

# Impacts of Proposed Inclusionary Zoning Policy

Case Study with recently completed multifamily development

Gerding Edlen project name: Muse

- Completed October 2016
- 58 units, 5 over 1 podium construction
- Zoning: EX(d) (Central Employment)
- Base FAR: 3:1 (30,000 sf on a 10,000 sf lot)
- Max Height: 65 feet
- Max FAR with residential bonus: 6:0 (60,000 sf on a 10,000 sf lot)
- Actual building GSF: 51,898 sf
- Parking: 31 stalls (0.53 stalls/unit)

PHB recommendation for Projects in Zones with Base FAR below 5.0

- 1) 20% at 80% MFI with
  - a. Density bonus of 3.0 FAR
  - b. 10-year tax exemption on affordable units only
  - c. CET exemption on affordable units only

OR

- 2) 10% at 60% MFI with
  - a. Density bonus of 3.0 FAR
  - b. 10-year tax exemption on affordable units only
  - c. CET and SDC waivers on affordable units only



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### Effect of proposed policy on Muse, inclusive of incentives:

	Baseline Project - Muse	20% at 80% - PHB Proposal	Variance	10% at 60% - PHB Proposal	Variance
Yield	5.55%	4.85 %	-0.70%	5.12%	-0.43%
Unlevered IRR Year 11	9.93%	8.04%	-1.89%	8.85%	-1.08%
Yield Year 11	7.46%	6.30%	-1.16%	6.79%	-0.67%

The impact of the policy as written to project returns are such that it would not attract financing capital without either a significant increase in income – meaning higher rent on the market rate units – or a significant cost savings – meaning either reduced construction costs or land costs. The following two options look at the necessary changes to achieve the same yield, assuming 20% at 80% MFI.

### Option 1: Increase income

With 20% at 80% MFI, the net operating income (NOI) decreases by 11%. In order to get back to the baseline yield (NOI/cost), rents would have to **increase by \$183 per unit, per month**. That means, with current rents at \$2.79 per square foot, they would need to increase to \$3.06 today, which is above market and unachievable.

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**Option 2: Decrease cost**

Since we are unlikely to capture this increased rental income, we look to decreasing costs. The costs would have to decrease by \$33 per square foot on construction cost (an 11% or \$1.7 million reduction overall), or the land price would have to decrease 100% from \$170 per square foot of land to \$0.

In order to decrease construction costs, considerations include:

- less expensive cladding (design review issue)
- less expensive envelope (energy code issue)
- fewer amenities and lower quality finishes (market issue)

This previous example showed a multifamily building that has already been completed. If we were to build the same building of the same quality now, it is even more extreme, as construction and land costs have increased dramatically. For this same building in similar location, construction costs have increased 9% per year, and land price in the area has risen 27% per year.

**Effect of proposed policy on Muse if built now, inclusive of incentives:**

	Baseline Project - Muse	20% at 80% - PHB Proposal	Variance	10% at 60% - PHB Proposal	Variance
Yield	4.64%	4.01%	-0.63%	4.26%	-0.38%
Unlevered IRR Year 11	7.72%	5.78%	-1.94%	6.61%	-1.10%
Yield Year 11	6.24%	5.22%	-1.02%	5.65%	-0.59%



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As it is, doing the same quality project is not feasible in today’s market and would not attract financing capital. With the policy as written, additional financial burdens are imposed. To make the project feasible with 20% at 80% MFI, the NOI would need to increase by 26%, increasing rents by \$543 per unit, per month. The costs would have to decrease by \$99 per square foot on construction cost (a 26% or a \$5.2 million reduction overall), or the land price would have to decrease 100% WITH an additional reduction of \$49 per square foot in construction costs.

As written, the PHB policy will have the following effects:

- It will require either significant compromises in the quality, design and/or sustainability of the product that gets built in our city
- It will require market rents to increase significantly, exacerbating affordability
- It will encourage developers to build in the far suburban reaches of Portland, encouraging suburban sprawl
- It will slow or halt supply of housing

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