

Findings Memo

Summary of Findings – Plaza Saltillo TOD

I. Introduction and Purpose

HDR was retained to analyze the economic feasibility and financial returns of Transit Oriented Development on Capital Metro's 10 acres at the Plaza Saltillo station area on the Commuter Rail line. This Memo summarizes key findings and recommendations. Appendix 1 contains more detailed information on assumptions as to project characteristics, costs, and revenues; development pro forma models; and resultant outputs and sensitivity analysis.

II. Concept

Capital Metro has three key objectives for its land at Plaza Saltillo:

1. Achieve redevelopment with uses that will support increased ridership of the Commuter Rail line and other transit services.
2. Obtain some degree of revenue support from the land resource for use towards its transit operations, if not immediately, then over time as longer term market and surrounding neighborhood trends support increased values.
3. Achieve a use concept that the neighborhood will support.

Based on these objectives, the past station area planning efforts, the current TOD Zoning Ordinance and market realities, the most promising uses at Plaza Saltillo are predominantly residentially oriented with some level of mixed uses such as retail, live/work, artists studios, offices, and community oriented uses.

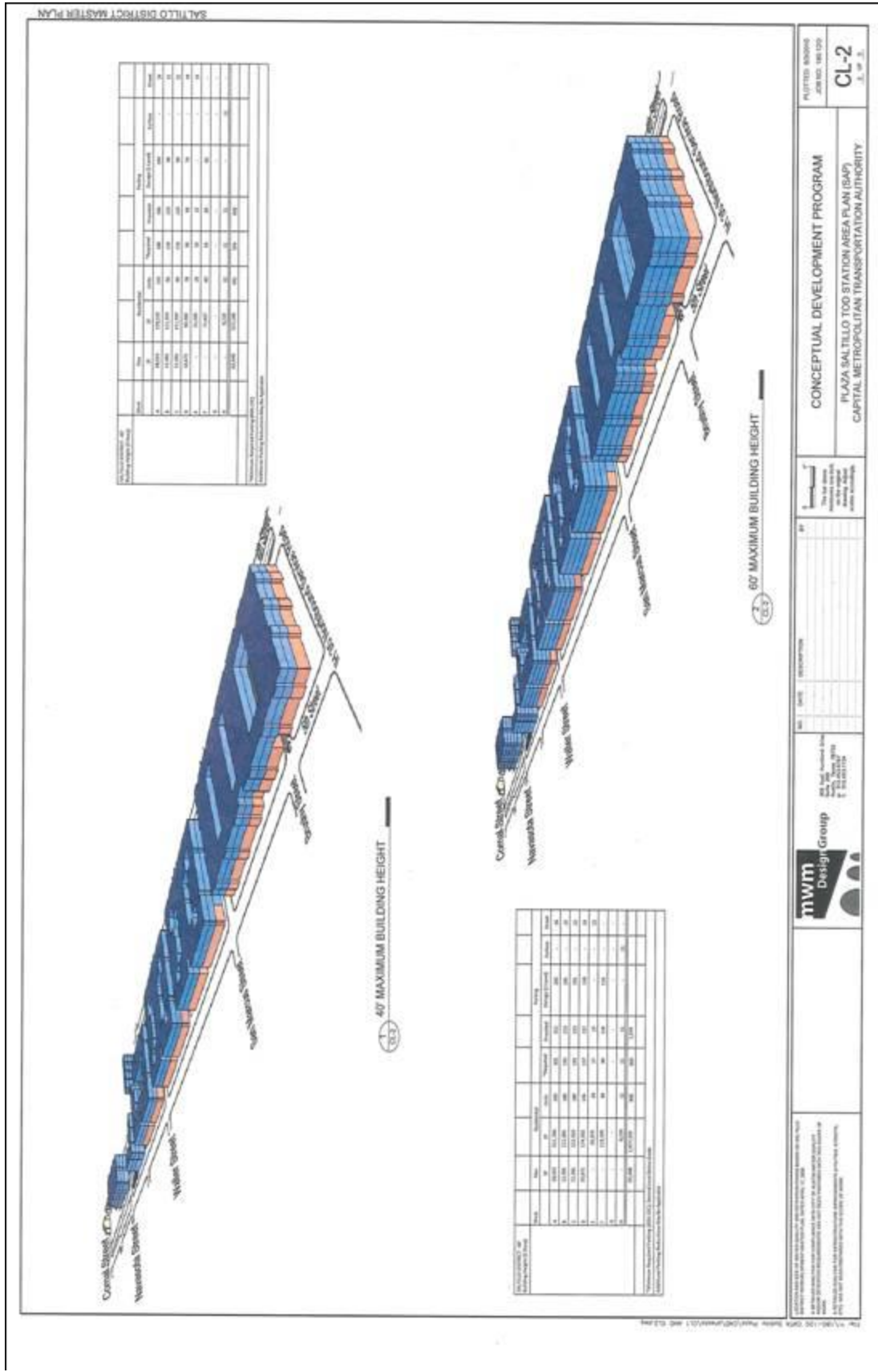
MWM Design Group has developed residentially focused massing plans (with ground floor flex-space) for development at the Plaza Saltillo site based on the already approved TOD Zoning ordinance for the site. A conceptual layout of the site is shown in Drawing 1 attached, which shows alternative build outs to the 40 foot (3 stories) and 60 foot (5 stories) height limits. MWM also developed gross square footage envelopes and unit count potentials, based on application of other aspects of the Zoning Ordinance (e.g. parking requirements, setbacks, mix requirements, etc).

Basically two alternative build out plans (illustrated on the following page) are assumed:

- Low-Rise 3 story build-out: yields approximately 500 residential units and 63,000 square feet of ground floor flex-space. Parking is in a covered grade level deck in the center of each block, with units and landscaped courtyards above. This scenario DOES NOT require meeting any affordable housing targets.
- Medium-Rise 5 story build-out: yields approximately 900 residential units and 63,000 square feet of ground floor flex-space. Parking is in a two level deck in the center of each block (one level below grade, other at grade) with units and landscaped courtyards above. This scenario DOES require the inclusionary provision by the developer of 15% of the total housing units at certain affordable income levels (in return for the added density), with the City of Austin also having the right to "buy down" another 10% of the units, if it so chooses and provides the funds.

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It should be noted that the plans tested include only the parking needed for the onsite developments, and some of this parking is included as curbside spaces. Parking for development is provided (per the TOD ordinance) at 60% of the standard requirements; and there is no general station area commuter parking included.

Area wide site preparation costs: The contemplated developments will require preparation costs that are not considered in this analysis of the market feasibility of constructing a mixed-use development on the site. These preparation costs include, but may not be limited to:

- relocation of the existing railroad tracks and addition of a second track west of Navasota St in accordance with the adopted Station Area Plan
- meeting CBD standards for detention and water quality (regional plan off site)
- utility infrastructure to the site
- environmental mitigation
- construction of streets in accordance with the adopted Station Area Plan, including streetscapes
- Lance Armstrong Bikeway

These improvements will require funding for construction before the individual blocks as shown in the Station area Plan would be ready for onsite development by one or more developers. These area wide site preparation costs have been estimated in previous studies to be between \$8 million and \$12 million, depending upon actual on-site soils conditions, drainage needs, utility requirements, etc. The present analysis does include onsite costs that a developer would be expected to provide, including internal landscaping, sidewalks, parking, utilities, etc.

III. Conclusions

Under the assumed price and cost assumptions explained in Appendix 1, both Low-Rise and Medium-Rise scenarios were analyzed. The financial feasibility of each proposed project is expressed in terms of both residual land value, and in profit as a percentage of costs. At a given land value, a project is feasible for a developer if it generates at least a 10% profit, a minimum for a real estate development to be possible. A project is deemed feasible for Capital Metro if the residual land value (at a reasonable developer profit percentage) is greater than zero, meaning that the development would not need a subsidy and might eventually generate revenue.

Low-Rise market-rate rental projects might be marginally feasible in the next 3 – 5 years if any land value return to Capital Metro is deferred until a future date when it can then be based on further increased rents. This conclusion assumes that the area wide site preparation costs (*referred to above*) are NOT borne by the developers. At maximum assumed rent levels (\$1.60/SF/month by time a project opens in 3-5 years) residual land value for these sites would still need to be essentially zero for a number of years to induce financially feasible development. This would also be true at the 5 story level provided there were no affordability requirement needed to earn the additional density and/or height. When the City's 15% affordability requirement is added in, the 5 story rental scenario becomes unfeasible, even with land value held at \$0.

“Sticker” rents for recently completed projects in the East Austin area (for example, Robertson Hill Apartments, Mosaic at Mueller, and Red River Apartments) are near \$1.60/SF/month, but effective rents have been substantially lower since most of these projects are presently offering 1- 2 months free rent. (If an apartment listed at \$1.60/SF/month is rented with 2 months of free rent, then the effective rent is \$1.33/SF/month.)

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Low-Rise 3 story condo projects selling at \$200/building square foot would be feasible for land values up to about \$20/SF of land. The Medium-Rise 5 story condo development would be feasible at values of up to about \$12/SF of land, working in the 15% affordability requirements. While several years ago, a small volume of condos may have been selling in this area for \$250 - \$300/SF, the sales market at that time was much more buoyant, the product novel in this district, credit readily available and the volume of offerings limited. Very few units have been sold in the past year or so, and it is not evident that there is any depth to the Plaza Saltillo district condo market at \$200/square foot.

Therefore, feasibility of development at Plaza Saltillo depends on recovery in the real estate market in general. When the market does recover sufficiently to the point where real estate lending and real estate development activity re-emerges, then it would seem that the most plausible products at Plaza Saltillo will be: 1) Low-Rise rental housing at market rents (i.e., no designated affordable units) 2) Low-Rise condominiums at market prices (i.e., no designated affordable units) and 3) Medium-Rise condominiums with the requirement that 15% of the units be designated as affordable. In all cases, area wide site preparation costs (as outlined above) would have to be carried by a party other than the on-site developers.

Therefore, for Capital Metro to be able to move forward on any projects on its land at Plaza Saltillo the following conditions would need to be met:

1. Alternate sources of funding are needed to absorb the area wide site preparation costs of \$8 to \$12 million. These costs could be offset by funds from such parties as various types of Federal grants, the City of Austin, a multi-jurisdictional TIF district, etc.
2. Market rate rental housing feasibility will be constrained to the Low-Rise scenario, unless the City of Austin itself either funds any affordable housing requirements or excuses developers of at least some of the Plaza Saltillo blocks from having to meet affordability requirements for rental housing. It is possible that higher density development at Plaza Saltillo would be feasible if dedicated affordable housing on part of the site were combined with releasing the remaining site area from affordable housing requirements.
3. For a market rate rental project to go forward in the existing market conditions, the condition set in Paragraph #1 immediately above would have to be met, Capital Metro would have to look for a delayed and long term return on its land, and developers would have to be reasonably convinced they could achieve average rents of about \$1.60/SF/month within the next few years.

Sales housing scenarios, while theoretically feasible at \$200/SF, appear unlikely to succeed in the next few years, given the state of both the lending and local real estate sales markets. Longer term, i.e. 5-10 years from now, they could be a good prospect.

This analysis is based on current market conditions. If the first challenge, that of area wide site preparation costs, can be met in the next 3-5 years, then development is possible under these conditions. Should these challenges persist for more than 5 years, a new analysis would be needed to accurately account for changed conditions.

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Appendix 1: Assumptions, Models and Summary of Findings

I. Assumptions

The following are the key assumptions used for inputs into the Rental and Sales models summarized in the next section (II). Inputs in the models that can be varied are shown shaded in grey in the model input sheets.

Rental Models:

Units and Square footage: MWM Architects determined maximum building envelopes and translated this into gross building square footage. They also determined a maximum number of units to associate with this square footage based on their parking layouts and calculations, thereby allowing derivation of a maximum assumed average unit size of about 1175 gross square feet. This was then turned into a net rentable square feet (NRSF) average by HDR by applying an assumed efficiency factor of 90% to the gross square footage. Separately HDR obtained average unit sizes (net rentable square feet categorized by number of bedrooms) in the market place from a sample of over 10 apartment complexes of similar nature (density and configuration) in the Austin marketplace. The respective averages were 850 NRSF for 1 BR, 1200 NRSF for 2BR and 1500 NRSF for 3 BR. A unit mix was then simulated to approximate the overall average size (about 1050 NRSF) suggested by the maximum MWM building envelope, given that the market typically builds mainly 1 and 2 BRs, and a much smaller percentage of 3 BRs. [It should also be noted that there is no requirement that the entire MWM building envelope be used up – if the market justifies smaller units, they could all be smaller and leave some of the potential building envelope unused. However, the market survey does support the typical unit sizes (in square footage) described immediately above].

Flex space square footage is taken directly from the MWM plan. No assumption or evaluation is made as to whether there is a market for this amount of space.

Rents: Rents shown for multifamily (\$1.60/NRSF/month) are the maximum average market rents assumed achievable at the site in the next 3 or so years. They are based on the quoted “sticker” rents on a range of projects of similar nature in the area (Mosaic at Mueller, Robertson Hill Apartments and Red River Apartments), but these projects are all currently offering 1 to 2 months free rent and other concessions, so “effective” rents are considerably (8%-17%) lower. Plaza Saltillo is not generally perceived by the marketplace as having a superior location to any of the above referenced projects – in fact, on average, it may be slightly less attractive for volume absorption. At this point the model does not distinguish variation in rental rates (per square foot) based on the number of bedrooms in the units; but typically smaller units (studio, and 1 BR’s) will rent at higher per square foot rents than 2 or 3 bedroom units. For the purposes of the level of analysis in this memo, these distinctions are unnecessary and just an overall average per square foot is used.

Rents for “flex space” are assumed “triple net” (NNN) with tenant paying all utility, insurance and property tax expenses, and common area charges on top of the assumed rent. No allowance has been made for corridors or other reductions in the gross square footage. It is not believed that any large quantity of retail or flex space can be rented at this site at rents above the stipulated level with any expectation that the tenants would long remain in business.

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Affordability Assumptions: The percentage allocation of affordable units amongst 1, 2 and 3 BR unit sizes, and different levels of income and affordable rents are as set forth in City of Austin guidelines. The total percentage of units to be in the overall “affordable” category in a project is set by the zoning requirements for bonus density or height. The affordable units, on average, are assumed to be somewhat smaller than the market rate units due to the fairly generous size of the market rate units.

Operating Costs: Most of the operating costs are assumed to be fixed based on unit size and cost and general project characteristics independent of the income characteristics of the occupants. However, some cost items, such as vacancy rate, bad debts, and management fee will vary depending on the rental income potential of individual units and in these cases it's better to express those cost items as a percentage of the potential income stream. Property taxes are assumed to be much less on affordable units due to the substantially lower Assessor's values typically placed on such units, as compared to market rate units.

Valuation: Capitalization rates are applied to net operating income to determine value of the project's stabilized income (after being open a year or so) to an investor on the open market. Small variations in capitalization rates (e.g. the difference between 6.5% and 7.0%) can cause major swings in project value. Until fairly recently (mid 2008) capitalization rates had been trending downward (thus increasing values) due to the flood of money that was pouring into the real estate markets and low levels of perceived risk. Since the recent real estate crash cap rates rose substantially (by approximately 2 points or more in some markets) substantially hurting project values. There has been some improvement since mid 2009 but the future is uncertain. Overall, since 2007, cap rates have risen (and hence values decreased) due both to the uncertain and tough lending environment and substantially diminished expectations that rents will always rise at a steady and healthy clip in the future.

Development Costs: These are approximations of typical and customary cost elements in the current local real estate environment. It should be noted that the model currently uses \$10/sf. of land for onsite routine site improvements (i.e. utilities, sidewalks, streetscapes, landscaping etc) within the property line and DOES NOT INCLUDE any of the costs for “areawide site improvements” (including any soils cleanup, track relocation and other items outlined in the Summary of Findings) .

Land Cost: This is one of the prime input assumptions being varied to see what its potential impact on project profitability would be.

Sales Models:

Units and Square footage: Same assumptions as in the Rental Models.

Sales Prices: A maximum of \$200/NSF is used and assumed to be the highest level at which any significant amount of product could be potentially “moved” over the next few years, notwithstanding that a small to moderate amount of product had been sold at prices of around \$250/sf or slightly above, at the peak of the recent real estate boom. Right now, the volume of transactions is so limited that it is difficult to determine a true “market clearing” price for a large volume of sales e.g. 75-100 units/year.

Affordability Assumptions: These reflect the different rules and levels in effect for sales as opposed to rental housing, specific to the Plaza Saltillo Station Area Plan, per the TOD Zoning Ordinance.

Other Costs: These reflect being a for sale project, as opposed to a rental project.

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II. Models

A series of two page spreadsheets was earlier forwarded to Capital Metro to enable simulation of 3 and 5 story variants for both rental and sales housing scenarios. These models also allow for variations in the percentage and amount of affordable housing assumed in each project and its impact on the results.

The first page of each model contains on the left the “input” section, with the numbers that can be varied or “tested” shown in shaded cells. The right hand “output” section shows key summary outputs, including number of units and parking spaces, density, project cost, project value (upon completion, using the assumed capitalization rates) project costs, and calculated net profit or loss expressed both in absolute dollar terms and as a percent of project cost. [This profit margin is important: any project that shows less than at least a 9% profit margin over total costs is unlikely to be able to proceed in today’s markets].

The “output” section also shows the assumed land value associated with the particular run and compares that to assumed on-site improvement costs, as well as parking costs, and to the subsidy to achieve any specified affordable housing goals.

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III. Summary of Findings

Table 1 below shows the summary results of 18 model runs for the two “central blocks” labelled B and C on the MWM plan – that is the blocks between Waller and San Marcos Streets. These are fairly typical blocks and representative of the rest of the project, as currently laid out.

Table 1

	Central Blocks : B & C					
	Rental @ \$1.60/sf/mth			Sell at \$200/sf		
	3 Floors 0%	5 Floors 0%	5 Floors 15%	3 Floors 0%	5 Floors 0%	5 Floors 15%
% Affordable						
Site Area						
Capital Metro Land : Acres	3.6	3.6	3.6	3.6	3.6	3.6
Square Feet	157,426	157,426	157,426	157,426	157,426	157,426
City of Austin ROW: Acres	0.4	0.4	0.4	0.4	0.4	0.4
Square Feet	16,553	16,553	16,553	16,553	16,553	16,553
Dwelling Units						
% Affordable	192	360	360	192	360	360
Parking Spaces	0	0	15	0	0	15
Flexspace : Square Feet	240	426	426	240	426	426
	24,762	24,762	24,762	24,762	24,762	24,762
Density: Cap. Metro Land Only	53	100	100	53	100	100
Cap. Metro and ROW	48	90	90	48	90	90
Site Development Costs: \$10/sf.	\$ 1,574,258	\$ 1,574,258	\$ 1,574,258	\$ 1,574,258	\$ 1,574,258	\$ 1,574,258
Parking Costs	\$ 3,500,000	\$ 8,239,241	\$ 8,239,241	\$ 3,700,000	\$ 8,634,000	\$ 8,634,000
Land Value at \$0/sf	\$0	\$0	\$0	\$0	\$0	\$0
Project Value	\$ 39,152,189	\$ 69,799,229	\$ 63,267,944	\$ 44,994,300	\$ 81,114,300	\$ 75,660,300
Project Costs	\$ 35,763,895	\$ 63,900,478	\$ 62,622,730	\$ 37,404,610	\$ 66,976,819	\$ 65,603,283
PROFIT	\$ 3,388,294	\$ 5,898,751	\$ 645,214	\$ 7,589,690	\$ 14,137,481	\$ 10,057,017
% of Costs	9.5%	9.2%	1.0%	20.3%	21.1%	15.3%
Land Value at \$10/sf	\$ 1,574,258	\$ 1,574,258	\$ 1,574,258	\$ 1,574,258	\$ 1,574,258	\$ 1,574,258
Project Value	\$ 39,152,189	\$ 69,799,229	\$ 63,267,944	\$ 44,994,300	\$ 81,114,300	\$ 75,660,300
Project Costs	\$ 37,431,941	\$ 65,568,525	\$ 64,290,777	\$ 39,072,657	\$ 68,644,866	\$ 67,271,329
PROFIT	\$ 1,720,248	\$ 4,230,704	\$ (1,022,833)	\$ 5,921,643	\$ 12,469,434	\$ 8,388,971
% of Costs	4.6%	6.5%	-1.6%	15.2%	18.2%	12.5%
Land Value at \$30/sf	\$ 4,722,775	\$ 4,722,775	\$ 4,722,775	\$ 4,722,775	\$ 4,722,775	\$ 4,722,775
Project Value	\$ 39,152,189	\$ 69,799,229	\$ 63,267,944	\$ 44,994,300	\$ 81,114,300	\$ 75,660,300
Project Costs	\$ 40,768,034	\$ 68,904,617	\$ 67,626,869	\$ 42,408,749	\$ 71,980,958	\$ 70,607,422
PROFIT	\$ (1,615,845)	\$ 894,612	\$ (4,358,925)	\$ 2,585,551	\$ 9,133,342	\$ 5,052,878
% of Costs	-4.0%	1.3%	-6.4%	6.1%	12.7%	7.2%

On the rental side, only the 3 floor project at \$0 land cost comes close to generating market acceptable profit margins in today’s market, even at the maximum assumed rental ceiling of \$1.60/sf. A 5 floor variant would also generate close to an acceptable profit margin assuming 0 affordable units, but this is not permitted under the zoning ordinance. The 15% affordable housing set-a-side (in the 5 floor model) renders the rental projects unviable even with \$0 land cost.

On the sales side, the 3 and 5 floor projects appear to be viable at land prices to perhaps \$15-\$20/sf, even with the affordable housing requirement for the 5 story scenario. Viability would however be predicated on the assumption that there is a volume sales market for units at

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\$200/sf. This is largely unknown at the present time.

Table 2 below repeats the analysis for the “West” block (San Marcos Street to I-35) using the same basic building model and cost/revenue assumptions. The results(in terms of profit margins) are very similar to those achieved for the Central Blocks. Variations are due only to slightly different proportions on that block between flex space and residential space, numbers of parking spaces, and density.

Table 2

	West Block					
	Rental @ \$1.60/sf/mth			Sell at \$200/sf		
	3 Floors 0%	5 Floors 0%	5 Floors 15%	3 Floors 0%	5 Floors 0%	5 Floors 15%
% Affordable						
Site Area						
Capital Metro Land : Acres	2.6	2.6	2.6	2.6	2.6	2.6
Square Feet	111,514	111,514	111,514	111,514	111,514	111,514
City of Austin ROW: Acres	0.4	0.4	0.4	0.4	0.4	0.4
Square Feet	16,553	16,553	16,553	16,553	16,553	16,553
Dwelling Units						
% Affordable	0	0	15	0	0	15
Parking Spaces	186	311	311	186	311	311
Flexspace : Square Feet	28,015	28,015	28,015	28,015	28,015	28,015
Density: Cap. Metro Land Only	52	102	102	52	102	102
Cap. Metro and ROW	45	88	88	45	88	88
Site Development Costs: \$10/sf.	\$ 1,116,878	\$ 1,116,878	\$ 1,116,878	\$ 1,116,878	\$ 1,116,878	\$ 1,116,878
Parking Costs	\$ 2,426,000	\$ 5,156,000	\$ 5,156,000	\$ 2,428,000	\$ 5,158,000	\$ 5,158,000
Land Value at \$0/sf	\$0	\$0	\$0	\$0	\$0	\$0
Project Value	\$ 28,748,984	\$ 52,099,110	\$ 47,382,071	\$ 32,583,750	\$ 60,103,750	\$ 56,164,750
Project Costs	\$ 26,669,128	\$ 47,770,789	\$ 46,847,971	\$ 27,797,781	\$ 49,993,252	\$ 49,001,254
PROFIT	\$ 2,079,856	\$ 4,328,321	\$ 534,100	\$ 4,785,969	\$ 10,110,498	\$ 7,163,496
% of Costs	7.8%	9.1%	1.1%	17.2%	20.2%	14.6%
Land Value at \$10/sf	\$ 1,115,136	\$1,115,136	\$1,115,136	\$1,115,136	\$1,115,136	\$1,115,136
Project Value	\$ 28,748,984	\$ 52,099,110	\$ 47,382,071	\$ 32,583,750	\$ 60,103,750	\$ 56,164,750
Project Costs	\$ 27,853,856	\$ 48,955,518	\$ 48,032,700	\$ 28,979,737	\$ 51,175,209	\$ 50,183,210
PROFIT	\$ 895,127	\$ 3,143,592	\$ (650,629)	\$ 3,604,013	\$ 8,928,541	\$ 5,981,540
% of Costs	3.2%	6.4%	-1.4%	12.4%	17.4%	11.9%
Land Value at \$30/sf	\$ 3,345,408	\$3,345,408	\$3,345,408	\$3,345,408	\$3,345,408	\$3,345,408
Project Value	\$ 28,748,984	\$ 52,099,110	\$ 47,382,071	\$ 32,583,750	\$ 60,103,750	\$ 56,164,750
Project Costs	\$ 30,223,314	\$ 51,324,975	\$ 50,402,157	\$ 31,343,650	\$ 53,539,121	\$ 52,547,123
PROFIT	\$ (1,474,330)	\$ 774,134	\$ (3,020,087)	\$ 1,240,100	\$ 6,564,629	\$ 3,617,627
% of Costs	-4.9%	1.5%	-6.0%	4.0%	12.3%	6.9%

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The eastern blocks were similarly tested and show similar results.

Sensitivity Analysis:

Beyond the impact of fluctuations in capitalization rates, the rental project's profitability results show great sensitivity to changes in rental rates and also to operating cost ratios.

- For each 10 cents per sf/month change in rent – profit will change by 7 to 9 percentage points. For example, instead of being say 9.5% in the first example in table 1 above, it could be approximately 16.5-18.5% if rents were \$1.70/sf/month; or .5-2.5% if they were \$1.50/sf/month.
- For each 1 point change in operating expenses (e.g. increase in assumed vacancy rate from 6% to 7%) there will be a roughly 2% point change in profit margin.