



MEMORANDUM

TO: City of Missoula

FROM: Winter & Company, with Urban Advisors

DATE: September 11, 2018

RE: Missoula Design Excellence Economic Feasibility Analysis

Introduction

This document explores how the new Overlay Design Standards and Incentives may affect the cost of development in a variety of case studies analyzed by Urban Advisors. It focuses on four theoretical projects that highlight specific situations in which the new Overlay Design Standards may influence development feasibility. The analysis utilizes pro formas to model the return on asset generated by various development case studies. Each case study has a baseline scenario that works within current land use regulations, and then alternative scenarios are calculated that test the impact of the proposed Overlay Design Standards.

These are some of the key standards that are proposed and which are addressed in the analysis:

- A requirement to step back upper floors of a building, after a designated height; this varies by context
- A requirement to use a minimum percentage of traditional masonry or natural materials on a building; this also varies by context

These are the Incentives that also are considered:

- A reduction in the required parking ratio, based on proximity to facilities for alternative modes and the provision of additional bike parking
- A reduction in activity area requirements, based on proximity to recreational facilities
- A reduction in overall site landscaping requirements, dependent on land use

In testing the effects of stepping back upper floors, the potential reduction in leasable space is modeled in some scenarios. In many projects, this setback area could be developed as an outdoor space (either as a deck or balcony) that would be an amenity for tenants and could in fact result in higher rents for those floors, but this potential added value is not included in these scenarios.

These are the case studies:

1. Case Study 1: Downtown Inner Core High-Rise Office
2. Case Study 2: Downtown Gateway Mid-Rise Multi-Family
3. Case Study 3: Downtown Gateway Vertical Mixed-Use
4. Case Study 4: Corridor Typology 2 Small Scale Retail

Analyzing performance

Development costs are estimated for site work, building construction and soft costs (fees, etc.). A contingency, based on industry standards also is assumed. Construction costs are estimated, using the square footage of buildings that were assumed for the different case study locations. Leasing performance analysis uses current leasing rates and assumes typical levels of occupancy to vacancy. These are then used to compare development costs with potential revenues to determine the potential return on asset that may be achieved.

Typical goals for Return on Asset for leasing are:

Office:	8.0% - 9.0%
Commercial:	8.0% - 9.0%
Multifamily:	6.5% - 7.0%

Case Study 1 – Downtown Inner Core High-Rise Office

This case study explores a theoretical high-rise office development in the Downtown Inner Core Context Area. The zoning in this case study is CBD-4. The bullets below summarize the assumptions for each of the scenarios in case study 1.

- **1a- Baseline Scenario of 8 Stories:** This scenario assumes an 8-story office building built under existing land use regulations; that is, there is no upper floor stepback, no traditional masonry material requirement, etc. An 8-story scenario approximates the highest scale of development Missoula has seen recently in the Downtown.
- **1b- New Overlay Design Standards Scenario of 8 Stories, with Reduced Upper Floors:** This scenario takes the baseline building in 1a and applies the proposed new standards. These include the upper floor stepback and the traditional masonry requirements for both street facing and non-street facing walls. No additional stepped back floor is projected, as a means of regaining space that would be reduced because of the upper floor setback. Note, however, that on-site parking is not required and therefore that benefit is not realized.
- **1c- New Overlay Design Standards, with One Additional Story:** As in 1b, this scenario applies the proposed new standards. It explores how one additional floor may be added, in order to regain space that otherwise would be eliminated because of the setback requirement. It tests the return on asset for a building that is built under the new Overlay Design Standards. The project, therefore, is a 9-story design.
- **1d- Maximum Height Permitted Scenario:** Similar to 1a, this scenario works with the assumptions of the existing land use code. It assumes that the intended project would be a 12-story office building, built to the 125' height limit allowed by zoning.

Key findings:

The return on asset for the four scenarios described above is as follows:

- **1a: 8.3%**
- **1b: 8.0%**
- **1c: 8.0%**
- **1d: 8.3%**

In this case study, the impact of the new Overlay Design Standards results in a minor decrease in the return on asset, of -0.3%. Adding an extra floor doesn't have a significant impact on the return on asset. However, it should be noted that a project that 'maxes' out the building envelope allowed by the existing zoning still produces an 8.3% return on asset, which is the same as scenario 1a. This demonstrates that the new Overlay Design Standards have a relatively small impact on the return on

asset, even in the Downtown Inner and Outer Core Context Areas where the Incentives are not available.

Case Study 2 – Downtown Gateway Mid-Rise Multi-Family

This case study explores a theoretical multi-family residential development in the Downtown Gateway Context Area. The zoning for this theoretical site is C1-4. The bullets below summarize the assumptions for each of the scenarios in case study 2.

- **2a- Baseline Scenario:** This scenario assumes a 3-story apartment building built under the existing code requirements, including the density limit of 1 unit per 1,000 square feet of the site. Given the limit on the unit total created by this density cap, the building program can accommodate all allowable units within 3 stories (so there is no need to build higher).
- **2b- New Overlay Design Standards Scenario and with the Density Limit:** This scenario takes the baseline 3-story multi-family building in 2a and applies the new design standards, including the traditional masonry/natural materials requirements for both street facing and non-street facing walls. This project also utilizes the Incentives that are available to projects in the Design Overlays. The proposed parking requirement reduction allowed by the Incentives provides a small savings in cost.
- **2c- New Overlay Design Standards, with no Density Limit.** This scenario explores a multi-family building that is built in accordance with the new Overlay Design Standards, but is allowed to build more units than what is permitted under the existing density limit for multi-family development in C1-4. This project also utilizes the Incentives that are available to projects in the Design Overlays. In this case, the benefit of the proposed parking reductions is more exaggerated since the number of units (and therefore the number of parking spaces required) is higher. In this case the building is 5 stories in order to accommodate the extra units and square footage.

Key findings:

The return on asset for the above scenarios is as follows:

- **2a: 7.2%**
- **2b: 7.1%**
- **2c: 6.6%**

In this case study, the cost of the new Overlay Design Standards is insignificant. The return on asset is only slightly reduced between scenarios 2a and 2b (0.1%). Because the 3-story building in scenario 2b is below the proposed maximum street wall height in the Downtown Gateway Context Area, no upper floor stepback is required. The Incentives, including the parking requirement reduction, help offset some of the cost of the traditional masonry/natural materials and the other proposed standards. Scenario 2c explores the impact of eliminating the density cap in the existing zoning. The building in 2c is built to 5 stories and has additional units in lieu of the density limit in the existing code. However, the return on asset decreases for 2c. This is because a large portion of the development cost is devoted to the permitting, design, and other “soft” costs, and the value added by each additional unit is proportionally insignificant to the overall value of the development. Still, 6.6% is a reasonable return on investment. This case study may indicate, however, that removing the density limit may not be the most effective way to incentivize housing development.

Case Study 3 – Downtown Gateway Vertical Mixed Use

This case study is similar to case study 2, except that the building program calls for a vertical mixed-use development rather than a purely multi-family residential development. The zoning for this theoretical site is also C1-4. The bullets below summarize the assumptions for each of the scenarios in case study 3.

- **3a- Baseline Scenario of 5 Stories:** This scenario assumes a vertical-mixed use building that is 5 stories. Because vertical mixed-use development is not subject to the same density limit as purely multi-family development in the C1-4 zone district, this theoretical development assumes more units and a larger building.
- **3b- New Overlay Design Standards Scenario of 5 Stories:** This scenario takes the baseline building in 3a and applies the new Overlay Design Standards, including the upper floor stepback and the traditional masonry/natural materials requirements. No additional floor is constructed to compensate for the reduced floor area that results from the stepback. This project utilizes the Incentives that are available to projects in the Design Overlays.
- **3c- New Overlay Design Standards Scenario, with One Additional Story:** This scenario explores how one additional floor might impact the return on asset for a building that is built under the new Overlay Design Standards. That is, it has a 6th floor. However, one additional floor would require a more expensive construction method, as provided in the building code. This is factored in. This project also utilizes the Incentives that are available to projects in the Design Overlays.

Key findings:

The return on asset for the above scenarios is as follows:

- **3a: 8.4% (commercial portion); 6.7% (residential portion)**
- **3b: 8.3% (commercial portion); 6.8% (residential portion)**
- **3c: 8.3% (commercial portion); 6.6% (residential portion)**

Similar to case study 2, case study 3 shows that the cost of the new Overlay Design Standards is insignificant. The return on asset remains essentially unchanged between scenarios 3a and 3b (the commercial return on asset drops slightly, but the residential return on asset increases slightly). Even with the required upper floor stepback and the other design standard requirements, scenario 3b maintains a very similar return on investment as the baseline scenario. This means the added cost of the new design standards is offset by the Incentives. Scenario 3c shows that if an additional story were added to the building in scenario 3b, the return on asset drops slightly. This is due in part to the more expensive construction method needed to achieve a 6-story building.

Case Study 4 – Corridor Typology 2 Small Scale Retail

Case study 4 examines a small scale, single-story retail building in Typology 2. The zoning for this theoretical site is B2-2. The bullets below summarize the assumptions for each of the scenarios in case study 4.

- **4a- Baseline Scenario of 1-story Building:** This scenario assumes a single story 7500 square foot retail building built under the existing code requirements.
- **4b- New Design Overlay Standards Scenario:** This scenario applies the new Overlay Design Standards to the building in the baseline scenario 4a. Because the building is one-story, it does not hit the maximum street wall height limit in the new standards. However, it must comply with the natural material percentages and other requirements in the new design standards. This project also utilizes the Incentives that are available to projects in the Design Overlays. This includes the parking reduction. However, in this scenario, no additional floor area is projected, even though the reduced parking requirement could in theory permit doing so.
- **4c- New Design Overlay Standards Scenario, with Additional Square Footage:** This scenario explores how a development could offset any potential costs associated with the new Overlay

Design Standards by building additional square footage in the area of the site that is no longer needed for parking, due to the parking requirement reductions available in the Incentives. Otherwise, the assumptions are the same as scenario 4b.

Key findings:

The return on asset for the above scenarios is as follows:

- **4a: 8.0%**
- **4b: 8.1%**
- **4c: 10.8%**

In this case study, the benefit of the Incentives (primarily the parking requirement reduction) more than offsets any potential additional costs associated with the Overlay Design Standards. The return on asset increases from 8.0% to 8.1%. Furthermore, scenario 4c shows that the reduction in the parking requirements could allow for additional retail square footage, which would significantly increase the return on asset.

Summary

In summary, the above four case studies demonstrate, across multiple development types and scales, that the impact of the Overlay Design Standards on development costs is low when the Incentives are also utilized. In some cases, the Overlay Design Standards when applied with the Incentives may actually help increase the return on asset. The proposed parking requirement reduction seems particularly beneficial.

It is understood that many variables affect development costs, rental and sales rates, and subsequent return on assets calculations, and others may run calculations that differ from these. Nonetheless, by using the same costs and income variables for each of the related scenarios, the relative comparisons among them are informative. **The key finding is not the specific return on asset for each scenario, but the fact that in all cases the return is not affected significantly by the new standards.**

Also note that these case studies do not estimate the creative ways in which responding to the proposed design requirements would yield projects of greater value to the developer and property owner and the enhanced value to the community that would occur.