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TDR 101

Transferable development rights are dramatically transforming D.C.'s real estate market

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They're one of the hottest things in commercial real estate today, but they aren't listed on CoStar. You can't find them in the classifieds or advertised on the side of a building.

Transferable development rights, or TDRs, are an intangible asset bought and sold in a haze of mystery and truly understood by only a few people in the city. Read: zoning attorneys.

Although they've been around for 15 years, TDRs have only recently made an impact on D.C.'s real estate market, thanks to the downtown housing boom and a dearth of prime development sites.

But how do they work? Where do you get them? And, most importantly, how much will they cost you? We've got your answers.

First, a history lesson. The District created TDRs in 1992 as part of the Downtown Development Overlay District. The goal was to provide incentives for development, particularly of housing and department stores, in downtown D.C. It's all spelled out in Title 11, Section 1709 of the D.C. code. Go ahead and look if you dare, but be forewarned: It's not for the faint of heart.

The concept allows developers doing projects downtown to generate bonus density that can be used or sold to build bigger projects than normally allowed in other parts of town. While the "receiving zones" generally allow a 6.5 FAR, or floor area ratio, and 90-foot heights, using TDRs allows a 10 FAR and a building up to 130 feet tall.

There originally were two receiving zones where the TDRs could be used -- one area just west of the central business district and one just west of Union Station -- but the city added three more zones in 1996. They are NoMa, the area south of the National Mall and the area just north of the new baseball stadium (though that area was designated well before the stadium was on the radar screen).

Allison Prince, a zoning attorney at Pillsbury Winthrop Shaw Pittman, says bonus density was a way to appease developers angry over the restrictive Downtown Development district. "It was a devastating blow to the real estate community at the time," she says.

How do you create them? Developers generate TDRs in three ways: preserving historic sites, developing the city's "preferred uses," or building residential space in the overlay district. Different uses generate different amounts of TDRs. For instance, new housing south of Massachusetts Avenue NW generates TDRs on a 2-to-1 basis. That means 200,000 square feet of condos or apartments would yield 400,000 square feet of TDRs. Theaters and department stores generate TDRs at 3-to-1.

Remember that sizzling five-year housing market? That resulted in the most TDRs created so far. Consider JPI's Jefferson at Penn Quarter, the building boom on both sides of Massachusetts Avenue and the housing at the Spy Museum.

OK, you've started a project that will generate TDRs. Now what do you do? Call your zoning attorney and brace yourself. This is where it gets fun.

When all the criteria have been met, the owner is responsible for submitting a covenant to the city for review by the Office of Planning, attorney general and zoning administrator. When approved, the covenants are recorded.

Travis Parker, who has reviewed the covenants for the Office of Planning, says the city approves on average about a dozen a year.

What owners do with those rights is up to them. They can either use them on their own projects in the receiving zones, sell them to other developers or bank them for the future.

This is where the mystery comes to play. Because of the nature of the covenants, there's no easy way to track how many TDRs have been created or used since 1992. There's no easy way to track who has sold theirs or how much they sold it for.

"No one really has an accurate record of all the TDRs being held by private holding companies," Prince says.

How do you sell them? When you go to sell your TDRs, you'll be ringing up your attorney again. The rights are transferred to other developers using certificates of transfer, which must be recorded and provided as part of the building permit process.

What makes the process fascinating is how TDRs are sold. It's not exactly the black market of real estate, but only a handful of developers, brokers and attorneys know who has them and who needs them. Jayne Shister, a vice president at Cassidy & Pinkard Colliers, estimates that about 4.8 million square feet are still available as TDRs.

"There are transactions going on all the time," says Chip Glasgow, a real estate attorney at Holland & Knight. "TDRs are very readily available."

They are sold via standard purchase and sale agreements, but unlike real property, the transaction and their prices are not recorded anywhere. There are no official comps.

When Kaempfer created the first TDRs with its redevelopment of the Warner Theatre in the 1990s, it was in unchartered territory when pricing the TDRs for sale to another Kaempfer entity to build 1900 K St. NW. Prince says they went for $38 a square foot, but that rate plunged when they became readily available in the marketplace as downtown redevelopment skyrocketed. Values dropped as low as $3 a square foot (tough for those who bought them up at $15 a square foot), but they are beginning to head higher.

Glasgow says the going rate nowadays is in the $5 to $7.50 range a square foot, but Prince recently heard of them reaching $8.50. "The TDR market has been Economics 101 -- law of supply and demand," she says. She recommends that clients buy them if they own buildings in receiving zones. In other words, you can buy the right to build an extra 100,000 square feet for under a million dollars. How much value will that bonus density add to your property? You do the math. Again, it's simple economics.

Although redeveloped sites downtown conceivably will continue to generate TDRs until and if the law is changed, the pace will almost certainly slow down. "There will be a point where there just won't be as many as we'd like," Prince predicts.

Although TDRs don't expire and can be resold as many times as the market will bear, the city could change the law, perhaps even as part of the upcoming zoning rewrite (see story, page 5). When some city leaders realized TDRs could be used to build taller buildings near the ballpark and blocking the fans' view of the Capitol, there was discussion about disallowing their use in that part of the city. Lawsuits were threatened, and the city backed down.

Will such threats dampen the TDR market? Probably not. There's too little space to build in D.C. and plenty to stress over without worrying about changes you can't anticipate to a law you can't understand.

TDRs in action

W?ant evidence that transferable development rights are changing the city? Look no further than the west side of the central business district.

Developers are using TDRs to update several older buildings west of 19th Street NW, often by adding floors to existing buildings. The most visible project currently is 2121 K St. NW, where ING Clarion is adding three floors with nearly 52,000 square feet. And at least three other projects are under way or slated to begin soon: 1129 20th St. NW; 2175 K St. NW; and 2021 K St. NW (to be renamed 2011 K).

"This is a very complex way to create a new building," says J.P. Spickler, a principal at Fox Architects who's involved with the latter three projects.

In addition to a maze of zoning issues, developers must consider their buildings' structures, how to integrate the old and new, and how construction will affect existing tenants. It's also more expensive than starting from scratch: New Class A buildings cost about $180 a square foot to build, while additions and renovations cost about $420 a square foot.

Spickler says most buildings completed in the 1960s and '70s were "overstructured," meaning they were built to support more weight than called for by their designs. Most can easily support a three-story steel or even concrete addition. When the structure isn't enough, as is the case with some 1980s buildings, architects can use carbon-fiber reinforcing to boost the structural capacity of existing columns.

Architects also must update the safety systems, adding a fire control room, a voice-annunciated alarm and strobes and pressurizing stairs. New lobbies, elevators and restrooms also are standard. "High-paying tenants don't want to feel like they're going through a Class C building to get to a Class A building," Spickler says.

One of Spickler's biggest challenges is the facade. Some developers want a brand-new one for the entire building, while others want to keep the current facade, forcing architects to find a way to integrate the two. "It can't look like a big new head on a small old body," he says.

So do additions make the building appear to tenants like one seamless Class A building commanding Class A rents throughout?

"Someone else will ultimately judge that for me," Spickler says. "But that's my goal."

A TDR checklist

- Are you sure your property is in a receiving zone?
- How high is the current building and how high will you be able to build with TDRs?
- Will you need zoning variances or can you build by right with the TDRs?
- Can the building's structure support the weight of new floors?
- Will you create a new facade or integrate the skin of the new floors into the existing facade?
- How will you mitigate the effects of construction for existing tenants?