

Residential and Mixed-Use Real Estate Development Economics

Presented to:
City of Santa Clara
June 15, 2020



Presentation Outline

1. Introduction to ULI San Francisco District Council
2. Key Development Concepts & Case Study
3. Affordable Housing
4. Focus on Fees
5. Question and Answer

Libby Seifel

President, Seifel Consulting Inc.

Faculty, UC Berkeley Masters in Real Estate Development + Design

- Teaches Public Private Partnerships at UCB MRED+D
 - Advises public agencies and developers on infill projects and the “dark chocolate” of real estate development
 - Boston native, where she helped found a non-profit developer that built mixed income housing in the South End neighborhood
 - Urban Land Institute, SPUR, NPH, APA
 - Lives above Glen Canyon which has best hiking trails and wildlife in San Francisco plus many of the City’s best restaurants within walking distance if you like to climb hills!
-



Jan Lindenthal

Chief Real Estate Development Officer
MidPen Housing Corporation

- More than 25 years in affordable housing in the Bay Area
 - Joined MidPen in 2009
 - Oversee a team of 45+ Real Estate Professionals dedicated to building affordable homes for those in need in our community.
 - More than 3,800 affordable homes in MidPen's pipeline
 - Board member of SV@Home; California Coalition for Rural Housing; and Build it Green
 - Lives in Pacific Grove with husband and 3 children.
 - Runner, Body Surfer, Knitter, Star Gazer
-



Drew Hudacek

Chief Investment Officer, Development Properties
Sares Regis Group of Northern California, LLC

- Joined Sares Regis in 1999
 - Focused on Land Acquisitions & Capital Markets
 - Project Entitlement Experience
 - Urban Land Institute, SPUR SJ & Stanford Golden Shovel
 - New Jersey native
 - Lives in Silicon Valley with his wife and two teen/tween daughters
 - Swimmer, cyclist, surfer and skier
-



ULI Introduction

About ULI SF

- Our mission is to provide leadership in the responsible use of land and in creating and sustaining thriving communities worldwide. ULI San Francisco carries forth that mission by serving the Bay Area's public and private sectors with pragmatic land use expertise and education.
- We bring together a thriving and dedicated multi-disciplinary community of professionals that deliver market-based, innovative and implementable solutions to the Bay Area and beyond.

Strategic Priorities:

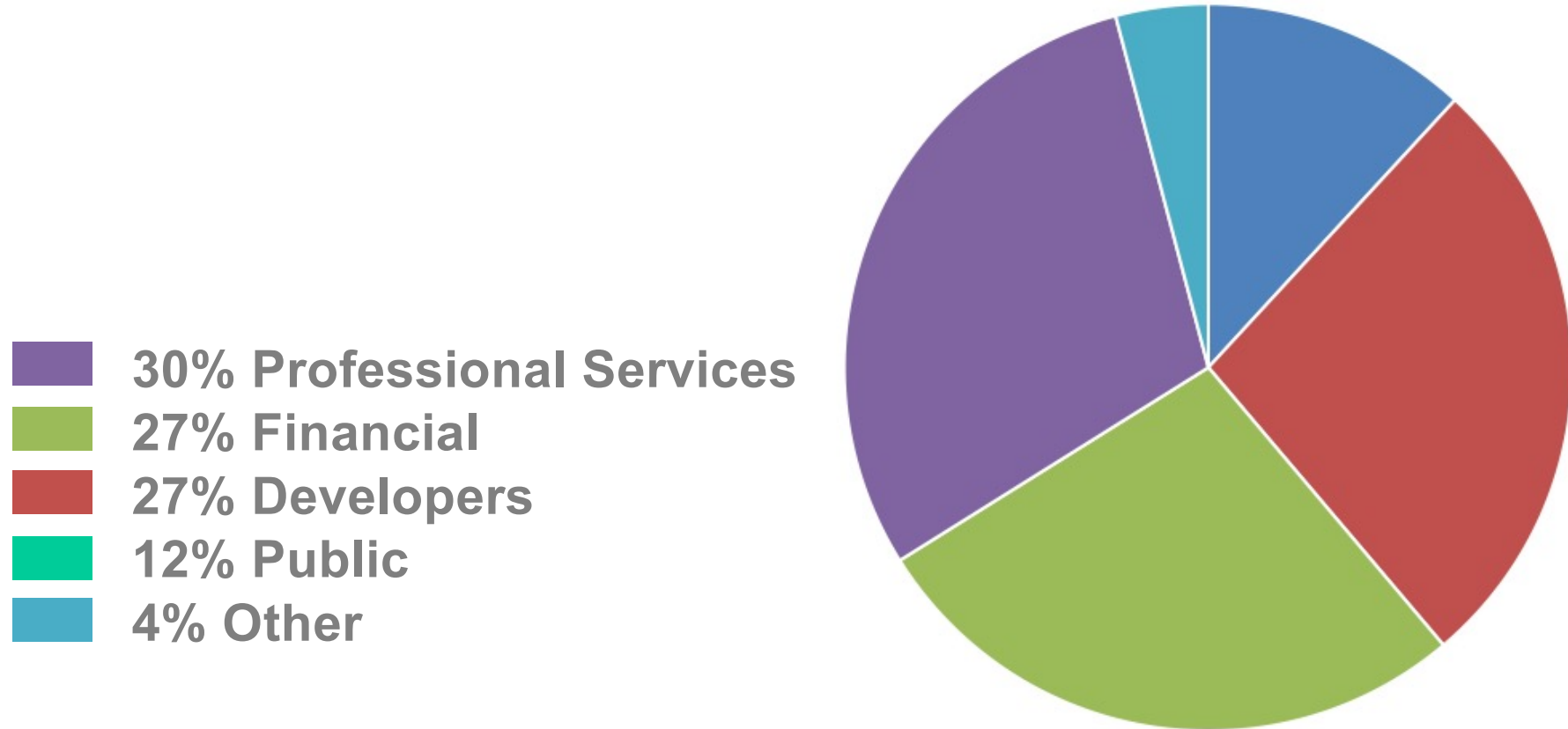
- Inform and influence land use practices
- High quality educational programs
- Provide professional development opportunities
- New insights and solution on the future of cities

What We Do

- Educational Programs
- Professional Development
- Policy & Practices + Sustainability
- Housing the Bay

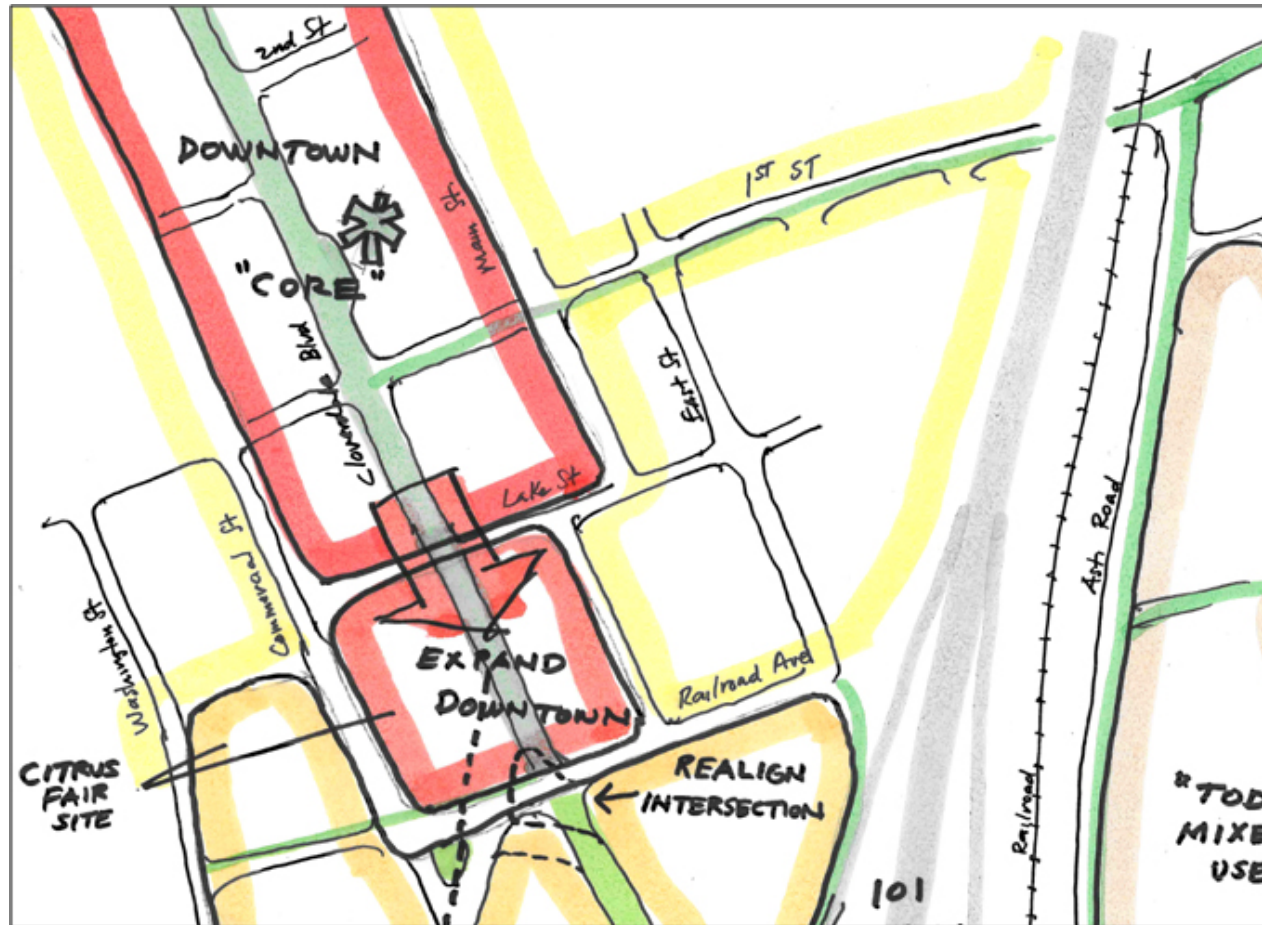


Our Members



Public Sector Programs + Opportunities

- UrbanPlan for Public Officials
- City Development Partnership Training
- City Council Study Sessions
- Technical Assistance Panels



Research and Publications

Finance for Real Estate Development

Charles A. Long
Published by ULI



Section 1– What is RE Development?



Daddy or Mommy Builds Parks

Development today is more complicated – *physically and economically.*

- Mix of uses
- Increased density
- More conversions from old uses or infill challenges
- Physical constraints like dirty soil
- Community benefits more important, but often costly
- More complicated development economics



Santana Row

Entitlements – *complex & challenging*

- More public involvement
- Concerns about height & density
- Need to fund development impacts
- Lack of infrastructure funding
- Often long process for environmental and design review
- Referendums and ballot measures



The Modera

People often ask us “what is land worth?”

The value of land, particularly in California,
is not about just the land or location...
it's about the “Entitlements”

The value of land is tied to:

- The rights associated with land
- The right to build on the land
- Or the probability that you can build on the land

The Other Players & The Process

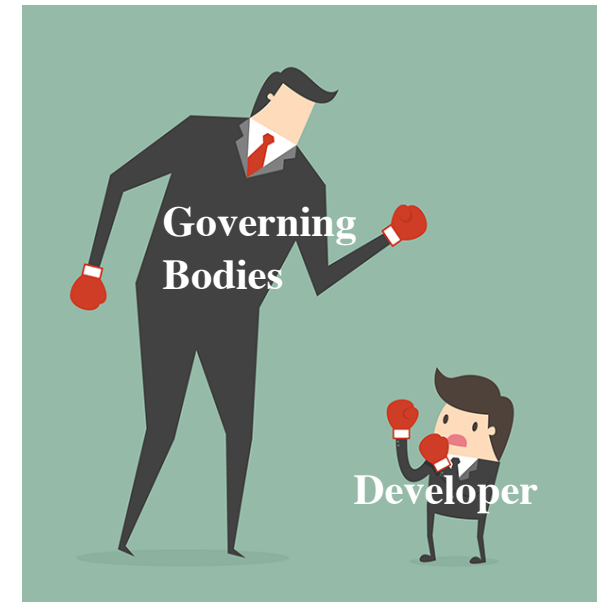
What do Developers do?

- Bring together capital, ideas and expertise to build or renovate real estate projects
- Bring together architects, contractors, lawyers, brokers, and government agencies, all of which have their own agenda, to create projects

- The field is multi disciplinary
- Not everybody knows how to do every product type
- Product development cycle is very long

Three Rules of Real Estate Development

NO RULES



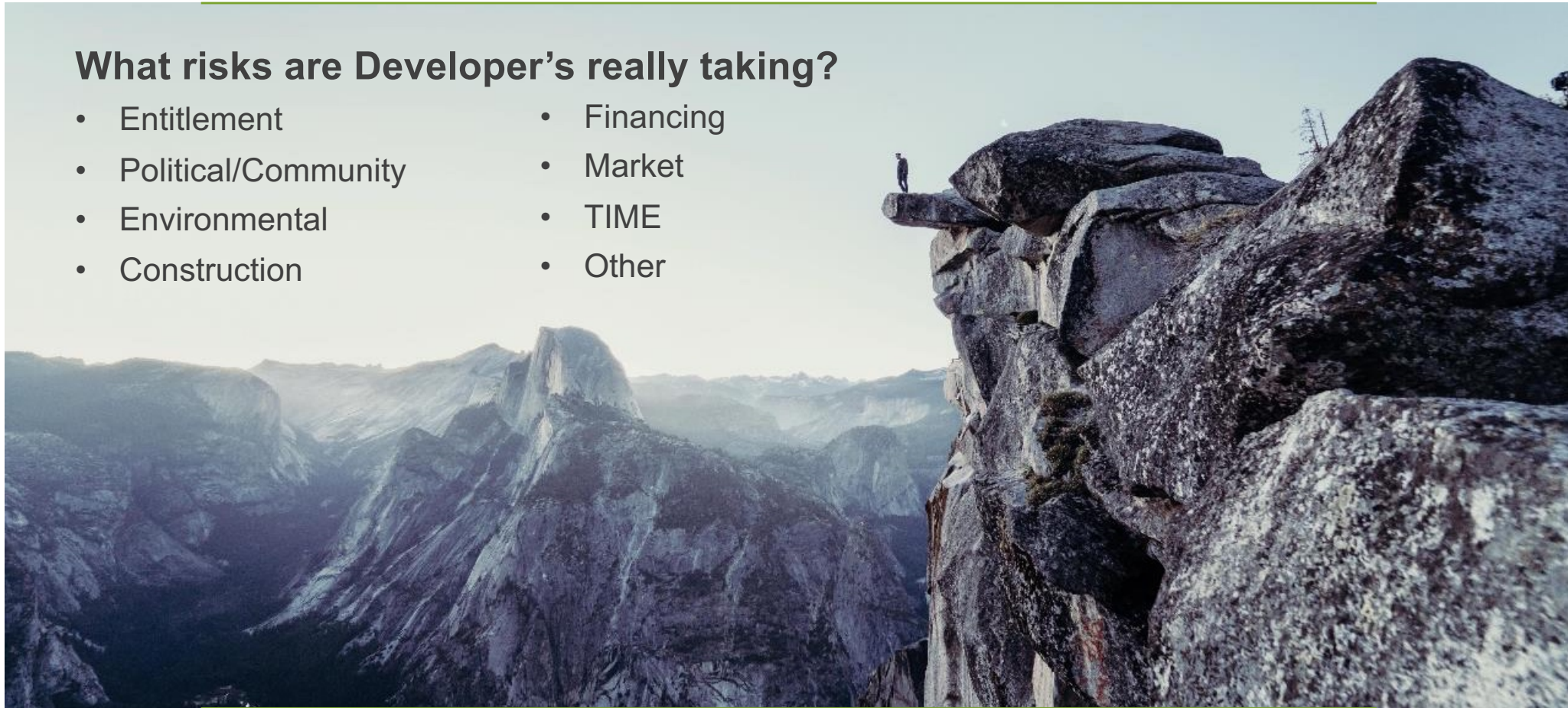
1) There are no Rules

2) You have no Rights

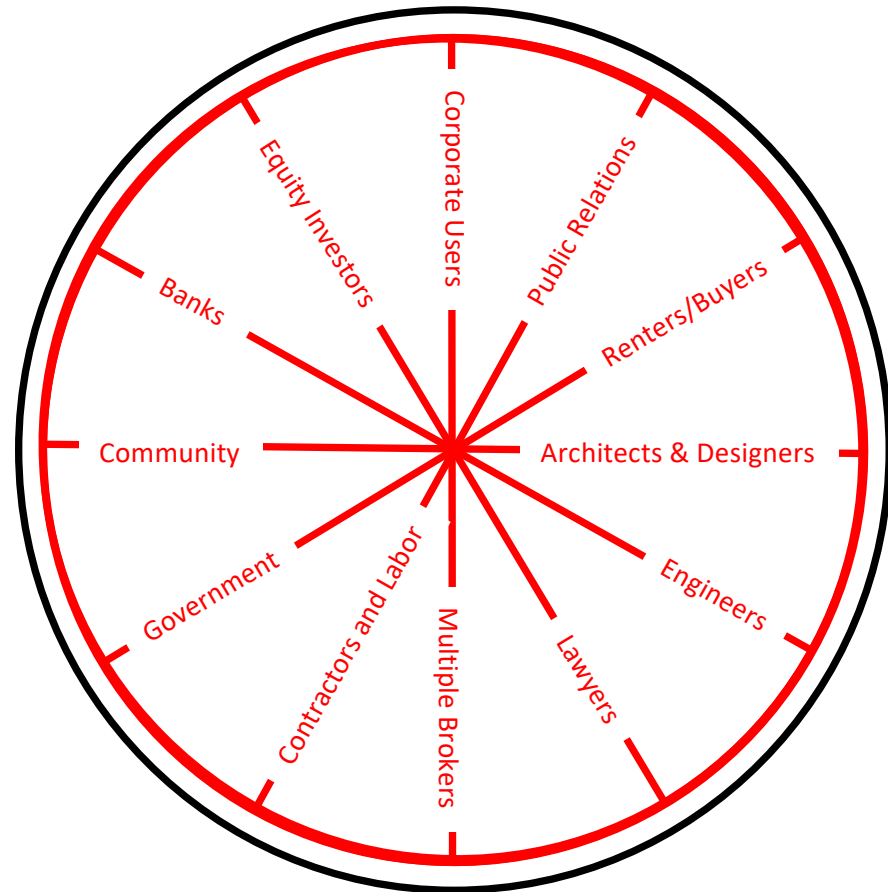
3) The Process is Not Fair

What risks are Developer's really taking?

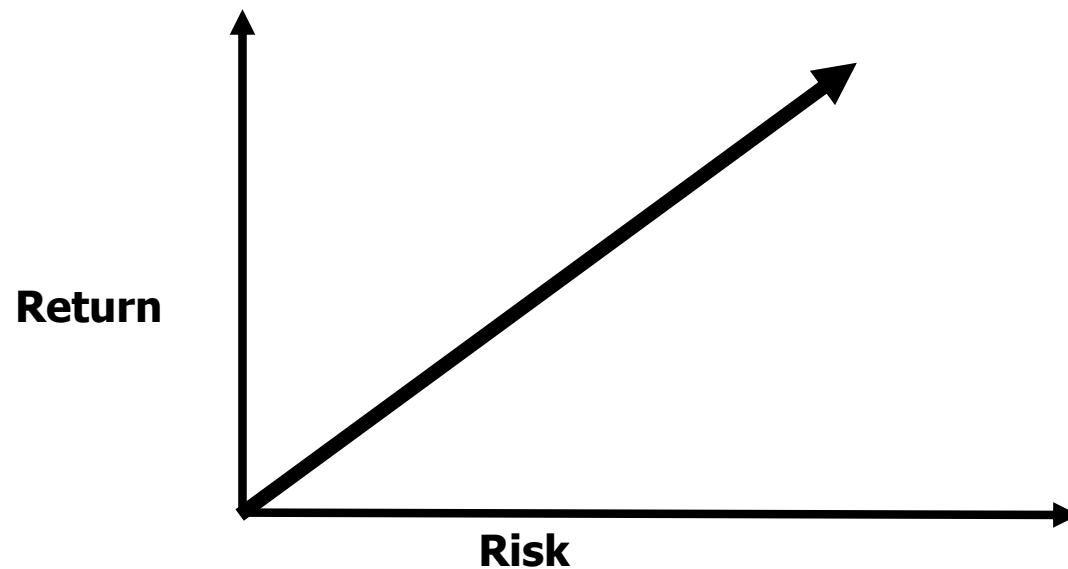
- Entitlement
- Political/Community
- Environmental
- Construction
- Financing
- Market
- TIME
- Other



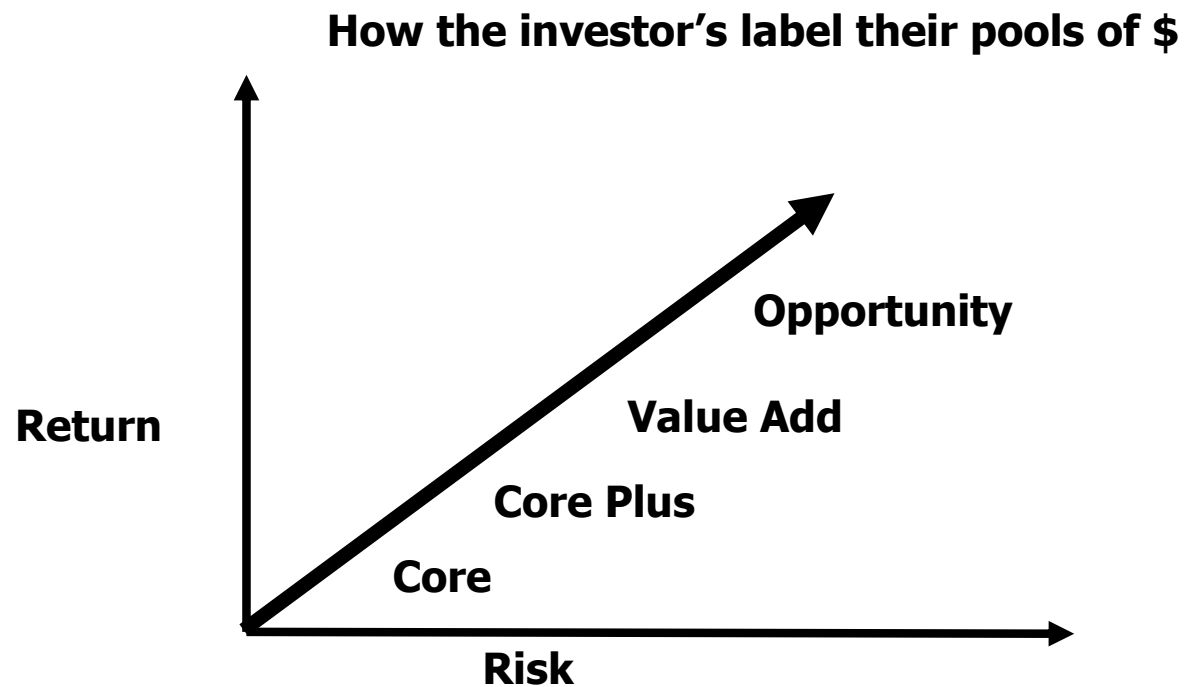
Developer's Dharma Wheel



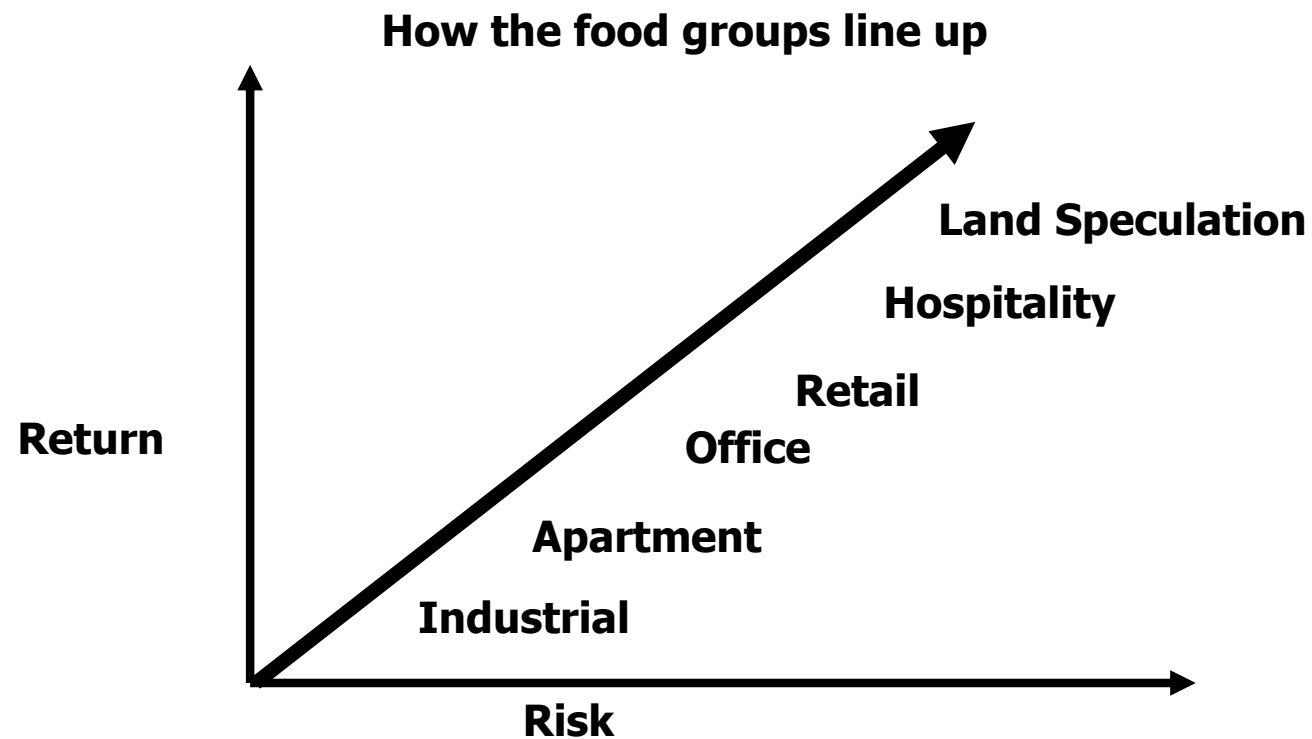
A universal truth of all investment is that capital strives to generate the highest return for the least amount of risk.



Different Types of Risk and Return



Risk and Return of Different Food Groups



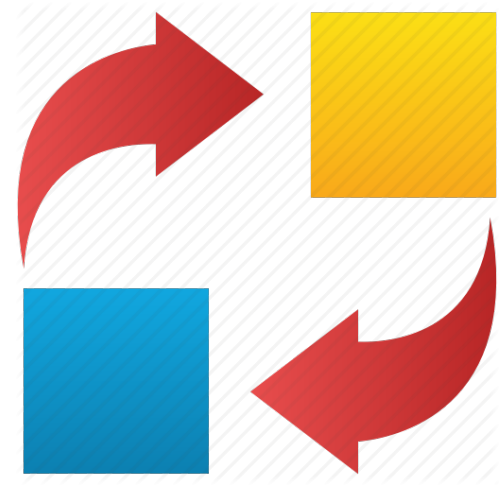
Three (3) Appraisal Methods



Income



Comparables



Replacement Cost

Residual Land Value Analysis

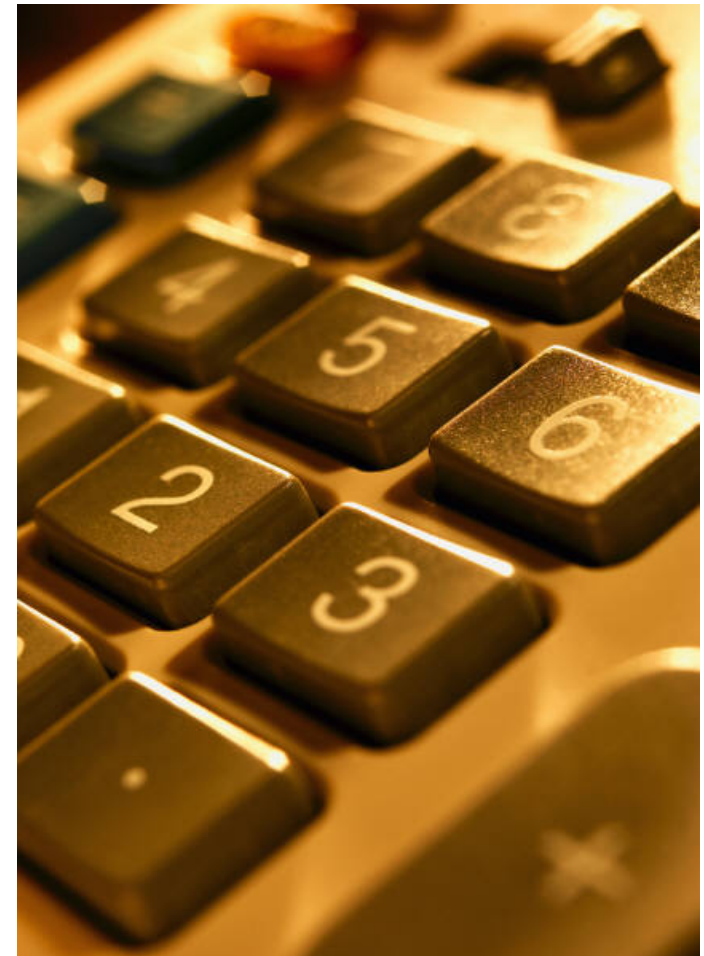
- Calculated based on the difference between potential value of new development and projected development costs

Residual Land Value Calculation

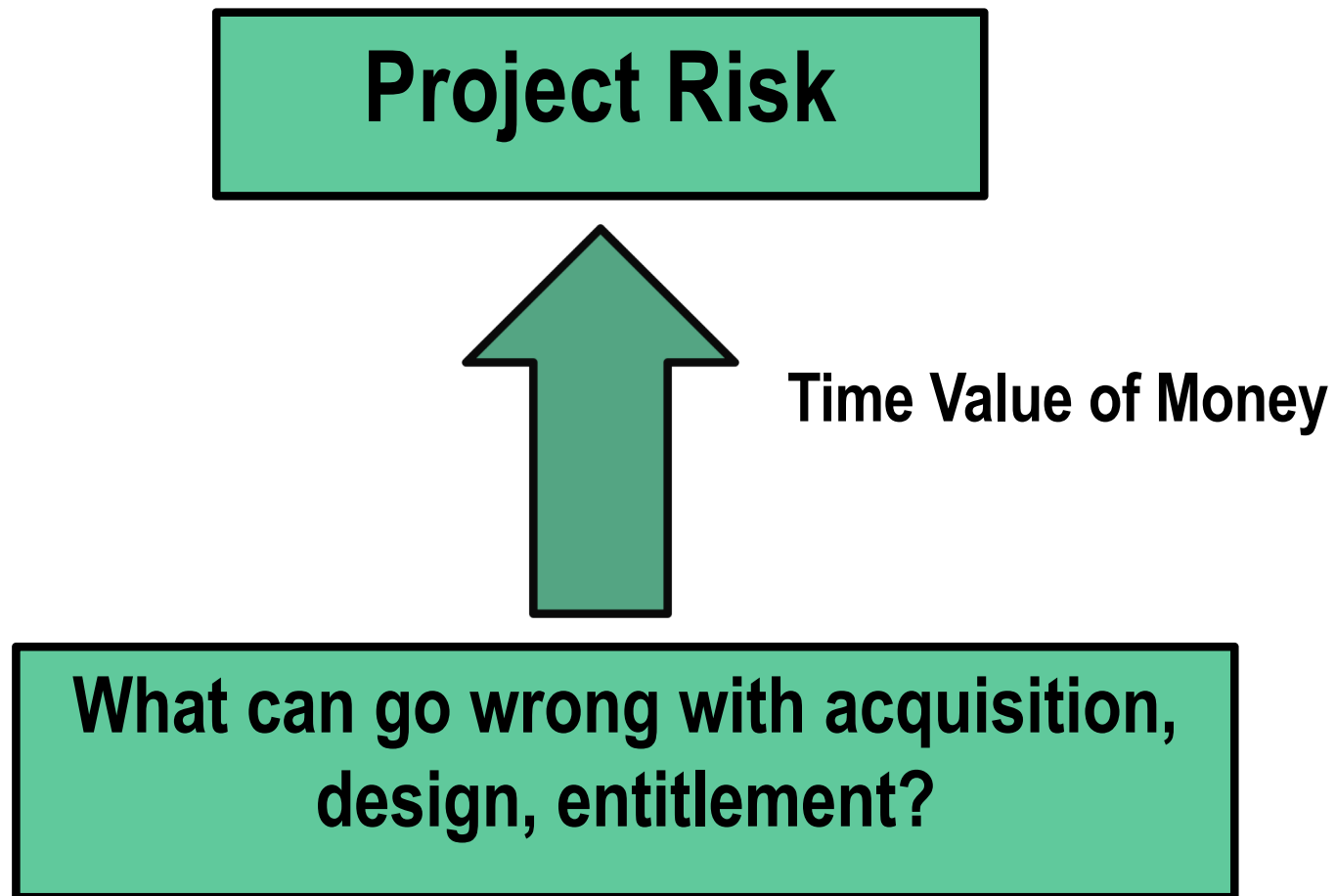
Potential Development Value

Less: Projected Development Costs

Residual Land Value



**As pre-development is most risky phase,
capital is most expensive.**



Cap Rates

Cap rate indicates investor perception of:

- Availability of capital
- Perceived financial strength
- Reliability of income and potential for price appreciation



Cap rate also indicates market strength

$$\text{Cap Rate} = \frac{\text{Net Operating Income (NOI)}}{\text{Project Value}}$$

$$\text{Project Value} = \frac{\text{NOI}}{\text{Cap Rate}}$$

Low cap rate indicates market strength/low cost of financing

High cap rate indicates market weakness/high cost of financing

<u>NOI</u>	<u>Cap Rate</u>	<u>Value</u>
\$1,000,000	5%	??
\$1,000,000	10%	??



<u>NOI</u>	<u>Cap Rate</u>	<u>Value</u>
\$1,000,000	5%	\$20,000,000
\$1,000,000	10%	\$10,000,000

Return on Cost

$$\text{Return on Cost} = \frac{\text{Projected NOI}}{\text{Development Cost}}$$

(ROC)

- *ROC is used to analyze future income-producing properties*
- *Cap Rate is used to value properties already operating or to estimate future value of new development*
 - *Both are calculated based on NOI*
- *The difference between the two reflects the risk of development & construction and potential returns*

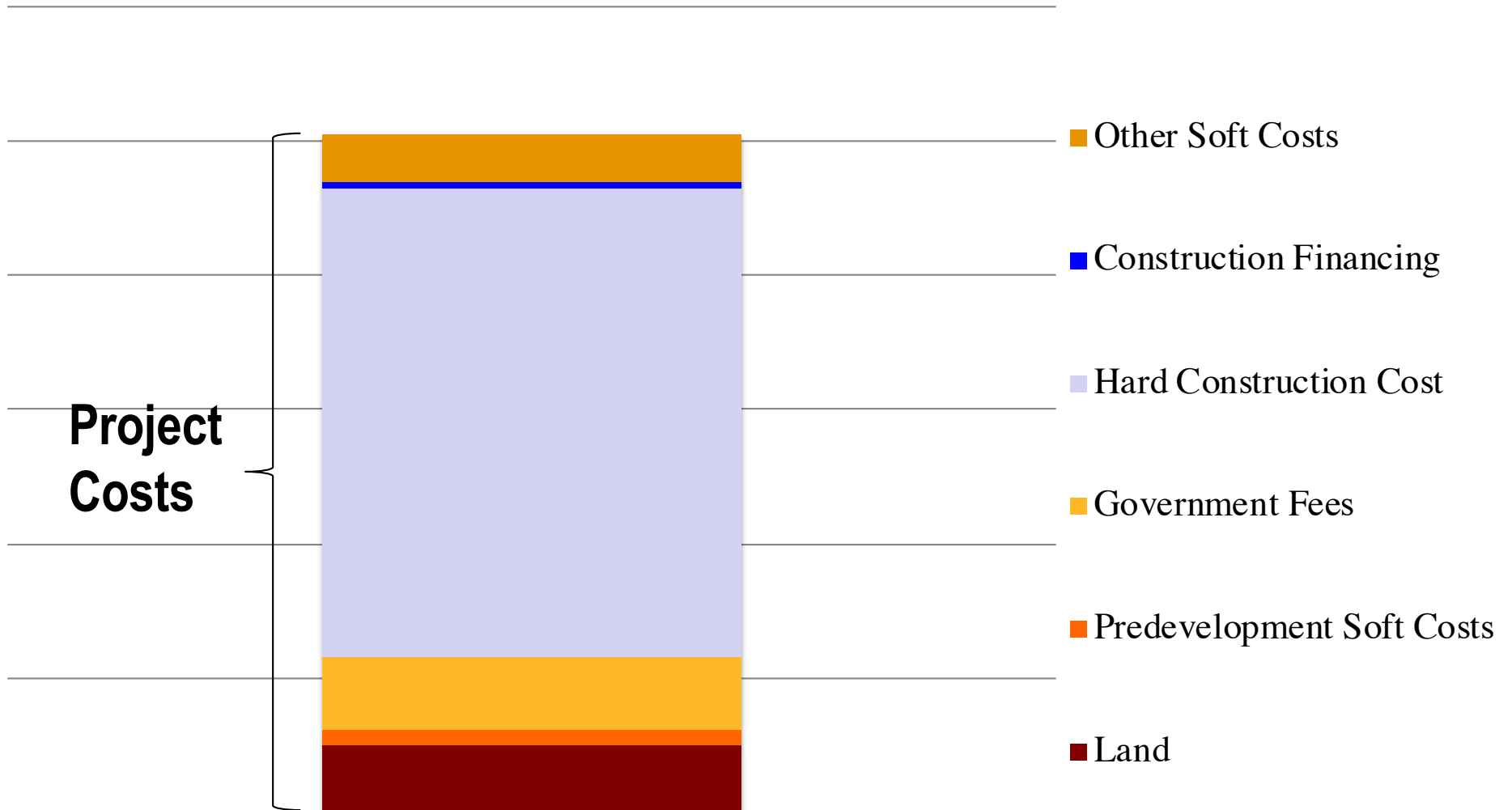
Trends B.C. (Before Covid)

- Interest rates at historic lows
- Cap rates at historic lows (i.e. values at highs)
- Construction costs increasing since GFC
- Rents no longer growing
- Development works when your go forward outlook is “blue sky”

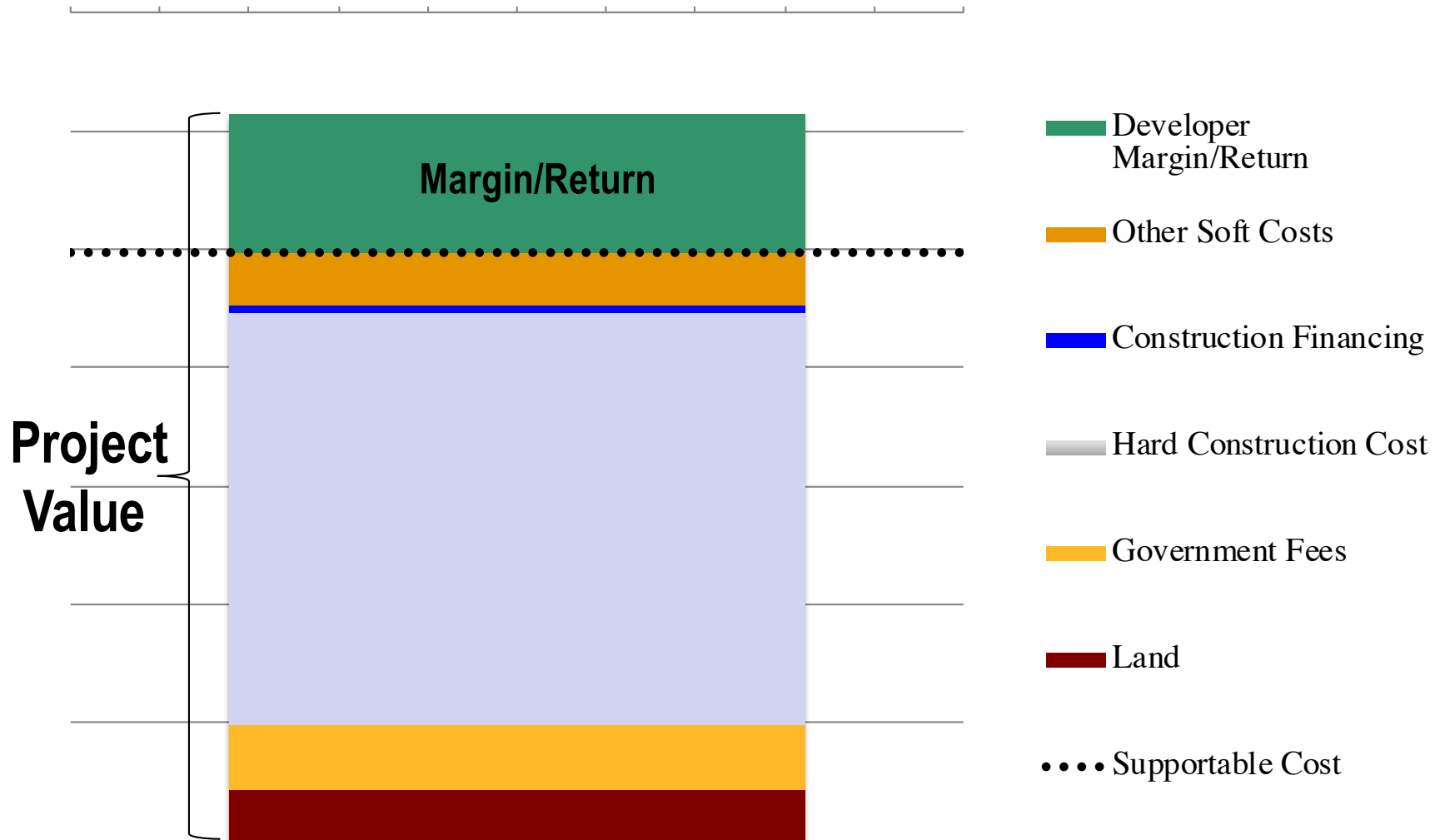
Development Feasibility



Development Feasibility – Future Project Costs



Development Feasibility Framework



Multi-Family Case Study

Existing Property and Land Use

- About 20,000 SF of existing retail

Potential Residential Development

- 200 Apartments proposed with
 - 10% on site affordable

Proposed Building Characteristics

- About 170,000 leasable SF (NRSF)
- 7 stories
- Podium construction
- About 300 parking spaces
- Ground floor retail (street frontage)



2 Pierce Avenue

What is value of existing retail?

Retail NOI

Cap Rate

Value

\$357,500

??

??

Will the Landowner Sell?

Retail NOI

Cap Rate

Value

\$357,500

6.5%

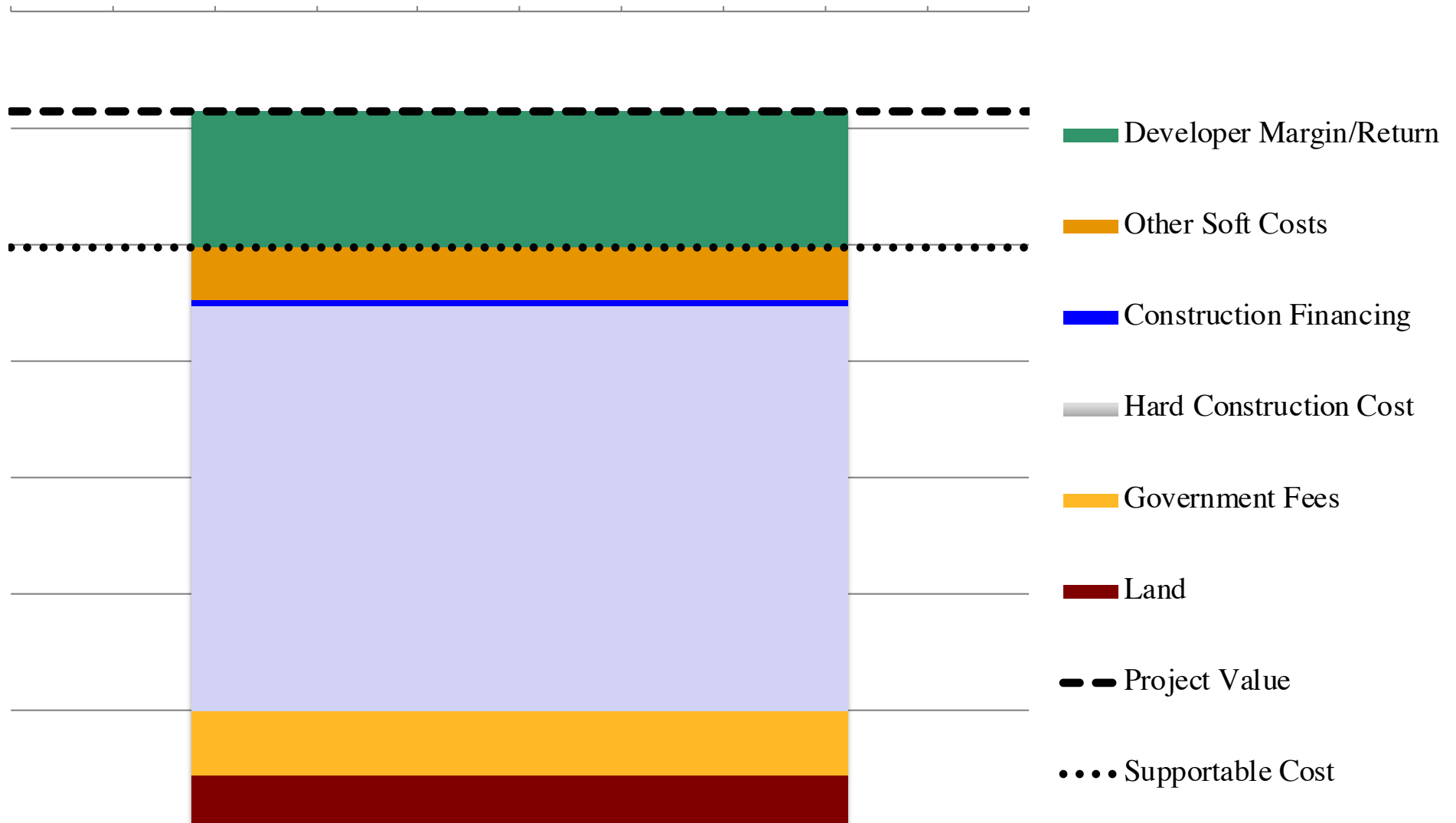
\$5,500,000

- Would seller be willing to sell building for this amount?
- How much more would have to be paid given that developer may option property for 2+ years?

Project Characteristics

Characteristics	
Total Units	200
Market Rate	180
Below Market Rate	20 with on-site BMR
Average Apartment Size	885 SF
Market Rate Rent/SF	\$3.95/sf
Market Rate Rent /Month	\$3,500
Parking	380 spaces
Residential Net Rentable Area	177,000 SF
Retail Area	8,000 SF

Base Case



Base Case

10% On Site BMR's

Net Operating Income	\$5,600,000
Return on Cost Target	5.25%
Total Supportable Development Cost	\$106,700,000
Less: Total Costs Without Land	\$90,700,000
Residual Land Value (RLV)	\$ 16,000,000

***Yahtzee:** Residual Land Value above \$5,500,000 commercial value.*

Sensitivity Analysis 1

Offsites/Fees Up \$20,000 per Unit

Net Operating Income	\$5,600,000
Return on Cost Target	5.25%
Total Supportable Development Cost	\$106,700,000
Less: Total Costs Without Land	\$94,700,000
Residual Land Value (RLV)	\$12,000,000

***Yahtzee:** Residual Land Value drops by \$4.0M
but still high enough to make a deal.*

Sensitivity Analysis 2

Construction Cost Up 10%

Net Operating Income	\$5,600,000
Return on Cost Target	5.25%
Total Supportable Development Cost	\$106,700,000
Less: Total Costs Without Land	\$97,200,000
Residual Land Value (RLV)	\$ 9,500,000

***Yahtzee:** Residual Land Value dropped by \$6.5M but still high enough to make a deal.*

Sensitivity Analysis 3

15% On-Site BMR

Net Operating Income	\$5,360,000
Return on Cost Target	5.25%
Total Supportable Development Cost	\$102,100,000
Less: Total Costs Without Land	\$90,700,000
Residual Land Value (RLV)	\$ 11,400,000

***Yahtzee:** Residual Land Value dropped by \$4.6M
but still high enough to make a deal!*

Sensitivity Analysis 4

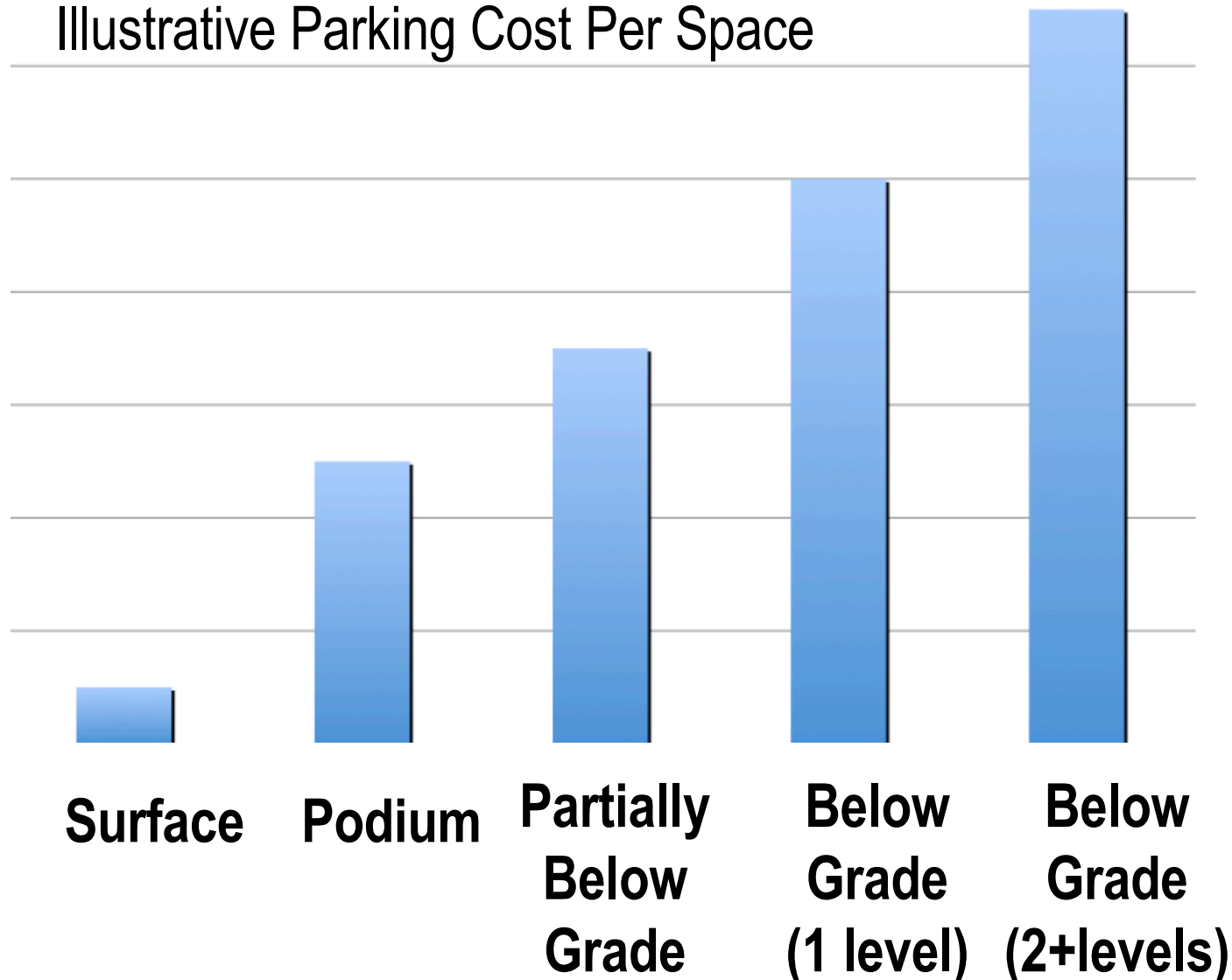
All of the Above

Net Operating Income	\$5,360,000
Return on Cost Target	5.25%
Total Supportable Development Cost	\$102,100,000
Less: Total Costs Without Land	\$101,200,000
Residual Land Value (RLV)	\$900,000

No Deal! Residual Land Value is well below existing value!

Impact of the retail and its parking?

Illustrative Parking Cost Per Space



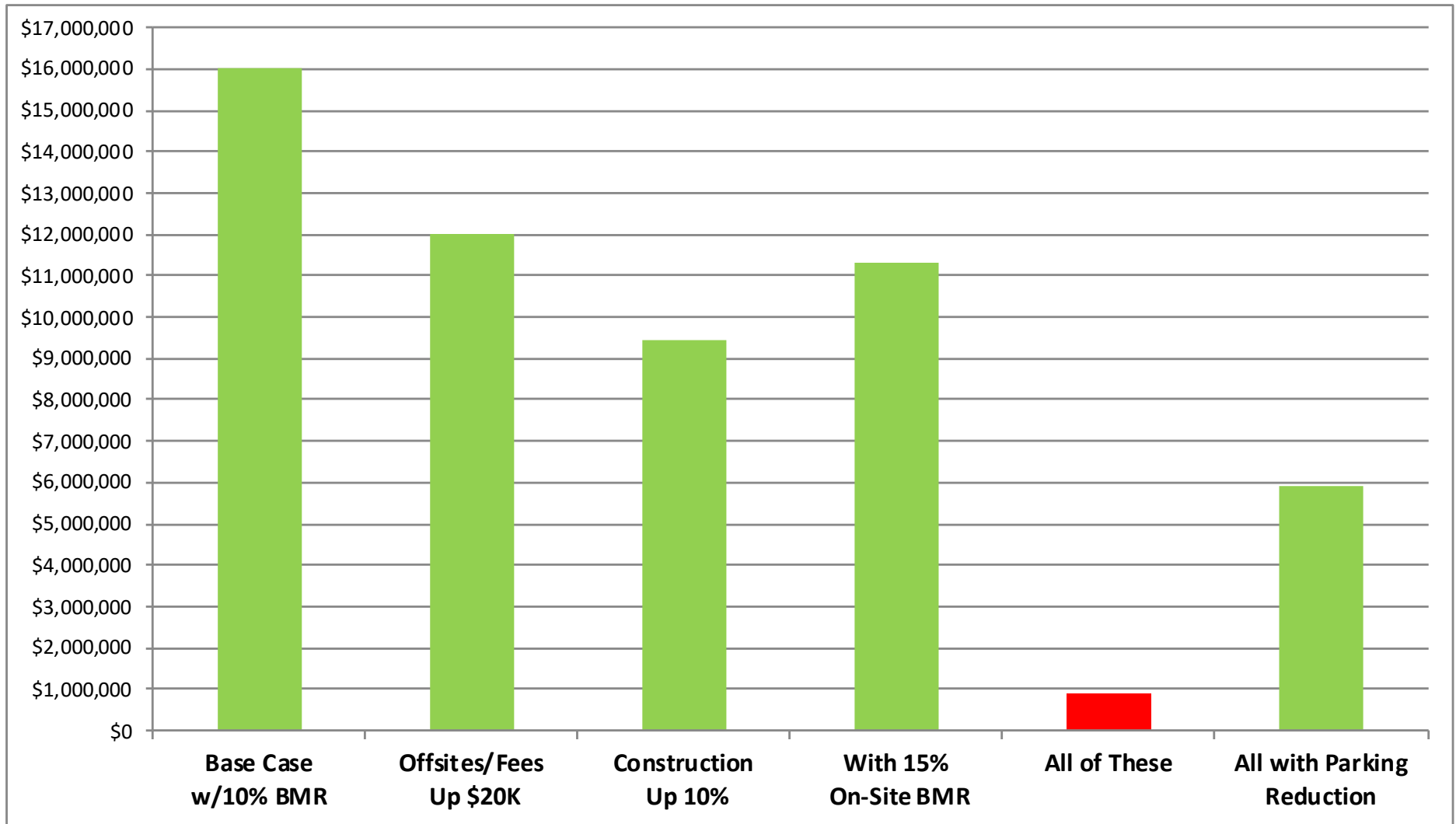
Sensitivity Analysis 5

All of the Above with Less Parking and No Retail

Net Operating Income	\$5,360,000
Return on Cost Target	5.25%
Total Supportable Development Cost	\$102,100,000
Less: Total Costs Without Land	\$96,100,000
Residual Land Value (RLV)	\$ 6,000,000

***Yahtzee:** Residual Land Value goes up by \$5.1M and is again high enough to make a deal!*

Results of Sensitivity Analysis



Residual Land Value Under Base Case and Five Scenarios

Is there still a deal?

Base Case: 200 apartments with 10% BMRs and retail

Sensitivity Cases:

- | | |
|---|---------|
| • 1 - 15% On-site BMR | Deal |
| • 2 - City fee increases by \$20,000 | Deal |
| • 3 - Construction costs are 10% higher | Deal |
| • 4 - All of the above | NO Deal |
| • 5 - All of above, no retail & parking reduction | Deal |

Q&A on Section 1



Section 3– Development Fees and Taxes



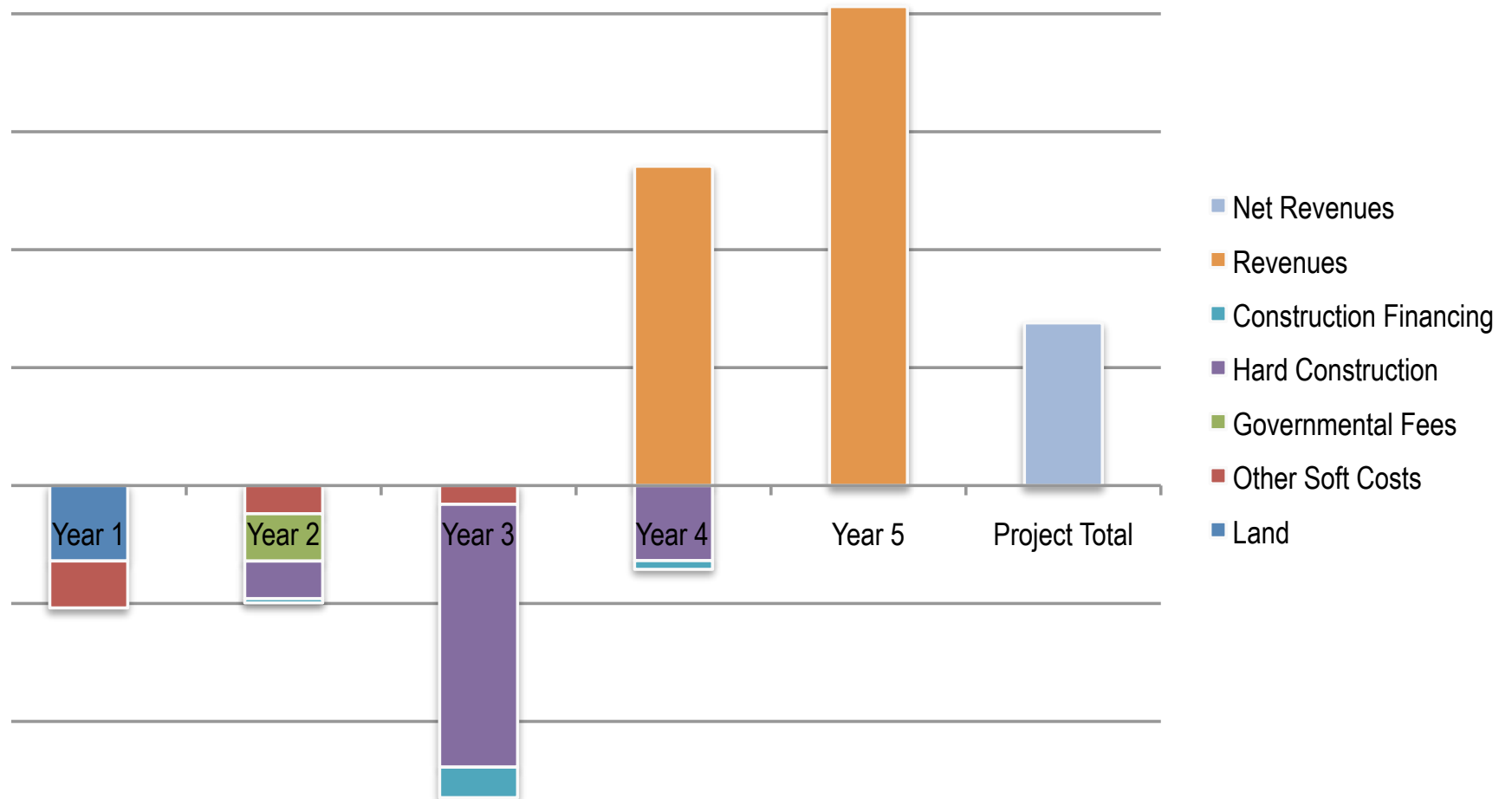
“Looks like you’re on top of the new regulations.”

Entitlement and Permits – Time is Money



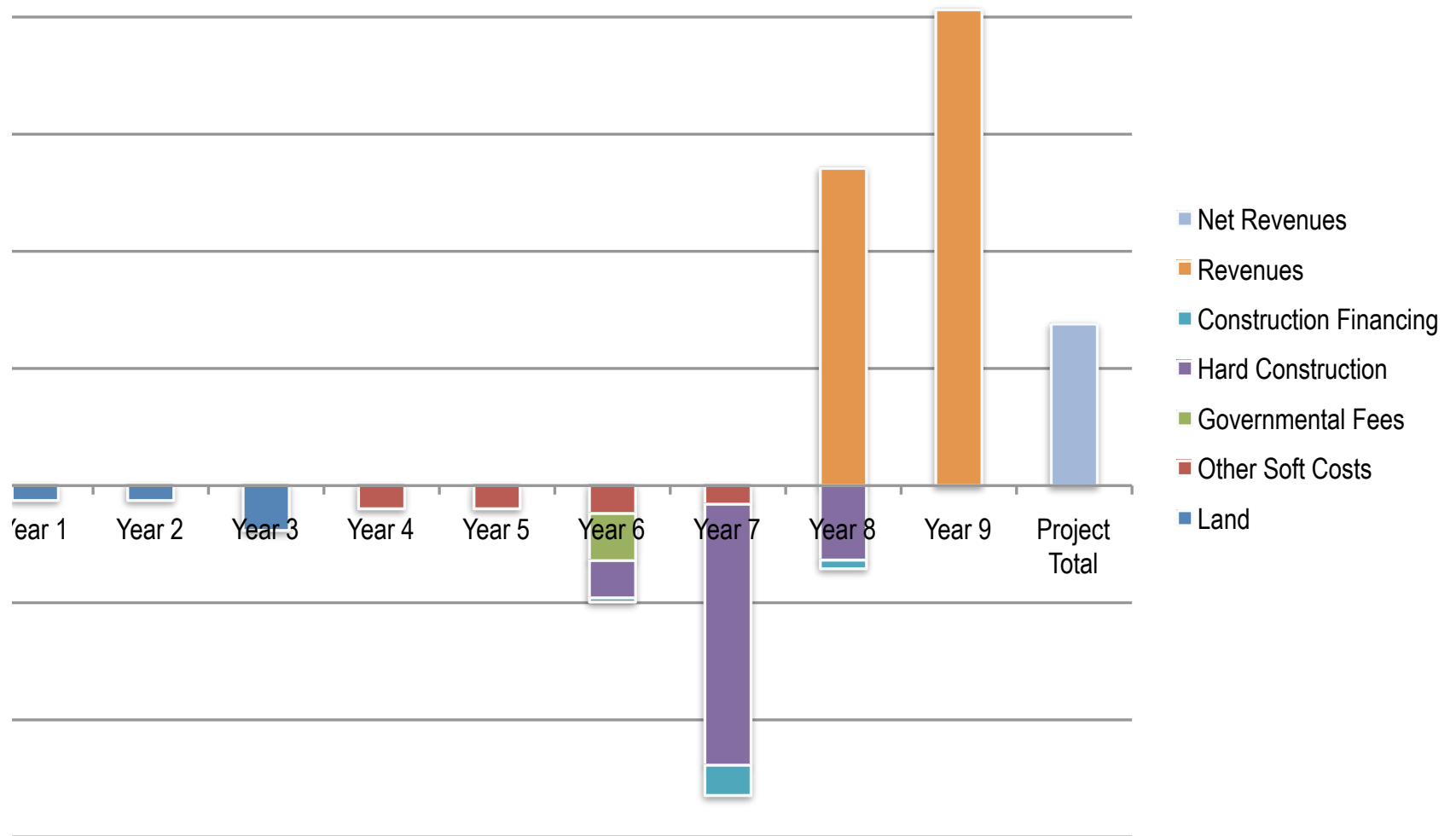
- Upfront capital is high risk and must deliver greater returns
- Potential impacts of entitlement and permit processes
 - Extend the schedule
 - Modify project significantly
 - Increase costs

Upfront Land Payment and Fast Entitlement



Residential Development– Yahtzee!

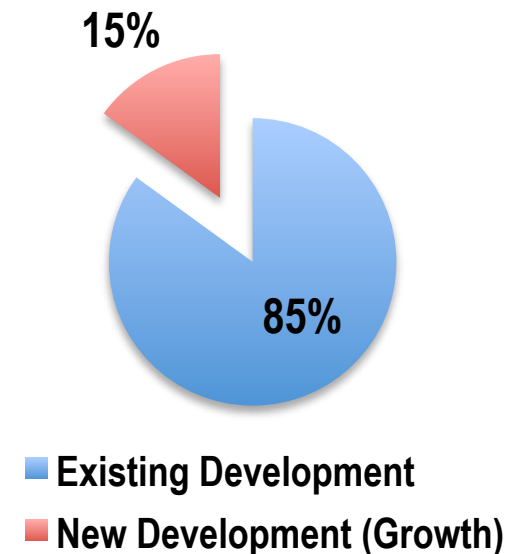
Optioned Land and Slow Entitlement



Residential Development– **No Deal!**

- Developers build public infrastructure and facilities based on improvement plans to address or mitigate the impact of new development.
- Alternatively, developers may pay development impact fees to mitigate these impacts.
- **Impact fees must be based on new development's fair share of these costs as demonstrated by a nexus study.**

New Development's Fair Share



Timing When Fees Are Imposed

What timing could make projects more feasible?

Figure 4: Fee Imposition Timing Across Case Study Cities

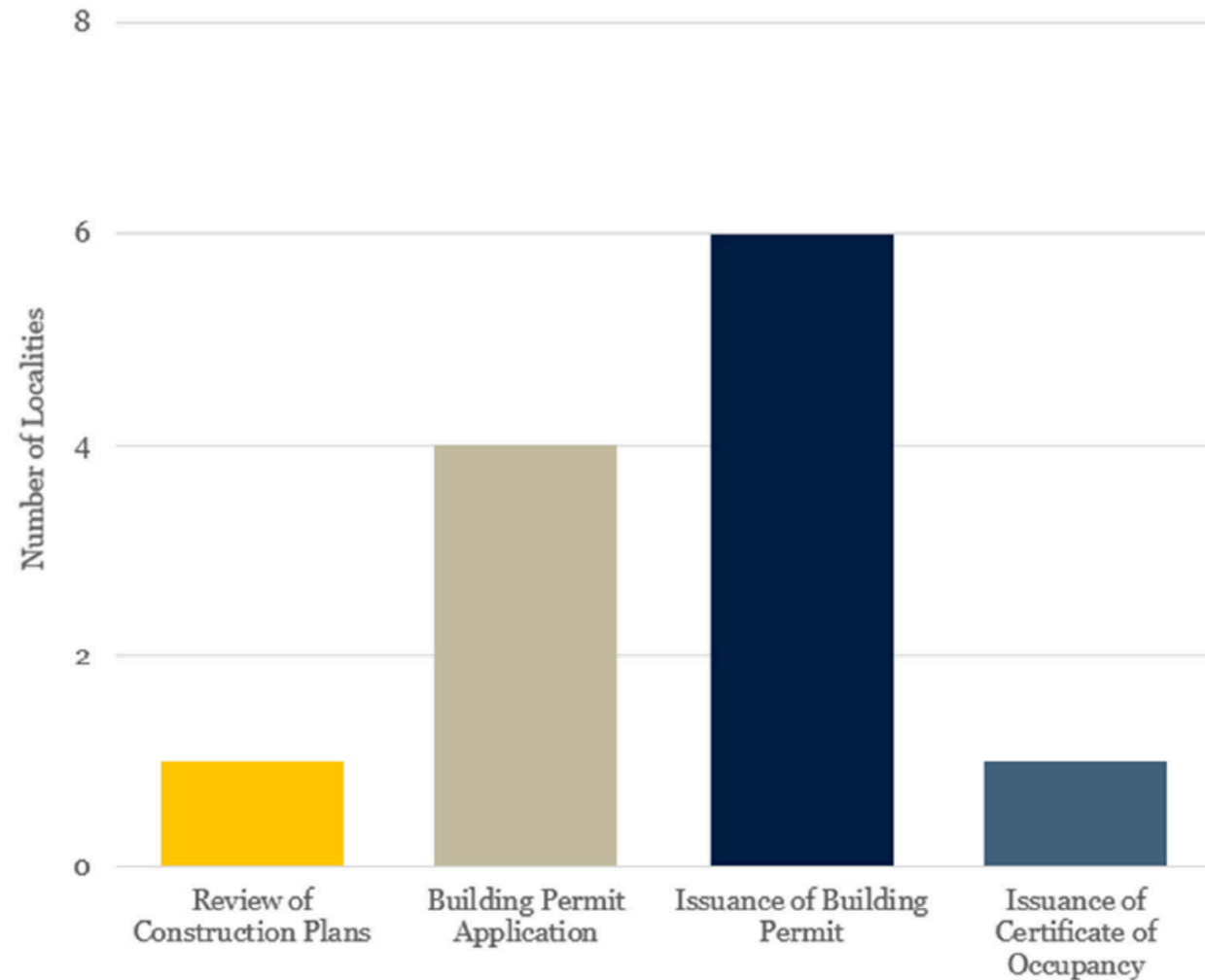


Figure 3: Case Study and Sample Cities and Counties

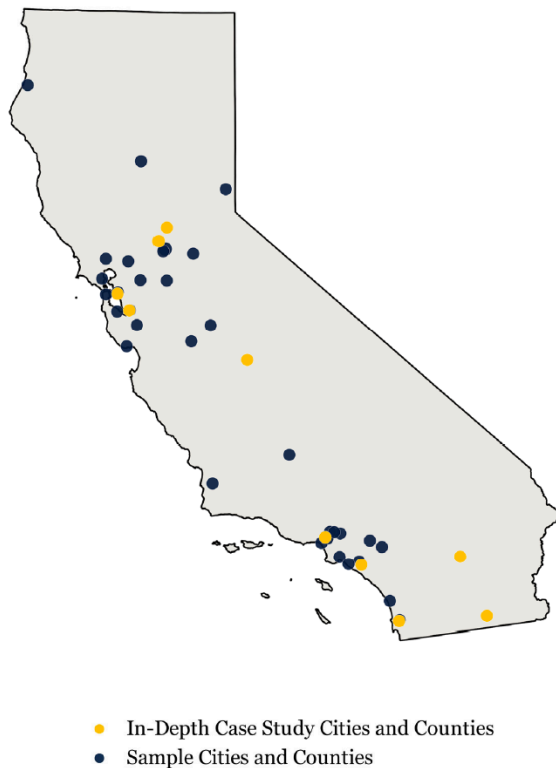
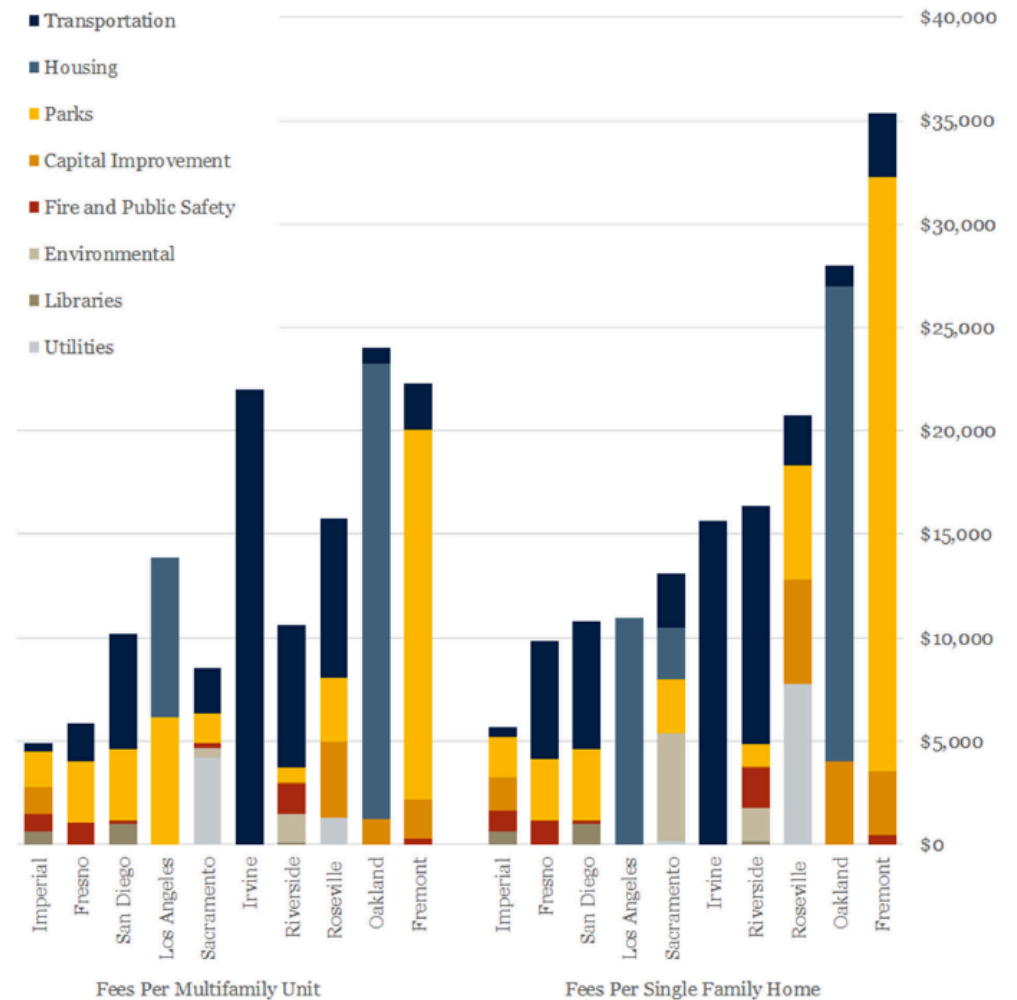
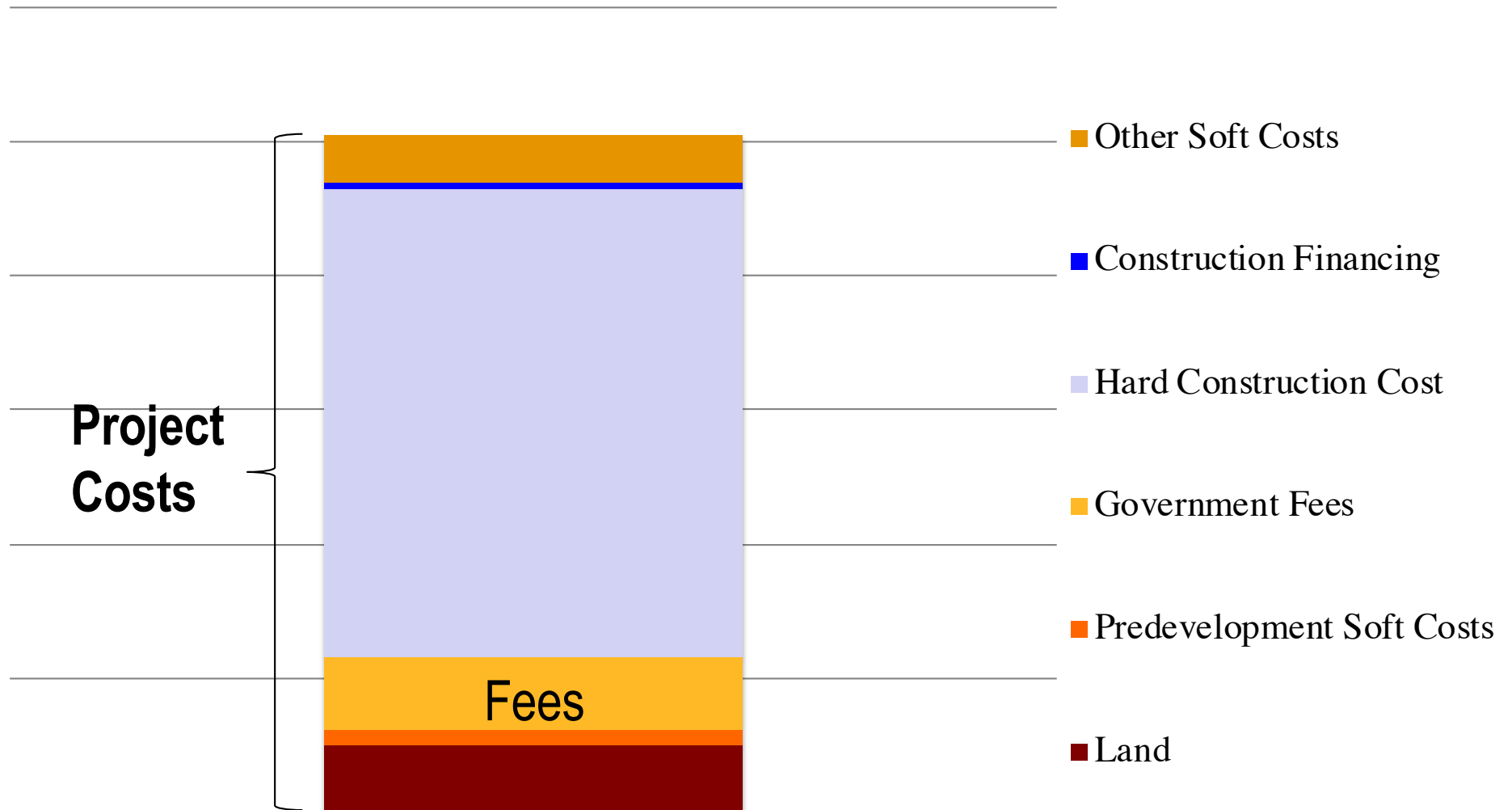


Figure 7: Total Mitigation Fee Act Fees by Type
Estimated for a Unit in Prototypical 100-Unit Multifamily
and 20-Unit Single-Family Projects

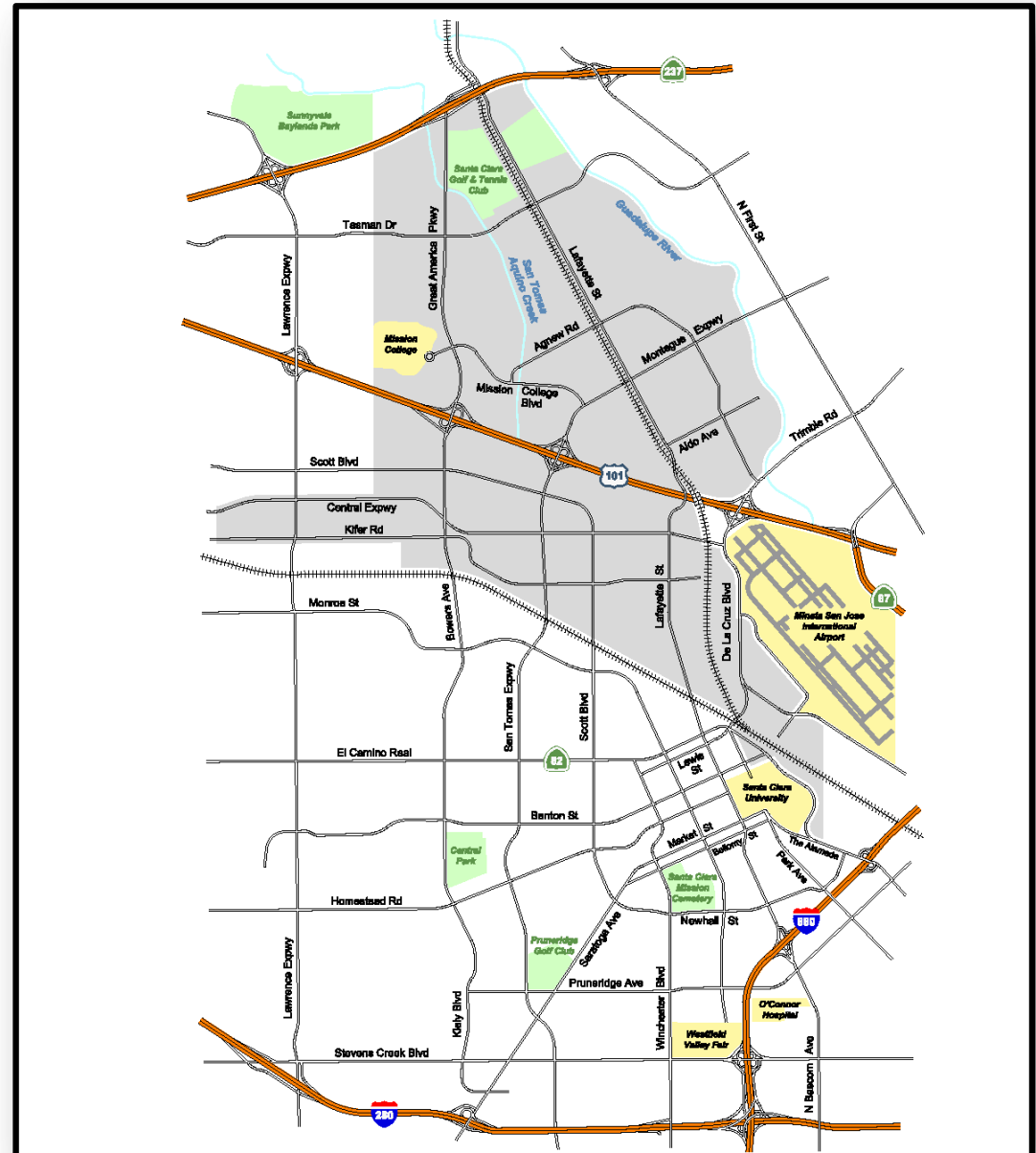


Feasibility Framework– Fees as Part of Project Costs



Traffic Impact Fee

- Established in 1988 as part of Traffic Mitigation Program
- One time fee charged to new development
- Fees used for capital facility and infrastructure costs
- Current fee exemptions
 - Affordable housing
 - Retail < 50,000 SF



Recent Changes in Santa Clara Traffic Impact Fees

Land Use	2018	2020
Office and R&D (per S.F.)	\$1.00	\$1.44
Industrial (Per S.F.)	\$0.67	\$0.79
Warehousing, Utilities, and Communications (per S.F.)	\$0.20	\$0.23
Hotel/Motel (per room)	\$400	\$755
Multi-Family Residential (per unit)	--	\$554
Single-Family Residential (per unit)	--	\$1,245
Retail (per S.F.)	--	\$4.79

Nexus Study 2019

- **Facilities Needed at current standards to meet residential growth demand**
 - Quimby (3.0 acres/1000 res) = 85.18 acres
 - MFA (2.6 acres per/1000 res) = 73.82 acres
- **Cost per capita for new parks and improvements at current standards**
 - Park Land = \$9,719 to \$12,105 per capita, depends upon Zip Code Area and Project application type (Quimby or MFA)
 - Park Improvements = \$3,471 per capita
- **Program administration**
 - 2 % additional



Policy Alternatives

- **Alternative 1**
 - Increase Fees
 - Recover Park Improvement Costs at \$3,471 per capita
 - Recover Park Land Acquisition costs at \$9,719 to \$12,105 per capita
- **Alternative 2**
 - Phase in Increased Fees
 - Recover Park Improvement Costs over three year period, 25% of per capita amount per year 2019=\$868, 2020=\$1,736, 2021=\$2,604, 2022=\$3,471.
 - Recover Park Land Acquisition costs at \$9,719 to \$12,105 per capita
- **Alternative 3**
 - Recover Park Improvement costs at less than \$3,471 per capita, (at less than \$1.335 million per acre).

PARK FEES

Rates Effective 1/1/20 for all projects deemed complete on or after December 28, 2019.

	95050		95051		95054	
	Quimby	MFA	Quimby	MFA	Quimby	MFA
Total Single Family (SF) Dwelling Fee	\$40,588	\$36,044	\$42,913	\$38,059	\$43,296	\$38,390
Total Multi Family (MF) Dwelling Fee	\$32,688	\$29,028	\$34,561	\$30,651	\$34,869	\$30,918

Website: <https://www.santaclaraca.gov/our-city/departments-g-z/parks-recreation/park-impact-fees>

- Basis for impact fee calculations (nexus study)
 - Land values
 - Capital improvement/facility costs
 - Application by land use
- How and when fees are charged (including phase-in)

	Los Angeles	Sacramento	Roseville	Oakland	Irvine	Fremont
Schools:	Square Feet	Square Feet	Square Feet, Units	Square Feet	Square Feet	Square Feet
Parks and/or Art:	Units	Square Feet, Bedrooms, Units	Units	Bedrooms	Valuation	Bedrooms, Square Feet
Transportation:		Trips, Constr. Cost, Units	Units	Units	Square Feet, Units	Bedrooms
Capital Improvement:	Units		Units	Units	Valuation	Bedrooms
Housing:		Square Feet		Units	Units	Square Feet
Fire and Public Safety:			Valuation			Bedrooms
Environmental:		Square Feet	Units			

Impact fees are collected according to a variety of metrics, which can incentivize project design choices; per-unit fees tend to encourage projects with fewer, larger units.

- Housing developments of 10 or more units must provide at least 15% affordable units onsite.
- Average of all affordable units must be affordable to households at Santa Clara County areawide median income (100% AMI).
- Smaller projects (<10 units) can pay a housing fee.
- Ordinance allows alternative means of compliance like land dedication.

AFFORDABLE HOUSING FEES

FOR-SALE RESIDENTIAL PROJECTS

Tenure Type	January 18, 2019 & beyond (per square foot)
Single-Family Home	\$32.04
Townhome	\$26.70
Condominium	\$21.36

RENTAL RESIDENTIAL PROJECTS

Tenure Type	January 18, 2019 & beyond (per square foot)
Rental Residential (any tenure type)	\$21.26

- Fees for most school districts are established by California State Allocation Board based on Level I Assessment per Square Foot.
- Fees typically increase every two years based on change in RS Means Index, which increased 7.64% statewide from 2018 to 2020.
- SCUSD adopted a slightly lower fee on housing at \$4.01/SF in 2020

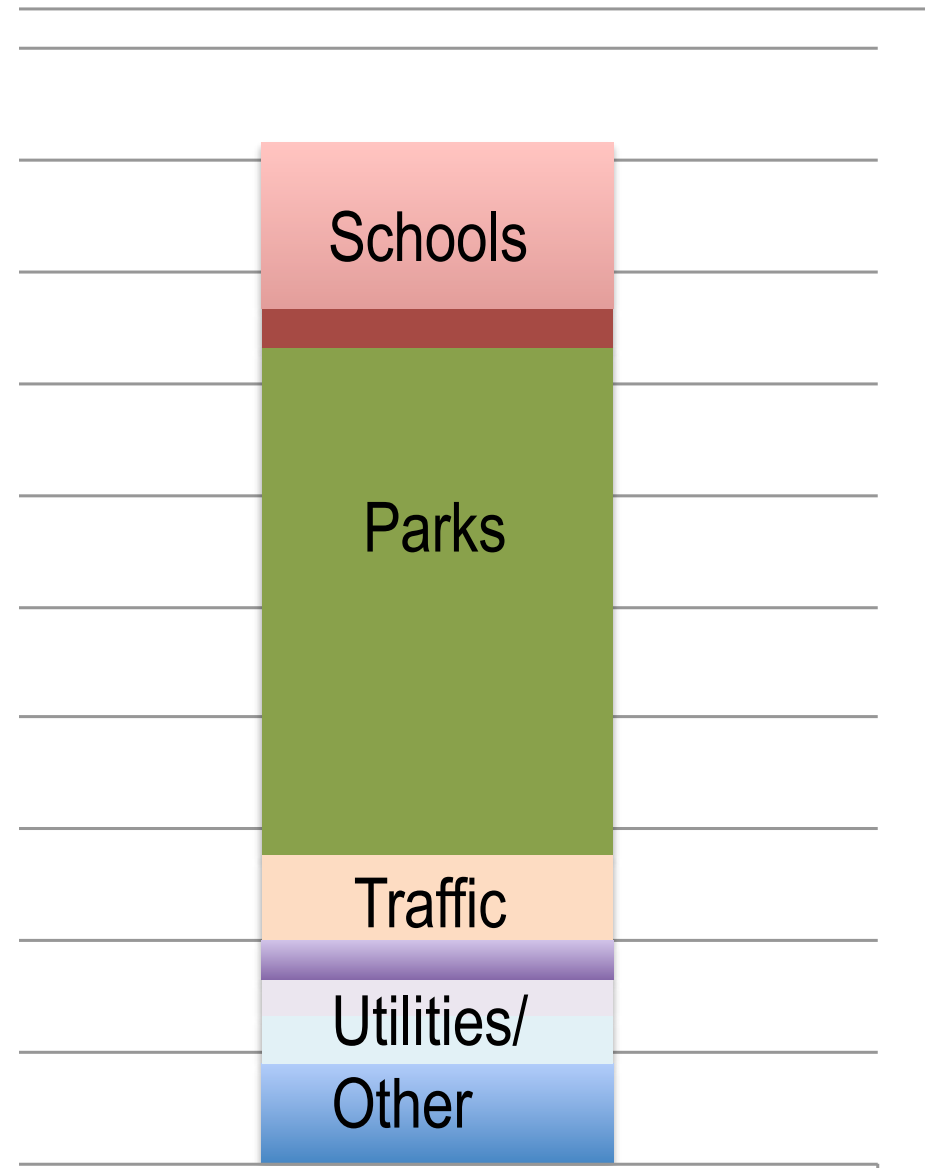
RS Means Index Maximum Level I Assessment Per Square Foot

	2016	2018	2020
Residential	\$3.48	\$3.79	\$4.08
Commercial/Industrial	\$0.56	\$0.61	\$0.66

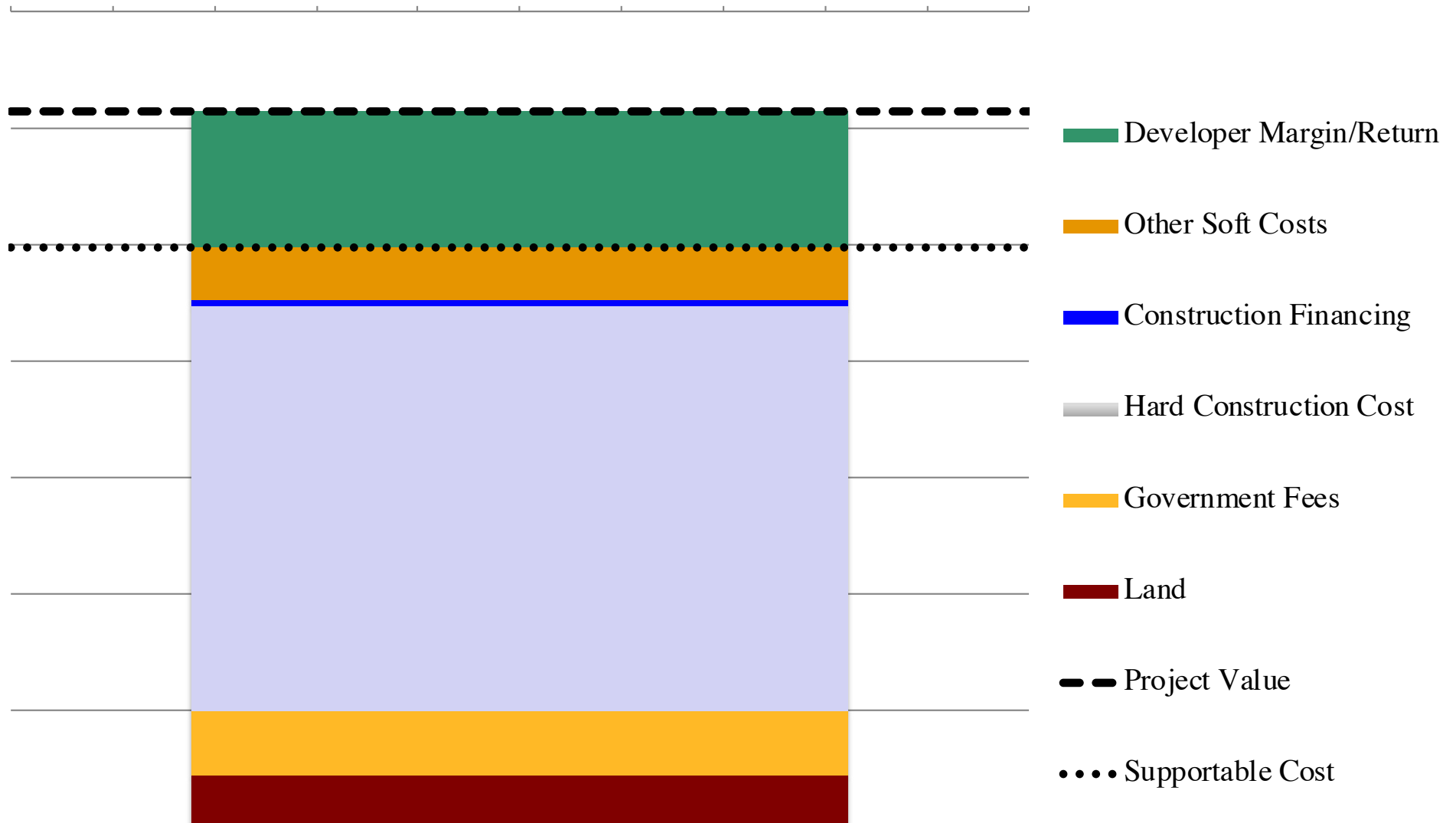
Due to its monetary shortfall, Developers are requested to include a Voluntary Community Benefit amount to fully mitigate the actual impact of the development on schools.

Current estimated Santa Clara fee cost for typical rental unit in City of Santa Clara:

- **\$3,000** for planning, design review, building and MEP+Fire
- **\$31,000** for parks
- **\$600** for traffic + offsites?
- **\$4,000** for schools + contribution?
- **\$16,000** for affordable housing if not provided on site
- **TBD** Utilities
- Other?



Feasibility Framework– Base Case



Sensitivity Analysis 3

15% On-Site BMR

Net Operating Income	\$5,360,000
Return on Cost Target	5.25%
Total Supportable Development Cost	\$102,100,000
Less: Total Costs Without Land	\$90,700,000
Residual Land Value (RLV)	\$ 11,400,000

***Yahtzee:** Residual Land Value dropped by \$4.6M
but still high enough to make a deal!*

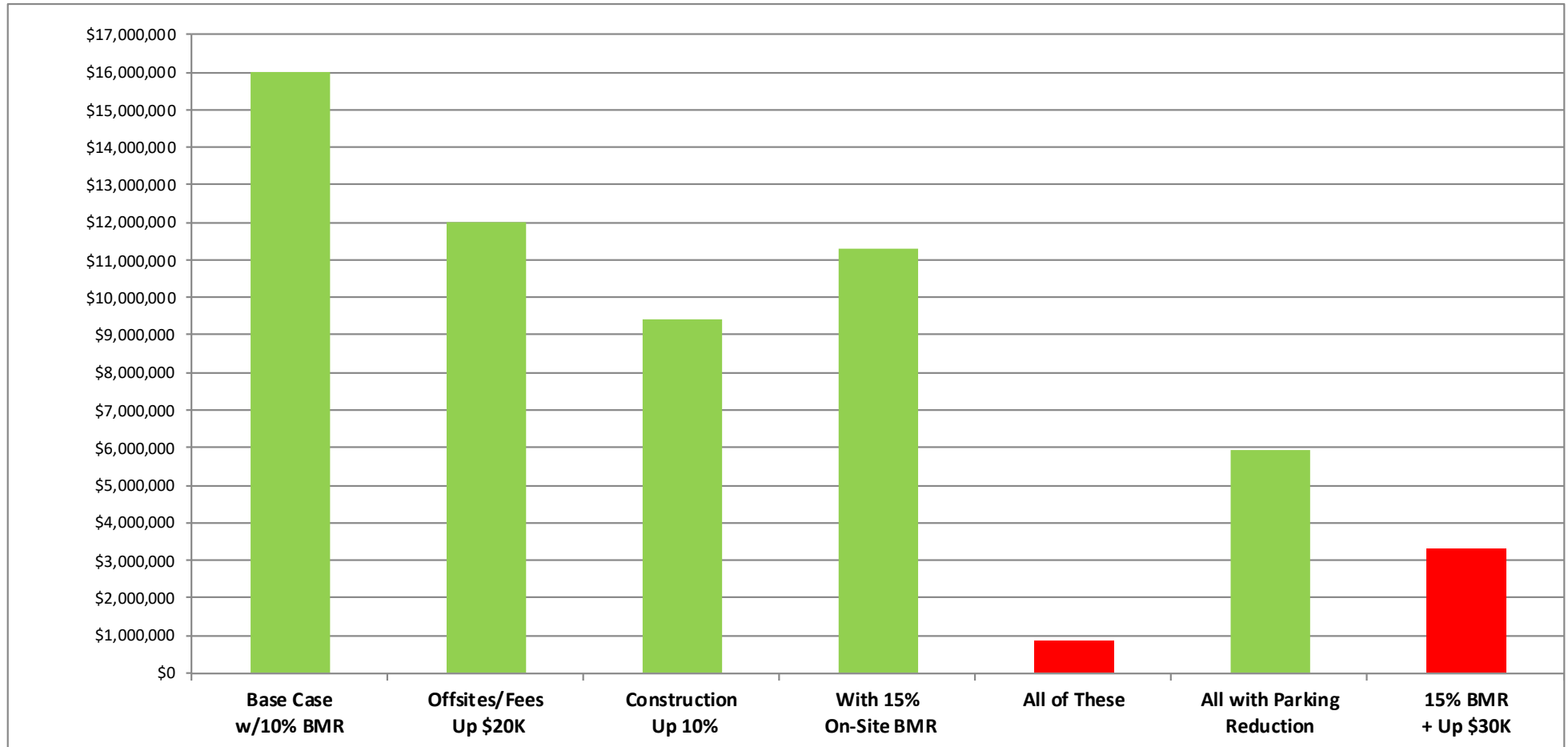
Sensitivity Analysis 6

15% On-Site BMR + \$30,000 Fee & School Increase

Net Operating Income	\$5,360,000
Return on Cost Target	5.25%
Total Supportable Development Cost	\$102,100,000
Less: Total Costs Without Land	\$98,700,000
Residual Land Value (RLV)	\$ 3,400,000

No Deal! Residual Land Value is well below existing value!

Results of Sensitivity Analysis



Residual Land Value Under Base Case with Sixth Scenario

- Streamlining (time is \$)
- Reduce ground floor retail
- Parking, parking, parking!
- Fee credits for improvements
- Timing of fee payments
- Density Bonus Law
- Others?



"Yes, you are a developer and yes, you're agile but that doesn't necessarily make you an agile developer."

Q&A on Section 3



Section 1 and 3 Presenters from ULI San Francisco District Council

Drew Hudacek

**ULI SF District Council - Chair
Chief Investment Officer
Sares Regis of Northern California**



Elizabeth (Libby) Seifel

**Board Member
ULI SF District Council
President
Seifel Consulting Inc.**

