CoStar Group; Downtown Austin Alliance

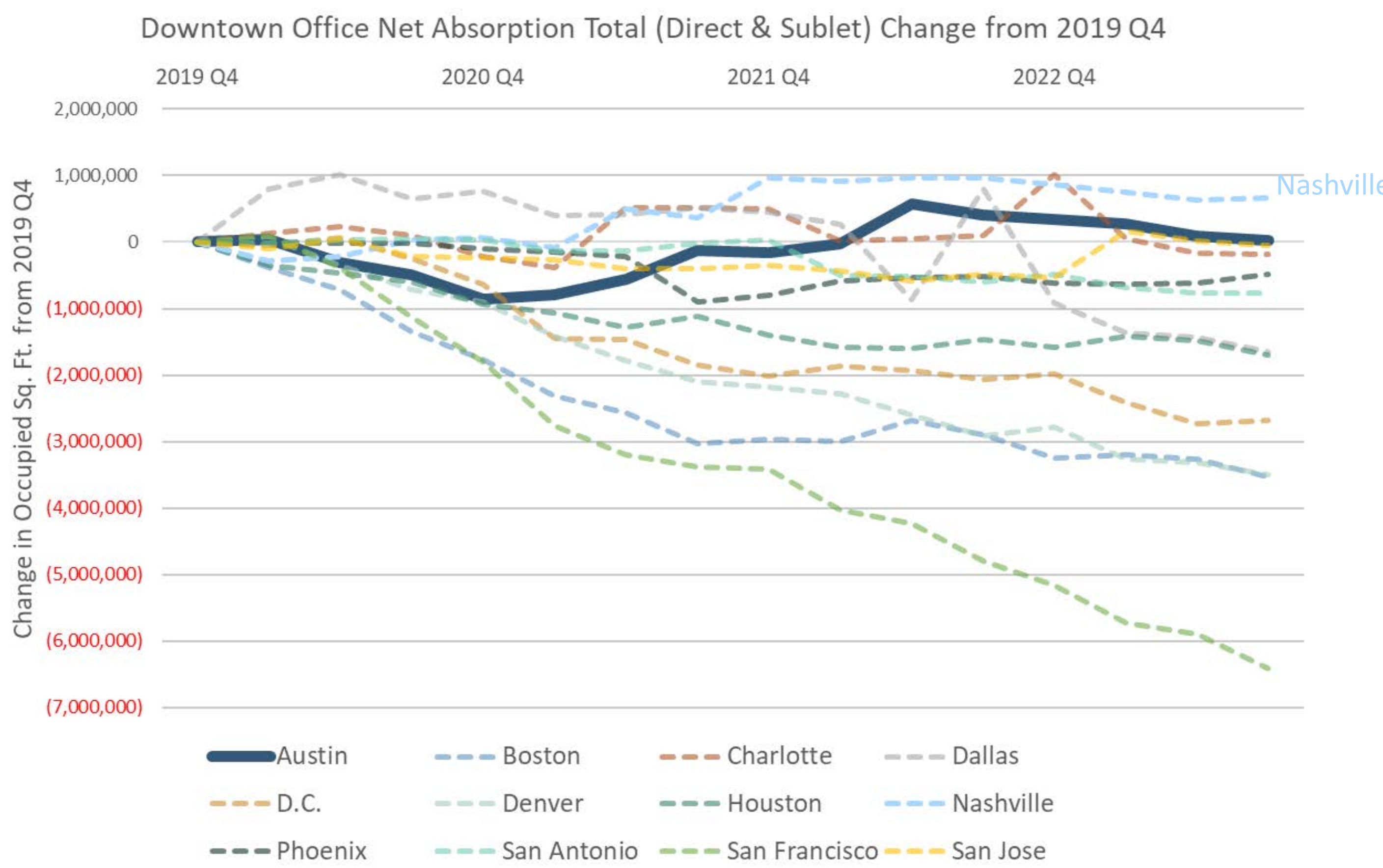
Residential

Downtown Austin has added almost 1,700 units since the end of 2019, placing it in the middle of the pack compared to other downtowns studied



Source: CoStar Group, EPS

Downtown Austin Office Occupancy has remained remarkably stable post-pandemic compared to many Major U.S. Cities

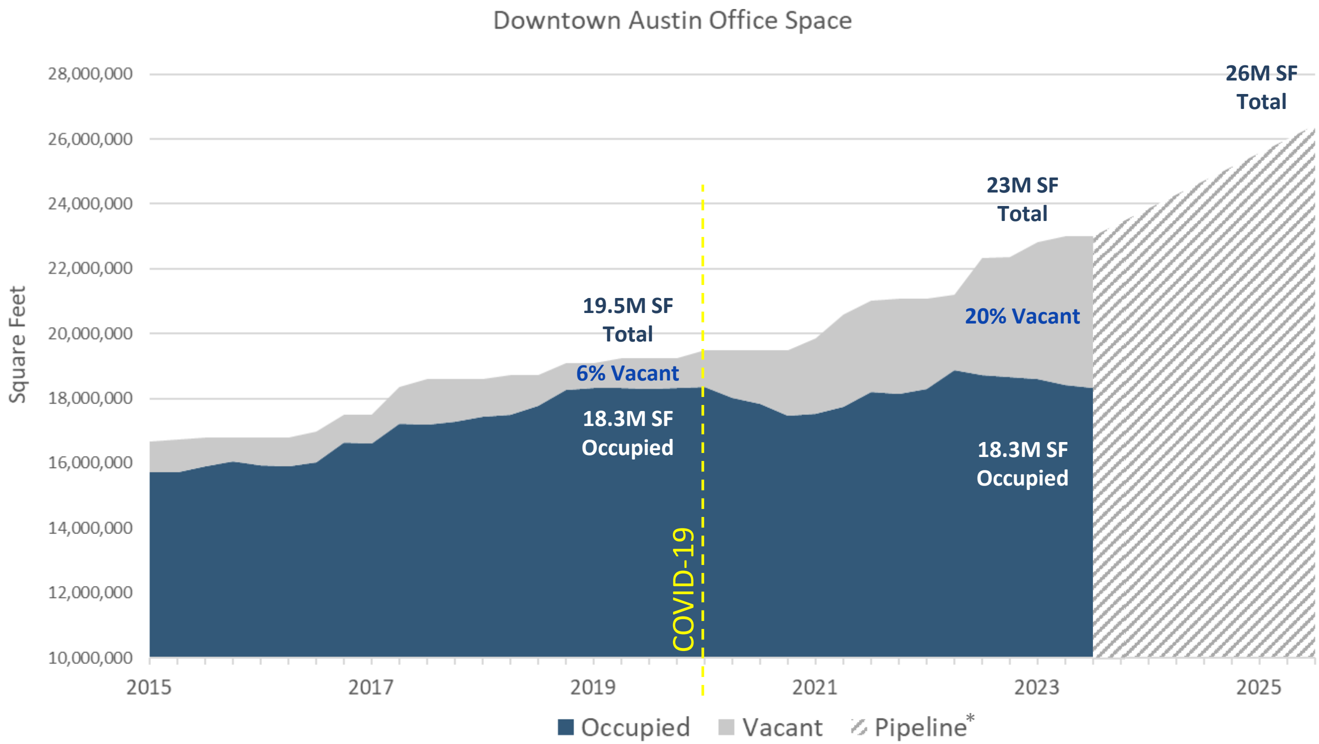


Source: CoStar Group, EPS

HIGH OFFICE VACANCY RATES ARE LARGELY DUE TO INCREASE IN SUPPLY - TOTAL OCCUPIED DOWNTOWN OFFICE SQ. FT. IS ACTUALLY SAME AS 2019

DOWNTOWN HAS RECEIVED 3.4M SF IN NEW DELIVERIES SINCE 2020

ANOTHER ~3M SF IS CURRENTLY UNDER CONSTRUCTION IN DOWNTOWN



*Pipeline includes all 3.4M SF of office under construction downtown, assuming full buildout by Q4 2025 with a linear rate of delivery.

Source: CoStar Group; Downtown Austin Alliance

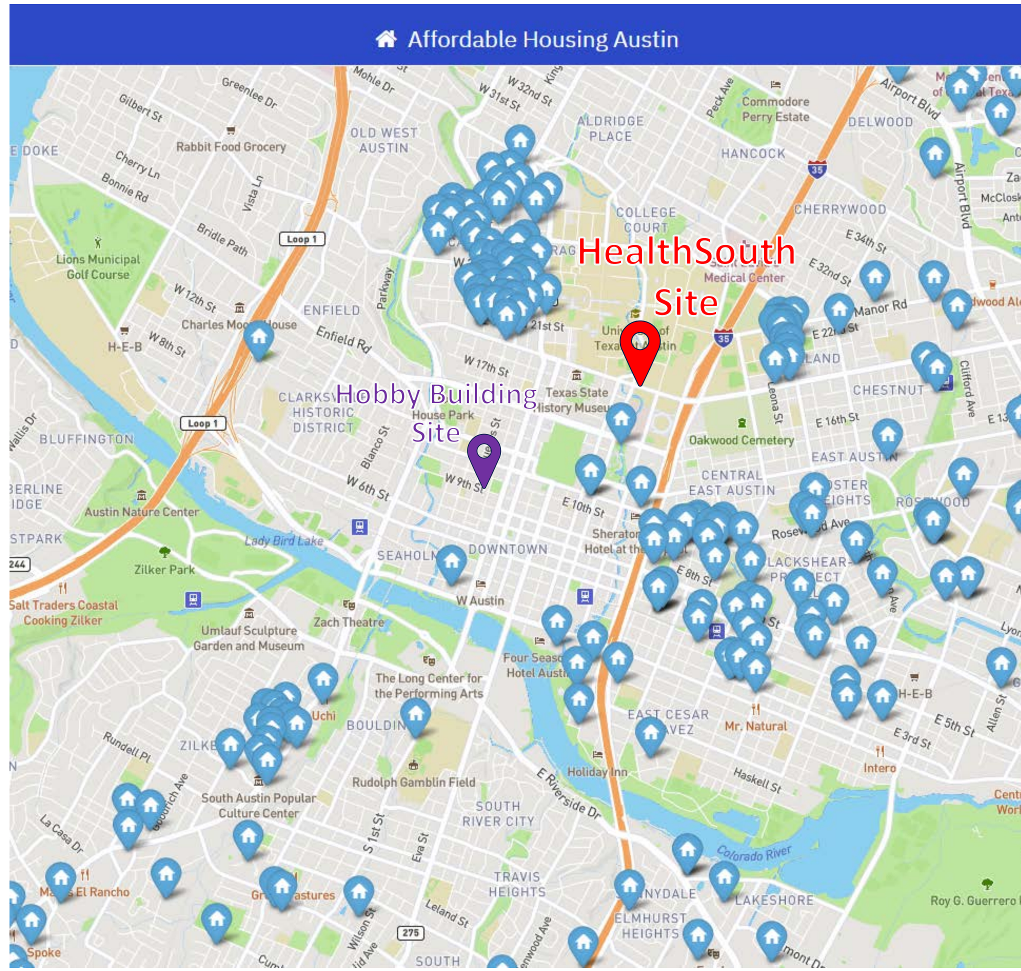
AFFORDABLE HOUSING

RELATIVELY FEW AFFORDABLE HOUSING OPTIONS DOWNTOWN

MOST DOWNTOWN PROPERTIES SHOWN FEATURE AFFORDABLE UNITS IN DENSITY BONUS PROJECTS

PUBLIC EMPLOYERS CONTACTED INDICATE MANY OF THEIR WORKERS QUALIFY AS LOW AND VERY-LOW INCOME

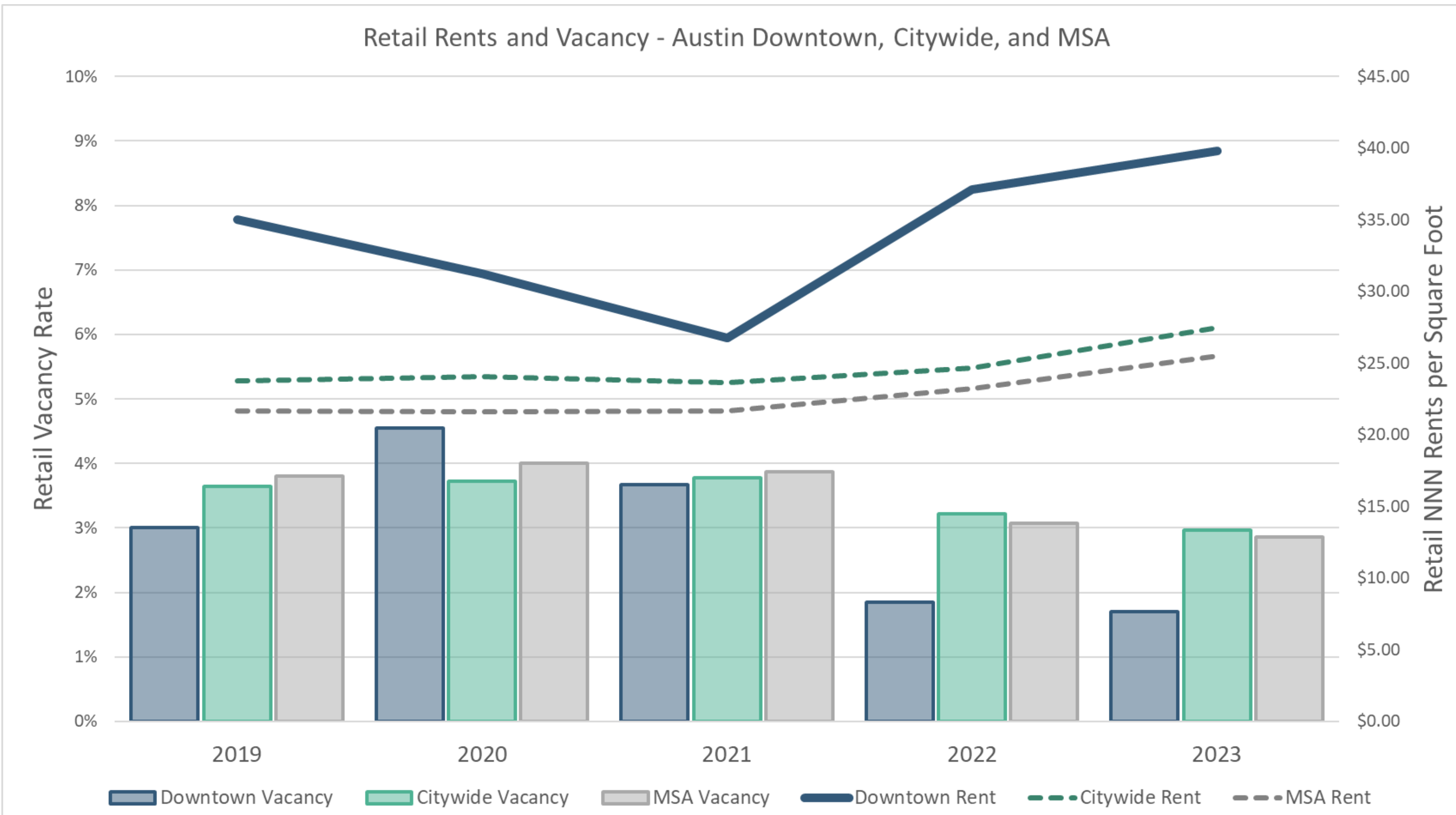
STATE AND CITY ANNOUNCED INTEREST IN REDEVELOPING HOBBY BUILDING AS HIGH-DENSITY, MIXED-USE FEATURING AFFORDABLE HOUSING, BUT TARGETS AND TIMING TBD



Source: [Affordable Housing Austin (atxaffordablehousing.net)](atxaffordablehousing.net)

Retail

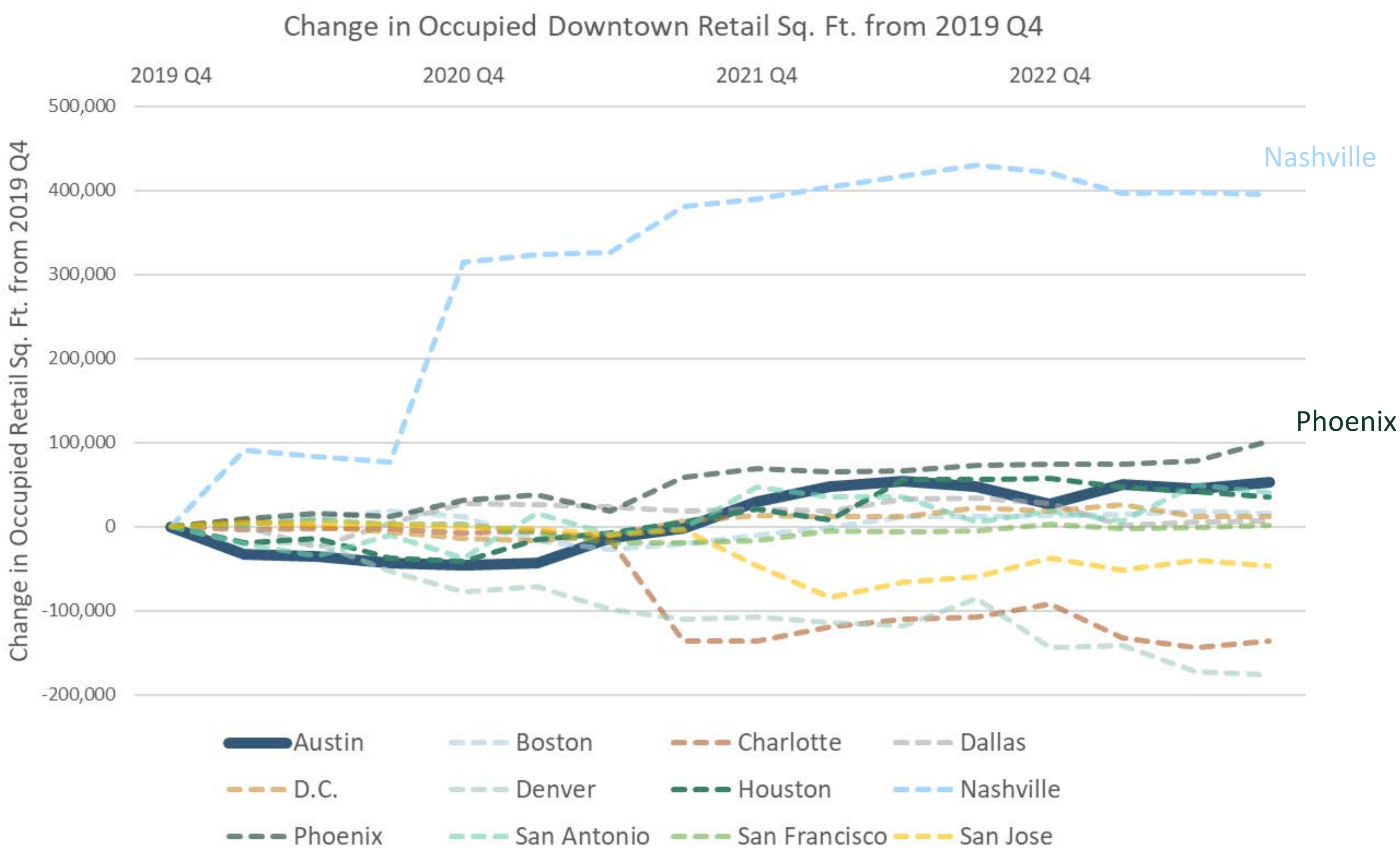
Downtown Austin Retail rents have grown since 2019 but more slowly than in the broader region, even though downtown Vacancy is very low



Source: CoStar Group, EPS

Retail

After a slight dip in the early pandemic, Austin's Downtown retail Occupancy has recovered and improved, outperforming 9 of the 12 downtowns studied



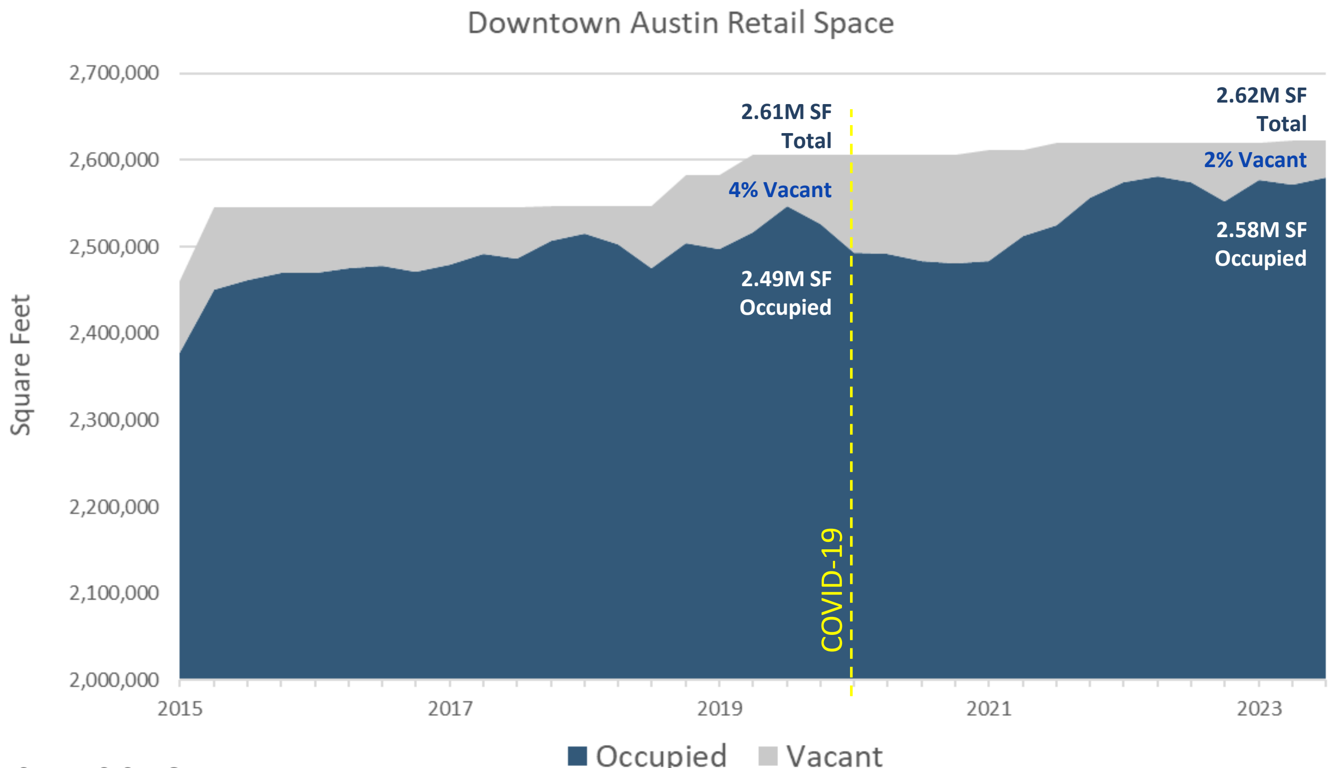
Source: CoStar Group, EPS

Retail

A LACK OF SIGNIFICANT NEW RETAIL DELIVERIES IN DOWNTOWN AUSTIN SINCE 2019 HAS LED TO VERY TIGHT VACANCIES, SIGNALING DEMAND FOR MORE SPACE

DOWNTOWN RETAIL MARKET HAS SEEN VERY LITTLE SUPPLY INCREASE

VACANCY RATES HAVE DECREASED AT A FASTER RATE DOWNTOWN THAN CITYWIDE OR IN THE BROADER MSA, SUGGESTING DESIRE FOR RETAILERS TO LOCATE DOWNTOWN



Source: CoStar Group

SUMMARY OF FINDINGS

- Mid- and long-term, Downtown Austin is a very attractive market for development
- Near-term projects face challenges from recent development cost inflation and stiff recent and planned competition
- Affordable Housing is in high demand regionally and particularly scarce downtown, where many low-income employees work

Overview of Capital Markets, JLL

Jeff Coddington, Managing Director
JLL Capital Markets

Steve Garven, Senior Director
Public Institutions & Higher Education

2023 Economy

A mixed picture

There are signs inflation has peaked. While consumer spending has remained resilient, demand-side pressures on inflation continue to ease in 2023. Wage growth is slowing, outsized fiscal stimulus from the last couple of years continues to fade, and excess savings are burning off relatively quickly under the weight of higher prices and a desire to spend.

No Fed rate cuts expected until 2024. With inflation running at four-decade highs, the Fed took bold steps in 2022 and YTD 2023 to tamp down inflation. Recent remarks from the Fed continue to tamper investor confidence.

Government policy tightening. Government spending is expected to become more contentious and challenging. Practically, this means for the first time in decades the US economy should head into a period of slowing without fiscal stimulus to help soften the blow.

A tight labor market represents positives and negatives. Wages grew by around 5% on a year-over-year basis for most of 2022. Coupled with such strong job gains, this helped enable consumers to continue spending, supporting inflation to an extent. A healthy labor market should enable the economy to weather the slowdown

Economic growth slow in 2023 but looking less like a recession. Real gross domestic product (GDP) increased at an annual rate of 2.4% in the second quarter of 2023, according to the "advance" estimate. In the first quarter, real GDP increased 2.0%.

Current state of the capital markets

01

Government debt rating downgrade and U.S. Treasury's heightened quarterly borrowing estimate **causing noise in bond markets**; 10-yr UST again elevated and more volatile

02

Debt markets generally liquid across lender categories albeit at elevated cost of capital; local/regional banks one spot of relative weakness

03

More investors banking on 'higher for longer'; underwriting deals assuming 10-yr UST settles at 3.0% to 3.5% in medium term

04

Distress: Delinquencies accelerating; give-backs to lenders increasing in office sector; and selectively, in hotel sector

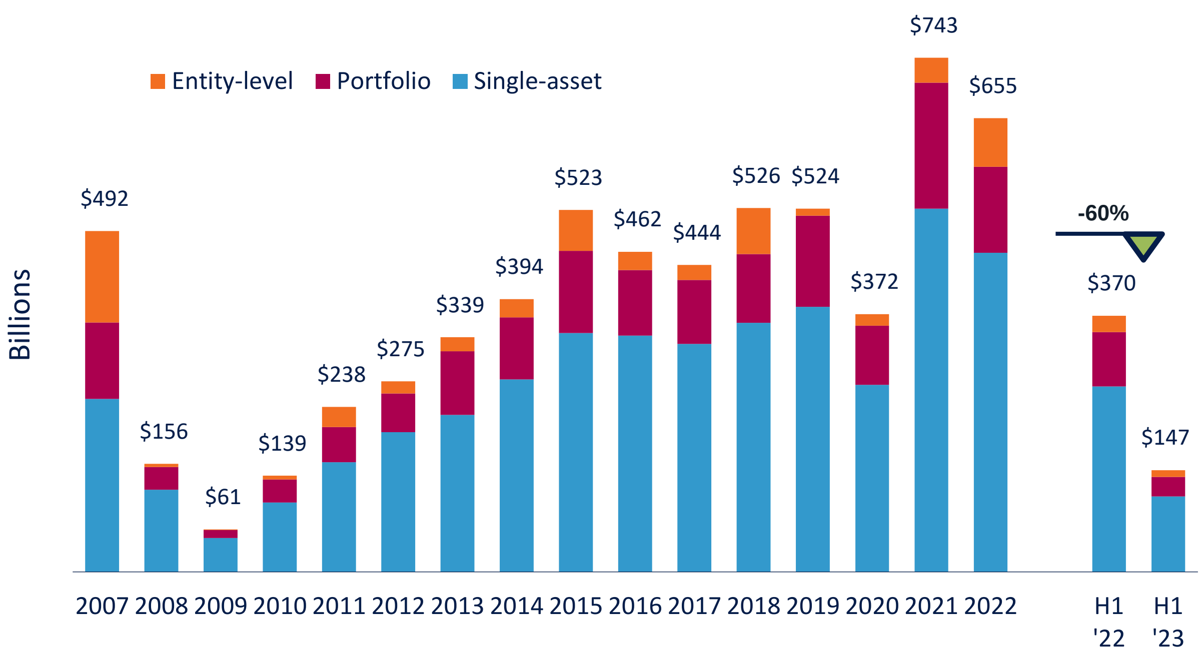
05

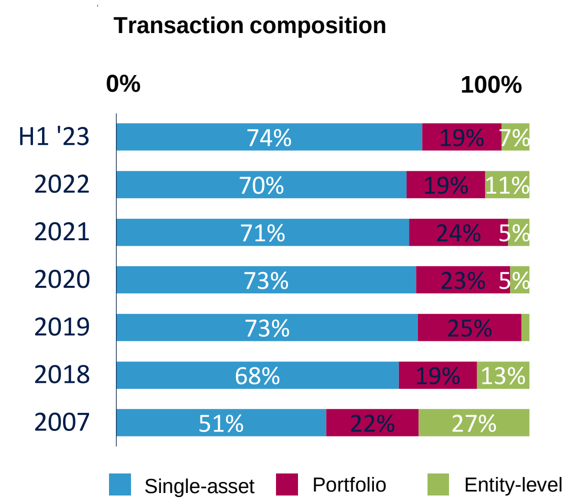
CRE debt is not deemed to be a systemic risk for U.S. banks: CRE loans represent 23% of banks' overall loan portfolios, in other words, not an outsized share

06

Dry powder at record levels but denominator effect still limiting inflows into CRE; fundraising continues to be challenged

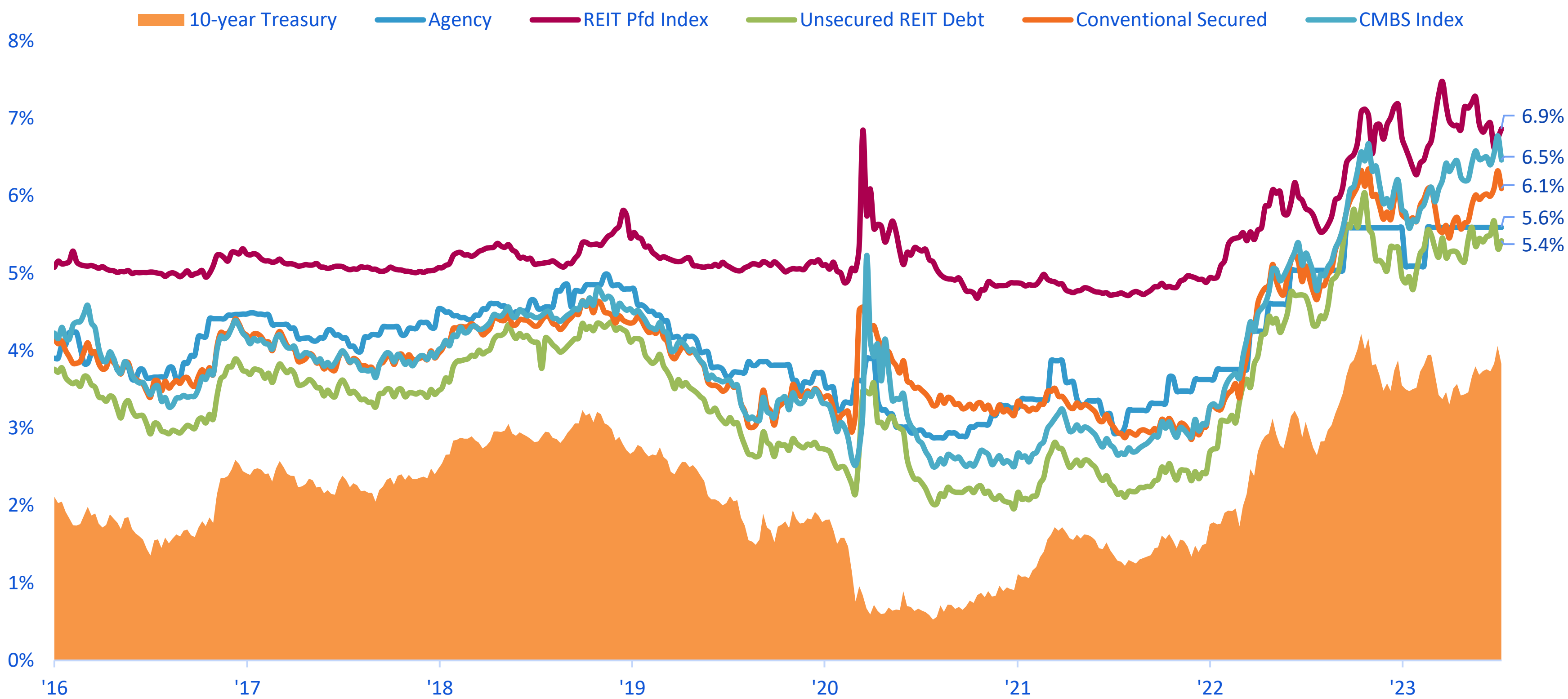
Transactions volume is down precipitously but y-o-y comps will start looking more favorable in third quarter





Source: JLL Research, Real Capital Analytics (transactions over $5 million, includes entity-level transactions), includes: office, industrial, multi-housing, retail, hotels and seniors housing. Includes recaps; excludes refinances

Commercial real estate debt costs continue to be volatile



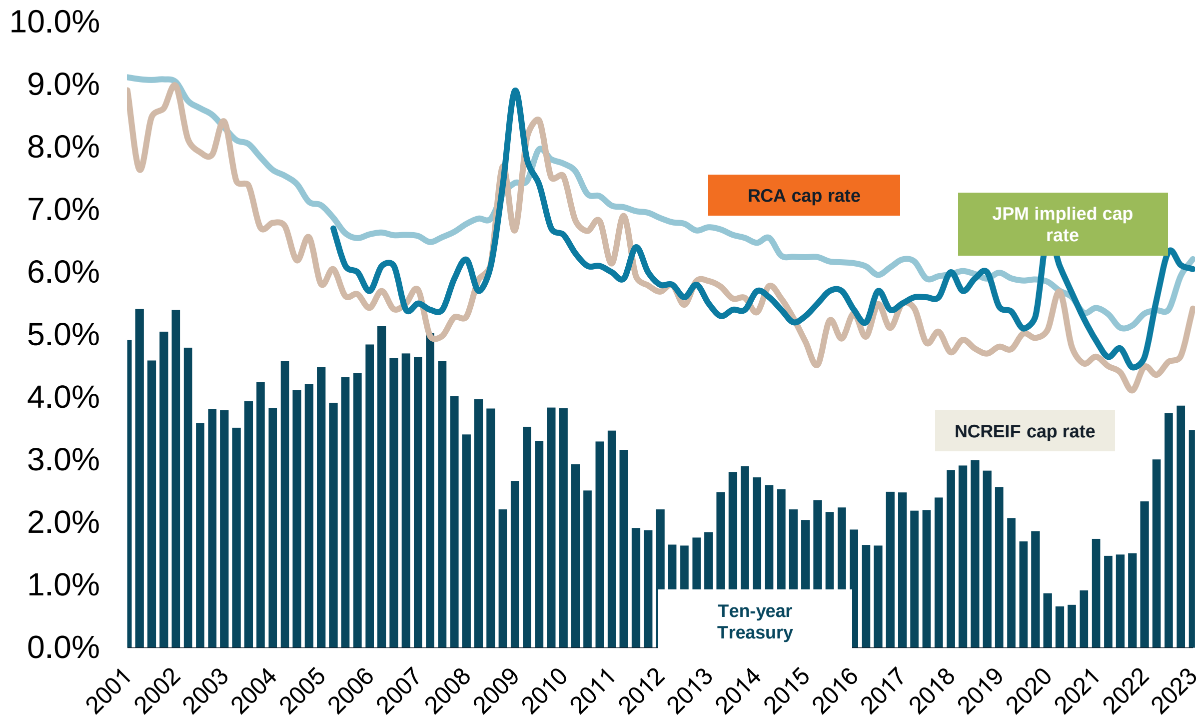
Source: JLL Research, Green Street (as of 07.21.23) Representative of 10-year money

Higher interest rate environment challenging

	Index			+	Spreads		=	Borrowing rates	
	Term SOFR (1M)	5-Year treasury	10-Year treasury		A / BBB corp average	Real estate (10-Year)*		10-Year	
Current	5.32%	4.30%	4.12%	+	140 bps	150-200 bps	=	5.36%-6.12%	⟵ Elevated over mid-May levels
3/15 – 5/15 2023	4.88%	3.53%	3.45%		145 bps	150-200 bps		4.95%-5.45%	⟵ Steady state?
Nov 2021	0.04%	1.14%	1.53%		94 bps	100-140 bps		2.53%-2.93%	⟵ Anomaly
2018 average	2.06% *(30D LIBOR)*	2.75%	2.91%		123 bps	120-150 bps		4.11%-4.41%	⟵ Benchmark?

*Assumes core/core plus assets with low to moderate leverage.
Source: Bloomberg Finance L.P. (Current is as of August 3, 2023)

Capitalization rate spreads



In 2018:
- Four interest rate increases during the year
- Treasury averages 2.9%
- Total return driven by income

In 2019:
- Three interest rate cuts during the year
- Treasury averages 2.1%
- Total return driven by income (but slows overall)

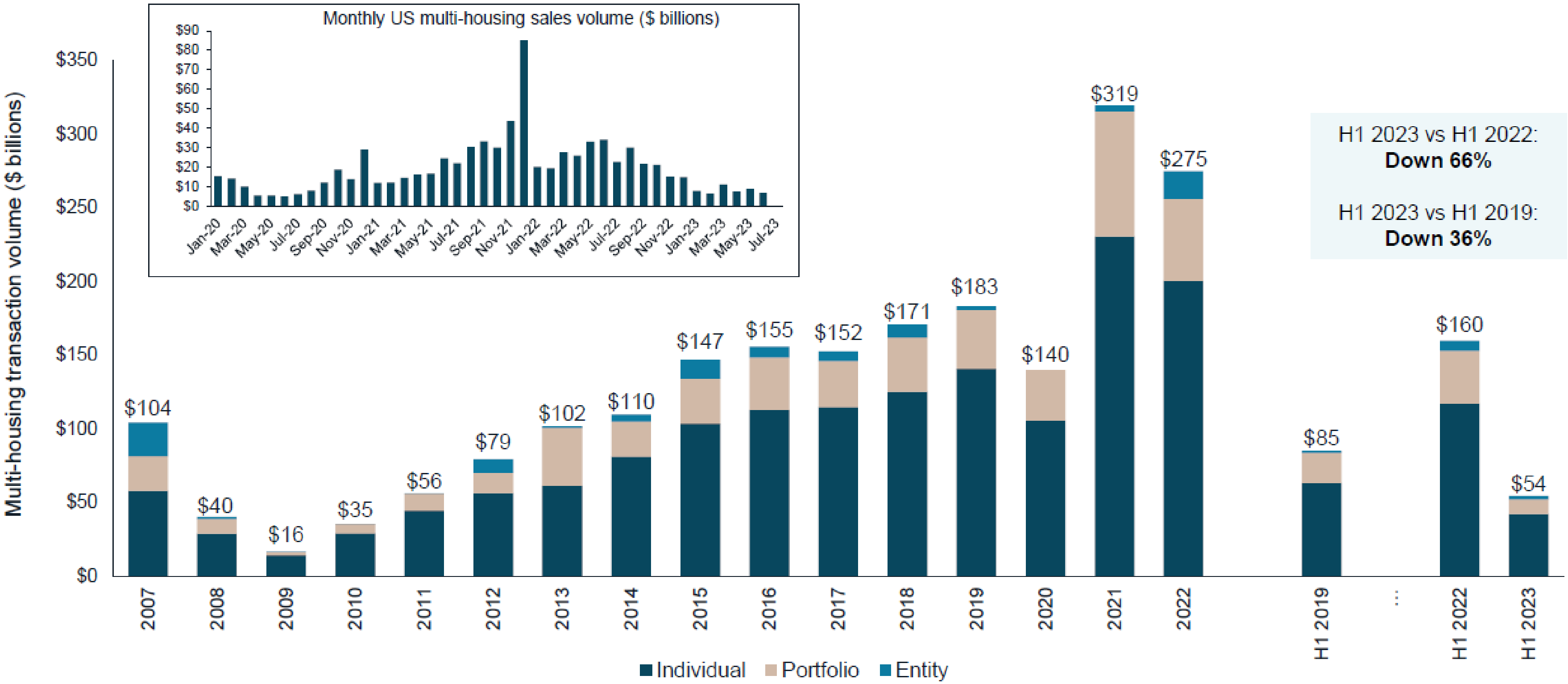
Spreads (bps)

	2023 Q1	2019	2018	LT avg.
RCA	273	393	311	364
JPM	257	326	301	306
NCREIF	194	284	189	276

Source: JLL Research, Real Capital Analytics, JPMorgan, National Council of Real Estate Fiduciaries, Federal Reserve (Ten-year Treasury values pertain to quarter-end figure)

Speed and scale of rate hikes this cycle unprecedented, portending to shorter overall duration and plateau before future cuts

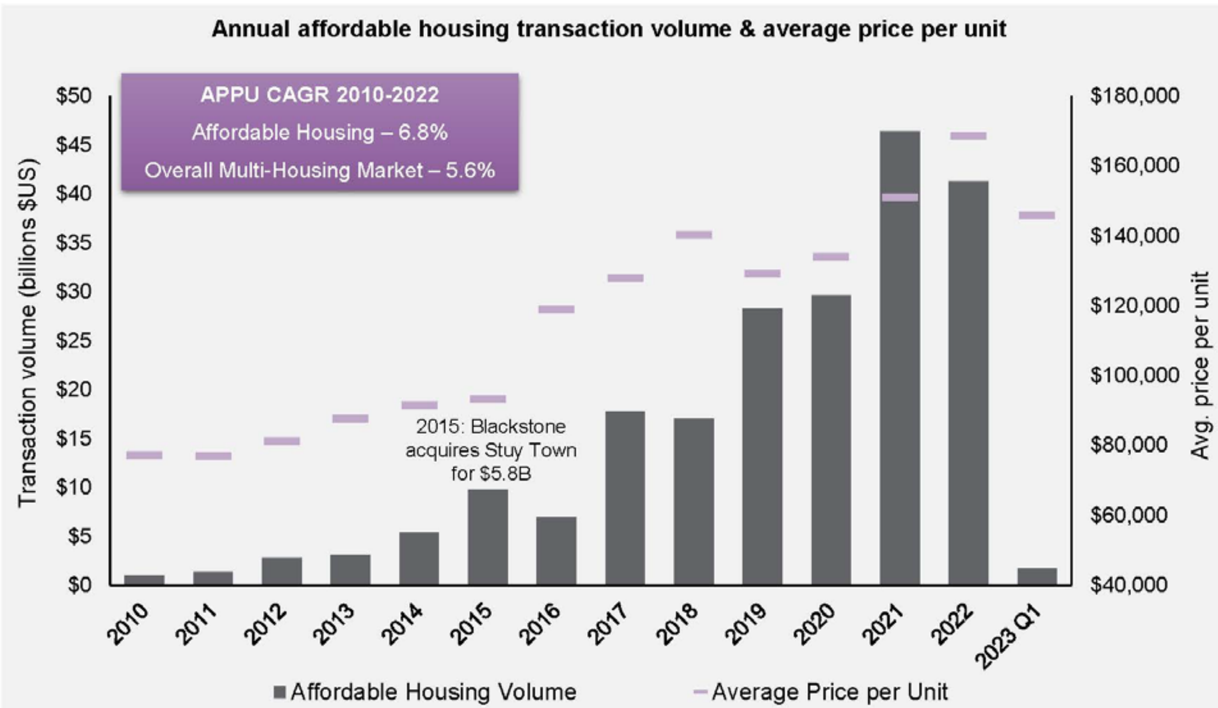
US multi-housing transaction volume slowed 66% YoY through July; portfolio activity remains muted as rates challenge large transactions

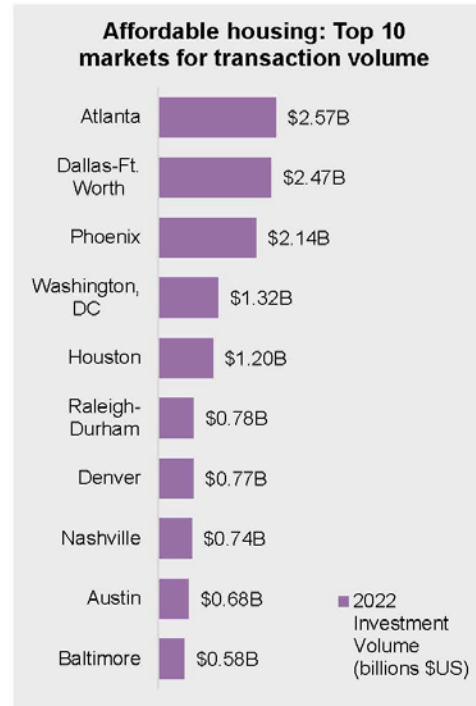


Source: JLL Research, Real Capital Analytics (transactions greater than $5.0 million)

Affordable & Workforce Housing Trends

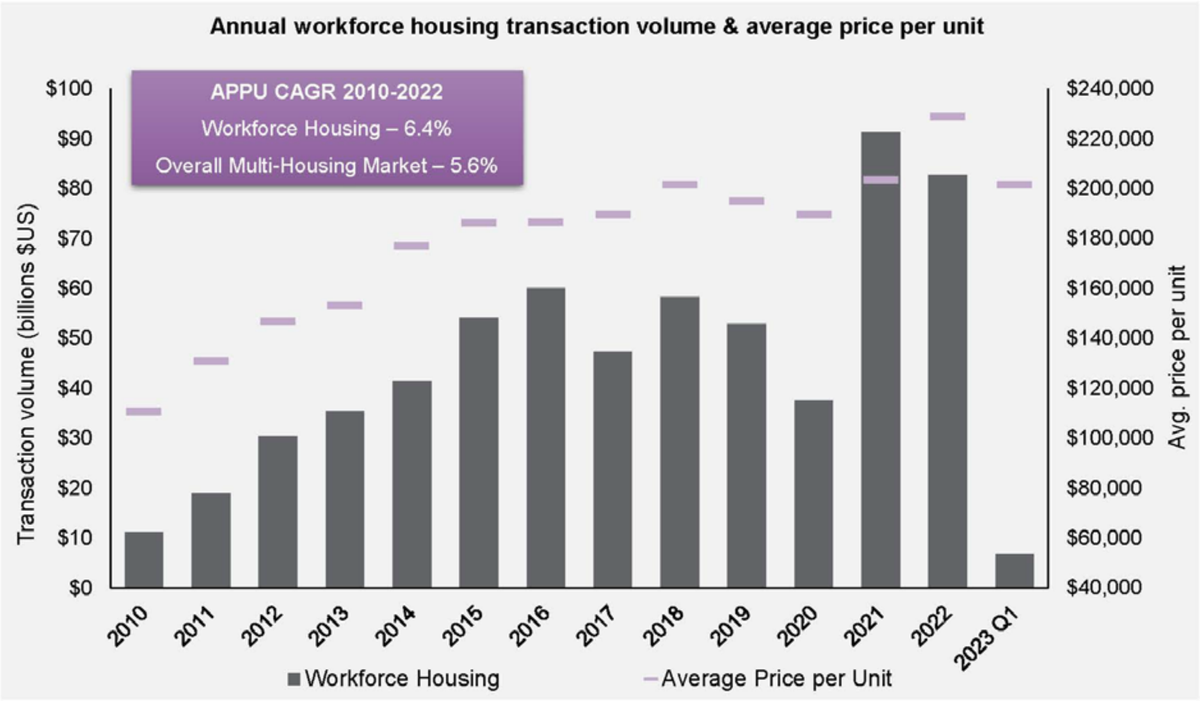
Affordable housing transaction volume has steadily increased since 2010 as institutional interest grows





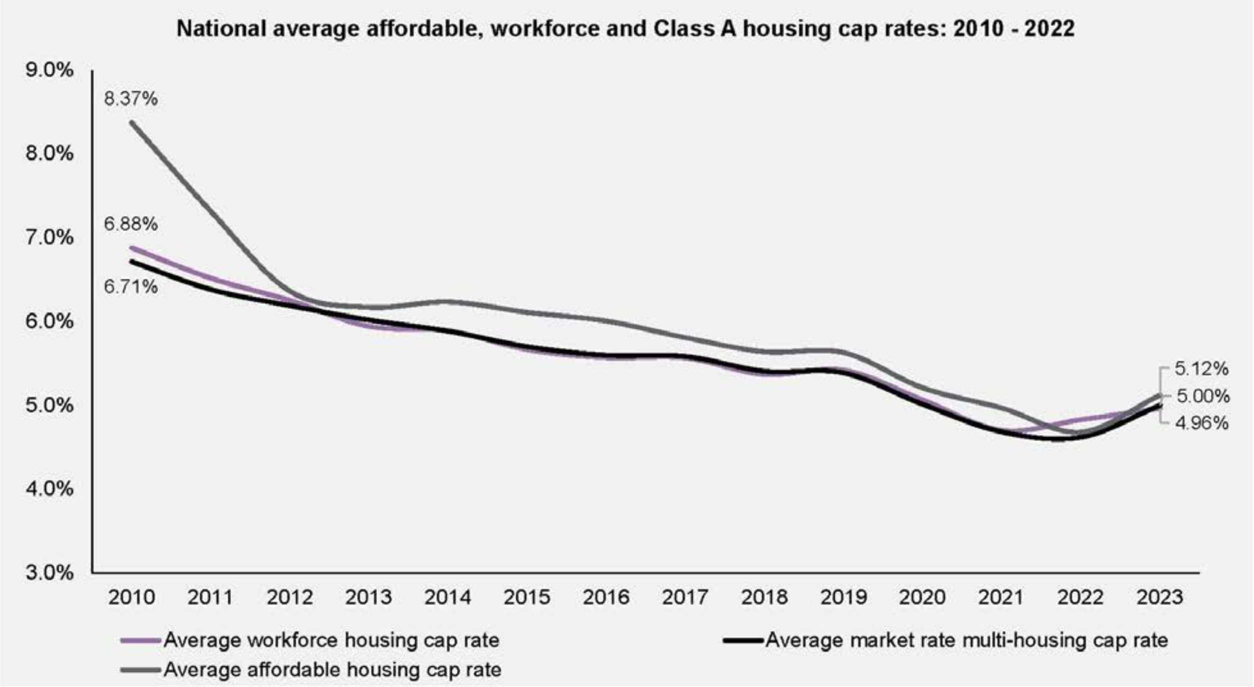
Source: JLL Research, Real Capital Analytics (transactions larger than $5.0 million)
Note: Analysis pertains to subsidized multi-housing assets as defined by Real Capital Analytics. Real Capital Analytics classifies an asset as subsidized if it is known as affordable housing or has a government subsidy, such as Section 8.

Workforce housing investment volume in the US has grown 18% annually since 2010



Source: JLL Research, Real Capital Analytics (transactions larger than $5.0 million)
Note: Workforce housing defined as assets completed or renovated more than 15 years before year of transaction. Workforce housing investment volumes exclude government-subsidized affordable housing properties.

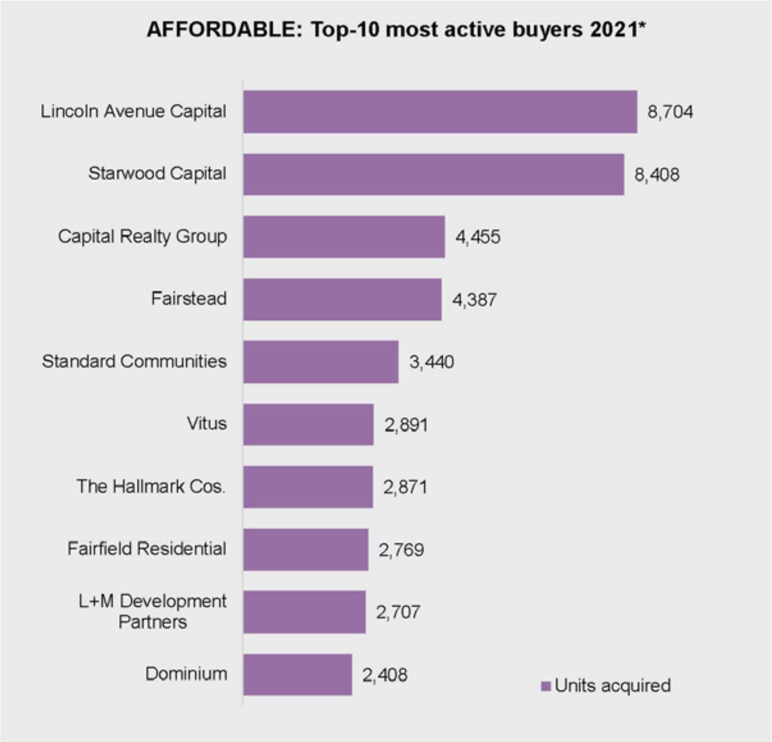
Affordable and workforce housing offer less expensive entry points and stable returns relative to Class A product 6.88%

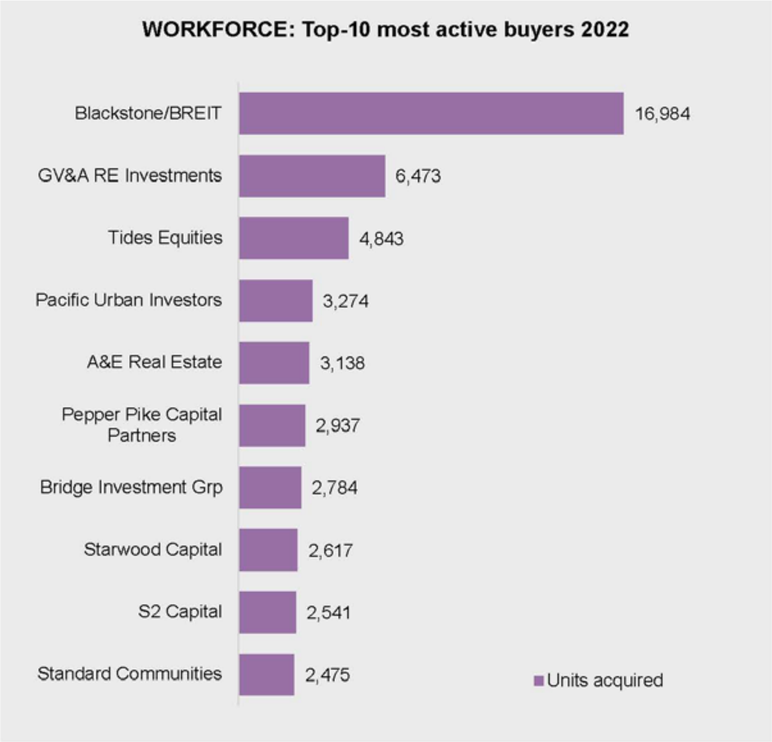


- Following the Great Financial Crisis, the affordable housing market started stabilizing and began to attract increasing institutional investors. Increased liquidity and structure improved the sector's transparency.
- These dynamics coupled with further growth in the amount of capital entering the space & LIHTC burn-off contributed to nine consecutive years of cap rate compression in affordable housing prior to 2023.
- Investment demand for workforce housing in the U.S. has also grown steadily and consistently, with eight consecutive years of cap rate compression in the sector in the past cycle.

Source: JLL Research, RCA
Note: Workforce housing defined as assets completed or renovated more than 15 years before year of transaction.

Strong institutional and private capital representation across affordable and workforce housing



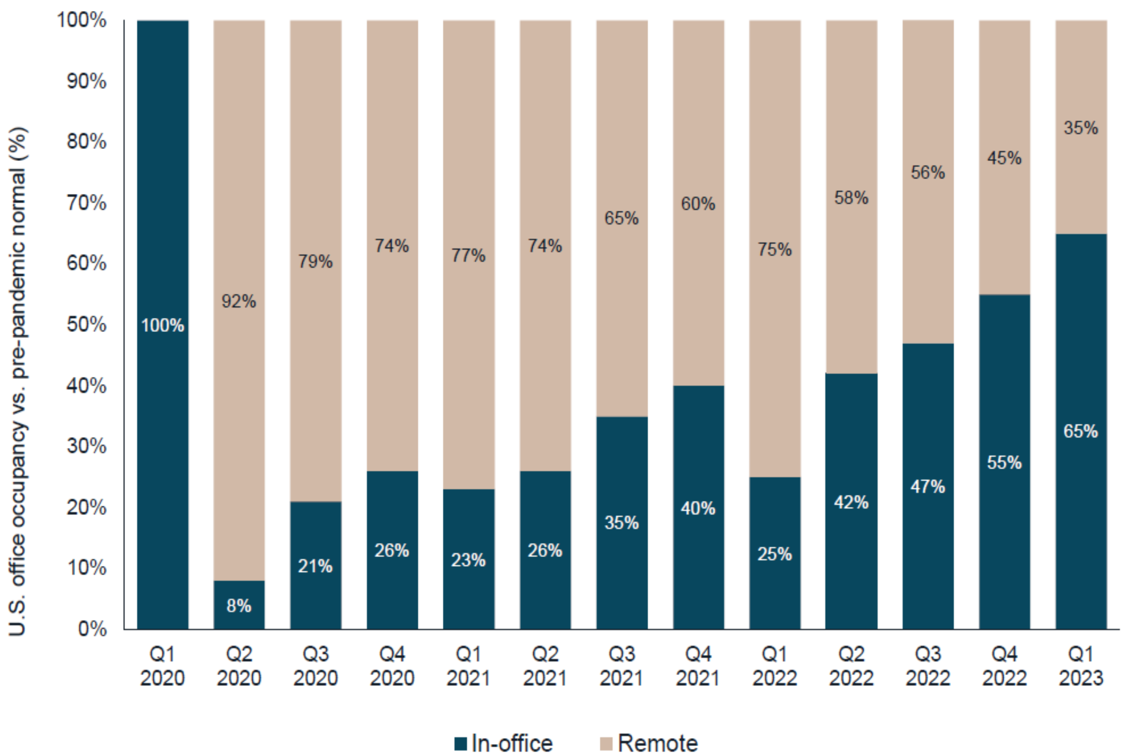


Source: JLL Research, Real Capital Analytics (transactions larger than $5.0 million), housingfinance.com
Note: Workforce housing defined as assets completed or renovated more than 15 years before year of transaction.
*2022 year-end data will be released in June 2023.

Impacts to Texas / Austin Markets

JLL

Office re-entry reaches post-pandemic high following recent mandates; former laggard/gateway markets benefitting



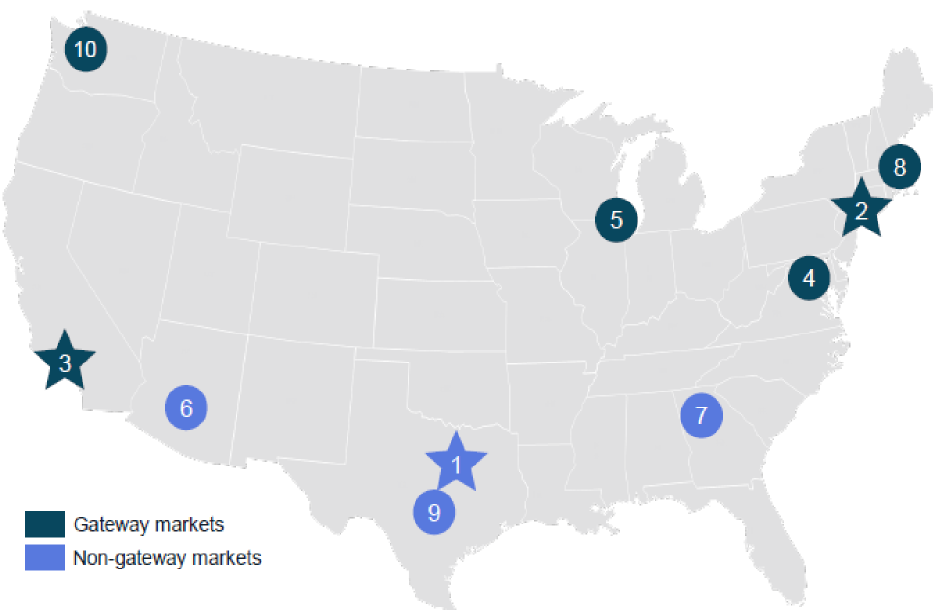
Market	Re-entry rate (%)
Austin	60.5%
Houston	57.6%
Dallas	53.8%
Los Angeles	45.0%
Washington, DC	44.4%
Chicago	45.2%
New York	46.6%
Philadelphia	40.8%
San Francisco	39.2%
Silicon Valley	40.4%

Includes non-desk-using employees, such as janitorial and mail room staff, who reported to the office throughout the pandemic. As of 9/26/22.

Source: JLL Research, Kastle

JLL

Capital begins a return to major gateway markets in H1 2023 as investment managers look towards established job centers



2019	2022	H1 2023	Market	H1 2023 Transaction Volume ($M)
1	1	1	Dallas-Ft. Worth	$3,668
4	4	2	New York	$2,850
5	6	3	Los Angeles	$2,458
2	7	4	Washington, DC	$2,145
12	12	5	Chicago	$1,620
6	3	6	Phoenix	$1,601
3	2	7	Atlanta	$1,596
10	16	8	Boston	$1,528
11	9	9	Austin	$1,433
7	11	10	Seattle-Bellevue	$1,277
8	5	11	Houston	$1,065
31	51	12	SF Mid-Peninsula	$1,019
18	8	13	Orlando	$901
9	14	14	Denver	$858
21	15	15	San Antonio	$765
39	19	16	Miami-Dade County	$758
22	22	17	San Diego	$719
14	10	18	Charlotte	$645
15	18	19	Tampa	$627
25	38	20	Silicon Valley	$605
19	23	21	Northern New Jersey	$537
28	24	22	Fort Lauderdale	$507
34	29	23	Kansas City	$468
43	32	24	West Palm Beach	$455
27	13	25	Nashville	$449

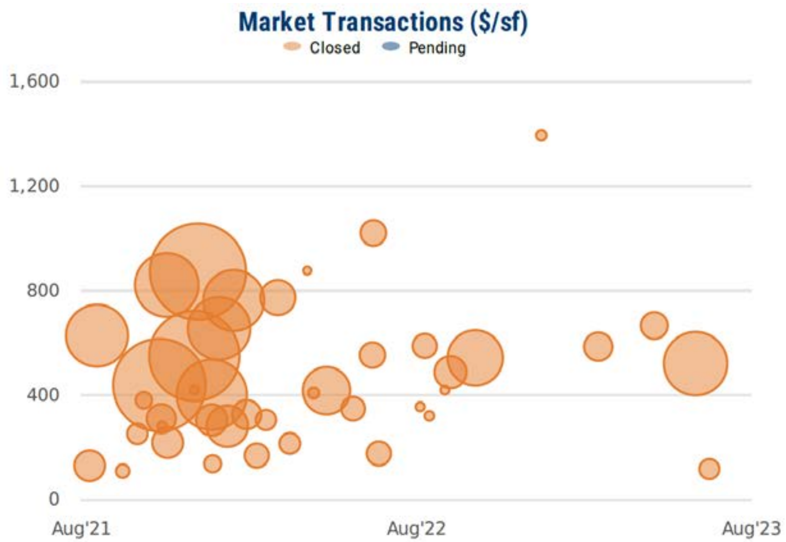
Source: JLL Research, Real Capital Analytics (transactions greater than $5.0 million)

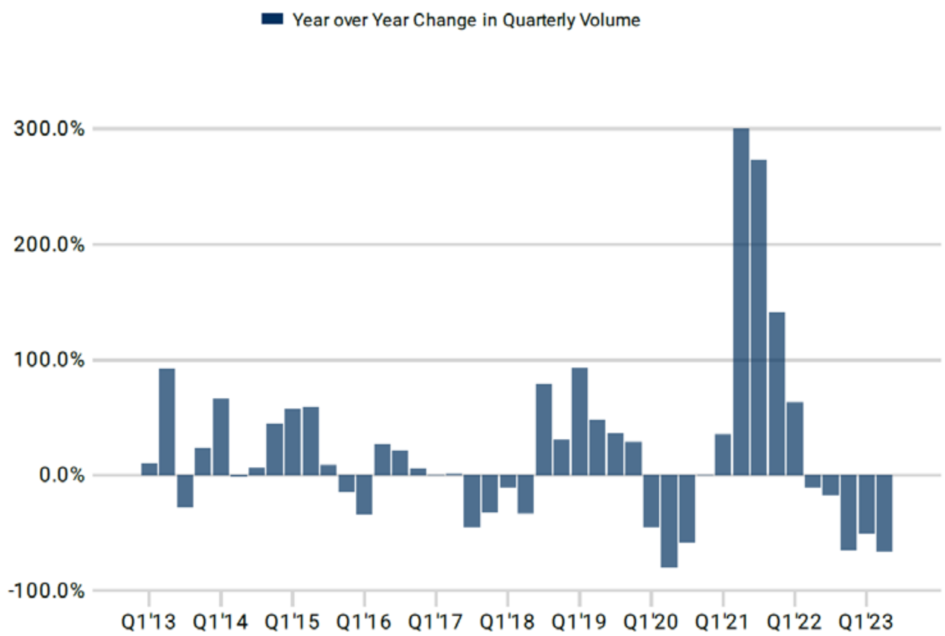
JLL

Austin Market Snapshot

	Last Four Quarters	YOY Change	Q2 '23	YOY Change	Q3 '23 to Date & Pending
Volume ($m)					
Individual Property Volume	**$6,292.4**	-49.2%	**$1,076.4**	-56.6%	**$546.3**
Portfolio Volume	**$2,691.7**	-52.5%	**$219.2**	-83.4%	**n/a**
Total Volume	**$8,984.1**	-50.2%	**$1,295.6**	-65.9%	**$546.3**
# Props	**384**	-30.8%	**74**	-41.3%	**17**

Austin Market Snapshot





Effect on Public-Private Partnerships

JLL

Impact on Public-Private Partnerships

P3s require different approach as investment climate tightens

Tight underwriting resulting in less lending, fewer projects, and increased return thresholds. Investors and developers are becoming increasingly cautious. The increased risk in project delivery and occupancy is showing up in higher return thresholds. Not only is the cost for debt rising, the cost of equity is too.

Social and policy-based objectives are struggling to pencil. Faced with stubbornly high construction costs, increasing rates for debt and equity and a generally conservative approach to underwriting, it is increasingly challenging to support social and policy-based benefits on the back of projects.

Public entities are considering different options to deliver community benefits. In relation to ground lease/leaseback P3s, many public sector entities are reassessing their strategies.

- Wait out the economy. With low hold costs, many public entities have decided to pause their projects until the lending and construction climates improve. Focusing on strategy, planning and design, there is advancement that can be achieved in this period.

- Improve the land value. Through demolition of existing improvements or investment in horizontal infrastructure, public landowners are finding ways to increase their land's value.

- Mitigate project risk. Occupancy guarantees, master leases, tax incentives. Public entities are assessing all available tools to de-risk projects and attract partners.

- Capital infusion. Where the need cannot wait, public entities are pulling from their own coffers to make infeasible projects feasible by becoming equity partners or self developing.

What is needed for a meaningful CRE capital markets recovery to set in?

Fed has to signal that interest rate increases are stopping

Bond markets and debt spreads have to stabilize

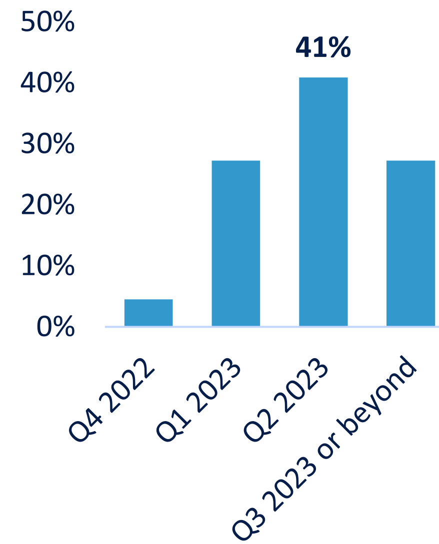
Investors' risk premium around recession risk must not worsen

Large money center banks have to meaningfully return to the market

More clarity has to emerge around office demand

Core funds' appraised valuation marks need to reflect current 'spot' values

Which quarter will represent the market bottom in terms of closed transaction volumes / investor sentiment?



Source: JLL survey of 25 top LPs and institutional investors – February 2023

CITY OF AUSTIN

Conclusions

1. Best opportunity to create a mix of affordable housing within Palm District is the former HealthSouth site.
2. Redevelopment led by Austin Housing Finance Corporation with a role to be determined for Austin Economic Development Corporation.
3. Current market conditions and community priorities support affordable housing and ground floor retail.

Scenarios

OPTION 1: AHFC issues Request for Qualifications (RFQ) in Q1 2024 for both parcels.

OPTION 2: AHFC issues solicitation after market conditions improve no later than Q3 2024 for both parcels.

OPTION 3: Phased Approach

Phase 1 - AHFC issues solicitation in Q1 2024 for one parcel.

Phase 2 - AHFC issues solicitation for 2nd parcel after market conditions improve.

Q&A

City's Project Team

Housing: Mandy DeMayo
Financial Services-Real Estate: Marek Izydorczyk
Law: Ron Pigott
Economic Development: Susana Carbajal, Margaret Shaw