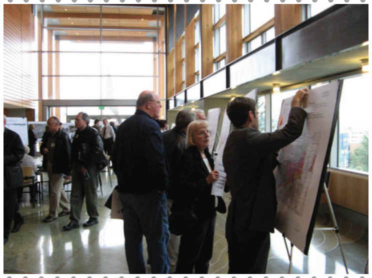
Urban Land Institute
Seattle

ULI Technical Assistance Panel Recommendations

Bel-Red Incentive Zoning Feasibility

September 2008

Bel-Red Corridor Bellevue, Washington



ULI Seattle

The Urban Land Institute provides leadership in the responsible use of land and in creating and sustaining thriving communities worldwide. ULI Seattle, a district council of the Urban Land Institute, carries forth that mission as the preeminent real estate forum in the Puget Sound region, facilitating the open exchange of ideas, information and experiences among local, national and international industry leaders and policy makers.

Our mission is to:

- Build a regional vision of the Puget Sound area that embraces and acts upon quality growth principles.
- Encourage the collaboration among all domains – public and private – of the real estate industry.
- Build consensus among industry and public leaders who influence land use, transportation, environmental, and economic development policies.

City of Bellevue

Incorporated in 1953, Bellevue is the fifth largest city in Washington, with a population of approximately 120,000 covering more than 31 square miles between Lake Washington and Lake Sammamish. It is the high-tech and retail center of the Eastside, with more than 130,000 jobs and a growing skyline of gleaming high-rises. While business booms downtown, much of Bellevue retains a small-town feel, with thriving, woodsy neighborhoods and a vast network of green spaces and recreational facilities that keep people calling the place "a city in a park."

Bellevue's downtown provides office space for thousands of professionals as well as condominiums and apartments for people who want to live in an urban setting. The population is growing and becoming more diverse. City planners anticipate 7,000 additional residents by 2010, with 18,000 more jobs expected in Bellevue by then.

Special thanks to City of Bellevue staff Matthew Terry, Dan Stroh, Emil King, and Paul Inghram. Without their exhaustive contributions, this panel report would not have been possible.

Contact us:

ULI Seattle
700 Fifth Avenue, Suite 6100
Seattle, WA 98104

tel: 206.224.4500
fax: 206.224.4501
email: seattle@uli.org
www.seattle.uli.org

Urban Land Institute Seattle

Table of Contents

ULI Technical Assistance Panel Recommendations

Bel-Red Incentive Zoning Feasibility

INTRODUCTION

The redevelopment of the Bel-Red corridor presents a unique opportunity to create a thriving mixed-use neighborhood, a large-scale model of sustainability, and an economic engine for the entire Eastside.

The original Bel-Red Subarea steering committee report in September 2007, said it well: "Positioned as it is between downtown Bellevue and Microsoft, this area offers unparalleled opportunity for high quality office space and residential development."

> *"Positioned as it is between downtown Bellevue and Microsoft, this area offers unparalleled opportunity for high quality office space and residential development."*

Aerial view of the Bel-Red corridor looking southwest toward Bellevue

This is a crucial corridor, fed by established and emerging high-tech companies. The energy inside and outside the corridor can be leveraged to create a more attractive, pedestrian-friendly place for people to live and work. Zoning is the vehicle to make this happen, and the incentive system is a way to gain developer participation in redevelopment and its benefits.

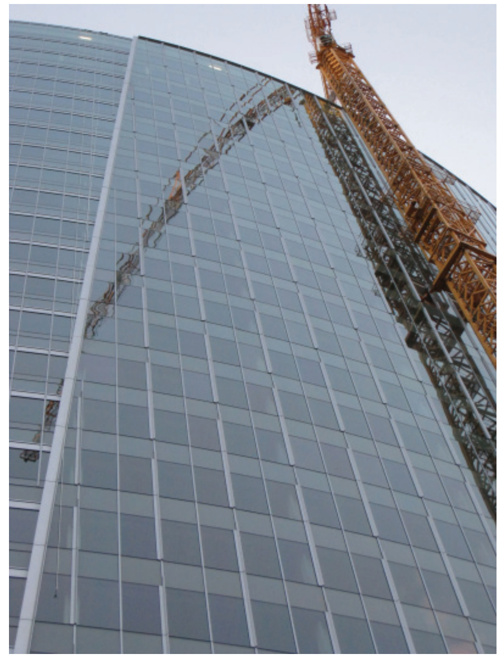
To support this vision, the subarea plan and rezone includes an array of public amenities. The planning effort ties the vision and the critical issues facing the corridor into a comprehensive set of policies. As intended, the incentive system can be expected to translate a shared vision of the corridor into a complete, walkable neighborhood with parks, green space, ecological restoration, and transportation choices. Potentially, the contemplated Bel-Red up-zone will bring jobs into the city,

> *"Arriving at the most conducive balance between developer costs and zoning-based incentives is more art than science."*

create a vital mixed-use neighborhood, and generate impact/incentive fees. These fees can contribute substantial resources toward planned infrastructure investments, in addition to the ongoing positive tax generation capacity of the development. The Bel-Red corridor is poised to make the leap into a more sustainable future.

The ULI Technical Assistance Panel ("the Panel") has been impressed with the thorough approach, the extent of citizen participation, and the overall work product presented by City staff. Although the Panel has recommendations for changes, this should not diminish in any way the overriding findings of the Panel: The City of Bellevue has done an excellent job, and an incentive zoning system should be adopted in the Bel-Red corridor.

Deriving the potential "lift" from the new zoning, along with funding for new infrastructure and benefits for all, depends upon a realistic financial model. This financial model serves as a tool for policy as well as a predictor for redevelopment in the actual zoning area within a relevant time frame. It must balance the economic behavior of a variety of private developers and investors with the financial goals of the city. At the same time, it is reasonable to expect that, given a certain amount of momentum in redevelopment, the plan and the neighborhood itself will serve as an incentive, inviting participation from a wide sample of the development community. The Panel supports the dual objectives of encouraging redevelopment and initiating an income stream, while not placing land owners and developers coming into the area at a competitive disadvantage.



The total cost of delivery with today's economics is in the range of $375-$400 per rentable square foot.

Arriving at the most conducive balance between developer costs and zoning-based incentives is more art than science—subject to competing scenarios, many market variables, and honest differences in opinion. In general, the Panel finds the Property Counselors (PC) report to be a very good effort that represents one of many ways to look at the subarea rezone from a financial modeling perspective.

However, taken in the aggregate and applied throughout the Bel-Red subarea, the fees associated with the incentive system under review—when combined with other types of fees as part of the overall costs of development—are prohibitive for most parcels. In the opinion of the Panel, they exceed the ideal fee-incentive balance by as much as 100 percent.

ANALYSIS

Model Assumptions

In order for the financial model to serve its purpose of supporting the incentive system for the redevelopment of the Bel-Red corridor, some fundamental assumptions should be adjusted or corrected:

Adjust stabilized property value downward. The success of the financial model for the incentive system is driven, to a large degree, by the estimate of stabilized property values after the rezone is in effect. In the opinion of the Panel, those values are overstated in the PC model. Stabilized property value is tied to exit capitalization rates, and the assumed exit rates in this model are well below historical averages. Developers must make assumptions about the exit capitalization rate in order to attract capital for the development, and small adjustments upward in those rates can easily render a hypothetical development not feasible, given all other assumptions in the model.

Move estimates of total cost of project delivery upward. One of the critical determinants of success for a financial model supporting incentive zoning is the accurate estimation of the total cost of delivering a new project. Through the lens of their combined experience with desirable project types and incentive systems, the Panel

"Parking will not provide a dependable source of income within the redevelopment horizon."

focused intensively on the cost models presented in the PC report for particular project types, and came to a number of conclusions. The estimate of hard cost for core construction seems supportable across the model; however, the Panel believes that the PC financial model tends to understate the total cost of project delivery. For example, the total cost of delivery of a high-rise office in Scenario 1 ($45 per square foot land base) is presented as $345 per rentable square foot. The actual total cost of delivery with today's economics is in the range of $375-$400 per rentable square foot.

Specifically, the model ***understates:***

1) The opportunity cost of capital. At least in the office model, the use of today's construction costs and tomorrow's rents in the PC model is problematic. The static, dual time frame does not appear to account for carrying costs of capital, and this leads to further understatement of costs. The interest carry cost can be significant in a two-year development process.

The financial model must accommodate a variety of project types with very different development scenarios.

2) The cost of tenant improvement and leasing commissions in the office model.

In contrast, the model ***overstates the income potential for parking space.*** The office model relies on parking income. In the opinion of the Panel, parking will not provide a dependable source of income within the redevelopment horizon.

Property Types

Recognizing the diversity of land uses within the Bel-Red subarea, it is clear some properties can be developed soon, and many are not ready for redevelopment even under the new zoning. However, to be relevant and fair to all, the financial model that supports the incentive system based on Floor Area Ratio (FAR) must accommodate a variety of project types with very different development scenarios. The recommendations made below will:

"The base FAR should be the same for all, and the incentive system should be adjusted so that the cost of excess FAR is similar for every project."

Adjust incentives to be more inclusive and consistent. What may work as an incentive for one may not work at all for another. As contemplated in the PC report, incentives would be the same for a 30-acre industrial redevelopment site purchased for $40 per land square foot, as it would be for a 1.5-acre, 0.5-FAR office building near the future transit station that can only be acquired for $100 per land square foot or more. For redevelopment to actually occur in both cases, there must be a sufficient gap ("lift") between the value of the property in its current use and the value of the property as land for a new project under improved zoning. But fundamental assumptions about lift based on stabilized property values—as well as the cost of project delivery—are very different for these scenarios. In the opinion of the Panel, the base FAR should be the same for all, and the incentive system should be adjusted so that the cost of excess FAR under the incentive system are similar for every project (see Policy Recommendations, below).

Encourage residential development and affordable housing in specific ways. All of the planning documents and public feedback emphasize the need to create residential development in the corridor. Our recommendations for the zoning code and the incentive system are focused on that objective as well, for both market-rate housing and affordable housing.

"An incentive zoning process can work—provided it is simple to understand, easily implemented, and provides a clear economic incentive for the developer/property owner to pursue redevelopment."

POLICY RECOMMENDATIONS

Even with these concerns about the financial modeling, and the wide variations in existing conditions, we believe that the overall approach of the incentive zoning system is sound public policy, and that an incentive zoning process can work—provided it is simple to understand, easily implemented, and provides a clear economic incentive for the developer/property owner to pursue redevelopment. To that end, we submit the following recommendations, intended to overcome modeling concerns and to achieve the City's stated objectives. The net result of these recommendations will be to marginally increase allowable FAR and therefore reduce the per-square-foot cost of excess FAR, so that desired development is more likely to occur in the Bel-Red corridor.

The cost of any bonus FAR through the incentive system, at least initially, should be the same for both commercial and residential development. Furthermore, the Panel believes that to be successful in the near term, total incentive fees should not exceed $15 per square foot of bonus FAR. In other words, aggregate incentive fees should not exceed current development land value. The Panel believes this would provide a clear and necessary economic incentive to the property owner/developer. The opportunity to increase the fee will occur after development momentum is established.

Framework Recommendations

- **Keep the base FAR.** The base, as-of-right FAR of 1.0 throughout the district, as proposed by staff, is reasonable, and we do not recommend any changes.
- **Increase first-tier lift inside nodes.** For commercial development inside designated nodes, 2.5 of FAR incentive zoning lift should be available, for a maximum FAR of 3.5.
- **Increase first-tier lift outside nodes, also.** A FAR lift of 1.0 through the incentive zoning system should be available for commercial development outside nodes, for a maximum FAR of 2.0.
- **Allow a second-tier bonus.** For commercial modes, a second bonus of up to .5 FAR should be allowed throughout the district when Transferable Development Rights (TDRs) or other desirable features are part of the project. This establishes the maximum FAR on commercial projects at 4.0. In this recommendation, we are treating project features and TDRs equally. The public benefit is essentially the same regardless of the location of that benefit.
- **Do not apply any FAR limit to residential buildings.** Instead, residential density should be restricted by height. This is because of the implicit need to incorporate significant light and air to these structures in order to make them livable and marketable. In order to exceed the established base FAR, the residential developer must pay the bonus incentive fee for every square foot, less exclusions, above that area established by the base FAR.
- **Add underground parking to bonus list.** To encourage amenities that contribute to the overall quality of the built environment as Bel-Red is redeveloped, the Panel recommends that underground parking should be added to the list that qualifies for bonus FAR—a list that includes stream restoration, natural drainage features, public art, public restrooms, and LEED/sustainable elements. This is based on the belief that underground parking would make a substantial contribution to the quality of the built environment as it is redeveloped, and it is unlikely to yield income to developers in the near term.

Technical Observations

- **Waive fees for inclusion of affordable housing.** In the event the performance option for affordable housing is chosen, any incentive zoning fee due for increased building area above the base should be waived. This complete waiver is recommended only for the affordable housing component.

- **Consider the burden of transportation impact fees when balancing total incentive fees.** As part of the zoning changes, the city is contemplating an increase in the transportation impact fee throughout the city, to $5,000 per peak evening hour trip. This is a significant increase in a redeveloping area. Additional development fees beyond this increase, combined with the incentive zoning above, do not seem feasible, and are not assumed in our financial modeling nor our recommendations.

- **Count privately financed public amenities toward incentive.** The first-tier incentive zoning fee should be allowed to be offset for incorporation, or contribution to, approved public benefit amenities in the district or in the project as proposed. For example, if a developer elects to daylight a previously culverted stream as part of a new development, the actual cost of the daylighting would directly reduce any incentive zoning fee due in connection with the new development. The cost here would only offset that appropriate component of the incentive fee system, not the entire incentive fee. This encourages designated amenities that are successfully integrated into private developments.

> *"Encourage designated amenities that are successfully integrated into private developments."*

- **Recognize conveyance of land to public use.** Base FAR should not be lost in the event a land owner conveys land for right-of-way, or any other public use. There should be a clear incentive to land owners and developers to give up significant portions of land. As a result of this policy, the city can avoid the burden of causing rights-of-way, and other conveyances for public use, to be acquired by the more costly and time-consuming method of eminent domain.

- **Encourage Transferable Development Rights (TDRs).** TDRs are an important tool for the acquisition of right-of-way, for the creation of green space, and for the retention of existing businesses.

- **Eliminate phasing.** The Panel sees no reason to wait to adopt the zoning, or to phase in the Bel-Red incentive system. Development momentum will generate fees, creating the possibility of increasing those fees in the future. Funding for public investment will be available sooner. Eliminating phasing will allow property owners and developers to plan and build based upon market dynamics under a consistent zoning umbrella.

"Eliminating phasing will allow property owners and developers to plan and build based upon market dynamics under a consistent zoning umbrella."

- **Features of the subarea plan that limit building bulk and scale are more than adequate.** The proposed building code for the Bel-Red Subarea includes significant setback requirements and lot coverage maximums, which will minimize the impact of larger building footprints. In addition, new development within the Bel-Red Subarea will be subject to design review, which will also have a positive effect on building design as it relates to bulk and density.

- **Lot coverage requirements should be allowed to increase and setbacks should be allowed to decrease in the event a property owner conveys land for right-of-way, or other public use.** This is especially important in the designated nodes, where higher densities are contemplated and a more urban streetscape is warranted.

Parking requirements should anticipate a future transit-oriented neighborhood for the Bel-Red corridor.

- **There should be no floor plate restrictions up to 100 feet of building height. At that point, a "tower" setback may be implemented.** The proposed base zoning and the related building code for the Bel-Red Subarea dictate a very suburban, low-density development scheme, especially with respect to residential buildings. For example, residential buildings are limited to 12,000 square feet of gross floor area above 40 feet and 9,000 square feet above 80 feet of building height. It will not be economically viable to build floor plates this small within developing tracts of land that generally comprise the study area. These restrictions essentially limit buildings to approximately 75 units each, given a 65 foot height—the maximum wood frame building allowed by code. In the PC example, it would be necessary to build six buildings in order to achieve the 500,000 square feet of area in the model. This does not seem to serve the overall intent of the rezone, especially in the transit-oriented nodes. Limiting buildings to this scale will add to both cost of construction and ongoing cost of operations, which will very likely cause larger developers to overlook this district.

- **Developments that take part in the incentive program should be allowed a priority processing in order to expedite entitlement and construction activities.** This will serve as an important and self-evident incentive to potential developers.

- **Minimum parking requirements should anticipate a future transit-oriented neighborhood for the Bel-Red corridor.** These minimums also encourage shared parking arrangements when mixed-use projects are pursued. Parking requirements can be proposed by the applicant and become part of a development's conditions of approval. This will provide flexibility based upon proposed use and current infrastructure in place. Market demands will essentially dictate on-site parking until the transit nodes have been fully developed.

CONCLUSION

With a far-reaching planning effort and an incentive zoning system, the City of Bellevue has taken important steps toward realizing the great possibilities that lie in the Bel-Red corridor and the potential for achieving a vital neighborhood and economic engine for the future.

These recommendations are intended to contribute to the dual objectives of that incentive zoning system: new development will pay for its share of the cost of public infrastructure, and that development is economically feasible. In truth, the first and overriding objective cannot be realized without the second. Development must occur in order for incentive fees to be collected. Furthermore, to begin accruing the public amenities and funding the infrastructure that affirm the participation of developers, it is important that momentum is established.

However, because finding the balance and establishing the momentum is dependent on many variables over time, the Panel recommends a review of the code in three years, to assess whether the balance has been achieved. Specifically, this review should focus on the actual cost of excess FAR above the base, and assess whether this cost is inhibiting desired investment in the corridor. Once redevelopment in the corridor attains critical mass, incentive fees can be increased.

Members of the Panel believe that these recommendations create a greater probability that the Bel-Red corridor will develop sooner, and in a way that complements the Bellevue Central Business District and the city as a whole. The recommended FAR levels are significantly below downtown Bellevue, and will lead to a pedestrian-friendly, medium-scale, vital neighborhood within the city.

Combined with the overall goals of the City of Bellevue, a realistic and balanced incentive zoning system will speed redevelopment and help to connect the Bellevue Central Business District, Bel-Red, and Redmond in a cohesive and comprehensive way. With a diversity of land uses and a variety of retail, office, and residential opportunities in Bel-Red, the entire city will become even more vibrant, and all citizens will benefit.

ULI Seattle Technical Assistance Panel **Professional Biographies**

- ***Patrick Callahan, Panel Chair*** Patrick Callahan is founder and CEO of Urban Renaissance Group, a Seattle-based full-service commercial real estate company. He is a 15-year veteran of Equity Office, a Chicago-based national owner and operator of commercial real estate. There, Callahan served as a senior vice president from 2000-2006, overseeing a large region that eventually included Seattle and Bellevue, Portland, and Denver. He was responsible for more than 300 employees and provided oversight and accountability for approximately $4 billion of real estate with annual revenues of approximately $450 million. He played a leadership role in the largest real estate transaction in U.S. history (at the time), when Equity Office acquired Spieker Properties. While co-managing the company's development pipeline in the Pacific Northwest, his projects included Kruse Woods V and Kruse Oaks II (Lake Oswego, Oregon), and City Center Plaza and First and Main (Portland). During his tenure with Equity Office, Callahan directed the repositioning and renovation of Columbia Center in downtown Seattle. He is a graduate of Miami University (Oxford, Ohio).

- ***Matt Anderson, Panelist*** Matt Anderson is a Senior Project Manager with Heartland, a multi-disciplinary consulting firm that specializes in development strategy and analysis. With more than 10 years of experience in real estate and city planning, he leads teams engaged in property development, strategic planning, financial analysis and economic development throughout the Western United States and Mexico. In the private sector, he has managed development of a major resort in Baja as well as mixed-use infill in Seattle, and also takes site acquisition and disposition assignments. Public sector projects typically focus on ways to integrate and leverage real estate development economics with planning and policy objectives. Clients include Fortune 500 companies, developers/landowners, Native American Tribes, port authorities and urban municipalities. Prior to joining Heartland, he analyzed commercial real estate in the San Francisco Bay Area and worked as a land use consultant in Portland, Oregon. Anderson is a graduate of the University of Oregon, and holds a master's degree in urban and regional planning from Portland State University. He is a member of the American Institute of Certified Planners (AICP), and is licensed to sell real estate in Washington.

- ***Sarah Rick Lewontin, Panelist*** Sarah Rick Lewontin is the Executive Director of Housing Resources Group (HRG), a Seattle non-profit dedicated to the development of high quality, safe and permanent affordable housing. During its 28-year history, HRG has developed nearly 2,700 units of affordable housing and currently operates 1,643 apartments in 28 buildings. As of June 2008, HRG has nine affordable housing projects in development, totaling 648 apartments. HRG provides property management for its portfolio, and coordinates services for residents. During her thirteen years at HRG, Lewontin has managed development of numerous multi-family and mixed-use projects using a broad range of funding sources, including historic preservation and low-income housing tax credit investment, tax-exempt bond financing, grants and loans from investors, bank lenders, federal, state, local and private agencies. Her 80-employee organization develops five to nine multifamily projects at a time, some for other nonprofit organizations. Lewontin is the Urban Community Advisor serving on the Executive Council of ULI Seattle, and she lectures at the University of Washington and national conferences and serves on the board of the Housing Development Coalition of Seattle and King County (past president). Lewontin switched careers to affordable housing development in 1994 following two decades of corporate real estate development and facilities strategic planning with US West. She is a graduate of Reed College.

- ***John Marasco, Panelist*** John Marasco is Managing Director of Development Properties for Security Properties Inc. (SP), a Seattle based national real estate investment and operating company engaged in the acquisition, development, financing, operation and disposition of primarily multi-family residential property. He is also the executive member of SP's multifamily development affiliate, with activities focused in the greater Seattle area, Portland and San Francisco Bay area markets. For over twenty five years, Marasco has created real estate investments for ownership by companies and their partners, providing expertise in property analysis, acquisition due diligence, financial structuring, development, rehabilitation and turnaround scenarios. Prior to joining SP in 1991, he served as acquisitions manager for a Seattle area real estate and syndication company. He is a graduate of the University of Oregon and attended graduate school through the University of Washington's Department of Civil Engineering. He maintains a Washington Real Estate Broker's license and has received a University of Washington Certificate in Commercial Real Estate.

- ***Adrienne Quinn, Panelist*** Adrienne Quinn is the Director of Seattle's Office of Housing. The Office of Housing is the City's investor in low-income and affordable housing, and is responsible for development and administration of a wide range of programs and policy development, from homeless housing to mixed-income redevelopment. Currently, the office has a 42-person staff and a $43 million budget. Prior to joining the Office of Housing, Quinn was a partner at the law firm Buck & Gordon, LLP. In her practice, she represented private companies, nonprofits and municipalities in all facets of land use and environmental law. Quinn was recently named one of Washington's top 50 women lawyers by Washington Law & Politics magazine and has repeatedly been named a Super Lawyer by the magazine. Quinn is a former member of the Seattle Planning Commission, the Housing Development Consortium Board and the Plymouth Housing Group Board of Trustees. She is a graduate of Seattle University School of Law, and received a Master of Divinity degree from Harvard University Divinity School and a bachelor's degree with honors from the College of the Holy Cross.

- ***Stephen Blank, Panel Contributor*** Stephen Blank is the ULI Senior Resident Fellow for Finance. Before joining ULI in 1998, he was the managing director of real estate investment banking for CIBC World Markets.

Summary of Panel Recommendations

- Keep the base FAR.
- Increase first-tier lift inside nodes.
- Increase first-tier lift outside nodes, also.
- Allow a second-tier bonus.
- Do not apply any FAR limit to residential buildings.
- Add underground parking to bonus list.
- Waive fees for inclusion of affordable housing.
- Consider the burden of transportation impact fees when balancing total incentive fees.
- Count privately financed public amenities toward incentive.
- Recognize conveyance of land to public use.
- Encourage Transferable Development Rights (TDRs).
- Eliminate phasing.
- Features of the subarea plan that limit building bulk and scale are more than adequate.
- Lot coverage requirements should be allowed to increase and setbacks should be allowed to decrease in the event a property owner conveys land for right-of-way, or other public use.
- There should be no floor plate restrictions up to 100 feet of building height. At that point, a "tower" setback may be implemented.
- Developments that take part in the incentive program should be allowed a priority processing in order to expedite entitlement and construction activities.
- Minimum parking requirements should anticipate a future transit-oriented neighborhood for the Bel-Red corridor.

Contact us:

ULI Seattle
700 Fifth Avenue, Suite 6100
Seattle, WA 98104

tel: 206.224.4500
fax: 206.224.4501
email: seattle@uli.org
www.seattle.uli.org