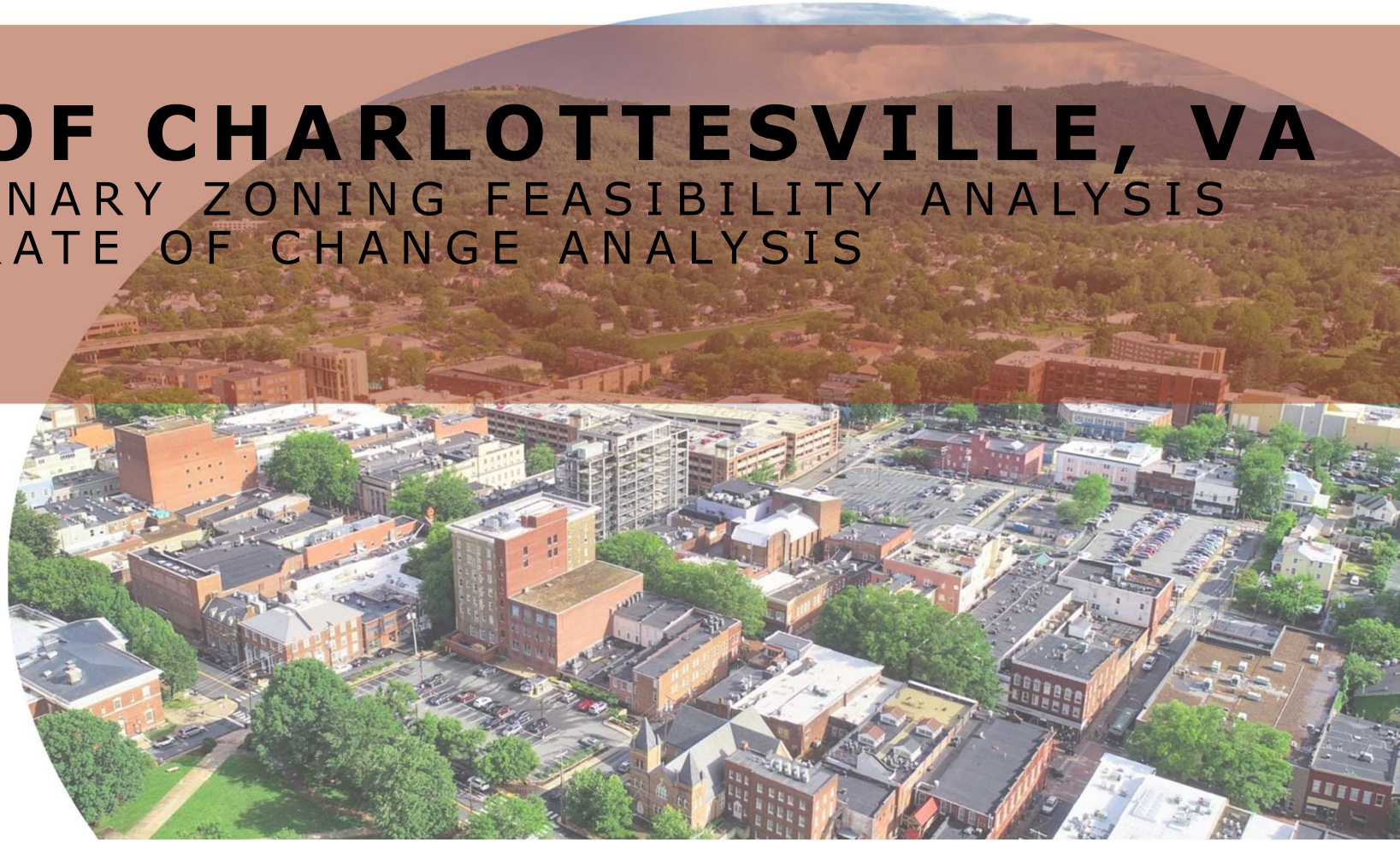
CITY OF CHARLOTTESVILLE, VA

INCLUSIONARY ZONING FEASIBILITY ANALYSIS
ZONING RATE OF CHANGE ANALYSIS



RKG ASSOCIATES INC

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INTRODUCTION

BACKGROUND

The City of Charlottesville is seeking to better understand the market and financial realities of its proposed zoning changes. Specifically, the City seeks to understand [1] the financial realities of its proposed inclusionary zoning (IZ) recommendation[1] to require projects with ten or more units to provide 10% of those units at a price point affordable to households earning 60% of the Area Median Income (AMI) and [2] the potential rate of change that may occur with the proposed R-A, R-B, and R-C zoning districts encouraged by the potential change in value due to the new zoning policies and allowances.

[1] Under Virginia law, and in Charlottesville's proposed zoning ordinance, an IZ program/ordinance is referred to as an Affordable Dwelling Unit (ADU) program/ordinance. This report will use the term IZ.

PROCESS - ANALYSIS

The model enables the City to test a series of prototypical developments to understand the financial implications of the proposed zoning ordinance changes.

For the IZ policy analysis, RKG tested specific scenarios and development typologies to determine the relative financial feasibility impact in relation to current market conditions, the proposed IZ policy, and the proposed bonus density recommendation (an additional two floors of housing in exchange for a 10% unit set-aside at 50% of AMI). RKG modeled projects in five distinct subareas of the City, defined through empirical and market analysis, to test potential changes across the city's unique housing submarkets.

For the rate of change analysis, RKG modeled different development programs across four unique subareas for each zoning category (R-A, R-B, and R-C) including an assessment of the proposed bonus density recommendation (additional units in exchange for making 100% of the units price controlled to a maximum of 60% AMI).

The importance of this analysis cannot be understated, as setting the appropriate parameters for any residential zoning ordinance is key to ensuring housing development accommodates various income levels across the city while minimizing impact on future development activity.

PROPOSED IZ POLICY

SET ASIDE

Projects including more than 10 units are required to designate 10% of the total number of units on-site as income controlled. Any fractional units (e.g., an 11-unit development would require 1.1 income-controlled units) is required to round up to the next whole unit (2 units in this case).

AMI

All income-controlled units are required to be priced affordably (pay less than 30% of gross income less utility allowances) for households earning 60% of Area Median Income (AMI).

BONUS DENSITY

Projects willing to commit to a 10% set aside at 50% of AMI would be entitled to two additional floors of residential development. This is contingent on meeting the other site requirements (e.g., setbacks).

PAYMENT IN LIEU

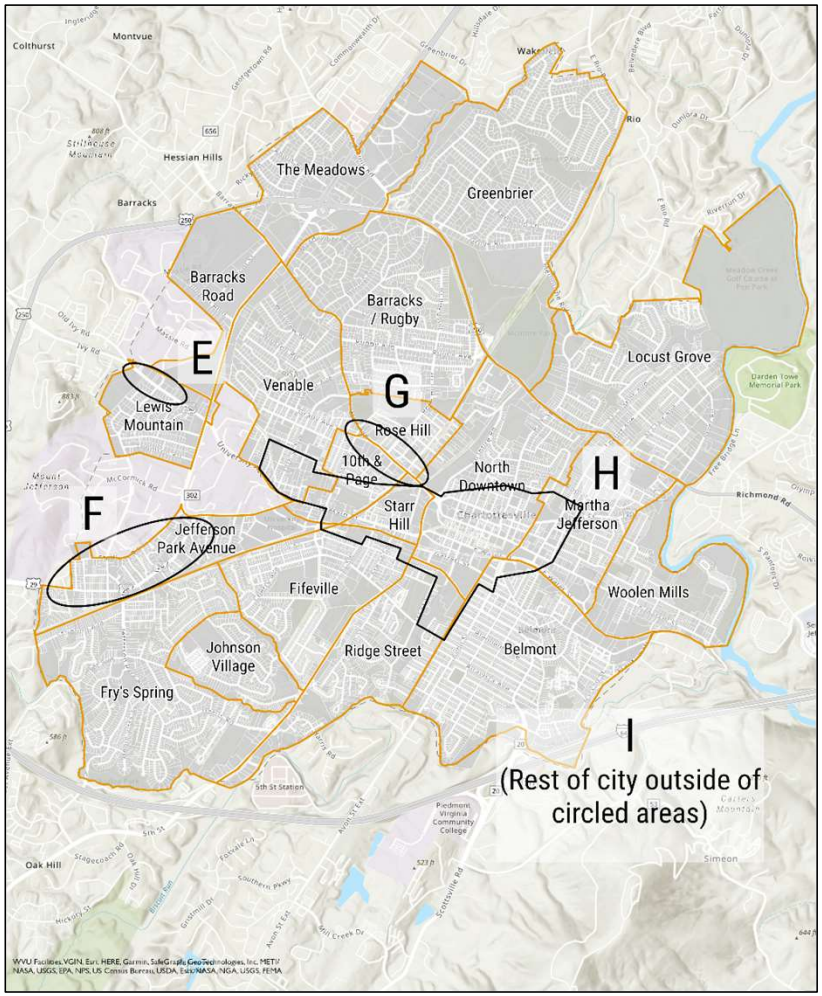
Developers have an option to provide a financial contribution to the City's Housing Trust Fund in lieu of providing on-site units. The current proposed payment in lieu (PIL) values are:

Unit Type	Rental Units	Owner Units
Studio Units	$195,000	N/A
1-Bedroom Units	$260,000	$165,000
2-Bedroom Units	$360,000	$230,000
3-Bedroom Units	$405,000	$435,000

SUBAREA BOUNDARY MAP
INCLUSIONARY ZONING

RKG Associates research indicates that multifamily rental income performance varies within the City. Most notably, zoning districts located closest to downtown Charlottesville achieve the greatest rental incomes (on a per square foot basis) than other areas of the City. Areas denoted as “E” and “F”, proximate to the University of Virginia, have the next highest rent capture. Area “I”, effectively rental zones in the rest of the City, have the lowest rent capture in the rest of the City.

To this end, the analysis separated these areas to better understand the financial feasibility calculations for rental properties. In effect, the assessment measures whether the proposed zoning changes vary based on location in Charlottesville.



PROPOSED RESIDENTIAL POLICY

ZONING DISTRICTS

The proposed zoning allocates former single-family districts into three distinct districts called R-A, R-B, and R-C. Each district has its own regulations regarding building mass, setbacks, etc.

R-A

Properties located in the R-A district are allowed to have up to three dwelling units if the lot is vacant or the existing structure is removed. As a bonus, R-A parcels can accommodate four units if the existing dwelling is preserved and the new structure can abide by development requirements. A different bonus of six units is being considered, with all six units being required to be priced for households earning at 60% AMI.

R-B AND R-C

Like R-A, the rules for maximum number of units are determined by whether development is new, infill, or redevelopment. A similar bonus density for affordability also is available.

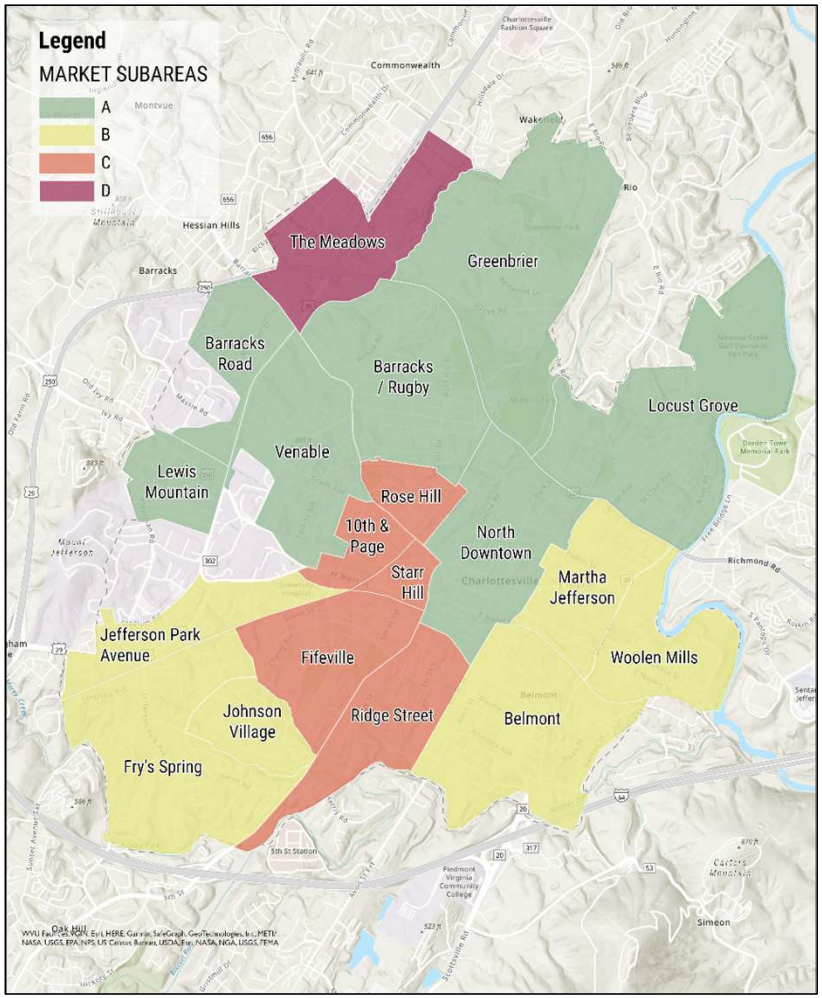
The following table details the maximum for each zoning district.

Zoning District	Maximum Units Demolition	Maximum Units Infill	Maximum Units 100% Affordable
R-A District	3	4	6
R-B District	6	8	12
R-C District	8	8	12

SUBAREA BOUNDARY MAP
RATE OF CHANGE

Like the rental analysis, RKG Associates research indicates that homeownership values vary within Charlottesville. RKG used the City's established neighborhood boundaries to create four distinct subareas for assessment. Area "A", locates in the northern part of the City, has the highest housing values (per square foot) for new construction units. Area "B" follows area "A". The historically African-American neighborhoods near downtown and The Meadows have the lowest home values, on average.

These differences are important to analyze separately for the Rate of Change analysis, as the value created by allowing 3-unit (R-A), 6-unit (R-B) and 8-unit (R-C) structures on previously single-family lots will impact the potential for speculation much differently based on potential value creation and existing home values.



METHODOLOGY

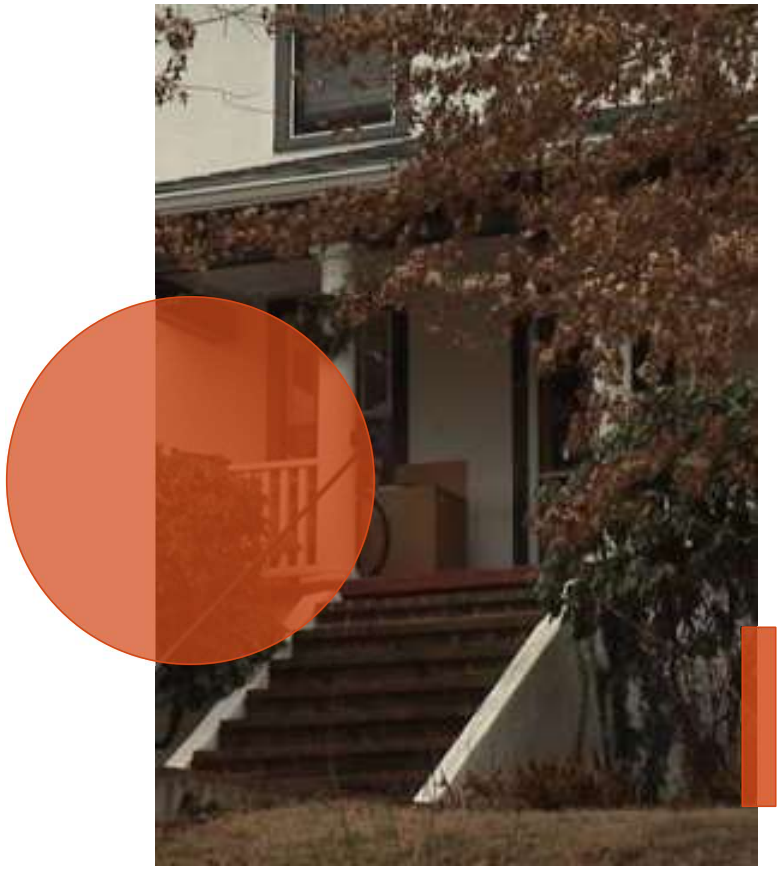
METHODOLOGICAL OVERVIEW

THE FINANCIAL FEASIBILITY MODEL IS A PROFORMA-BASED EXCEL MODEL THAT IS DESIGNED TO TEST THE FINANCIAL IMPACT OF POTENTIAL POLICY CHANGES AGAINST THE FINANCIAL RISK/REWARD OF A POTENTIAL INVESTMENT.

RKG's financial feasibility model uses locally-sourced data to determine how changes to Charlottesville's zoning code (both the Inclusionary Zoning component and the transition from traditional single-family designations) could impact the financial performance of a potential project. At its most basic level, the model is designed to capture construction and operational costs and compare those to potential revenues to determine if the project will meet or exceed local return expectations.

The model has the capability to test variations across nearly all data points to test the sensitivity of dozens of variables on financial feasibility. This includes variability in construction costs, land costs, operational costs, development type and size, location within the City, and more. The model is also set up to test changes in affordability metrics such as the percentage of affordable units, target AMIs, unit thresholds, and more.

While the model is a powerful tool to understand the impacts of changes to the zoning code and the sensitivity of modifying assumptions, it is not intended to be the only analytic or policy tool the City of Charlottesville should consider as it weighs changes to its zoning policies.



METHODOLOGY
MODELING INPUTS

All financial feasibility modeling is based upon three principal components: construction costs, operational revenues, and operational costs. Each component relies upon several market-based and financial inputs for the model to be effective.

RKG Associates' approach to model building focuses on using locally-derived inputs so that findings are relevant to the community/study area being considered. To this point, RKG conducted a comprehensive analysis of all facets of financial feasibility of residential development in the City of Charlottesville.

The primary inputs for which local data was derived include, but is not limited to:

Construction Costs
- Soft costs – design and preparation
- Hard costs – materials and construction
- Land costs – physical location

Operation Costs
- Financing costs – debt and equity to pay for the project
- Marketing, management, repairs, property taxes

Operational Revenues
- Rental rates and sale prices
- Parking revenue

METHODOLOGY
CONSTRUCTION COSTS

To determine hard costs for construction and parking, RKG interviewed several for-profit and non-profit developers, as well as referencing Marshall & Swift Valuation Services data to build out customized per square foot construction costs for stick, stick over podium, and steel frame construction typologies.

Similarly, RKG collected information on construction costs for two types of parking costs: surface lots and structured podium parking.

Lastly, a land cost analysis was conducted by RKG on recently completed residential projects to understand the land price per unit developers have paid. RKG used interview data from for-profit and non-profit developers to verify the research.

METHODOLOGY
OPERATIONAL COSTS

Development financing is possibly the most important element of any real estate deal. Different types of financing are available depending upon the scale of the project.

Through interviews with for-profit and non-profit developers, RKG gained an understanding around debt, operational costs, and vacancy assumptions used in developer proformas.

Additionally, information on financial return expectations was obtained and used as a benchmark for the financial feasibility model to understand the impact policy changes may have on a projects financial return metrics.

METHODOLOGY
REVENUES

RKG collected rental rate data for residential projects completed since 2018, which included pricing for efficiency (studio), one-bedroom, two-bedroom, and three-bedroom apartments.

The market rental rates were used as a baseline for the analysis and compared to information obtained from developer interviews.

The sales values of housing units were determined through a combination of market research and utilizing the City's property sales database to parse the most recent sales values by bedroom count.

The results were used to set baseline assumptions around sale prices in the model.

MODELING INPUTS

DEVELOPMENT ASSUMPTIONS
HARD AND SOFT COSTS

Hard construction costs vary by building construction type:

- Stick
- Stick over podium
- Steel
- Ownership (Condo and TH)

Soft costs average around 15% of hard costs.

Parking is expensive, ranging from an average of $22,000 per space for surface parking to $50,000 per space for structured parking

Construction Assumptions

Hard Construction Costs (PSF)	Apartment	Condo/Townhouse
Stick	$230	$175
Stick Over Podium	$300	N/A
Steel Frame	$400	N/A

Soft Costs (% of Hard Cost)	
Soft Costs	15.00%

Parking Costs (Per Space)	
Surface	$22,000
Structured Aboveground	$50,000
Structured Belowground	$100,000

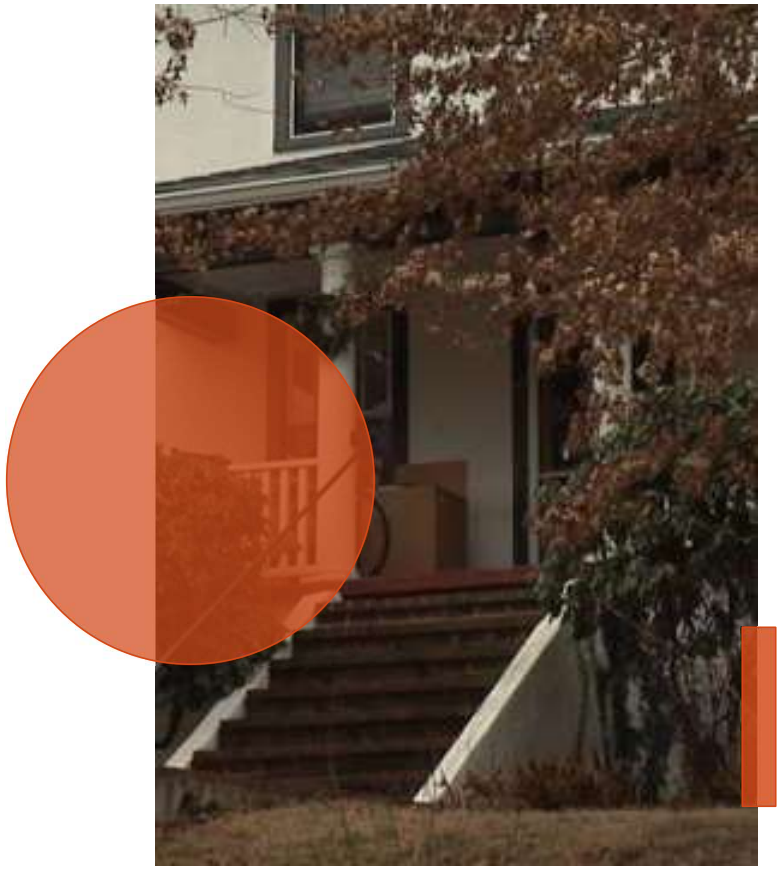
Note: Values are based on data collected from stakeholders.

OPERATING EXPENSES

Operating expenses are the cost of a property owner to market, maintenance and manage a rental property.

Operating costs do not vary for market rate or income-controlled units, as costs do not change dramatically based on a tenant.

Vacancy and collection loss for new construction projects are consistent throughout Charlottesville, with most impacts reflecting turnover (time between tenant occupation).



Operating Expenses (As a % of Rental Revenue)	
Operating Expenses (Market Rate)	25%
Vacancy & Collection Loss	5%

Note: Values are based on data collected from stakeholder interviews.

Source: Developer Interviews, RKG Associates, 2022

DEVELOPMENT ASSUMPTIONS FINANCIAL

Changing interest rate environment makes financing a project more difficult. Recent increases in interest rates have adversely impacted new development

Larger developers can attain better rates than smaller developers.

Equity requirements average around 20%

Developer returns vary depending on the type of metrics they use, with owner development and renter development having different metrics.

Financial Assumptions

Financing Costs	
Interest Rate	6.00%
Equity Required	20%

Expected Financial Return	Average
Internal Rate of Return (Rental)	12.00%
Internal Rate of Return (Ownership)	20.00%
Return on Cost	5.50%

Note: Values are based on data collected from stakeholder interviews.

REVENUE ASSUMPTIONS
OWNERSHIP SALE PRICES PER SF

RKG used the City's property assessment database and Multiple Listing Service (MLS) data to analyze sales prices by neighborhood for new construction product built in the last five years.

Sales prices varied substantially, with the more traditional suburban area of the City (Area A) commanding the highest prices per square foot.

Price differential between new construction and existing stock is substantial.

Neighborhood	Condominiums	Townhomes
Area A	$570	$325
Area B	$370	$285
Area C	$300	$255
Area D	$300	$255

Note: In cases where data points were unavailable, RKG is showing the average price of the City adjusted to the study area
Source: RKG Associates, 2023

REVENUE ASSUMPTIONS
MARKET RATE RENTS PER SF

RKG conducted a market survey using online databases and information provided by multifamily developers/operators to analyze rents by neighborhood for new construction product built in the last five years.

Based on interviews with developers, rent on new product is generally priced at a premium between 10% and 15% above the market. The financial feasibility analysis accounts for this.

Neighborhood	Studio	1BR	2BR	3BR
Area E	$2.75	$2.90	$2.50	$2.10
Area F	$2.75	$2.90	$2.50	$2.10
Area G	$3.00	$3.10	$2.90	$2.40
Area H	$3.00	$3.10	$2.90	$2.40
Area I	$2.40	$2.45	$2.35	$2.00

Note: In cases where data points were unavailable, RKG used the average price for the City adjusted to the that study area
Source: RKG Associates, 2023

MODEL OUTPUTS

THE CORE FUNCTION OF THE IDP MODEL IS TO UNDERSTAND HOW CHANGES IN POLICY IMPACT FINANCIAL RETURNS COMPARED TO MARKET EXPECATATIONS.

FINANCIAL ANALYSES

The model measures three financial outcomes using three different metrics; Return on Cost (ROC), Internal Rate of Return (IRR), and Land Values. Each measure represents a decision point for those involved in the transactions that make residential development financially feasible:

- ROC – Investors/Developers
- IRR – Developers/Operators
- Land Values – Property Owners

For a project to move forward, each group must have confidence that their investment requirements and return expectations can be met. Each group is measuring the risk/reward of a given project compared to other opportunities that may be in Charlottesville, elsewhere in Virginia, or in other markets across the United States.

It is important to recognize that for a project to move forward, it requires support from all three groups.

PROJECT EXAMPLES

To test the financial implications of the Inclusionary Zoning policy, the model was constructed with data local to different subareas across the City recognizing that revenue assumptions vary depending on where a project is located.

To highlight these differences, this report provides examples of how different development and location assumptions can impact financial feasibility including:

- Selected neighborhoods that have varying development typologies and market factors (e.g., price points)
- Impacts of smaller (25 units) and larger (200 units) projects in each study area
- Using different development assumptions based on project size and location

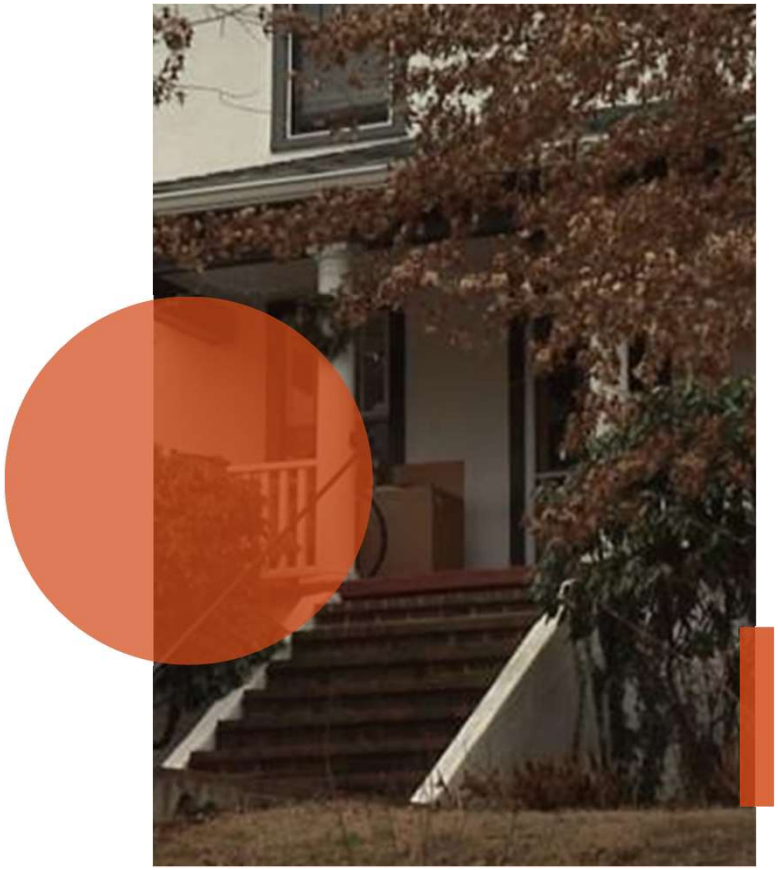
IMPLICATIONS

THE FINANCIAL FEASIBILITY MODEL IS LIMITED BY ITS INPUTS.

Given the complexity of development projects in diverse communities like Charlottesville, it is difficult to model every possible nuance or special situation that may create unique outcomes for a project. This particularly true for legacy-owned parcels and student-targeted development. To this point, this model uses averages and typical development scenarios based on recent development trends. The model is sensitive to changes in these underlying assumptions, so in the future if costs and revenues deviate from normal averages, we may anticipate outcomes in the model to change as well.

FINANCIAL PERFORMANCE IS JUST ONE FACTOR IN THE DECISION-MAKING PROCESS OF DEVELOPERS.

It is important to acknowledge that the financial performance of a project is one of many factors developers and investors consider when looking at a deal. Developers also assess project risk and feasibility based on ease of process and permitting, flexibility in zoning, location and amenities, strength of the market, and strategic value. Given the variability and difficulty of assessing all these additional factors, the model focuses primarily on the financial aspects of the project.



INCLUSIONARY ZONING ANALYSIS

INCLUSIONARY ZONING ANALYSIS

The financial feasibility analysis conducted by RKG provides key insights regarding the relative impact on financial feasibility resulting from the proposed Inclusionary Zoning (IZ) policy.

To that end, RKG modeled multiple prototypical development scenarios by calibrating the model with market-tested assumptions and tested the findings against real world examples.

The financial model calculates the basic go/ no-go decision a developer must make about a potential project. The decision to pursue a project comes down to overall financial return and risk exposure.

The model tests Internal Rate of Return (IRR) and Return on Cost (ROC) metrics. The rental analysis focuses on the IRR metric, as it was proven to be the most difficult to reach market return expectations (noted through feedback to currently be 15% preferred, 12% minimum).

The market scenario analysis provides an assessment of how a project would perform (financially) based on market averages for acquisition, construction, operation, and reversion.

The analysis presents the performance of projects when using the proposed set aside rate (10%) at the proposed Area Median Income (AMI) target rate of 60%.

RKG tested the development feasibility across several scenarios testing project size (number of units), construction typology (wood frame, podium), and proposed policy conditions (bonus density).

While the following pages detail the results, the universal implication is that the greater the set-aside requirement and lower target AMI, the greater the financial strain on a development project.

WOOD FRAME CONSTRUCTION

Multifamily rental development in areas E, F, G, and H are financially feasible under the proposed IZ policy guidelines (10% unit set aside at 60% of AMI) for projects that can be built using wood-frame construction (less than 5 floors total). While the IZ policy reduces the IRR, the project remains above the 12% minimum threshold.

Areas G and H perform better given their higher rent rates than Areas E and F. To this point, these areas could support up to a 15% set aside at 60% AMI and remain financially feasible.

The proposed bonus density strategy also works if the development can remain below 5 stories (e.g., in MX-3).

For Area I, multifamily development is not feasible due to the much lower rental rates captured in this area. The data indicate a development would require a lower price point for land (identified as $40,000 per unit) to reach the target threshold.

IRR	Market Rate Development			
	10 Units	25 Units	50 Units	100 Units
Area E/F	14.7%	14.5%	14.7%	14.7%
Area G/H	18.8%	18.7%	18.8%	18.8%
Area I	11.0%	10.9%	11.0%	11.0%

IRR	Proposed IZ Policy (10% at 60% AMI)			
	10 Units	25 Units	50 Units	100 Units
Area E/F	14.0%	12.4%	12.8%	12.5%
Area G/H	18.3%	16.2%	16.7%	16.3%
Area I	10.8%	9.1%	9.4%	9.0%

IRR	Bonus Density (10% at 50% AMI with 2 Floors)			
	10 Units	25 Units	50 Units	100 Units
Area E/F	12.5%	11.8%	12.3%	12.1%
Area G/H	16.4%	15.7%	16.3%	16.0%
Area I	9.4%	8.4%	8.9%	8.7%

PODIUM CONSTRUCTION

Transitioning from wood frame construction ($230 PSF) to podium construction ($300 PSF) without any appreciable increase in revenue creates substantial financial hardship for new multifamily development in Charlottesville.

This also holds true for projects that want to use the bonus density feature that will require them to switch from wood frame construction (5 stories) to podium construction (7 stories). Effectively, the cost of construction increase will render the taller development infeasible.

The analysis for steel-frame construction ($400 PSF) has similar, albeit worse, results for development feasibility.

Anecdotally, the cost of construction for buildings over 5 stories has reached a point where even student-targeted rental housing—which generates substantially higher PSF rent levels than more traditional rental developments—currently is not financially feasible without some mitigating cost offset (e.g., lower land prices).

IRR	Market Rate Development			
	10 Units	25 Units	50 Units	100 Units
Area E/F	5.3%	5.1%	5.3%	5.3%
Area G/H	9.9%	9.7%	9.9%	9.9%
Area I	0.8%	0.6%	0.8%	0.8%

IRR	Proposed IZ Policy (10% at 60% AMI)			
	10 Units	25 Units	50 Units	100 Units
Area E/F	4.6%	2.7%	3.0%	2.6%
Area G/H	9.1%	7.2%	7.5%	7.1%
Area I	0.4%	-1.6%	-1.4%	-1.9%

IRR	Bonus Density (10% at 50% AMI with 2 Floors)			
	10 Units	25 Units	50 Units	100 Units
Area E/F	3.0%	1.8%	2.5%	2.2%
Area G/H	7.6%	6.5%	7.1%	6.9%
Area I	-1.1%	-2.8%	-2.0%	-2.3%

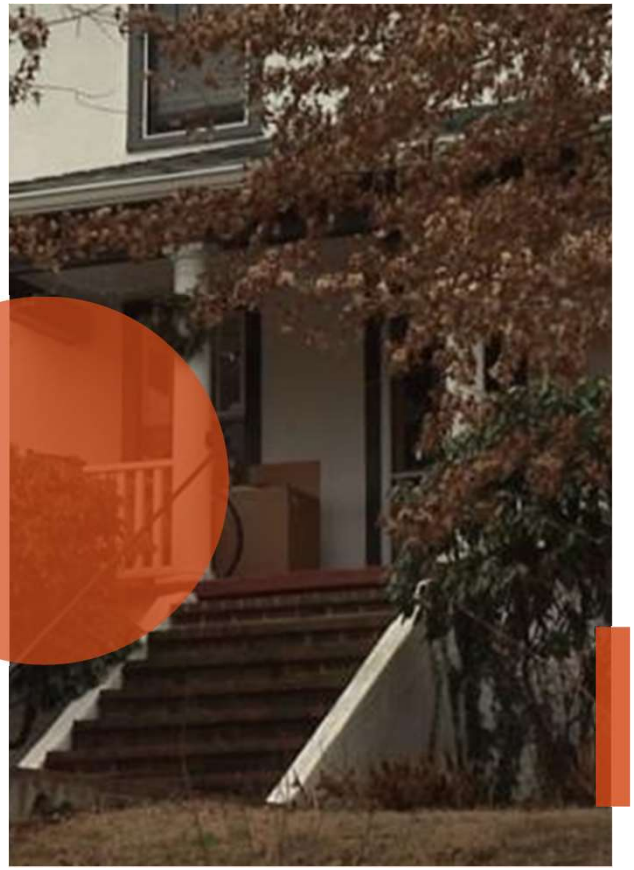
IMPLICATIONS

The proposed Inclusionary Zoning policy is appropriate in the City's traditional rental development areas.

The modeling indicates that requiring 10% of units at 60% of AMI is financially feasible in the areas surrounding Downtown, UVA, and along Route 29 (Area E). While the policy does have a slight negative financial impact on projects, the analysis indicates wood frame projects within Areas E, F, G, and H remain financially feasible.

The Downtown area could support greater affordability requirements.

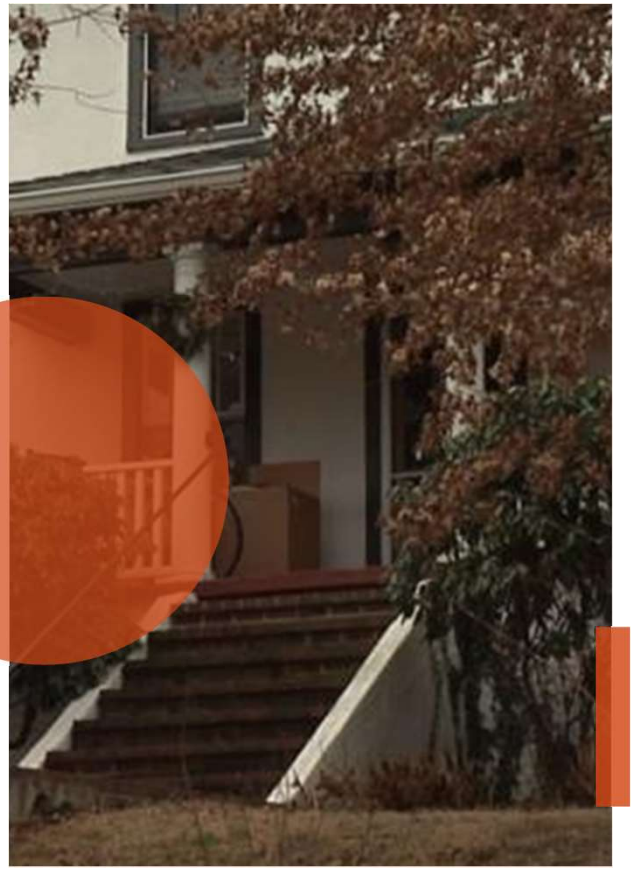
Due to the higher rent thresholds achieved in Areas G and H, the analysis indicates these areas could support a set aside rate of 15% and maintain financial feasibility (based on current conditions). Effectively, the higher rent capture can support a larger affordability requirement (either higher set aside or a lower AMI at 10% set aside). This would require the City to establish a tiered IZ policy based on location within Charlottesville.

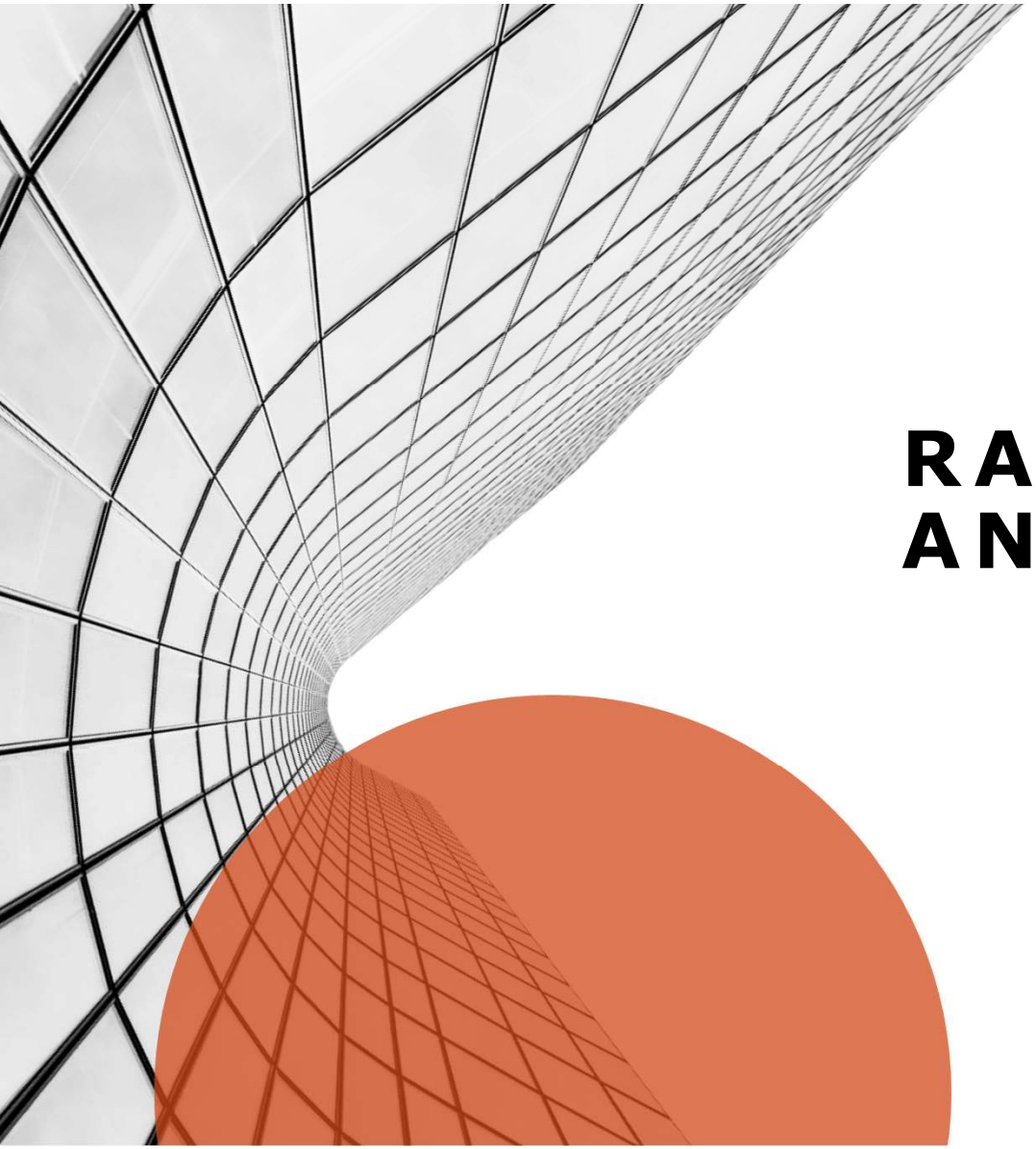


IMPLICATIONS

Concrete and steel construction is not supportable.

As noted, the cost differential for concrete and steel construction is prohibitively high in Charlottesville based on the likely revenue capture. In effect, the cost of buildings has exceeded the rent capacity for most projects. While RKG recognizes that specialty projects (e.g., senior care) that command much higher rent levels than a 'traditional' rental project could succeed, the average multifamily project is infeasible under current market conditions without some cost or revenue intervention.





RATE OF CHANGE ANALYSIS

RATE OF CHANGE ANALYSIS

The City is considering revamping its single-family (SF) zoning designations to allow for small, multi-unit structures. The proposed policy realigns the code into the zones R-A, R-B, and R-C. The introduction section details the maximum unit allowances in these areas *if the parcel can accommodate the other policy requirements (e.g., property setbacks).*

As part of this assessment, the City leadership requested that an updated analysis be done to determine the potential rate of change—or likelihood that an owner/investor will want to convert a single-family dwelling parcel into a multi-unit dwelling parcel—within these differing zones.

The rate of change analysis was performed in two phases

The first effort was to determine the value of a parcel to an investor/owner interested in executing on the multi-unit option. This effort uses the financial feasibility model to determine feasibility through isolating the land value. In short, the financial feasibility model provides a likely value that the typical parcel within R-A, R-B, and R-C would attract from a multi-unit investor.

The second effort is identifying how many parcels within R-A, R-B, and R-C that are valued below these new value thresholds and therefore would potentially be sold for infill (maintaining the existing unit) or redevelopment (demolishing the existing unit).

Like the IZ analysis, the rate of change analysis separated Charlottesville into four submarkets due to the value differential of the typical SF house.

DEMOLITION SCENARIO

The first scenario follows the base zoning where the existing structure is demolished and replaced with the maximum number of units (R-A is 3, R-B is 6, R-C is 8).

For Area A, the land value is strongest for an ownership development, consistent with the valuation and rent threshold data presented earlier in the document. Effectively, Area A has a much stronger ownership market than it does a rental market.

For Area B, valuation is higher as a rental development than if it was sold for an ownership development.

For Areas C and D, rental income thresholds are much higher than ownership unit values, making a redevelopment that includes rental units as more valuable to a potential investor.

These projected values are then compared against existing property values within each subarea within each of the proposed zoning district boundaries.

LAND VALUE	Rental Replacement Units		
	R-A	R-B	R-C
Area A	$271,826	$525,322	$702,228
Area B	$338,341	$658,351	$885,434
Area C/D	$446,298	$874,266	$1,160,294

LAND VALUE	Condominium Replacement Units		
	R-A	R-B	R-C
Area A	$848,698	$1,276,735	$1,702,313
Area B	$170,013	$362,995	$483,993
Area C/D	$56,300	$121,744	$162,324

INFILL SCENARIO

The second scenario follows the base zoning where the existing structure is retained, and additional units are built in an adjacent/adjoining structure. The maximum number of units for these scenarios are one higher for R-A and R-B. R-C is not proposed to offer an additional unit for retaining the existing structure.

Land values increase in zoning districts R-A and R-B accordingly due to having an additional revenue unit and eliminating the demolition costs (however, rehabilitation costs are considered).

This scenario would create greater value for an investor/developer.

LAND VALUE	Rental Replacement Units		
	R-A	R-B	R-C
Area A	$506,069	$702,228	$702,228
Area B	$588,921	$885,434	$885,434
Area C/D	$745,891	$1,160,294	$1,160,294

LAND VALUE	Condominium Replacement Units		
	R-A	R-B	R-C
Area A	$851,157	$1,702,313	$1,702,313
Area B	$241,997	$483,993	$483,993
Area C/D	$81,183	$162,325	$162,325

AFFORDABLE BONUS SCENARIO

The current zoning allows for an affordable housing bonus density that increases the maximum number of units of 100% of the units are income-controlled at 60% of AMI. The analysis shows that requiring 100% affordability at 60% of AMI renders all land valueless and would even require additional subsidy above getting the land for free.

LAND VALUE	Rental Replacement Units		
	R-A	R-B	R-C
Area A	($25,497)	($349,004)	($349,004)
Area B	($25,497)	($349,004)	($349,004)
Area C/D	($25,497)	($349,004)	($349,004)

RKG ran the analysis assuming only 50% of the units would have to be income controlled. It produced the following land values for a rental project (Areas E and F). Area G and H are slightly higher, while Area I is lower. Ownership projects still would create a negative land value

- R-A = $256,152
- R-B = $259,681
- R-C = $512,304

LAND VALUE	Condominium Replacement Units		
	R-A	R-B	R-C
Area A	($512,824)	($1,016,413)	($1,016,413)
Area B	($512,824)	($1,016,413)	($1,016,413)
Area C/D	($512,824)	($1,016,413)	($1,016,413)

UNIT VALUATION

The second step is to identify those parcels with a current value below the likely market valuation for each property based on the new zoning allowances in R-A, R-B, and R-C.

Based on the proposed boundaries for R-A, R-B, and R-C, there are 11,763 parcels located within these proposed designations.

	R-A	R-B	R-C	Total
Area A	3,236	774	129	4,139
Area B	3,697	842	544	5,083
Area C/D	2,082	210	249	2,541
Total	9,015	1,826	922	11,763

RKG Associates then parsed these parcels based on their current market value in comparison to the maximum value created by the rezoning for each subarea and each zoning group. The allocation was as followed

- Those valued at or above the created value
- Those 0% to 25% less than the created value
- Those 25% to 50% less than the created value
- Those more than 50% less than the created value

UNIT VALUATION

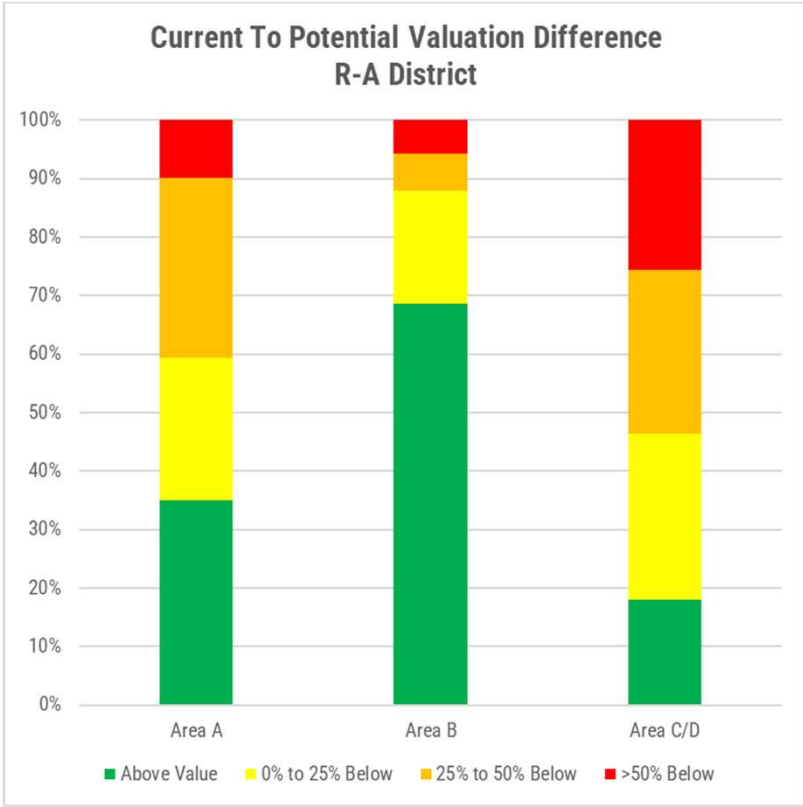
Parcels within Areas C and D (the sensitive neighborhoods within Charlottesville) have a much lower existing value compared to the potential value, on average. This means these parcels are more likely to be purchased for infill/redevelopment into market rate rental/ownership housing than Area A and Area B.

Based on the data analyzed for this effort, Areas C and D are 1.5x as likely to change than Area A and more than 4-times more likely to change than Area B. Based on consumption patterns, the rate of change in zoning district R-A for each Area is:

Area A – 2.22% annually (72 parcels annually)

Area B – 0.79% annually (29 parcels annually)

Areas C/D – 3.36% annually (70 parcels annually)



UNIT VALUATION

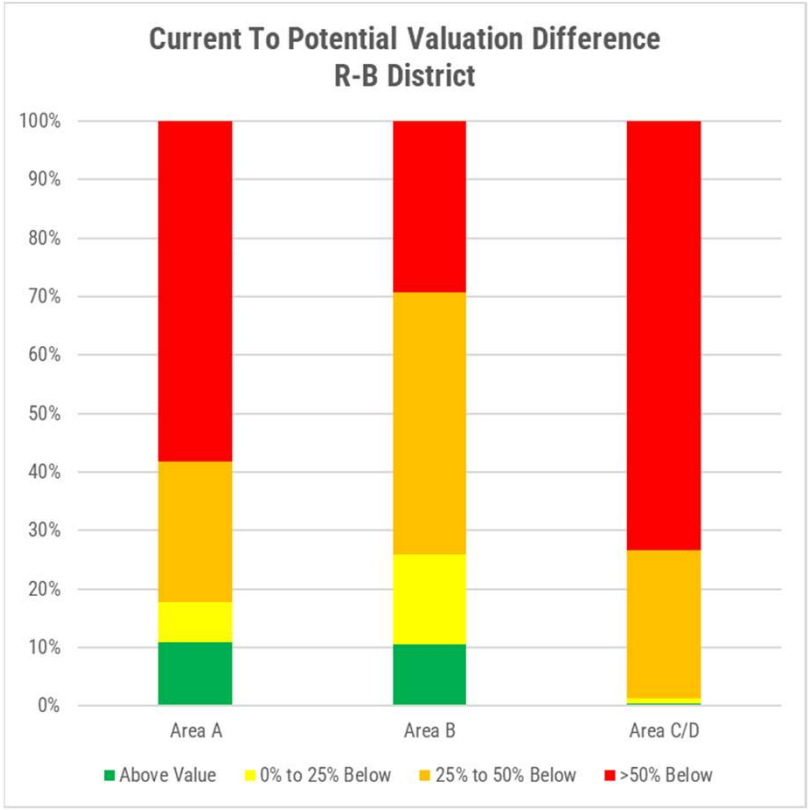
For zoning classification R-B, the additional allowed housing units create higher residual land values for redevelopment. As a result, the number of parcels where the new zoning will create a higher value than as the current use has gone up. As a result, the rate of change for R-B is much higher (4.39% annually to 7.00% annually) than in the R-A district.

Like the R-A analysis, the relatively higher land values in Areas A and B result in a comparatively lower rate of change Based on consumption patterns, the rate of change in zoning district R-B for each Area is:

Area A – 5.76% annually (45 parcels annually)

Area B – 4.39% annually (37 parcels annually)

Areas C/D – 7.00% annually (15 parcels annually)



UNIT VALUATION

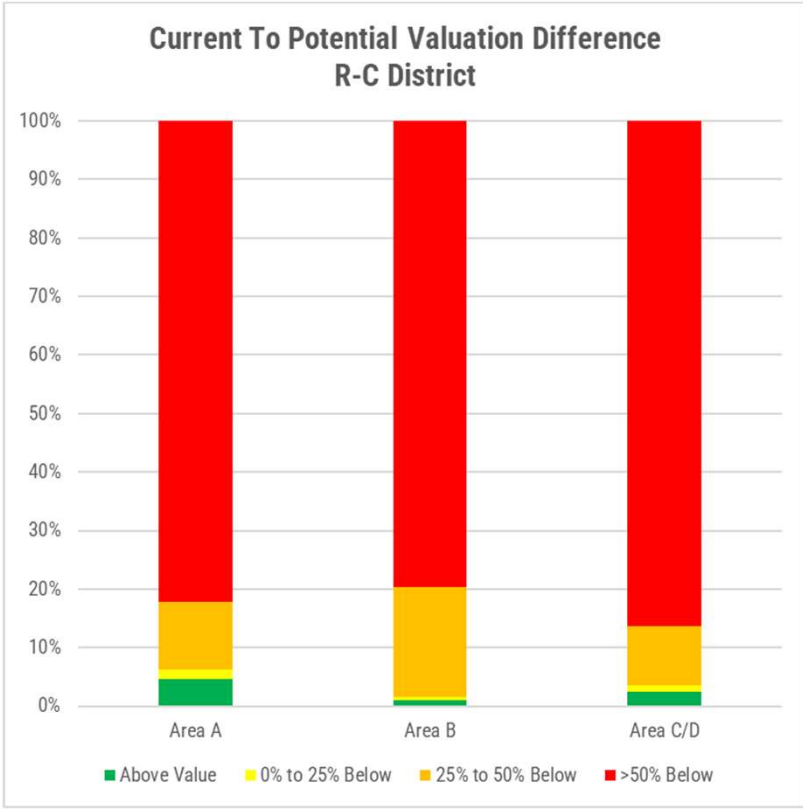
Allowing eight units by right on parcels previously used as single-family lots creates substantial market value (as rental or ownership). As a result, more than 80% of parcels in zoning classification R-C will become substantially more valuable for redevelopment. Unlike R-A and R-B, the value created exceeds existing values similarly across all four study areas.

Based on consumption patterns, the rate of change in zoning district R-C for each Area is:

Area A – 7.10% annually (9 parcels annually)

Area B – 7.22% annually (39 parcels annually)

Areas C/D – 7.36% annually (18 parcels annually)



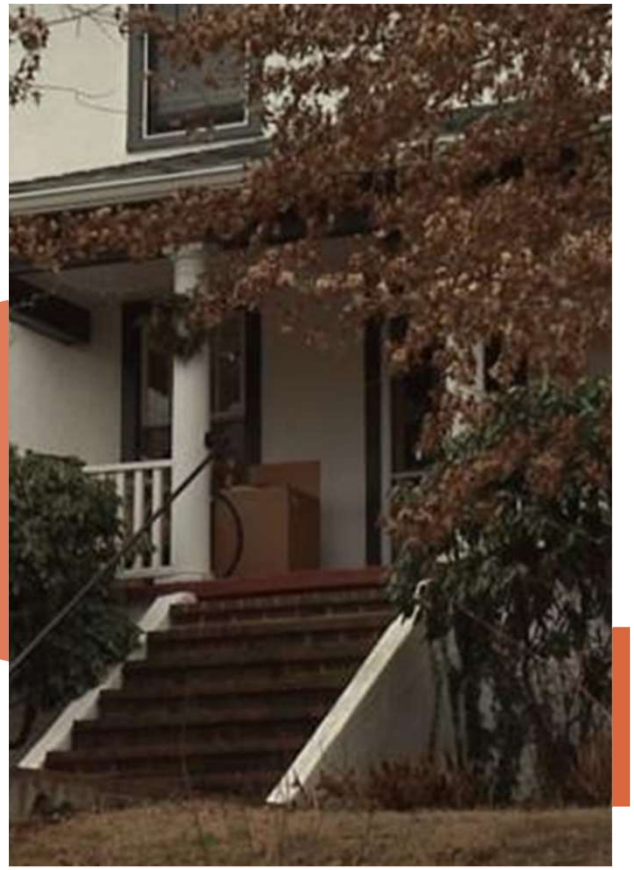
IMPLICATIONS

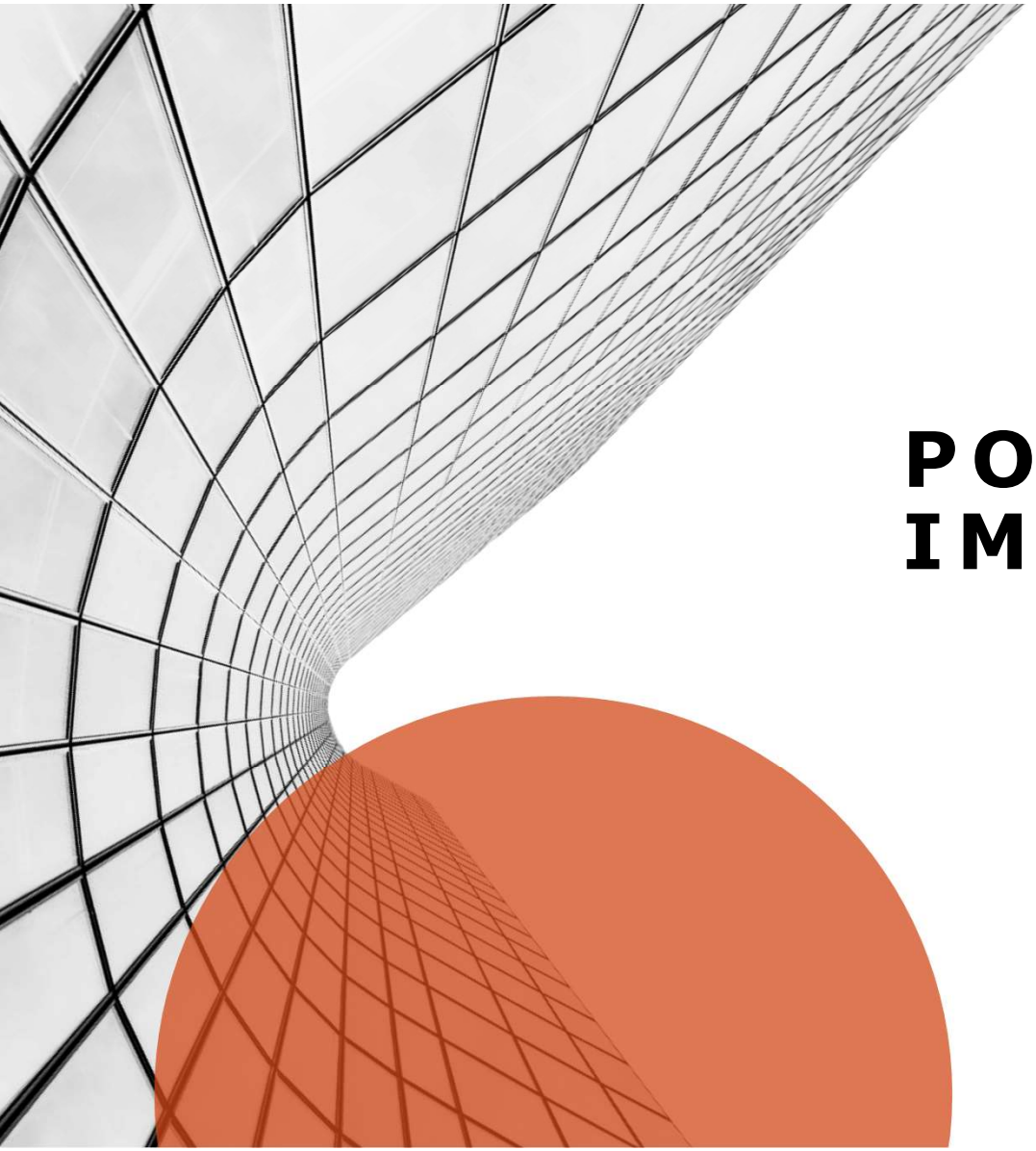
The new zoning classifications will have an impact on the current development patterns.

The data indicate that the new zoning groups will create value for several parcels within Charlottesville above their current value as single-family homes. The value creation varies substantially, with R-A having the least impact on value and R-C having the greatest. This is consistent with the development allowances, as R-C allows eight units by right compared to three units for R-A.

Rate of change analysis does not consider physical capacity of parcels.

It is important to note that the rate of change analysis currently assumes that no subdivision of the lot will occur. Based on the proposed zoning, a lot with an existing structure is considered to be developable. However, it is likely that some lots are not large enough to accommodate a 'full-sized' unit, or unit that meets the average size of recent construction. While micro units are popular, and continue to increase in popularity, having to develop smaller-than-average units would impact revenue, and therefore price. To this point, the existing analysis should be considered aggressive, with actual rates of change likely being lower.





POLICY IMPLICATIONS

CONSIDERATIONS

Partial Unit Rule – How to address partial unit calculations

The current zoning policy requires that any partial unit calculation be rounded up to the next unit. Under this formula a 10-unit development would be required to provide 1 income-controlled unit, but an 11-unit development would be required to provide 2 income-controlled units. This will create a financial disincentive for developers to build projects that require 'additional' income-controlled units above the ratio of 1 unit out of every 10 built.

To this point, RKG Associates recommends the City consider changing the policy recommendation from 'round up' to calculating the partial unit as a payment into the City's Housing Trust Fund. In these cases, the partial unit (0.1 units in the 11-unit example above) would be calculated as 10%, requiring a 10% payment of the calculated value provided to the developer by allowing that unit to be market rate instead of affordable.

In this instance, RKG Associates recommends using a value gap analysis approach to determine the partial unit value (described later in this section). This fairly reduces the financial burden of the 'round up' approach by collecting the pro rata share of a unit that the development would be required under the 10% set aside rule.

Payment In Lieu– How to address developers who want to opt out of delivering units on-site

There may be instances where developers will request to provide a cash payment instead of delivering the income-controlled units within their development. Reasons for this vary, but ultimately work against delivering new income-controlled units given the City's lack of remaining undeveloped land.

In these instances, RKG Associates recommends the City use a total construction cost approach (described later in this section) to determine what the financial contribution to the City's Housing Trust Fund must be for each income-controlled unit not delivered on-site.

The total construction cost approach provide the City with sufficient funds for land acquisition and development of a new unit, which will be required to deliver an income-controlled unit elsewhere within Charlottesville.

CONSIDERATIONS

Value Gap Calculation Approach

The value gap is the difference between the value of a market rate unit and that of an affordable unit. The value of a rental unit is determined by the net operating income and the capitalization rate; for an ownership unit it is determined by the sales value of the unit. In the case of affordable units, the amount of rent or sale price is limited to the target income threshold of the inclusionary zoning policy. This results in lower revenue for a developer. This loss of revenue translates into a loss of value (hence, the value gap) and negatively impacts the overall financials of a developer because the cost of construction and land to build either an affordable or market rate unit are essentially the same. As part of the modeling process, an option was created to utilize the difference in value due to the loss of revenue in determining the fee amount to charge for fractional units. A table showing current gap calculations is included at the end of this narrative.

RENTAL

$$\frac{NOI_{MR} - NOI_{IC}}{\text{CAP RATE}}$$

OWNER

$$PRICE_{MR} - PRICE_{IC}$$

MR – Market Rate
IC – Income-Controlled

Construction Cost Approach

The construction cost approach focuses on the costs to build a housing unit. This includes land acquisition, land development and soft costs (e.g., design and engineering), approval process, and the hard construction costs for development. A table showing construction cost calculations is included at the end of this narrative.

CONSIDERATIONS

Housing Voucher Considerations – Blending the IZ with voucher units

Communities (e.g., Boston, MA) have been incorporating housing choice voucher requirements into their inclusionary zoning policies. Creating a dedicated set aside for housing vouchers benefits both the community (creates more diverse, lower-cost housing) and the development community (voucher payments often match or exceed target AMI rent thresholds). The following table compares Charlottesville's FMR thresholds for vouchers with the 60% of AMI calculations.

	50% AMI	Voucher	60% AMI
Studio	**$1,055**	**$1,223**	**$1,271**
1 Bedroom	**$1,123**	**$1,231**	**$1,354**
2 Bedroom	**$1,269**	**$1,471**	**$1,531**
3 Bedroom	**$1,413**	**$1,829**	**$1,706**

As seen, using vouchers exceeds 50% AMI threshold revenues and is consistent with 60% AMI thresholds. This means including vouchers could serve much lower income households while having no, or even positive (using bonus density), financial feasibility impacts.

Financial Incentives – Maximizing the City' leverage with the new zoning requirements.

The use of financial incentives already exist in Virginia and the City of Charlottesville. Both the city and state provide financial support for certain housing projects (e.g., LIHTC projects), and are making direct and indirect contributions (e.g., reduced cost of publicly-owned land) to increase the production of price-diverse housing.

However, the City's financial tools have been exclusively used to augment other state and federal grant funds. With the new IZ requirements, the City can choose to invest in into private-sector projects. Most notably, the feasibility analysis reveals that achieving lower income thresholds (than 60% AMI) are more financially obtainable than higher set asides. Using City resources to 'buy down' the 60% AMI IZ units to something lower may more cost beneficial than investing in new construction LIHTC projects. The City can use existing programs, or even consider tax abatements, to increase the reach of the IZ without greater risk of market disruption.

CONSIDERATIONS

Approval Processes – The cost of gaining approvals from the City

Based on feedback from local real estate professionals, the development approval and permitting process in the City can be long and expensive depending on where a project is located, the size and complexity of the project, and if there is any neighborhood opposition to the project. It was noted that soft costs for construction can constitute as much as 20% of hard costs (between $46 to $80 PSF) for a project. This is a sizable percentage of total construction costs on a per square foot basis and is one of the few cost metrics the City can influence.

Finding ways to reduce those costs through these zoning changes, streamlining approval processes, and more proactive neighborhood planning that sets expectations for residents about future development can have a substantial impact on development costs, and therefore financial feasibility.

Maintaining the IZ Policy – Impacts of time on the feasibility findings

The results of this analysis vary (in some cases greatly) from the analysis performed in 2021. Development costs, operational expectations, interest rates, market pricing all change frequently. For example, the Median Income for a family of 4 in the Charlottesville region increased approximately 25% since 2021, going from $93,700 in 2021 to $123,300 in 2023. In this instance, a household (of 4 persons) earning 60% of AMI could afford a monthly rent (and utilities) payment of $1,405.50 in 2021. In 2023, the monthly rent payment would be $1,849.50.

This change in income thresholds impacts maximum rent levels for income-controlled units, which impacts financial feasibility and other calculations like value gap.

To this point, the City needs to update its IZ policy requirements and guidelines no more than every two (2) years to ensure the policy [1] does not create financial infeasibility over time, [2] promote outcomes undesirable to the city (e.g., making payments in lieu financially beneficial over delivering units on-site), and [3] ensures the goals and objectives of the policy still reflect the City's priorities and shifting opportunities.

RENTAL HOUSING VALUE GAP CALCULATIONS COMPARED TO MARKET RATE RENTS

AREAS E/F

	30% Affordable NOI	40% Affordable NOI	50% Affordable NOI	60% Affordable NOI	70% Affordable NOI	80% Affordable NOI	90% Affordable NOI	100% Affordable NOI	110% Affordable NOI	120% Affordable NOI
Studio	($133,871)	($103,931)	($73,991)	($44,051)	($14,111)	$15,828	$45,768	$75,708	$105,648	$135,588
1BR	($204,696)	($174,756)	($144,816)	($114,876)	($84,936)	($54,996)	($25,056)	$4,884	$34,824	$64,763
2BR	($266,720)	($236,780)	($206,840)	($176,900)	($146,960)	($117,020)	($87,081)	($57,141)	($27,201)	$2,739
3BR	($340,033)	($310,093)	($280,153)	($250,213)	($220,273)	($190,333)	($160,393)	($130,454)	($100,514)	($70,574)
Average	($236,330)	($206,390)	($176,450)	($146,510)	($116,570)	($86,630)	($56,690)	($26,751)	$3,189	$33,129

AREAS G/H

	30% Affordable NOI	40% Affordable NOI	50% Affordable NOI	60% Affordable NOI	70% Affordable NOI	80% Affordable NOI	90% Affordable NOI	100% Affordable NOI	110% Affordable NOI	120% Affordable NOI
Studio	($153,904)	($123,964)	($94,024)	($64,084)	($34,144)	($4,204)	$25,736	$55,675	$85,615	$115,555
1BR	($226,050)	($196,110)	($166,170)	($136,230)	($106,290)	($76,350)	($46,410)	($16,471)	$13,469	$43,409
2BR	($319,227)	($289,287)	($259,347)	($229,407)	($199,467)	($169,527)	($139,587)	($109,648)	($79,708)	($49,768)
3BR	($397,952)	($368,012)	($338,072)	($308,132)	($278,193)	($248,253)	($218,313)	($188,373)	($158,433)	($128,493)
Average	($274,283)	($244,343)	($214,403)	($184,463)	($154,524)	($124,584)	($94,644)	($64,704)	($34,764)	($4,824)

AREA I

	30% Affordable NOI	40% Affordable NOI	50% Affordable NOI	60% Affordable NOI	70% Affordable NOI	80% Affordable NOI	90% Affordable NOI	100% Affordable NOI	110% Affordable NOI	120% Affordable NOI
Studio	($105,825)	($75,885)	($45,945)	($16,005)	$13,934	$43,874	$73,814	$103,754	$133,694	$163,634
1BR	($161,130)	($131,190)	($101,250)	($71,310)	($41,370)	($11,430)	$18,510	$48,450	$78,390	$108,329
2BR	($241,626)	($211,686)	($181,746)	($151,806)	($121,867)	($91,927)	($61,987)	($32,047)	($2,107)	$27,833
3BR	($315,103)	($285,163)	($255,223)	($225,283)	($195,344)	($165,404)	($135,464)	($105,524)	($75,584)	($45,644)
Average	($205,921)	($175,981)	($146,041)	($116,101)	($86,161)	($56,222)	($26,282)	$3,658	$33,598	$63,538

OWNERSHIP CONDOMINIUM HOUSING VALUE GAP CALCULATIONS COMPARED TO MARKET RATE VALUES

AREA A

	30% Affordable NOI	40% Affordable NOI	50% Affordable NOI	60% Affordable NOI	70% Affordable NOI	80% Affordable NOI	90% Affordable NOI	100% Affordable NOI	110% Affordable NOI	120% Affordable NOI
Studio	($540,894)	($504,905)	($468,915)	($432,926)	($396,936)	($360,947)	($324,957)	($288,968)	($252,978)	($216,989)
1BR	($705,425)	($666,865)	($628,305)	($589,745)	($551,184)	($512,624)	($474,064)	($435,504)	($396,944)	($358,383)
2BR	($696,112)	($652,410)	($608,709)	($565,007)	($521,306)	($477,604)	($433,902)	($390,201)	($346,499)	($302,798)
3BR	($819,511)	($770,668)	($721,825)	($672,982)	($624,139)	($575,296)	($526,453)	($477,611)	($428,768)	($379,925)
Average	($690,486)	($648,712)	($606,938)	($565,165)	($523,391)	($481,618)	($439,844)	($398,071)	($356,297)	($314,524)

AREA B

	30% Affordable NOI	40% Affordable NOI	50% Affordable NOI	60% Affordable NOI	70% Affordable NOI	80% Affordable NOI	90% Affordable NOI	100% Affordable NOI	110% Affordable NOI	120% Affordable NOI
Studio	($346,235)	($310,246)	($274,256)	($238,267)	($202,278)	($166,288)	($130,299)	($94,309)	($58,320)	($22,330)
1BR	($391,164)	($352,604)	($314,044)	($275,483)	($236,923)	($198,363)	($159,803)	($121,243)	($82,682)	($44,122)
2BR	($419,869)	($376,167)	($332,466)	($288,764)	($245,063)	($201,361)	($157,659)	($113,958)	($70,256)	($26,555)
3BR	($450,897)	($402,054)	($353,211)	($304,368)	($255,525)	($206,682)	($157,839)	($108,996)	($60,153)	($11,310)
Average	($402,041)	($360,268)	($318,494)	($276,721)	($234,947)	($193,174)	($151,400)	($109,626)	($67,853)	($26,079)

AREAS C/D

	30% Affordable NOI	40% Affordable NOI	50% Affordable NOI	60% Affordable NOI	70% Affordable NOI	80% Affordable NOI	90% Affordable NOI	100% Affordable NOI	110% Affordable NOI	120% Affordable NOI
Studio	($245,957)	($209,967)	($173,978)	($137,988)	($101,999)	($66,009)	($30,020)	$5,970	$41,959	$77,949
1BR	($279,263)	($240,703)	($202,143)	($163,583)	($125,022)	($86,462)	($47,902)	($9,342)	$29,218	$67,779
2BR	($320,104)	($276,403)	($232,701)	($189,000)	($145,298)	($101,596)	($57,895)	($14,193)	$29,508	$73,210
3BR	($380,402)	($331,559)	($282,716)	($233,873)	($185,030)	($136,187)	($87,344)	($38,502)	$10,341	$59,184
Average	($306,432)	($264,658)	($222,884)	($181,111)	($139,337)	($97,564)	($55,790)	($14,017)	$27,757	$69,530

CONSTRUCTION COST CALCULATIONS

RENTAL CONSTRUCTION COSTS

	Average Square Footage	Construction Cost Per Foot	Total Cost Per Unit
Studio	525	$350.76	$184,152
1BR	715	$350.76	$250,797
2BR	1,050	$350.76	$368,303
3BR	1,560	$350.76	$547,339
Average	963	$350.76	$337,648

OWNERSHIP CONDOMINIUM CONSTRUCTION COSTS

	Average Square Footage	Construction Cost Per Foot	Total Cost Per Unit
Studio	975	$332.83	$324,510
1BR	1,088	$332.83	$362,120
2BR	1,243	$332.83	$413,709
3BR	1,452	$332.83	$483,138
Average	1,189	$332.83	$395,869

RKG ASSOCIATES INC

Charlottesville Zoning Impact Analysis

July 2023