PLACEWORKS

MEMORANDUM

Date: September 28, 2016

To: Carla Violet
Urban Planning Partners, Inc.

From: Steve Gunnells, Chief Economist

Subject: **Updated Pro Forma Peer Review**
Density Bonus Project at 2902 Adeline

This memorandum summarizes our review of the pro forma submitted by the project applicant to support the requested concessions and density bonus.

SUMMARY

The proposed project is the development of a six-story building with 44 market-rate units, 6 below-market-rate units, 4 live-work units, and 841 square feet of commercial flor area. The project represents a density bonus project with concessions and a use permit.

The base project allowable under existing zoning requirements would be a three-story building with 18 market-rate units and one live-work unit, either paying the affordable housing in-lieu fee or providing two of the 18 units at below market rates. The density bonus project, without a use permit and without a concession, provides 7 additional market-rate units over the base project (for a total unit count of 23 market-rate, 2 BMR, and 1 live-work units) accommodated with a fourth story.

To illustrate the need for the concession, the pro forma analysis provides two alternative versions of the proposed project. Variant A provides the same number of units and building square footage as the proposed project, but it accomplishes this in five stories rather than six by having all five stories cover the allowable building area on the R-4 and the C-SA portions of the site. Variant B–Lite, like the proposed project, limits all but the first story to the C-SA portion of the site. However, this alternative is limited to five stories, rather than the six in the proposed project, and consequently, it has fewer units and less total building square footage than the proposed project.

The review finds that the applicant's pro forma adequately demonstrates that density bonus project alone would not generate a sufficient rate of return to compensate for the inclusion of BMR units in the base project. The review also finds that the applicant's pro forma adequately demonstrates that the addition of the use permit (allowing for the fifth story in Variant A and Variant B–Lite) would improve the rate of return to that of the base project (Variant B–Lite) or slightly better (Variant A), but would not generate a sufficient return to be financially feasible. Finally, the review finds that the applicant's pro forma adequately demonstrates that the proposed project (with the density bonus, use permit, and concession) would generate a sufficient and reasonable rate of return.

Based on our review of the applicant's pro forma and the findings noted above, we conclude that the proposed project warrants the requested concession from a financial feasibility perspective.

COMMENTS

1. Purpose

The purpose of this memo is to review the pro forma submitted by the project applicant and determine if it:

+ Uses reasonable assumptions
+ Shows that the proposed project with the density bonus but no use permit and no concessions fails to generate a financially feasible return on par with the base project
+ Shows that the density bonus project with the use permit but without the requested concession fails to generate a financially feasible return on par with the base project
+ Shows that the proposed project with the density bonus, requested use permit, and concessions generates a financially feasible rate of return

Our review of this project is limited to the pro forma analysis prepared by Economic and Planning Systems, Inc., dated August 29, 2016. Because the applicant's pro forma provides a well-written description of the analysis, this report focuses on describing the key factors that change the rate of return among the various scenarios.

2. Building Height

The most important factor influencing the financial feasibility of the different scenarios is building height. As noted in the applicant's pro forma, residential units in stories above four are able to command higher rents per square foot. Thus, Variant A and Variant B–Lite generate a slightly higher overall average lease rate than the base and density bonus projects, and the proposed project generates a slightly higher overall average lease rate than all the other scenarios. Offsetting higher lease rates to a certain degree, however, additional stories necessitate more expensive types of construction.

3. Parking

Parking generates net revenue. The base project scenarios accommodate 17 parking spaces, and the other scenarios accommodate 24. This adds to the rate of return on the later scenarios relative to the base project scenarios.

4. Commercial Space

Commercial space generates revenue. The live-work units provide potential commercial space in all the scenarios, but the revenue from this commercial space is captured in the unit rents for the live-work units. The base project and density bonus scenarios provide no commercial-only building space. The proposed project and the two variants provide 841 square feet of commercial space, generating an annual gross income of $22,707. This commercial space improves the rate of return for these scenarios relative to the base and density bonus projects.

5. Findings

We have reviewed the assumptions and factors used in the applicant's pro forma and we find that these adequately reflect current market conditions and/or generally accepted industry standards.

Our review finds that the applicant's pro forma adequately demonstrates that:

+ The base project would generate a rate of return of 5.3 percent, which we would concur is not a financially feasible return.
+ The base project with BMR units generates a lower return on investment, 5.1 percent, than the base project. The density bonus project generates an even lower return of 5.0 percent. Both of these scenarios are not financially feasible.
+ Variant B–Lite, which includes the use-permit fifth story but not the concessions, would generate a 5.3 percent rate of return. This return is the same as the base project and not financially feasible.
+ Variant A, which also includes the use-permit fifth story but not the concessions, would generate a 5.5 percent return. This rate of return is marginal, at best. This project may face difficulty in attracting equity investment and obtaining financing.
+ The proposed project, with the density bonus, requested use permit, and concessions, would generate the highest return among the scenarios, 5.6 percent. As noted in the applicant's pro forma, however, even this rate of return is less than the 6 percent rate that similar projects would target.

The pro forma analysis indicates that the density bonus project does not generate a sufficient rate of return over the base project to compensate for the costs to provide BMR units. It also indicates that the density bonus project with the use permit does not generate a financially feasible rate of return. Finally, the analysis does show that the proposed project, with the density bonus, use permit, and concessions, should generate a rate of return that is financially feasible.

Based on these findings, we conclude that the requested concession is warranted from a financial feasibility perspective.