

**ECONOMIC EVALUATION FOR BEL-RED BONUS
INCENTIVE SYSTEM
RESPONSE TO ULI PANEL REPORT
PROPERTY COUNSELORS
SEPTEMBER 2008**

INTRODUCTION

The City of Bellevue is considering new zoning for the Bel-Red area. The proposed zoning will provide increased allowable density in the area, in return for investment in public infrastructure and public amenities. The incentive bonus system is intended to encourage more dense development as well as development that incorporates desirable features. The City has hired Property Counselors to assist them in evaluating the bonus incentive system and setting bonus rates that provide a real incentive, but also maximize public benefits. Property Counselors prepared a draft report in May 2008. The analysis in that report included a feasibility assessment to determine the economic performance of different development scenarios and the value created by additional density; as well as bonus rates that equated the cost of designated bonus features and the value of additional development rights.

The Seattle chapter of the Urban Land Institute (ULI) organized a Technical Assistance Panel to evaluate the City's proposed incentive bonus system and the Property Counselors economic analysis. The panel was asked to review the assumptions and conclusions of the Property Counselors analysis, as well as the overall objectives and structure of the bonus incentive system. The ULI Panel documented the results of their evaluation in a written report in September 2008.

Property Counselors has reviewed the ULI report and made revisions to the earlier analysis to respond to specific ULI comments. This report documents the results of the current analysis. It is organized in four sections:

- ULI Comments on Economic Analysis
- Revised Feasibility Analysis
- Revised Bonus Incentive System Analysis
- Appendix

ULI COMMENTS ON ECONOMIC ANALYSIS

The ULI Panel provided recommendations on a number of issues during their review. This report provides a response to those issues itemized below that are related to the economic analysis and calibration of the bonus incentive system. The remaining non-technical issues that the ULI Panel addressed are being considered by Staff in a separate memo.

The ULI Panel concluded that the previous economic analysis was a representative effort from a financial modeling perspective, but that in aggregate, the assumptions and conclusions led to overall fees that are not supportable by the current economic realities of development. Specific comments are discussed below.

1. The value of completed development is overstated because the assumed capitalization rates are too low. The financial model is very sensitive to assumed capitalization values. Capitalization rates are trending upward in the current financing climate. **Property Counselor Response:** Capitalization rates have been adjusted upward by 0.5% in this revised analysis.
2. The total cost of project delivery is understated. In the case of high-rise office space, the total cost of delivery in today's economics is \$375 to \$400 per rentable square foot. **Property Counselor Response:** Cost factors are adjusted upward to correspond to this range.
3. The opportunity cost of capital is understated. **Property Counselor Response:** The model includes the interest carry as one of several soft cost items. The aggregate factors for all soft costs are 31% to 33% of hard construction costs, factors that in aggregate, are reasonable for soft costs. No change was made in the analysis.
4. The cost of office tenant improvements and leasing commissions are understated in the office model. **Property Counselor Response:** Cost factors have been adjusted to correspond to the total delivery cost range identified above.
5. The income potential for parking is overstated for the office model. **Property Counselor Response:** Revenue factors are adjusted to exclude any charges for parking.
6. Total incentive fees should not exceed \$15 per square foot of additional development rights. **Property Counselor Response:** A \$15 per square foot value for additional development rights has been tested and is supportable given the results of this revised feasibility and bonus incentive analysis.
7. The city should consider increasing the maximum FAR allowed under the plan. A maximum FAR of 4.0 should be allowed for office projects. For residential projects, maximum allowable development would not be limited by FAR, rather by height and bulk factors. **Property Counselor Response:** Generally, higher allowable FAR's improve financial performance as the fixed cost of land is spread over more revenue-producing development. The residual value, the amount a developer could afford to pay for the land goes up, and the necessary bonus rate (the amount of additional development per unit of bonus feature) goes down. The

financial feasibility analysis and bonus analysis are expanded to consider scenarios with the higher development limits.

FEASIBILITY ANALYSIS

REVISIONS TO ANALYSIS

The original feasibility analysis considered 10 development scenarios. Based on the recommendations of the panel, the City also asked us to evaluate additional scenarios based on a maximum FAR of 4.0 for office projects within nodes, a maximum determined only by height and bulk limits for residential development within nodes, and higher FAR factors for scenarios outside nodes. City staff provided assumptions for the realized FAR for each scenario. It was assumed that projects would first maximize above-grade structured parking. The high-rise scenarios generally achieve the higher FAR's without underground structures parking, while the mid-rise scenarios do not. The assumed parameters can be summarized as follows:

Scenarios	Assumed FARs for Revised Analysis
Within Nodes	
1. High-rise Office	3.95
2. Mid-rise Office	2.46
3. High-rise Residential	4.35
4. Mid-rise Residential	3.04
5. High-rise Mixed	4.21
6. Mid-rise Mixed	2.89
Outside Nodes	
7. Office	1.00
8. Residential	2.00
9. Mixed Residential/Retail	2.30
10. Retail	1.53

The analysis is further expanded to consider the impact of alternative base land values. The original analysis assumed a base land price of \$45 per square foot. That value was intended to reflect a supportable price for an unimproved site given current zoning. The analysis was expanded to include an analysis of feasibility with an \$80 land price as well. Such a figure reflects the prices of some improved sites, or speculation regarding changes in zoning.

Other revised assumptions include the following:

The capitalization rates are increased to 6.0% for residential and 7.0% for commercial development.

Transportation impact fee estimates were provided by the City at a level equivalent to \$5,000 per trip.

For this analysis, a Local Improvement District (LID) assessment was assumed for Scenarios 1 and 2 (high-rise and mid-rise office) of \$2 per square foot of site area.. The LID assessment accounts for roughly a \$2 to \$3 reduction in the residual land value calculation for Scenarios 1 and 2.

Other cost and revenue rates were adjusted in response to the ULI comments as described above.

RESULTS AND CONCLUSIONS

The residual land value estimates are summarized in the following table.

Table 1
Estimated Residual Land Value
Comparison to Previous Analysis

	Previous Analysis	Current Analysis	
		Previous FARs	Revised FARs
Within Nodes			
1. High-rise Office	\$118.24	\$1.80	\$20.66
2. Mid-rise Office	68.43	16.71	16.71
3. High-rise Residential	137.54	65.93	133.48
4. Mid-rise Residential	91.08	42.29	56.34
5. High-rise Mixed Residential/Retail	125.76	57.00	119.37
6. Mid-rise Mixed Residential/Retail	84.80	36.20	46.40
Outside Nodes			
7. Office	49.46	(15.23)	(13.84)
8. Residential	37.77	13.07	33.88
9. Mixed Residential/Retail	35.06	10.47	34.79
10. Retail	30.80	4.75	33.57

The estimated residual land values are significantly lower than in the previous analysis for comparable FAR assumptions, reflecting the impact of the revised assumptions, particularly the higher capitalization rates. Further, the residual value for the high-rise office case is dramatically lower given the changes in development cost and parking revenue assumptions. With the higher FAR's in selected cases, the estimated residual values increase. In the case of the mid-rise scenarios (Scenario 2, 4, and 6), a 4.0 FAR can't be achieved without developing underground parking, and projected returns would discourage such a project. The performance of all scenarios would improve with reduced parking requirements. In the case of Scenario 1, a parking ratio of 2.5 spaces per 1,000

square feet rather than 3.0 spaces, would result in an estimated residual land value of \$50.17.

Considering the housing cases, the residual value per square foot of development is:

High-rise within Nodes: \$28 to \$30 total residual value per square foot of FAR

Mid-rise within Nodes: \$16 to \$18 total residual value per square foot of FAR

Outside Nodes: \$15 to \$17 total residual value per square foot of FAR

On an incremental basis the additional residual value per square foot of additional development for high-rise is \$14 to \$25 per incremental FAR depending on the base land value. A developer could pay an amount at the higher end of the range if he purchased the property for \$45 per foot, but an amount at the lower end of the range if the property was purchased for \$80 per square foot.

The conclusions of the additional analysis are summarized as follows:

1. The feasibility model is very sensitive to assumptions, particularly capitalization rates, and development costs.
2. FAR's of 4.0 could be achieved for high-rise office development without requiring underground structures parking. FAR's of 4.2 can be achieved for high-rise residential development without requiring underground structured parking. Mid-rise office would likely develop at an FAR of 2.5 without underground parking.
3. The financial performance of the higher FAR cases is stronger because the cost of land is spread over more revenue-producing development. For high-rise development the value of incremental development beyond a base value varies from \$14 to \$25 per square foot depending on the price paid for the property. The incremental value for mid-rise construction is lower.
4. The \$15 per square foot figure proposed by the ULI Panel for additional development rights falls within this range, and is a reasonable parameter for calibrating the bonus system.

BONUS INCENTIVE ANALYSIS

The bonus incentive analysis estimates bonus rates – the amount of additional development allowed per unit of bonus feature provided – at an amount that equates the estimated cost of the feature with the additional value that is received. Accordingly, the assumed value per square foot of development rights drives the bonus incentive system. As noted in the previous section, the ULI Panel recommended a value of \$15 per square foot of additional development. Such a rate is supportable given the results of the

feasibility analysis. For the purposes of the revised bonus incentive analysis, \$15 per square foot is considered as an appropriate bonus value.

The cost factors for the amenity features are unchanged from the previous analysis except for those like affordable housing subsidies or below-market community space rentals, which are affected by capitalization rate assumptions. In the case of affordable housing, the assumed subsidy per square foot of affordable is now \$69 for rental and \$109 per square foot for ownership. The cost factors reflect the value of foregone income for a mid-rise case, with affordable units priced at 850 square foot per unit rather than 1,020 square feet for the market units.

The estimated bonus rates are summarized in Table 2. The current estimated rates are compared to the range presented in the previous analysis.. Additional detail regarding the calculation of the bonus rates is provided in the appendix. Generally, the current rates are at the upper end of the range identified in the previous analysis.

Table 2. Summary of Incentive Rate Analysis

	Previous Analysis / Ranges (May 2008)	Current Analysis: Revised FARs
Workforce / Affordable Housing – Rental at 80% AMI		
Bonus Rate (SF Market / SF Affordable)	3.7 to 7.9	4.6
Workforce / Affordable Housing – Ownership at 100% AMI		
Bonus Rate (SF Market / SF Affordable)	5.5 to 11.5	7.2
Parks		
Bonus Rate (SF Building Area / SF Feature)	2.1 to 4.5	5.7
Stream Restoration		
\$ / SF Building Area	\$18.73 to \$39.24	\$15.00
SF Building Area / \$1,000 of Feature	25.23 to 53.39	66.7
Non-profit / Community Service Space (Subsidized Space)		
Bonus Rate (SF Building Area / SF Feature)	4.7 to 10.0	13.7
Public Restrooms		
Bonus Rate (SF Building Area / SF Feature)	6.3 to 13.3	16.7
Public Art		
SF Building Area / \$1,000 of Feature	25.23 to 53.39	66.7
Public Access to Outdoor Plaza		
Bonus Rate (SF Building Area / SF Feature)	0.9 to 1.9	2.3
LEED Gold or Platinum Certification		
FAR Bonus for LEED Gold (@5.0% cost premium)	0.13 to 0.27	0.27
FAR Bonus for LEED Platinum (@5.0% cost premium)	0.16 to 0.34	0.33
Active Recreation Area		
Bonus Rate (SF Building Area / SF Feature)	3.7 to 7.7	9.7
SF Building Area / \$1,000 of Feature	25.23 to 53.39	66.7
Natural Drainage Features		
Bonus Rate (SF Building Area / SF Feature)	0.3 to 0.6	0.7
Regional Transfer of Development Rights (TDRs)		Reserved

APPENDIX

SUMMARY OF FINANCIAL ANALYSIS: INCENTIVE RATIO CALCULATIONS

\$15 /sq. ft.Value
Add. Bldg. Area

Workforce Affordable Housing-80% of Median Rental

Change in Residual Value	
Lift Value per SF Building	15.00
Base FAR	1.0
Potential FAR	4.0
FAR Increment	3.0
Site Area	200,000
Additional Building Area	600,000
Lift Value	9,000,000
Affordable Subsidy (/gsf)	69.20
Equivalent Affordable Square Footage	130,058
Required Affordable as % of Additional	21.7%
Ratio: Additional to Affordable	4.61

Workforce Affordable Housing-100% of Median Ownership

Change in Residual Value	
Lift Value per SF Building	15.00
Base FAR	1.0
Potential FAR	4.0
FAR Increment	3.0
Site Area	200,000
Additional Building Area	600,000
Lift Value	9,000,000
Affordable Subsidy (/gsf)	108.70
Equivalent Affordable Square Footage	82,797
Required Affordable as % of Additional	13.8%
Ratio: Additional to Affordable	7.25

Parks

Lift Value per SF Building	15.00
\$/SF Cost of Feature	85.00
Bonus Rate (SF Bldg/SF Feat.)	5.67

Stream Restoration

Change in Residual Value	
Lift Value per SF Building	15.00
SF building Area / \$1000	66.67

Non-profit / Community Service Space

\$/SF Building Area	15.00
\$/SF Cost of Feature	206.00
Bonus Rate (SF Bldg/SF Feat.)	13.73

Public Restrooms

\$/SF Building Area	15.00
\$/SF Cost of Feature	250.00
Bonus Rate (SF Bldg/SF Feat.)	16.67

INCENTIVE RATIO CALCULATIONS, CONTINUED

	\$15 /sq. ft.Value Add. Bldg. Area
Public Art	
Lift Value per SF Building	15.00
SF building Area / \$1000	66.67
Public Access to Privately Developed Space	
\$/SF Building Area	15.00
\$/SF Cost of Feature	35.00
Bonus Rate (SF Bldg/SF Feat.)	2.33
LEED Certification	
Lift Value per SF Building	15.00
Base FAR	1.0
Potential FAR	4.0
FAR Increment	3.0
Site Area	200,000
Additional Building Area	600,000
Lift Value	9,000,000
Lift Value per additional FAR	3,000,000
Cost Premium (/GSF)	
Gold	20.00
Platinum	25.00
Cost Premium (@ 5%)	
Gold	800,000
Platinum	1,000,000
Equivalent FAR Increment	
Gold	0.27
Platinum	0.33
Active Recreation Areas	
\$/SF Building Area	15.00
\$/SF Cost of Feature	145.00
Bonus Rate (SF Bldg/SF Feat.)	9.67
Natural Drainage Features	
\$/SF Building Area	15.00
\$/SF Cost of Feature	11.00
Bonus Rate (SF Bldg/SF Feat.)	0.73