

## Tapping the Value of Density

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The amount of revenue that can be generated from a density recapture program is significant.

NOWADAYS, CITIES ACROSS AMERICA are grappling with issues related to increased density. Affordable housing, open space, infrastructure, and public amenities usually are part of any discussion on density, and the question ultimately becomes: “How do we pay for all of this, let alone encourage existing communities to embrace density in their own backyards?” While many public agencies exact fees or implement density bonuses, these efforts fail to achieve a significant impact, and—more important—fail to acknowledge the one true asset: density.

Public agencies leave a significant amount of money on the table when they “upzone” properties in new community plans. But there needs to be a mechanism that allows public agencies to recapture a portion of that created value. This idea is not new. In fact, it mirrors the value capture tax used by some cities in the United States and, more widely, in Europe and Latin America. This program was created

because governments realized that when they financed the construction of a new freeway or enhanced the ingress and egress of an existing highway, surrounding businesses benefited. As a result, they imposed a special assessment tax to recapture some of that value.

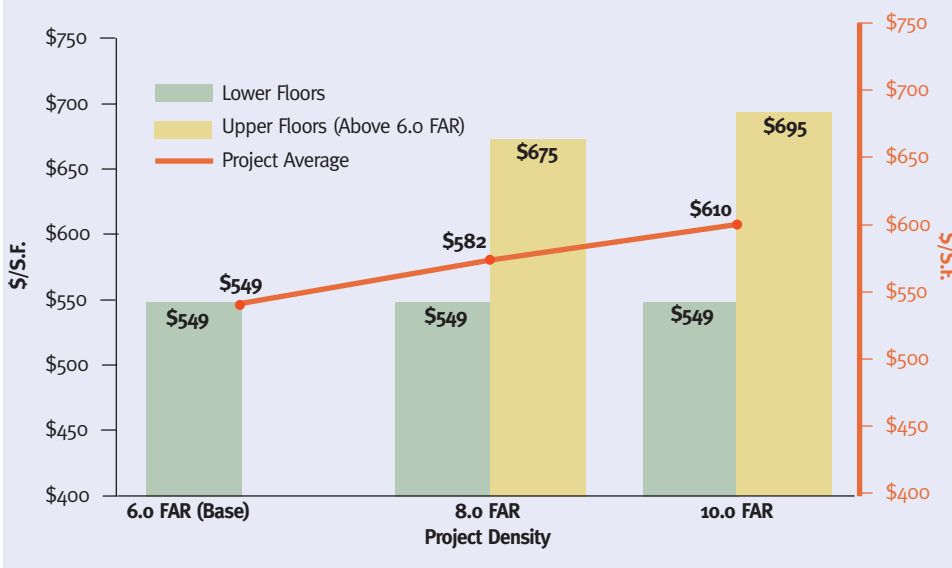
Upzoning property leads to a major windfall profit for landowners for two reasons. First, their property becomes more valuable because more units can be constructed. Second, units on higher floors generate more revenue than those on lower floors through view and prestige premiums.

Consider Figure 1, which shows the average revenue per square foot for a typical downtown San Diego residential project. The concept uses floor/area ratios (FARs) to create density. For instance, if a project achieves a 6.0 FAR, the average price for condominium units in this project is \$549 per square foot (\$5,901 per sq m). However, if the city were to upzone the property to an 8.0 FAR, then the newly added units on the top floors of the project would achieve \$675 per square foot (\$7,256 per sq m). In the 10.0 FAR scenario, the newly added units would achieve \$695 per square foot (\$7,471 per sq m).

Properties upzoned for higher density result in the creation of premium units with the highest sale prices, which ultimately add value to the property and the project. However, municipalities and the public receive little of that benefit while having to pay for most costs and absorbing the environmental impacts.

The amount of revenue that can be generated from a density recapture program is significant. Figure 2 shows an existing parcel in the San Diego region zoned for a 2.0 FAR and valued at \$150 per square foot (\$1,612 per sq m). If the city doubles the density for the property, the landowner can achieve \$165 per square foot (\$1,773 per sq m)—a 10 percent increase in value.

**FIGURE 1: AVERAGE SALES PRICE PER SQUARE FOOT FOR VARIOUS PROJECT DENSITIES**



**FIGURE 2: LOW-RISE DEVELOPMENT 2.0 FAR INCREASED TO 4.0 FAR LANDOWNER AND CITY PARTICIPATION IN DENSITY INCREASE**

	Landowner's Position (88 Units—Base FAR of 2.0)				
	Base FAR	\$/S.F. (Land)	\$/Unit <sup>1</sup>	Total Value	% Increase From Base FAR
2.0 FAR (Base)	2.0	\$150	\$93,750	\$8,250,000	
4.0 FAR	2.0	\$165	\$103,125	\$9,075,000	10%
	City's Position (Density Recapture)				
	Increase Unit Count	Recapture Rate	\$/Unit <sup>2</sup>	Total Value	Price per Gross Bldg. S.F.
2.0 FAR (Base)	0	0%	\$0	\$0	
4.0 FAR	97	25%	\$25,781	\$2,500,781	\$23

Notes:

<sup>1</sup>Landowner \$/Unit is based on the original 2.0 FAR (88 units)

<sup>2</sup>City's \$/Unit is calculated by multiplying the Landowner's \$/Unit by the recapture rate.

Source: The London Group Realty Advisors, Inc.

The developer can afford to pay the landowner \$103,125 per unit and must purchase the additional rights for 88 units from the city. The payment to the city for the development rights to build an addition 88 units is based on 25 percent of the per-unit value that the developer paid the landowner, or \$25,781 per additional unit, which results in \$2.5 million in revenue for the city.

The mid-rise to high-rise figure shows that the city can increase the recapture rate to 50 percent. This is because high-rise development achieves a higher sale price for a building's top floors, so the city can afford to charge more for the added density and the landowner still benefits. More important, there is a clear incentive for higher density because the landowner's value continues to increase. For the city, rezoning the property from an FAR of 6.0 to 10.0 would represent \$4.6 million in recaptured revenue.

While there are legal issues to address, the economics are clear: cities across the

nation are seeking answers to funding shortages, and recapturing density revenue is one solution. But urban infill has its unique set of challenges.

**It's a Different Business.** Developing higher-density communities requires a different mind-set than developing raw land, for both the public and private sectors. It is a different business for developers, with different profits, risks, and returns. As a result, public agencies should require new regulations and fee structures specific to urban development. Most important, these novel regulations and programs must encourage density.

For infill development, the timeline is shorter than for master-planned communities. There is no flexibility of long-term appreciation, and the developer must make a deal feasible in a short amount of time while mixing affordable units with market-rate construction.

The costs of services and facilities in large master plans are facilitated by the overall fee

structure. But because infill is incremental, there is no structure or economy of scale to aggregate the dollars to pay for the upgrades.

**Inclusionary Housing.** In San Diego, the per-unit cost of affordable housing ranges from \$160,000 in low-rise projects to \$225,000 in high rises. Denser projects are burdened with additional costs (a result of less achievable revenues) and land values decrease. At a certain point, the land value will be insufficient to compensate the existing business or cover any relocation and mitigation costs. Therefore, the landowner/business ultimately will be discouraged from selling its property.

Programs must encourage density rather than impose additional costs on projects. Some public agencies provide bonus densities for affordable housing, which is financially illogical because the profit of additional density is approximately \$40,000 to \$70,000 per unit, compared with a cost of \$225,000 per unit for high-rise construction.

**Acquisition, Relocation, and Site Costs.** In urban redevelopment, depending on the prior land use of the property and existing market conditions, the cost of purchasing and preparing land for development is a complicated and expensive process. Repositioning the property of an existing business entails relocation or buyout costs. In cases of a leased interest, the remaining value of the lease as well as the market value for the land must be paid. All these acquisition costs, of course, are in addition to any necessary site cleanup or remediation costs required to make the property environmentally and structurally buildable.

In high-density areas such as downtowns, these costs are manageable for developers because of the magnitude of the revenues. These costs represent more of a challenge for lower-density projects because the land cost

**FIGURE 3: MID-RISE TO HIGH-RISE DEVELOPMENT 6.0 FAR INCREASED TO 8.0 OR 10.0 FAR LANDOWNER AND CITY PARTICIPATION IN DENSITY INCREASE**

Landowner's Position (275 Units—Base FAR of 6.0)					
	Base FAR	\$/S.F. (Land)	\$/Unit <sup>1</sup>	Total Value	% Increase From Base FAR
From Base FAR					
6.0 FAR (Base)	6.0	\$195	\$39,000	\$10,725,000	
8.0 FAR	6.0	\$215	\$43,000	\$11,825,000	10%
10.0 FAR	6.0	\$235	\$47,000	\$12,925,000	21%

City's Position (Density Recapture)					
	Increase Unit Count	Recapture Rate	\$/Unit <sup>2</sup>	Total Value	Price per Gross Bldg. S.F.
6.0 FAR (Base)	0	0%	\$0	\$0	\$0
8.0 FAR	98	50%	\$21,500	\$2,107,000	\$19
10.0 FAR	195	50%	\$23,500	\$4,582,500	\$21

Notes:

<sup>1</sup>Landowner \$/Unit is based on the original 2.0 FAR (275 Units)

<sup>2</sup>City's \$/Unit is calculated by multiplying the Landowner's \$/Unit by the recapture rate.

Source: The London Group Realty Advisors, Inc.

## The Transformation of Florida's South Walton County

PREMA KATARI GUPTA

A region of resort communities, once derisively referred to as the “Redneck Riviera,” is now an area of soaring real estate values and architectural innovation.

(acquisition, relocation, and site costs) becomes a larger portion of the overall construction budget.

**Community Resistance.** The process of upzoning a community can prove arduous for local politicians and planners. Residents often resist increased density because of increased traffic, noise, and people; any community benefits to be derived from additional development usually are viewed as nominal.

Politicians and economists have realized the importance of incentivizing existing communities to make them more receptive to increased density. If residents can visualize and quantify the improvements to their community and quality of life, then they will more willingly accept density and welcome new development. One tactic is to issue infrastructure bonds to pay for the infrastructure and service upgrades. Other options are to provide parks and trail systems, landscaping, community centers, cultural amenities, pools, affordable housing, and public art for older neighborhoods being asked to increase density.

**Financing Public Projects.** Another challenge is assessing the amount of money needed to pay for public projects such as parks, open space, libraries, and other community amenities. Downtown San Diego, for

example, is currently experiencing an approximately \$100 million shortfall to acquire land needed for planned parks. Due to the high cost of land in downtown, the impact fee that would be allocated to a development to pay for this park system could be significant and add to the cost of development, making it more difficult for developers to build and, ultimately, discouraging development (and density), rather than encouraging it. Moreover, developers pass the added cost onto the consumer, thus exacerbating the region's affordable housing crisis.

Metropolitan areas are urbanizing, essentially growing “in” rather than “out.” Past mechanisms for financing new and upgraded infrastructure and public amenities, as well as the ongoing maintenance of communities, are rapidly becoming antiquated. A new set of revenue-generating tools needs to be created for municipalities—one that doesn't give density away for modest public benefit. It is time to start tapping into the value of density. **U**

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