

# Development Economics Principles

The Basics of Development Economics  
Development Costs & Proffer Potential  
Metro Impact On Proffer Potential

# Developer Economics

**To invest Developers must obtain enough income from a project to pay development costs and achieve an adequate investment return.**

# Adequate Investment Return

## *Return-On-Cost Thresholds\**

### Commercial

Net Operating Income = **8.5%** of Development Cost

### Apartments

Net Operating Income = **8%** of Development Cost

### Condominiums

Sale Proceeds = **120%** of Development Cost

*Return-On-Cost thresholds change with interest rates and risk.*

# Proffer Concept

**When the Developer obtains a return exceeding the return-on-cost threshold there is an opportunity for the Developer to invest in community-oriented amenities.**

**Examples of community benefits:**

**infrastructure, affordable housing contributions, the provision of open space, etc.**

# Proffer Example

## Illustrative Development Economics 5-Story Residential Project

Achievable Rent→	Net Operating Income	\$3,236,400
Development Cost→	Development Cost	\$40,194,600
	Return-On-Cost	8.1%
	<b><i>Proffer Potential</i></b>	<b><i>\$400,000</i></b>
	Development Cost	\$40,194,600
	Development Cost With Proffer	<u>\$40,594,600</u>
	<i>Threshold Return-On-Cost</i>	<i>8.0%</i>

Source: W-ZHA

# Development Costs

Base Illustrative Scenario  
Parking Impacts  
Height Impacts  
Site Impacts  
Other Considerations

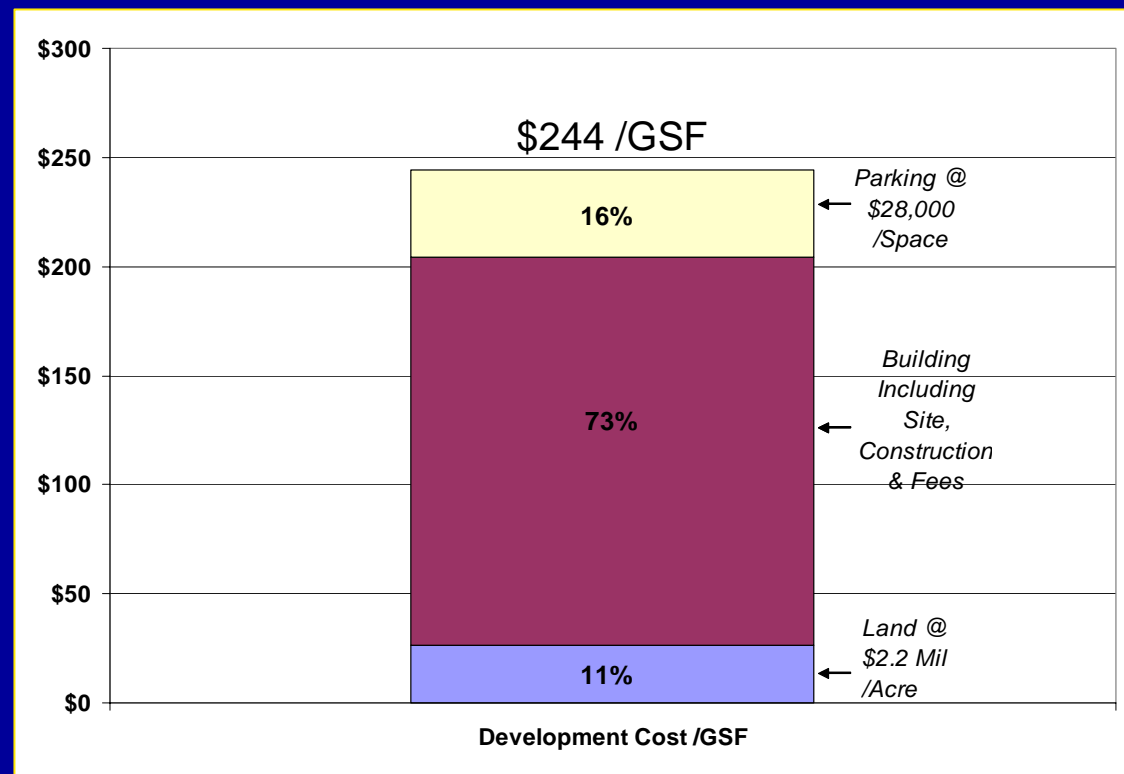
# Basic Assumptions

- 2-acre site with a value of \$2.2 million per acre
- 5 story building with 155 rental residential units
- 1.5 parking spaces per unit required (233 spaces)
- Parking rented at \$100 per space per month
- Parking is a blend of 1-story underground and 1 level above ground (\$28,000 /space)
- Supportable rent \$1,900 per unit



# Development Costs: *Base Scenario*

Development Cost /Gross Sq Ft of Building



*164,500 square feet has a development cost of ~ \$40 million.*



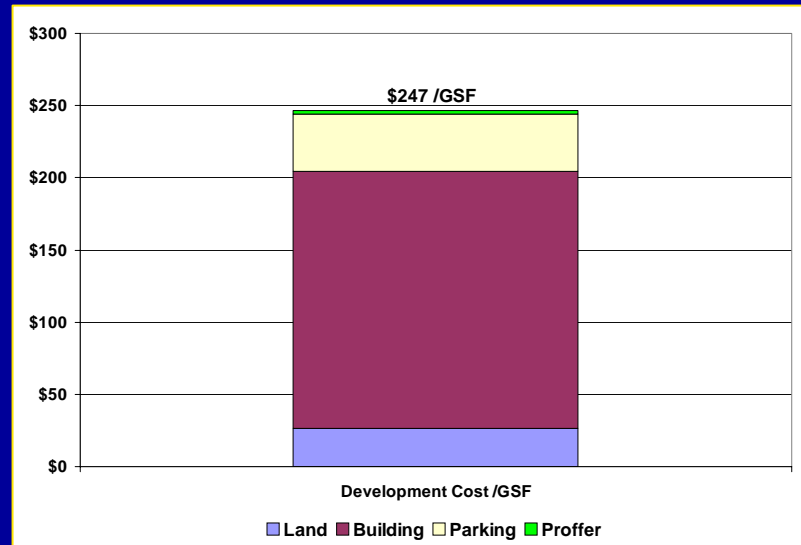
# Proffer Calculation Example

- Assumed rent at \$1,900 rent per month per unit
- More than adequate return given development costs
- Money available to fund infrastructure, parks, affordable housing, and/or community benefits

Illustrative Development Economics 5-Story Residential Project	
Net Operating Income	\$3,236,400
Development Cost	\$40,194,600
Return-On-Cost	8.1%
<b>Proffer Potential</b>	<b>\$400,000</b>
Development Cost	\$40,194,600
Development Cost With Proffer	\$40,594,600
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Source: W-ZHA

## Development Cost /GSF + Proffer



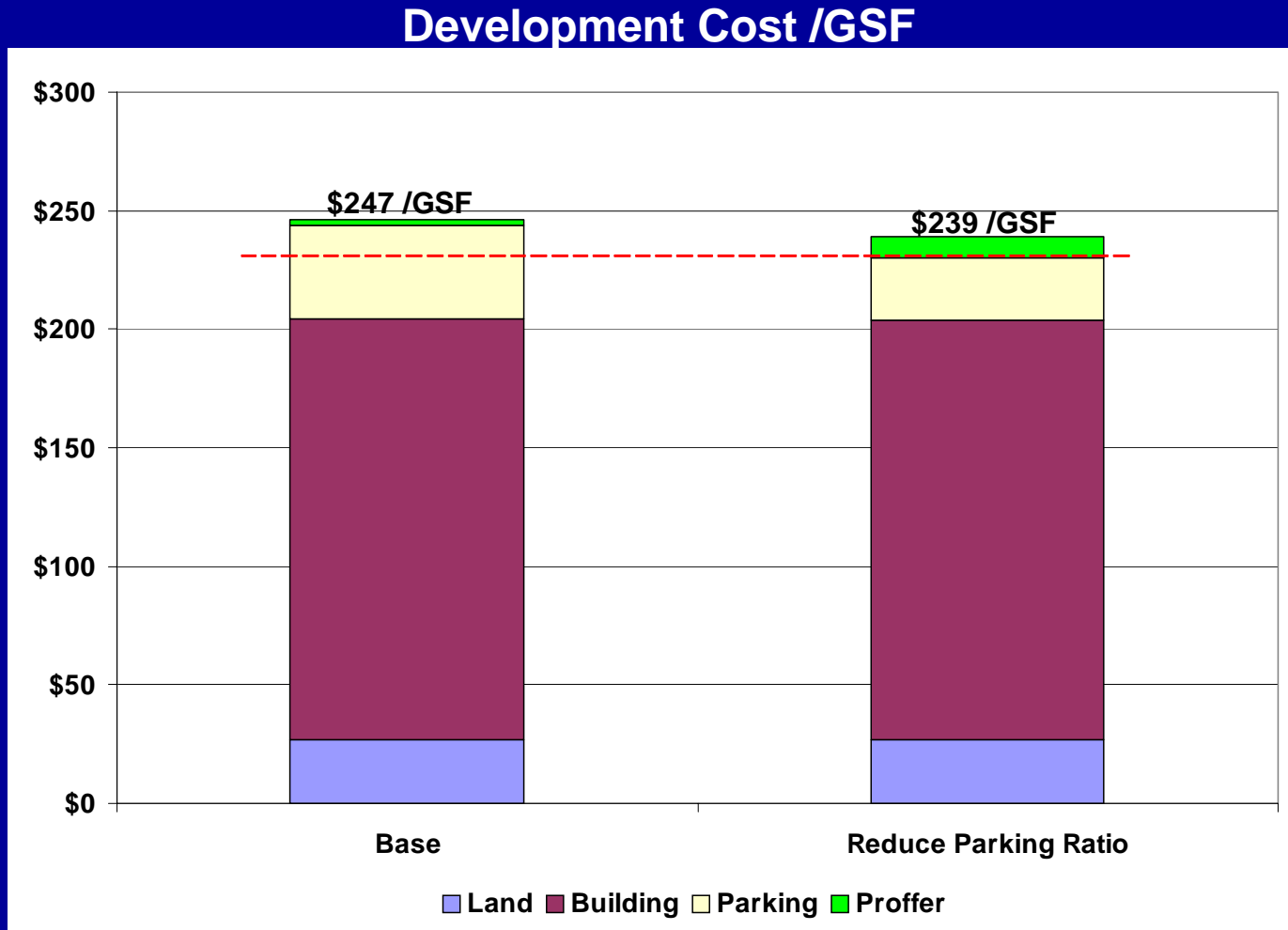
# Parking Implications

Parking Required

Type of Parking

# Parking Implications

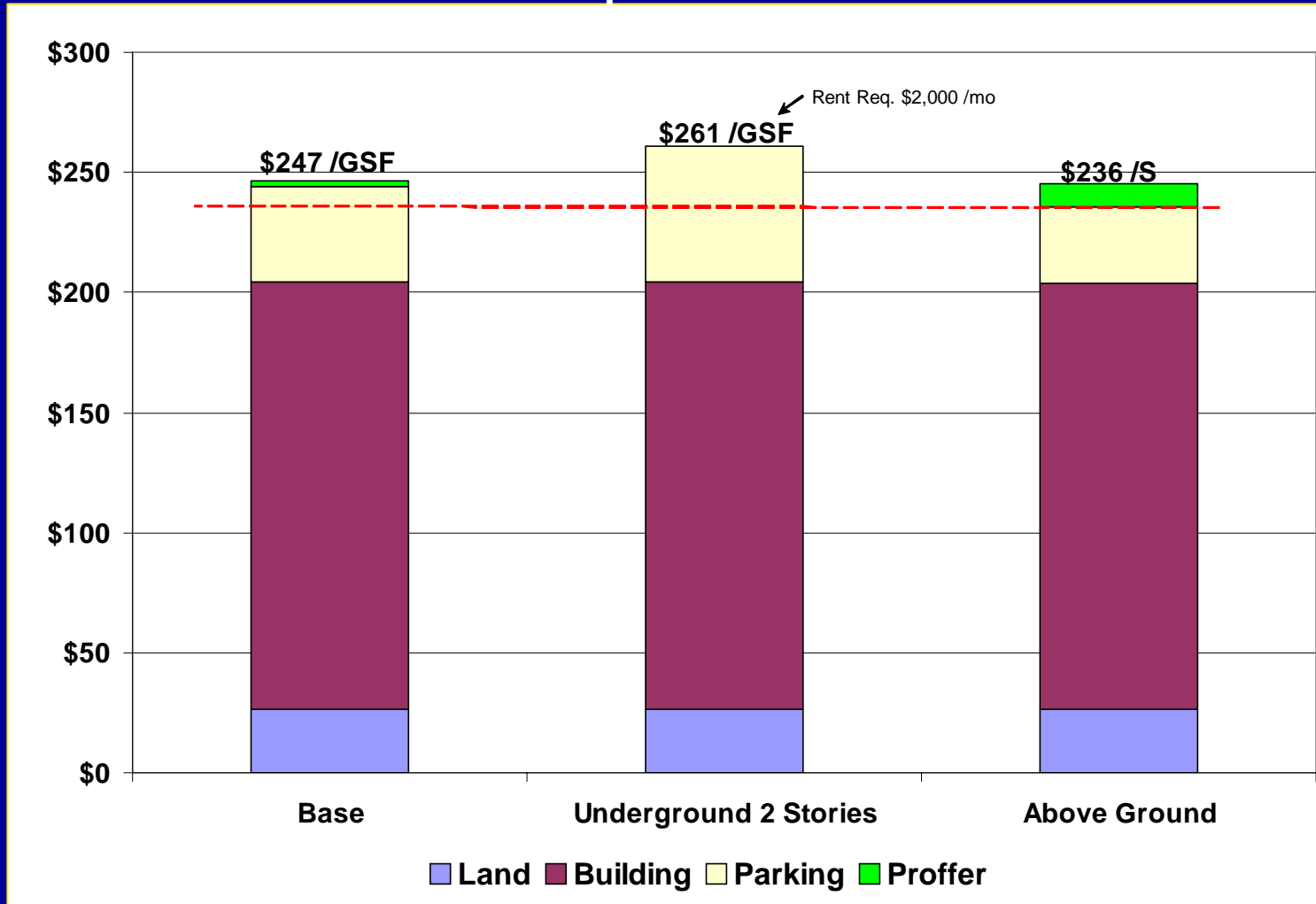
*Reduce Parking from 1.5 spaces /unit to 1 space /unit*



Parking reduced from 16% to 11 % of development cost  
Proffer potential increases to ~\$1,500,000

# Parking Implications - *Type of Parking*

## Development Cost /GSF



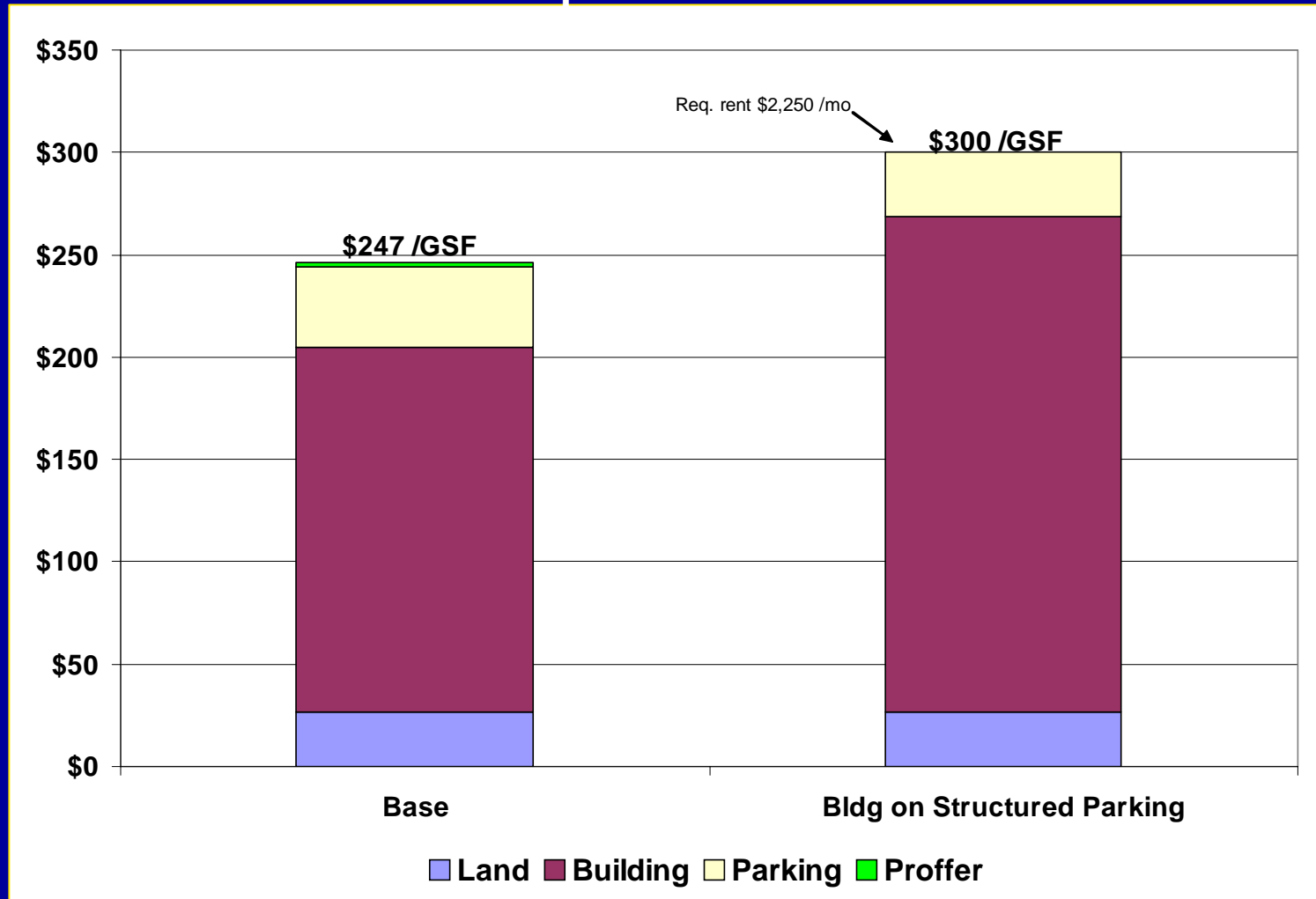
Above ground pkg proffer potential increases to ~\$1,600,000

# Above Ground Parking

- Above ground garage with architectural treatment \$22,500 per space, blend of underground and structure is \$28,000 per space → \$1.3 million in cost savings
- Standard garage would require .58 acres – at \$2.2 million per acre worth \$1.3 million
- **No yield use** on expensive land
- **Opportunity cost** of no future development of the land
- **Long term fiscal impact** far outweighs short-term proffer gain
- Typically, developers **preserve value** if possible

# Parking & Height: *5-stories of residential built on an above grade garage - 8 story project*

## Development Cost /GSF



Generally, over 5 stories triggers higher construction costs (steel)

# Site Costs



If site costs are \$1,500,000 /acre, not \$300,000, developer costs too high for supportable rent.

# Other Factors That Impact Cost

- Interest rates on financing
- Costs of materials like steel, cement, wood

*Developer does not control these costs*



# Summary

- Slight changes in development costs and rent impact proffer potential.
- Developers assume high risk with potentially high rewards. Some factors they control, others they do not.
- Building type and parking are the major cost categories.
- Site costs are highly variable.

# Metro Impact

Overview

Scenario Assumptions

Proffer Implications

# Metro Impact Overview: *Literature*

## Dallas DART LRT on Taxable Property Values (1997-2001)

- median values of residential property increased by **32%** ¼ mile from DART station vs 19% outside
- median value of office **25%** near station vs 12% outside
- negligible impact on retail value

## Santa Clara, CA (2001)

- Value for commercial properties within walking distance of commuter rail increased by **23%**, even higher in CBD locations

## San Diego County Rail Transit (2002)

- **46%** land value increase for condominiums
- **10% to 17%** for multifamily housing
- **91%** land value increase for Downtown office locations near rail
- **72%** increase for office parcels near trolley stations

## Washington, DC and Atlanta (2004)

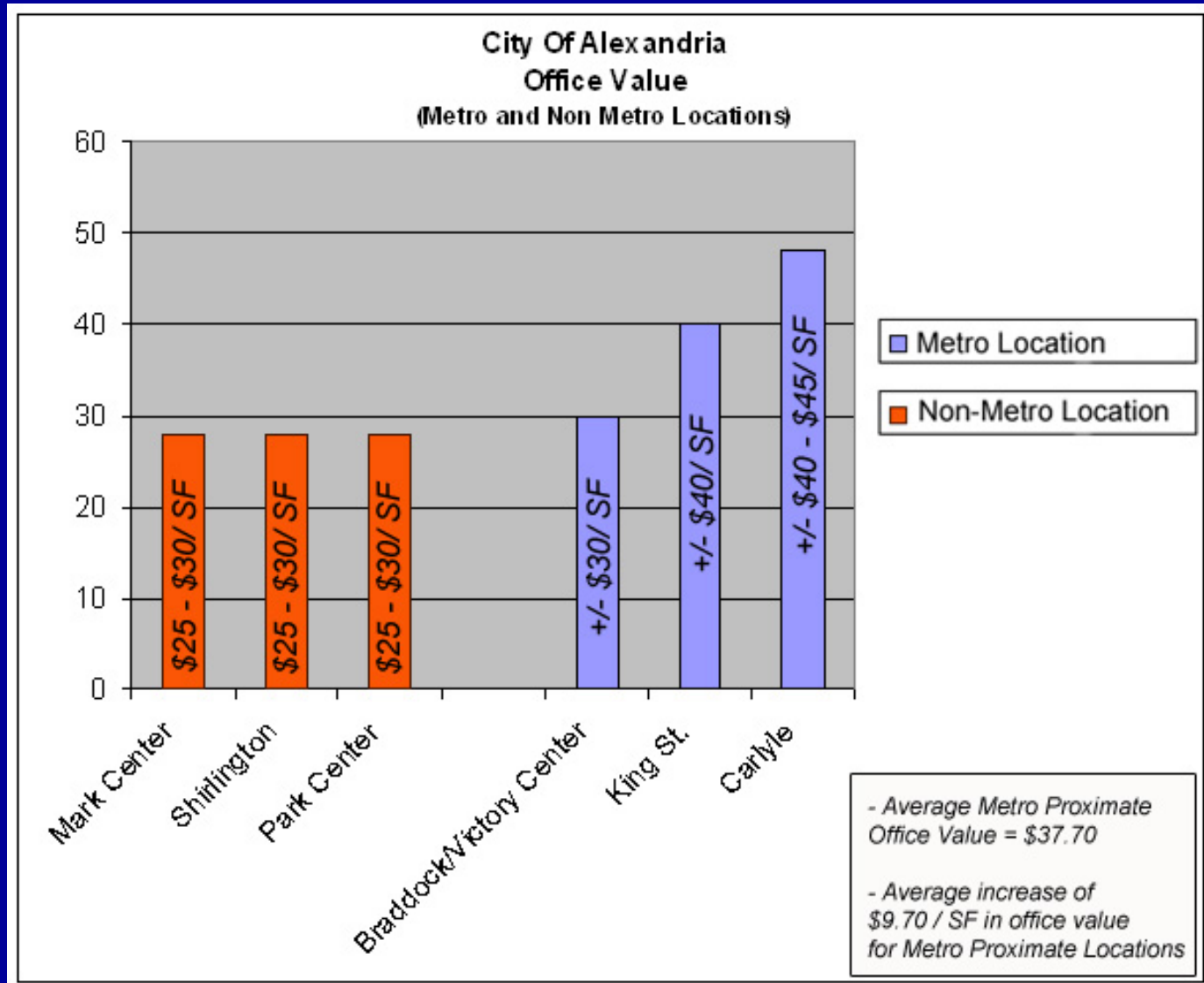
- Avg office rents increased by more than **\$3.00 /sf**
- Office vacancy dropped
- Avg building densities higher
- Higher share of regional growth/higher absorption

### *Transit Presence Impacts:*

*Property Value  
Building Density  
Absorption*

# Metro Impact Overview: Office

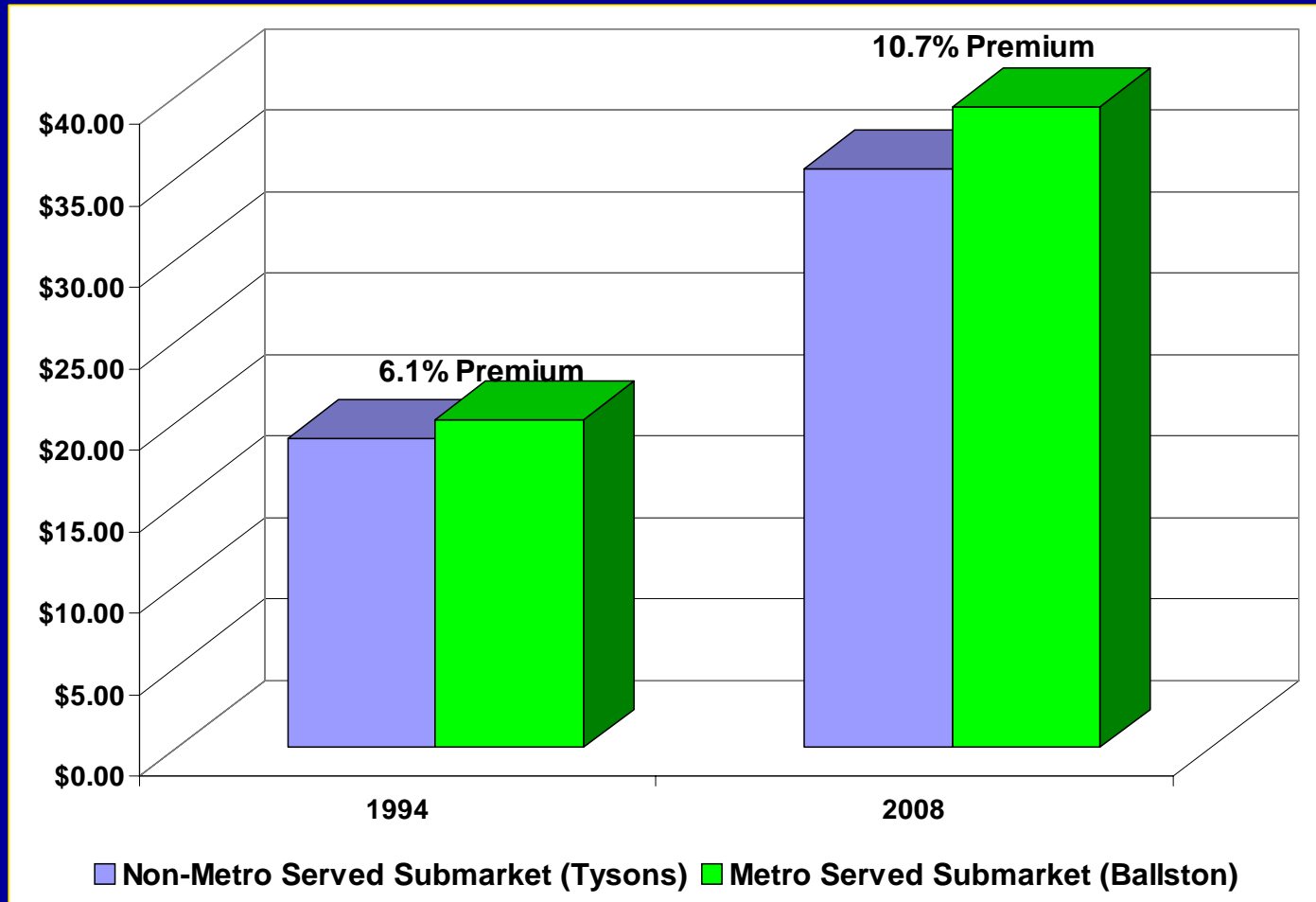
## Alexandria Office Comps



Source: City of Alexandria

# Metro Impact Overview: Office

*Non-Metro and Metro Submarkets: Asking Rents*



Source: Delta Associates (2008)

*Delta assumed 8% premium on office rents with Metro.*

# Metro Impact Overview: Residential

## Rent Premium for Proximity to Metro

	Low	High
Lincoln Property Co.	5%	10%
Bozzuto	10%	10%
Port Apartment Development	7%	8%
Charles E. Smith	3%	10%
Confidential	3%	3%
Trammell Crow Residential	6%	9%
Average	5.7%	8.4%
Delta Associates Estimate	7%	

Source: Delta Associates (2008)

# Scenarios

## Illustrative Proffer Impacts

Rental Residential  
Residential Condominium  
Office

# Rental Residential Implications

## *Assumptions*

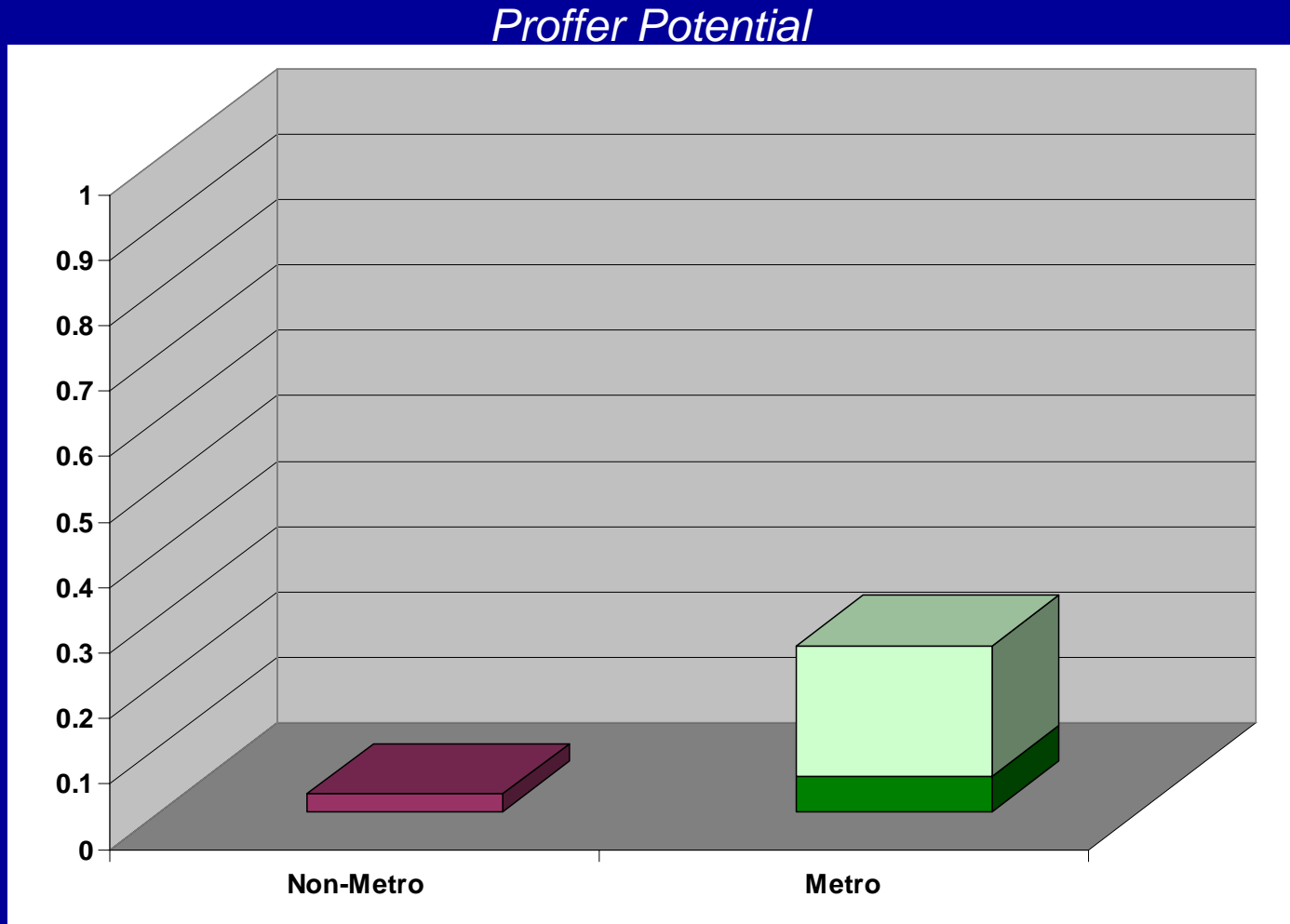
<b>Character</b>	<b>No Metro</b>	<b>Metro</b>	<b>Notes</b>
Height In Stories	5	12	Greater building density
Number of Units	155	310	
Parking Spaces /Unit	1.5	1.0	Transit reduces pkg need
Development Cost	\$244-\$254	\$281-\$291	Higher construction cost with high rise construction
Rent /Mo	\$1,900	\$2,250	Rents comparable to Carlyle Place, Meridian at Carlyle/Eisenhower





# Rental Residential Implications

*Proffer Potential*



# Residential Condominium Implications

## Assumptions

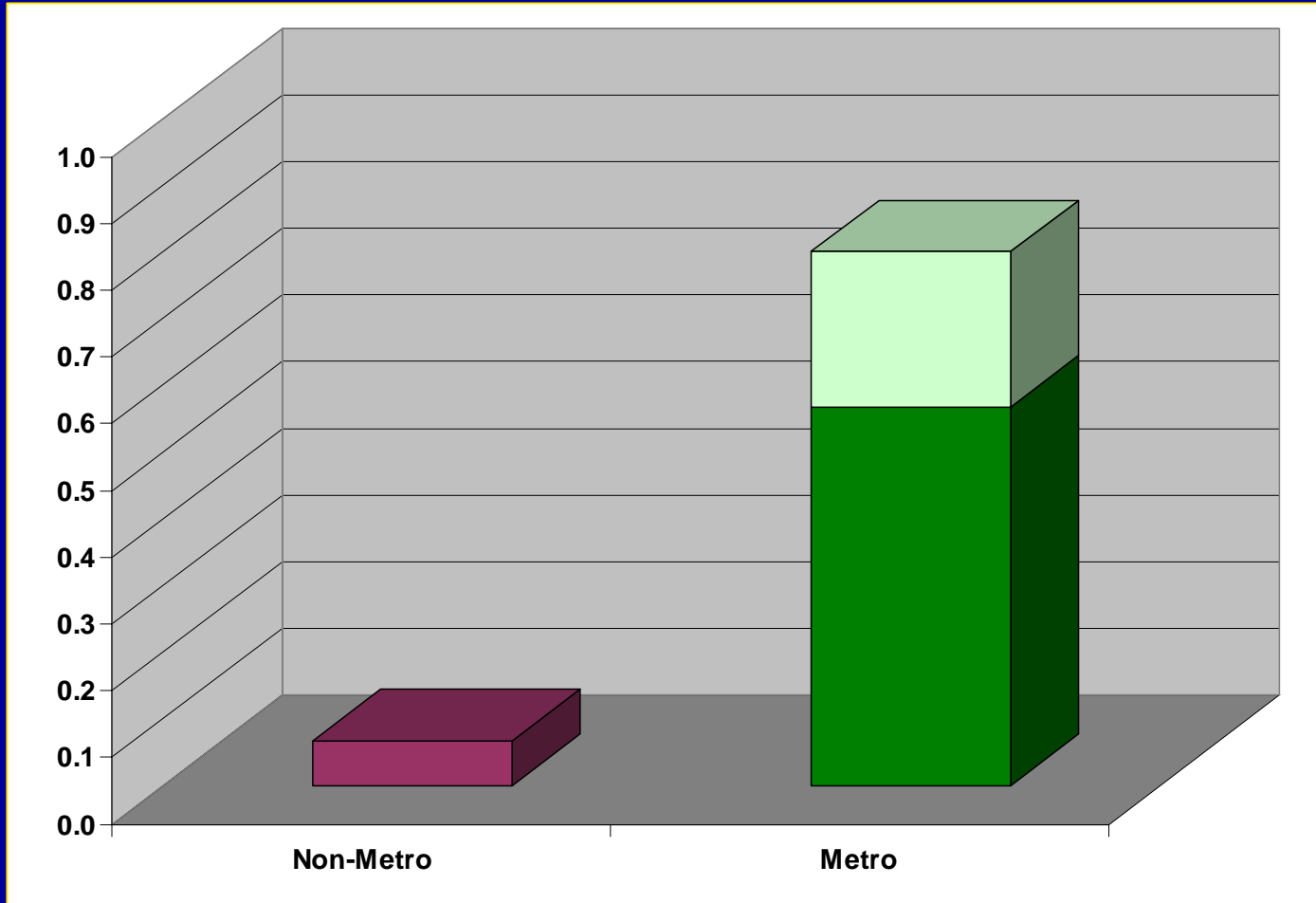
Character	No Metro	Metro	Notes
Height In Stories	12	12	Opportunity w/ Metro
Parking Spaces /1,000 sf	1.5	1.0	Transit reduces pkg need
Development Cost	\$288-\$298	\$276-\$286	High rise construction cost
Price /SF	\$430.00	\$450.00	7% increase in value w/ Metro
Parking Price for 0.5 car	\$25,000	\$0	1 parking space w/ unit price



# Residential Condominium Implications

*Impacts*

*Proffer Potential*



# Office Implications

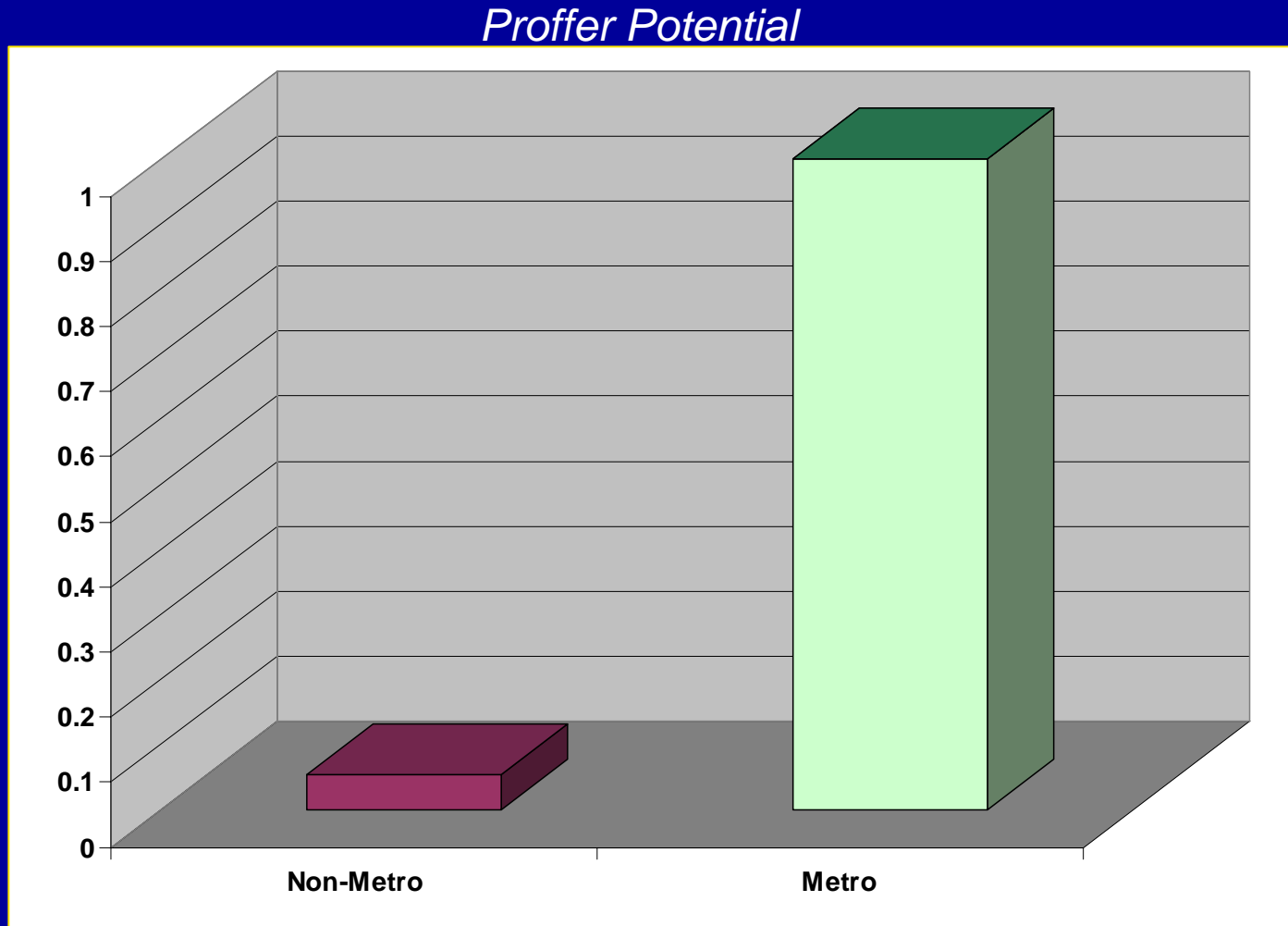
## *Assumptions*

<b>Character</b>	<b>No Metro</b>	<b>Metro</b>	<b>Notes</b>
Height In Stories	12	12	High Rise Construction
Parking Spaces /1,000 sf	2.03	1.66	Transit reduces pkg need
Development Cost	\$329-\$338	\$304-\$312	Lower Metro cost due to pkg reduction
Rent /Mo	\$38.00	\$41.00	8% rent premium assumed



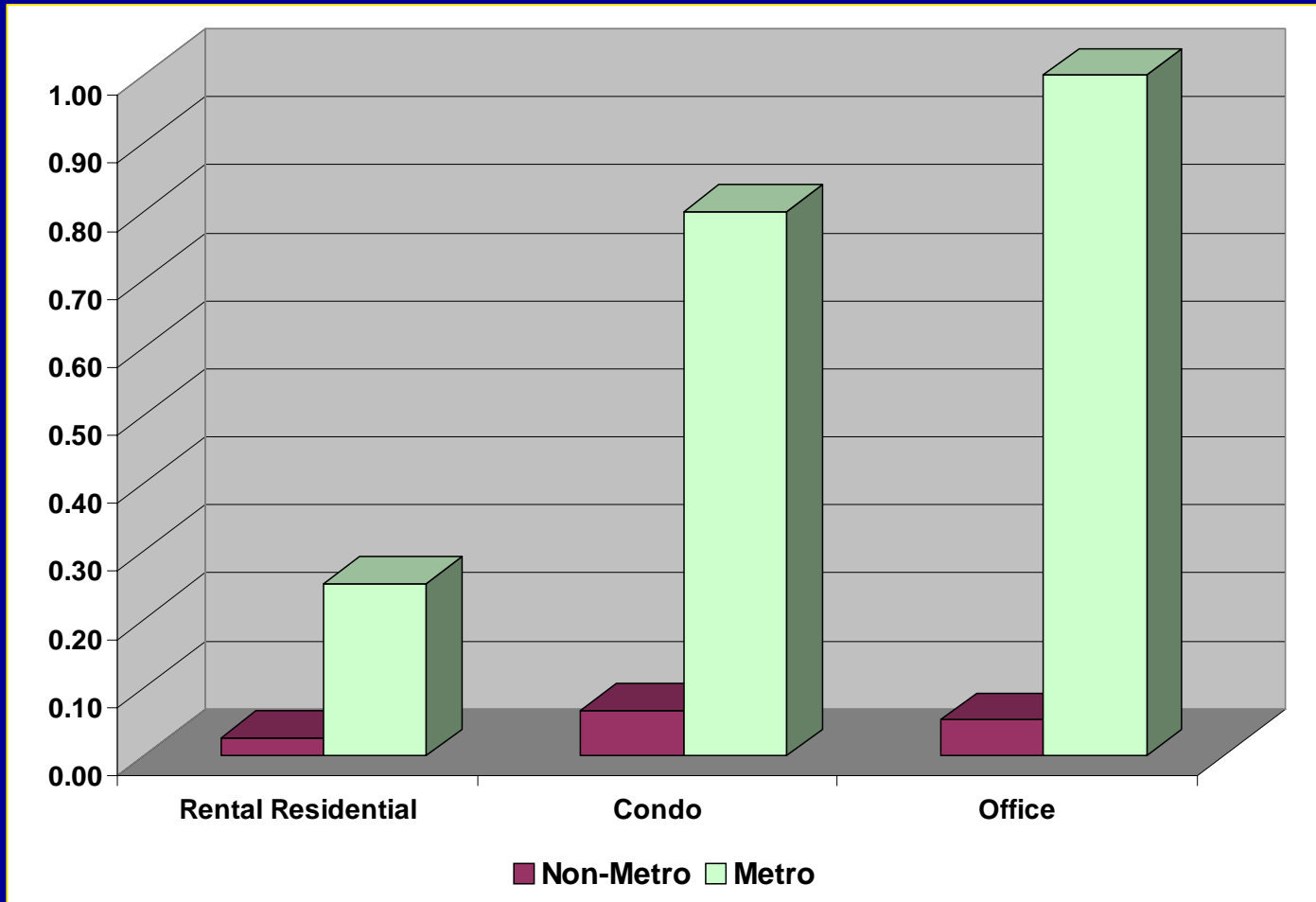
# Office Implications

*Proffer Potential*



# Summary: Metro Impacts on Proffer Potential

*Proffer Potential*



# Notes About Absorption

- Where office may be potentially the most profitable use, the near term market may be for rental residential. Metro may change the market positioning of the site to accelerate office development.
- All other things being equal, absorption (the amount and pace of development) near Metro stations is faster than non-Metro locations.

# Conclusions

- Proffer potential is driven by development economics – the potential is limited.
- Small changes in development cost and/or rent can have a significant impact on proffer potential.
- Parking (amount & type) is a major factor impacting proffer potential.
- Metro significantly increases proffer potential by creating market value (higher rents) and reducing development cost (less parking required).