

MEMORANDUM

TO: Mayor Appelbaum and Members of City Council:
Suzy Ageton
Crystal Gray
Ken Wilson
Macon Cowles
Angelique Espinoza
Lisa Morzel
Susan Osborne

FROM: Michelle Allen, Housing Planner

DATE: May 29, 2009

SUBJECT: Supplemental Information for 2 June City Council Meeting (Item 5B, Affordable Housing Review)

Attached for your review is the EPS analysis of proposed cash-in-lieu increases, which includes data pertinent to development project feasibility and directly related to the cash-in-lieu increase scenarios that may be considered by Council during its June 2 meeting. Staff did not indicate in the memo that additional material would be provided, because at the time the memo was submitted it was not at all clear that the results of this analysis would be available.

This topic will be discussed under agenda item 5B, the Affordable Housing Review, at the June 2, 2009 Council meeting. Dan Guimond from EPS will present a summary of the analysis at that meeting, and will be available to answer any questions from Council.

This information has been provided to the City Clerk, the Council materials distribution list and posted on the city web site.

MEMORANDUM

To: Michelle Allen – City of Boulder

From: Dan Guimond & Michael Gaughan – Economic & Planning Systems, Inc.

Subject: Price Analysis of Proposed CIL Escalation – EPS #18919

Date: May 29, 2009

The Economics of Land Use



Introduction

City of Boulder Housing Division staff is proposing to phase-in increases to the Inclusionary Zoning (IZ) cash in lieu (CIL) amounts from the current levels of \$110,000 for multifamily properties and \$120,000 for single-family properties at 15 percent compounded annual increase per year until 75 percent of the affordability gap in a given year is reached. The affordability gap will be estimated annually based on the difference between housing sales (for properties built in the previous 10 years) and the amount a low to moderate income household can pay.

Given current economic conditions, the target CIL goal is proposed to be set 25 percent below the level established by the affordability gap. This reduction was made to be conservative given current economic conditions, which may result in housing prices not appreciating at historical rates. The phased in approach will therefore help to moderate the impact of this cost adjustment on housing prices. For multifamily properties, the 15 percent annual increase would take 5 years to implement compared to 4 years at 20 percent and 3 years at 30 percent, as shown in **Table 1**.

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Table 1
Proposed CIL Payments by Year

Year	% Increase in CIL			75% of 2008
	15%	20%	25%	GAP 5.4%
Multi-Family				
2009	\$110,178	\$110,178	\$110,178	\$170,074
2010	\$126,705	\$132,214	\$137,723	\$179,258
2011	\$145,710	\$158,656	\$172,153	\$188,938
2012	\$167,567	\$190,388	\$199,140	\$199,140
2013	\$192,702	\$209,894		\$209,894
2014	\$221,228			\$221,228

Source: City of Boulder; Economic & Planning Systems

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Background

For this analysis, EPS utilized its previously developed feasibility model to determine the market prices at which development is feasible under the proposed CIL payments. EPS' analysis indicated that projects have limited to ability to absorb higher CIL amounts under current market conditions, as shown in **Table 2**. When 100 percent of the IZ requirement is satisfied through CIL payments, the market tolerance for the CIL payment ranges from \$115,000 to \$120,000 (excluding downtown). Alternatively, when 50 percent of the IZ requirement is achieved on-site the market tolerance ranges between \$90,000 and \$125,000 (excluding downtown). In downtown, the high cost of construction and high market prices results in the ability of projects to absorb significantly higher CIL payments when on-site units are not required. This analysis essentially verifies that current market prices reflect actual project costs plus reasonable developer profits.

As a result, any proposed increases to the CIL payment represent a change in costs to which market adjustment will need to occur through a combination of lower land prices and/or increased sales prices. Although the proposed increases are justified by a recalculation of the affordability gap, they are proposed to be implemented over time to mitigate the impact on market housing prices.

Increases to changes to the CIL payment will also result in increased viability of on-site units as they will become cost competitive with the CIL. For the majority of the scenarios tested in the EPS model, the CIL payment at which this occurs is approximately \$130,000. Within downtown, the payment at which on-site units become cost competitive is approximately \$650,000; however, at this CIL payment projects in downtown are not feasible.

Table 2
CIL Feasibility Thresholds

Scenario	% of Affordable Units On-site	
	0%	50%
Downtown	\$325,000	\$0
Transit Village	\$120,000	\$110,000
<u>Non-Premium Location</u>		
High Density	\$120,000	\$90,000
Med. Density	\$115,000	\$125,000

Source: Economic & Planning Systems

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Current Market Conditions

The market prices of new multifamily homes in Boulder have increased by an annual average rate of approximately 10 percent from 2000 to 2008. The dramatic price increase was the result of a number of factors including a diminishing supply of vacant land, limited residential supply, flexible lending standards, and low interest rates. These factors contributed to the ability of development projects to readily absorb increased CIL payments between 2000 and 2008.

Lending standards and decreased residential demand have already impacted market conditions. These changes are influencing development projects in the form of discounted market prices and longer sales absorption periods, which have decreased project revenues. As a result, even modest increases in the cost of development in the short term have the potential to affect project feasibility.

The analysis below quantifies the increase in market prices needed to achieve feasibility with new CIL payments which provides a measure to determine congruency with past price increases as well as the market implications for increasing the CIL payment.

Analysis & Findings

EPS analyzed the impact of the proposed multifamily CIL on market rate sales prices under the three methods for escalating the CIL payment. The analysis did not account for increases in the allowable affordable unit selling price, or rent increases in commercial space. Allowable affordable unit selling prices are based on average annual household incomes which have remained relatively flat for some time and are not expected to increase significantly in the foreseeable future. However, EPS did take into account both future increases in construction costs as well as decreases in the cost of land.

Construction Cost

Increased construction costs were incorporated into the analysis of future prices to determine the relationship between future market prices and the increases in price that are likely to be absorbed from market tolerance for higher prices. From 2000 to 2008 the cost of construction,

as measured by the Saylor Construction Cost Index, increased by 5.4 percent annually. This represents a significantly high rate of growth that was caused by the most recent real estate boom in the United States and large infrastructure projects abroad.

Flat to negative price growth is expected in the next several quarters as a result of current economic conditions. Moving forward, EPS used a conservative rate of growth of 3 percent annual growth. In virtually all scenarios, the increase in market prices caused by a 3 percent annual increase in construction costs equates to 0.3 percent annual growth in total housing price. This is less than the increase in market prices caused by increase in CIL payments alone, which range from 0.5 percent to 2.5 percent across all scenarios and escalation rates, as further explained below.

Land Cost

EPS assumed no growth in land prices, which effectively represents a lower land price going forward because of unrealized inflation gains as well as investor return expectations. Purchases of land or parcels suitable for new construction are based on evaluation of comparable sales in the area. As a result, land owners will be unwilling to accept less than the value which was paid for the land. However, a result of increases in the cost of development land holders may not realize the gains historically experienced. Similarly, land purchased with the intent of development occurs over a wide range of years. In EPS' analysis this initial purchase of land occurred anywhere from 1 to 8 years before development for current projects recently constructed or under construction. As a result, increases in development costs may not directly translate to lower land prices for many years as the market adjusts. When decreases do occur, they are most likely to occur in the form of little to no price increases in the near future, at least until housing price levels exceed the increases necessary to amortize the increase in the CIL.

Results

The impact of the proposed changes on market price is estimated for the 15 percent escalation rate in **Table 3**, the 20 percent escalation rate in **Table 4**, and the 25 percent escalation rate in **Table 5**, as summarized below.

Table 3 – 15 Percent CIL Escalation Rate

- With 100 percent of IZ units on-site, downtown prices are already sufficient to absorb all proposed cost increases, which results in 0 percent change in market price. With 50 percent of the IZ on-site, the annual price increase in 2009 would be 4.7 percent because the project's economies would continue to favor 100 percent CIL. The average annual price increase subsequently declines to 1.3 percent in 2014.
- In the Transit Village area, the estimated annual price increase would range from 0.5 to 1.8 percent over a five year period with 100 percent CIL. The price increases are lower (starting in 2011) when 50 percent of the IZ is constructed on-site, which indicates a financial disincentive to satisfying the IZ requirement with 100 percent CIL. The results are relatively similar for the medium and higher density scenarios.
- Assuming all IZ required units are satisfied by CIL payments, the highest total price increase is 10.9 percent over 5 years which occurs in a non-premium medium density location. The average annual price increase ranges from 0.5 percent to 2.1 percent, as shown.

- When 50 percent of the IZ requirement is met on-site, the largest total price increase of 6.7 percent occurs downtown. The next largest price increase occurs in a high density non-premium location at a total increase of 5.8 percent. The average annual price increase does not exceed 1.3 percent (outside downtown).

Table 4 – 20 Percent CIL Escalation Rate

- The downtown cost impacts are relatively similar using the 20 percent escalation factor as the 15 percent factor.
- The maximum average annual price increase needed to cover the increase in CIL increases from 1.2 percent to 2.1 percent in the Transit Village and high density scenarios.
- The maximum total price increase is 9.7 percent (over 4 years) in at a non-premium medium density location with 100 percent of the IZ requirement built on-site. When 50 percent of the IZ requirement is built on-site, the maximum total price increase is 7.4 percent which occurs at a non-premium high density location.

Table 5 – 25 Percent CIL Escalation Rate

- The downtown cost impacts remain similar to the previous two escalation factors with the largest gains in price occurring as a result of constructing 10 percent of IZ units on-site.
- The maximum average annual price increase needed to cover the increase in CIL grows from 2.1 percent to 2.3 percent in the Transit Village and as high as 2.8 percent in the some instances of the non-premium location scenarios.
- The highest total growth of 8.5 percent (over 3 years) again occurs at a non-premium medium density location with 100 percent of the IZ requirement built on-site.

Findings and Conclusions

The 15 percent escalation rate requires the most modest price increases and would result in annual increases below 2 percent per year. In most cases, the increase in market price required averages of 1.0 percent when 50 percent of the IZ requirement is built on-site. Price growth at 1 percent would appear to be a reasonable assumption given historic appreciation rates in Boulder and the limited supply of residential units that will be released into the market as the result of Boulder's growth policies. In addition, this result achieves the dual goals of decreasing the affordability gap as well as providing economic incentive for the construction of on-site units.

Table 3
Price Increases with Proposed CIL Changes @ 15%

Year	CIL Payment	Current Market Price	Adjusted Market Price w/ 3% Construction Cost Increase					
			0% On-site			10% On-site		
			15% Increase	%	Ann. Avg. %	15% Increase	%	Ann. Avg. %
Downtown								
2010	\$126,705	\$1,040,000	\$1,040,000	0.0%	0.0%	\$1,089,000	4.7%	4.7%
2011	\$145,710	\$1,040,000	\$1,040,000	0.0%	0.0%	\$1,094,000	5.2%	2.6%
2012	\$167,567	\$1,040,000	\$1,040,000	0.0%	0.0%	\$1,100,000	5.8%	1.9%
2013	\$192,702	\$1,040,000	\$1,040,000	0.0%	0.0%	\$1,107,000	6.4%	1.6%
2014	\$221,607	\$1,040,000	\$1,040,000	0.0%	0.0%	\$1,110,000	6.7%	1.3%
Transit Village								
2010	\$126,705	\$365,000	\$367,000	0.5%	0.5%	\$368,000	0.8%	0.8%
2011	\$145,710	\$365,000	\$374,000	2.5%	1.2%	\$372,000	1.9%	1.0%
2012	\$167,567	\$365,000	\$382,000	4.7%	1.5%	\$376,000	3.0%	1.0%
2013	\$192,702	\$365,000	\$391,000	7.1%	1.7%	\$380,000	4.1%	1.0%
2014	\$221,607	\$365,000	\$399,000	9.3%	1.8%	\$384,000	5.2%	1.0%
Non-premium Loc.- High Density								
2010	\$126,705	\$365,000	\$368,000	0.8%	0.8%	\$366,000	0.3%	0.3%
2011	\$145,710	\$365,000	\$375,000	2.7%	1.4%	\$374,000	2.5%	1.2%
2012	\$167,567	\$365,000	\$383,000	4.9%	1.6%	\$379,000	3.8%	1.3%
2013	\$192,702	\$365,000	\$391,000	7.1%	1.7%	\$382,000	4.7%	1.1%
2014	\$221,607	\$365,000	\$400,000	9.6%	1.8%	\$386,000	5.8%	1.1%
Non-premium Loc. - Med. Density								
2010	\$126,705	\$330,000	\$334,000	1.2%	1.2%	\$331,000	0.3%	0.3%
2011	\$145,710	\$330,000	\$340,000	3.0%	1.5%	\$335,000	1.5%	0.8%
2012	\$167,567	\$330,000	\$348,000	5.5%	1.8%	\$339,000	2.7%	0.9%
2013	\$192,702	\$330,000	\$357,000	8.2%	2.0%	\$343,000	3.9%	1.0%
2014	\$221,607	\$330,000	\$366,000	10.9%	2.1%	\$347,000	5.2%	1.0%

[Note] Assumes all price growth occurs in market rate residential units

[Note] Does not account for growth in affordable unit price or non-residential rental rates

Source: Economic & Planning Systems

Table 4
Price Increases with Proposed CIL Changes @ 20%

Year	CIL Payment	Current Market Price	Adjusted Market Price w/ 3% Construction Cost Increase					
			0% On-site			10% On-site		
			15% Increase	%	Ann. Avg. %	15% Increase	%	Ann. Avg. %
Downtown								
2010	\$132,214	\$1,040,000	\$1,040,000	0.0%	0.0%	\$1,089,000	4.7%	4.7%
2011	\$158,656	\$1,040,000	\$1,040,000	0.0%	0.0%	\$1,096,000	5.4%	2.7%
2012	\$190,388	\$1,040,000	\$1,040,000	0.0%	0.0%	\$1,103,000	6.1%	2.0%
2013	\$209,894	\$1,040,000	\$1,040,000	0.0%	0.0%	\$1,108,000	6.5%	1.6%
2014	---	---	---	---	---	---	---	---
Transit Village								
2010	\$132,214	\$365,000	\$369,000	1.1%	1.1%	\$369,000	1.1%	1.1%
2011	\$158,656	\$365,000	\$378,000	3.6%	1.8%	\$373,000	2.2%	1.1%
2012	\$190,388	\$365,000	\$389,000	6.6%	2.1%	\$379,000	3.8%	1.3%
2013	\$209,894	\$365,000	\$396,000	8.5%	2.1%	\$383,000	4.9%	1.2%
2014	---	---	---	---	---	---	---	---
Non-premium Loc.- High Density								
2010	\$132,214	\$365,000	\$370,000	1.4%	1.4%	\$367,000	0.5%	0.5%
2011	\$158,656	\$365,000	\$379,000	3.8%	1.9%	\$375,000	2.7%	1.4%
2012	\$190,388	\$365,000	\$389,000	6.6%	2.1%	\$385,000	5.5%	1.8%
2013	\$209,894	\$365,000	\$397,000	8.8%	2.1%	\$392,000	7.4%	1.8%
2014	---	---	---	---	---	---	---	---
Non-premium Loc. - Med. Density								
2010	\$132,214	\$330,000	\$335,000	1.5%	1.5%	\$332,000	0.6%	0.6%
2011	\$158,656	\$330,000	\$344,000	4.2%	2.1%	\$336,000	1.8%	0.9%
2012	\$190,388	\$330,000	\$355,000	7.6%	2.5%	\$342,000	3.6%	1.2%
2013	\$209,894	\$330,000	\$362,000	9.7%	2.3%	\$345,000	4.5%	1.1%
2014	---	---	---	---	---	---	---	---

[Note] Assumes all price growth occurs in market rate residential units

[Note] Does not account for growth in affordable unit price or non-residential rental rates

Source: Economic & Planning Systems

Table 5
Price Increases with Proposed CIL Changes @ 25%

Year	CIL Payment	Current Market Price	Adjusted Market Price w/ 3% Construction Cost Increase					
			0% On-site			10% On-site		
			15% Increase	%	Ann. Avg. %	15% Increase	%	Ann. Avg. %
Downtown								
2010	\$137,723	\$1,040,000	\$1,040,000	0.0%	0.0%	\$1,090,000	4.8%	4.8%
2011	\$172,153	\$1,040,000	\$1,040,000	0.0%	0.0%	\$1,097,000	5.5%	2.7%
2012	\$199,140	\$1,040,000	\$1,040,000	0.0%	0.0%	\$1,104,000	6.2%	2.0%
2013	---	---	---	---	---	---	---	---
2014	---	---	---	---	---	---	---	---
Transit Village								
2010	\$137,723	\$365,000	\$370,000	1.4%	1.4%	\$369,000	1.1%	1.1%
2011	\$172,153	\$365,000	\$382,000	4.7%	2.3%	\$375,000	2.7%	1.4%
2012	\$199,140	\$365,000	\$391,000	7.1%	2.3%	\$380,000	4.1%	1.4%
2013	---	---	---	---	---	---	---	---
2014	---	---	---	---	---	---	---	---
Non-premium Loc.- High Density								
2010	\$137,723	\$365,000	\$371,000	1.6%	1.6%	\$369,000	1.1%	1.1%
2011	\$172,153	\$365,000	\$383,000	4.9%	2.4%	\$379,000	3.8%	1.9%
2012	\$199,140	\$365,000	\$392,000	7.4%	2.4%	\$388,000	6.3%	2.1%
2013	---	---	---	---	---	---	---	---
2014	---	---	---	---	---	---	---	---
Non-premium Loc. - Med. Density								
2010	\$137,723	\$330,000	\$337,000	2.1%	2.1%	\$333,000	0.9%	0.9%
2011	\$172,153	\$330,000	\$349,000	5.8%	2.8%	\$338,000	2.4%	1.2%
2012	\$199,140	\$330,000	\$358,000	8.5%	2.8%	\$343,000	3.9%	1.3%
2013	---	---	---	---	---	---	---	---
2014	---	---	---	---	---	---	---	---

[Note] Assumes all price growth occurs in market rate residential units

[Note] Does not account for growth in affordable unit price or non-residential rental rates

Source: Economic & Planning Systems