



KEYSER MARSTON ASSOCIATES™
ADVISORS IN PUBLIC/PRIVATE REAL ESTATE DEVELOPMENT

MEMORANDUM

ADVISORS IN:

REAL ESTATE
REDEVELOPMENT
AFFORDABLE HOUSING
ECONOMIC DEVELOPMENT

To: Francie Stefan, Community and Strategic Planning Manager
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Subject: Financial Feasibility of LUCE Community Benefit Tiers

The City of Santa Monica (City) is currently updating the Land Use and Circulation Element (LUCE) of the General Plan. A fundamental feature of the updated LUCE is that developers may request additional height and floor area ratio (FAR) (Tiers 2 and 3) with the provision of community benefits. At your request, Keyser Marston Associates, Inc. (KMA) created a methodology for quantifying the financial feasibility of Tier 2 and 3 projects that provide community benefits.

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EXECUTIVE SUMMARY

The purpose of this memorandum is to provide a methodology for measuring the value enhancement provided by Tier 2 and 3 heights and FARs above the baseline. This methodology was created by KMA in a study of prototype sites across the City which measured the impact of varying location, site size, site configuration, and adjacencies. The KMA prototype analysis shows significant land value enhancements in Tier 2 and 3 projects for each of the prototype sites analyzed. These results support the notion that projects that provide community benefits under LUCE are able to achieve financial feasibility.

BACKGROUND STATEMENT

The foundation of the LUCE framework is the identification of baseline maximum building heights and FAR for each land use designation. Projects providing community benefits consistent with the community's broader social and environmental goals can

request height and FAR above the baseline, subject to discretionary review. The standards are defined in three tiers: the baseline tier (Tier 1 or Base Case) and two discretionary tiers (Tiers 2 and 3).

The components of the Tiers that are pertinent to this analysis are presented in the following table:

Tier	Height Limit	Community Benefits Required
1	32 Feet / 2 stories	No
1	35 Feet / 3 stories	Construct Affordable Units
2	45 Feet / 4 stories	Yes
3	Above 45 Feet	Yes

At the Tier 1 level, mixed-use projects are required to comply with the City's Affordable Housing Production Program by either paying affordable housing fees or constructing affordable units. However, Tier 1 projects that comply with the Affordable Housing Production Program by constructing affordable units are eligible to receive a three-foot height bonus, which brings the height limit to 35 feet. This is meant to allow for the construction of a three-story building.

It is a fundamental assumption of this analysis that any project requesting Tier 2 or 3 development standards will be required to comply with the City's Affordable Housing Production Program. Compliance with the Affordable Housing Production Program is not counted as a community benefit.

ANALYSIS

Prototype Pro Forma Analysis

To assist the City in quantifying the economic benefit created by providing additional height to development projects, KMA prepared pro forma analyses encompassing several prototype sites. The analyses involved the following types of sites:

1. Activity Center: 3 acre site, up to 5 stories;
2. Mixed-Use Creative: 2 acre site, up to 4 stories;

3. Boulevard: ½ acre site, up to 5 stories; and
4. Boulevard Low: ½ acre site, up to 4 stories.

The selection of prototypes allowed KMA to evaluate the effect of the following characteristics: location within Santa Monica, site size, site configuration, and adjacencies. An important underlying assumption is that a developer would only request a height and FAR increase if it is anticipated to enhance the project economics. The prototype analyses were undertaken to estimate the value enhancement generated by the Tier 2 and Tier 3 (where applicable) height limits, for each prototype site.

The results of the pro forma analyses showed significant value enhancement for Tier 2 and Tier 3 projects for each prototype site. In addition, Tier 1 projects showed equivalent or greater land values as compared to the existing zoning. The greatest land value was observed for a 5-story Boulevard project (Tier 3)

Case-by-Case Pro Forma Methodology

KMA utilized a case-by-case pro forma analysis to measure the value enhancement in the prototype scenarios. This methodology can be used by the City to estimate value enhancement in projects that request additional height and FAR. The results can then be used to assess the impact of community benefits on project feasibility. To conduct a case-by-case analysis, project specific pro forma analyses must be prepared. To create a consistent methodology, KMA set up a pro forma template to be used for each project. The components are as follows:

1. Estimate the Project Construction Costs –The construction cost estimate should provide separate cost estimates for the Tier 1 (Base Case) and the Tier being proposed for the project. The cost estimate should contain the following line items:
 - a. Direct Costs:
 - i. On-Site Improvements & Demolition;
 - ii. Parking Costs – number of spaces, type of structure, and cost by square foot or by space;
 - iii. Building Costs;
 - iv. Tenant Improvement Costs;
 - v. Contractor Costs;

- vi. Direct Cost Contingency Allowance; and
 - vii. Any additional cost premiums that apply to taller buildings/higher density construction should be identified.
- b. Indirect Costs:
- i. Architecture, Engineering, & Consulting;
 - ii. Public Permits & Fees;
 - iii. Taxes, Legal, & Accounting;
 - iv. Insurance;
 - v. Marketing & Leasing;
 - vi. Developer Overhead & Management; and
 - vii. Indirect Cost Contingency.
- c. Financing & Closing Costs:
- i. Construction Period Interest;
 - ii. Loan Origination Fees; and
 - iii. Cost of Sales – including sales commissions, closing costs, and warranty costs.
2. Estimate the Sales Revenue or Net Operating Income – The sales revenue will need to be projected for condominium mixed-use projects, and the net operating income will be used for apartment mixed-use projects. Projections should be provided for Tier 1 (Base Case) and the Tier being proposed for the project.
- a. The Gross Sales Revenue is based on the following information:
- i. Unit Mix – the total number of units, including market rate and affordable units;
 - ii. Base Unit Price – for market rate and affordable units; and
 - iii. Unit Premiums – including view/height premiums.
- b. The Net Operating Income is based on the following information:

- i. Program – the number of leasable square feet of apartment, retail, office, or other types of space;
 - ii. Lease Rate – The average rent for each use/space;
 - iii. Miscellaneous Income;
 - iv. Vacancy and Collection Allowance; and
 - v. Operating Expenses.
3. Estimate the Residual Land Value – The Residual Land Values for Tier 1 (Base Case) and the Tier for the proposed project are estimated as follows:
 - a. Condominium Mixed-Use Project = Projected Gross Sales Revenue – (Estimated Construction Cost + Threshold Developer Profit)¹
 - b. Apartment Mixed-Use Project = (Net Operating Income ÷ Threshold Return on Investment)² – Estimated Construction Cost
4. Calculate the Value Enhancement – The Value Enhancement is calculated by subtracting the Residual Land Value under the Base Case from the Residual Land Value under the Tier proposed for the Project. The difference represents the value enhancement generated by granting additional height and FAR to the project.

Uniform Methodology

The City may choose to employ a uniform methodology in estimating the value enhancement created by Tier 2 and Tier 3 height and FAR increases. A uniform methodology would require a significantly reduced number of variables to be defined. The chief benefit of this method is that it may be applied across-the-board to projects without having to analyze all the pro forma variables for each project.

¹ Threshold Developer Profit is the minimum profit required for a developer to undertake a condominium project. Profit is calculated as a percentage of gross sales revenue. To calculate land value, profit and total construction costs are subtracted from gross sales revenue.

² Threshold Return on Investment is the minimum stabilized return a developer requires for a rental project. The Return on Investment is defined as the net operating income (NOI) divided by the project's value. The value is estimated by dividing the NOI by the Threshold Return.

One possible example uniform method could be based on the incremental difference in sales revenues between a baseline project and a Tier 2 or Tier 3 project. The methodology for this approach is to project the sales revenues for each project scenario. Then, a percentage factor would be applied to the incremental difference in sales revenues, resulting in an estimate of the incremental change in value. This percentage factor represents the average change in land value as a percentage of incremental sales revenue.

The most important aspect of the uniform methodology is defining the percentage factor. One method for defining the factors is to study a series of prototype sites across Santa Monica. It is important to note that, because this method would be applied to all projects uniformly, a conservative factor should be chosen to avoid overestimating the value enhancement.

CONCLUSION / ISSUES FOR CONSIDERATION

The preceding analysis identifies a methodology to be used for quantifying the value enhancement for projects that request the tiered height and FAR bonuses included in the LUCE. The results of the KMA prototype analysis show that the community benefit tier structure of the LUCE provides a significant land value enhancement. The analysis suggests that financial feasibility will be achieved while also allowing community benefits to be incorporated into each project.

The KMA analysis is limited to creating a framework for quantifying the value enhancement generated by Tier 2 and 3, and assessing the ability for projects under LUCE to incorporate community benefits. The City has not yet established a policy or benchmark for identifying the appropriate level of community benefits. The process for determining appropriate community benefits will be initiated after adoption of the LUCE.