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MEMORANDUM

TO:	Planning Commissioners
FROM:	Sarah Dennis, Senior Planner, Planning Department
CC:	John Rahaim, Director, Planning Department Douglas Shoemaker, Acting Director, Mayor's Office of Housing
DATE:	July 24, 2008
SUBJECT:	Staff Response to Issues Raised by Peer Review of the Eastern Neighborhoods Financial Analysis

At the hearing on July 10th, and via email on July 17th, staff received memoranda from CBRE Consulting reviewing the *Eastern Neighborhoods Financial Analysis* (simply *Analysis* throughout this memorandum). Per the Commission's direction, staff has reviewed the memoranda and met with the authors. The purpose of this memorandum is to clarify the intent, assumptions and the findings of the *Eastern Neighborhoods Financial Analysis* for the Planning Commission and to respond to the issues raised in CBRE's memoranda directly. Most critical in this response is an understanding about the basic goal of the Analysis: *to evaluate the effect of new impact fees and affordable housing requirements in the context of anticipated increases in development potential and land value conferred by the rezoning.* In that context, the overall finding of the study remains that in many cases, after the costs of new requirements are taken into account, proposed policies result in a net positive return for land owners and a financially feasible project, as compared to conditions prior to the rezoning.

Overall Goal of the Eastern Neighborhoods Financial Analysis

The *Eastern Neighborhoods Financial Analysis* was developed to provide a comparison between current zoning and policy requirements and proposed zoning and fee/housing requirements. Its purpose was to provide policymakers with a long-term view of tradeoffs and impacts to provide a basis for the public policy choices before them. Fundamentally, the analysis is not a look at the feasibility of individual projects at a particular moment in time, but rather a comparative evaluation of the impact of new requirements in the context of anticipated increases in development potential and therefore land value. It is intended to guide long-range policy decisions, rather than to respond to the market at a given point in time.

It is important to note that the *Analysis*, and the points raised by CBRE, occur in a period of considerable volatility in the residential real estate market, related to credit access and the subprime loan crisis. Some potential consequences of the current economic climate could be a flattening of sales prices in the near term, given nationwide uncertainty and credit options; a flattening/decrease in land prices; and a softening of building costs. As the *Analysis* clearly stated, this turmoil in real estate finance markets, combined with other factors as noted above, could jeopardize the financial feasibility of many residential projects that would otherwise pencil.

Over the past week, Seifel prepared a supplemental assessment of the impact of fluctuations in construction costs and sales prices on land values, to give decision makers an idea of how project

feasibility could vary under different market conditions. This assessment tests the sensitivity of two of the ten proformas from the original *Analysis* to a range of potential changes in sales price and construction costs.[1] The results of that analysis are summarized in Exhibit 1 (attached) and discussed below in building costs and sales prices. The assessment demonstrates that, as expected, fluctuations in market conditions will impact project feasibility, regardless of zoning and policy changes within the Eastern Neighborhoods. Even so, if these impacts occur, they will have the same impact on overall project feasibility *with or without* the rezoning and its new requirements; and again, the Analysis is not intended to correct for varying market conditions.

To avoid the peril of developing long-range policy based on volatility at one given point in time, the *Analysis* relied on assumptions that reflect typical conditions and longer term trends. The *Analysis* began with assumptions in Keyser Marston's (KMA) *Citywide Inclusionary Housing Study* completed in 2006 (and currently being updated), based on actual pro formas for San Francisco development projects and verified by construction industry representatives and a Technical Advisory Committee comprised of local developers and housing professionals. These assumptions were reviewed for their applicability within the Eastern Neighborhoods and changes in cost and revenue trends over time. They were then vetted with development and housing industry representatives, at two Open Stakeholder Meetings (held May 15, 2007 and March 6, 2008) and at a number of informal meetings soliciting information from groups such as theHousing Action Coalition (HAC), SPUR Housing Policy Board, the Residential Builders' Association (RBA), and a number of individual developers and for profit and non-profit development companies.

Response to CRBE Consulting Peer Review

The following section addresses specific points outlined in CBRE's July 17, 2008 memorandum and clarifies the *Analysis* and proposed policies.

1. *Building Costs:* The *Analysis* relied upon on KMA's assessment of 2006 hard construction costs based on pro forma data and interviews with construction professionals, updated for recent inflation as reported by Engineering News Record (ENR) and reviewed by local developers, as discussed above. Hard construction costs vary based on site conditions, development type and changes in the cost of inputs such as labor and materials over time. While these costs have been escalating rapidly in recent years, the current residential market slowdown may moderate construction costs, particularly for labor. Exhibit 1 shows the impact of higher and lower construction costs on land value and the difference between current and proposed zoning and policy options. Given higher hard construction costs and steady sales prices, the per square foot value of land would decrease, demonstrating that, regardless of zoning and policy changes within the Eastern Neighborhoods, fluctuations in hard construction costs will impact project feasibility.

   The *Analysis*' comparative approach attempts to avoid policy-making based on such fluctuations. As shown in Exhibit 1, Table 1a, higher construction costs do not have a significant impact on the change between land values under current and proposed zoning in cases where building types are

[1] Copies of these two proformas as presented in the original *Analysis* follow Exhibit 1. The two proformas are representative of changes occurring as a result of the rezoning. For detailed assumptions, rezoning and policy information, please refer to the original Analysis dated May 22, 2008.

held constant. The majority of sites expected to see development within the Eastern Neighborhoods will not experience a change in heights or building type as a result of the rezoning. If height increases associated with the rezoning do result in changes to building types, construction costs for mid rise buildings will typically be higher than those for low rise buildings due to costs associated with steel and concrete construction. Proformas that change building type are thus more sensitive to fluctuations in construction costs, as illustrated in Exhibit 1, Table 2. However, construction costs for various building types may or may not increase or decrease in parallel. Thus, the change in land value given variations in building type could be greater or less than shown.

2. *Absorption Rates:* Absorption rates also vary based on market conditions and impact construction financing costs and project profitability. As discussed above, the *Analysis* relied upon on KMA's assessment of construction financing costs, which are based on typical absorption rates for the San Francisco residential market. In down markets lower absorption decreases project feasibility, regardless of zoning and policy changes within the Eastern Neighborhoods.

3. *Developer Returns:* Profit margins used in the residual land models are reflective of typical profit expectations in the San Francisco residential market. Measured in terms of return on net sales, assumptions used are within the range found by KMA in 2006 and its current update. These returns reflect the time and risk currently involved in the San Francisco entitlement and development process, and furthermore do not account for process improvements proposed by the Eastern Neighborhoods Plans (removal of conditional use requirements, CEQA tiering, and streamlined approvals for certain project thresholds). They neither reflect the current credit crunch nor the capital infusion into real estate experienced in recent years. They are instead an estimate of general profit expectations across various residential product types in San Francisco.

4. *Parking:* The Area Plans acknowledge that structured parking can significantly increase construction costs. Thus parking requirements allow, but do not require, parking. The Area Plans encourage underground parking wherever site conditions allow. They also discourage at-grade parking where it affects the public realm, so when at-grade parking is provided at street fronts, the Plans require the parking be wrapped with a minimum of 15 feet of active use. Project proformas evaluated a variety of parking types and locations based on project and site size. Where some or all parking is assumed to be sited at-grade, space is reserved for active ground floor uses. As described in the *Analysis* (Table A: Development Assumptions), diverse cost assumptions were made for at-grade and below ground parking, and unit sales price assumptions were adjusted downward to reflect parking ratios below 1:1.

5. *Construction Type/ Efficiency:* Efficiency reflects the proportion of a building's rentable area, not counting the area occupied by elevators, equipment, hallways, lobby, restrooms, etc. The *Analysis* uses an average efficiency of 80%, a number vetted by staff in their survey of projects currently in the Department. Staff's research showed that efficiencies generally range from 70-90% on most projects (depending on site layout and unit mix), confirming the assumed average of 80%. With that said, we have created a number of new small site analyses that take into account lower efficiencies (72%-75%) for smaller sites.

6. *Site Conditions:* The sites modeled in the *Analysis* do not account for the site-specific issues or challenges that may occur across the Eastern Neighborhoods. As has been stated at the Commission several times, this limited set of proformas cannot account for all potential variables across projects, and site conditions are no exception. Challenges such as awkward shape, difficult sub-soil conditions, or those that require remediation are typically reflected by lower land prices

than shown in our model. If such conditions were modeled, they would occur under both current and proposed zoning and would not change project feasibility.

7. *Unit Mix:* The Plans require that 40% or more of new units be "family-sized," containing two or more bedrooms. However, the plan provides a number of alternatives to increase developers' flexibility. First, the plan also allows developers the option of satisfying the family housing requirement by providing all of their required inclusionary units as "family-sized" in lieu of requiring this in the market rate units. Similar options are provided for the Middle Income housing option.

8. *Sales Prices:* Typical sales prices per square foot vary based on location, unit size, building height, and changes to market conditions over time. Based on sales price data provided by CBRE on July 22, 2008, new condominiums within the Eastern Neighborhoods have experienced average annual sales price growth of 10 to 13 percent over the past 15 to 20 years, although there have been years in which prices have declined. Sales price assumptions used in the Analysis were based on KMA's 2006 *Study* and inflated to 2008 values using a conservative 2 percent annually, then were compared to recent sales information available through DataQuick Information Systems and local developers and brokers in Spring 2008 and found to be consistent with comparable developments in and around the Eastern Neighborhoods. Of the new condominium sales data provided by CBRE, 6 sales occurring in and around the Eastern Neighborhood in 2008 were of units between 850 and 1,000 square feet, in buildings of 4 to 5 stories. Sales prices for these units ranged from $700 to $838 per net square foot, which is consistent with the Analysis' assumption of $754 per net square foot for units averaging 925 square feet. However, even given that consistency, Exhibit 1 has been prepared to demonstrate the impact of lower and higher sales expectations on land values, and on the changes in land value between current and proposed zoning and policy options. It shows that given lower sales prices, the per square foot value of land would decrease, but in times of higher sales prices, projects will become even more feasible than shown by the *Analysis*.

The Sedway analysis and other critiques of the Plan's policies suggest two issues for the Commission's consideration. First, the concerns that costs are understated relative to revenues raises an important point. To the extent that this is true, it will reduce the amount of money that a developer can pay for land—thereby reducing the likelihood that the property will sell and development will occur. This concern is particularly acute in the current economic climate. To ensure that the plan's policies do not create an unrealistic set of conditions over the longer term, staff has proposed that the regular Monitoring Program include "review of housing requirements and fees to ensure fees are not so high as to prevent needed housing or commercial development". Second, it is incumbent on the Planning Department and other city departments to communicate the plan's requirements and incentives more effectively. There appears to be some confusion about what was initially proposed and what has evolved through Commission direction and consultation with community members and the development community.

Exhibit 1
Sensitivity Analysis
Land Value and Change in Land Value Under Different Cost and Price Scenarios
San Francisco Eastern Neighborhoods

Table 1a--Existing Residential/Commercial Zones, no height increase, density increase[a]

Land Value per Lot Square Foot (under Proposed)[b]

Percent Change in Hard Construction[c]	Percent Change in Sales Price[c]				
	-10%	-5%	0%	5%	10%
-5%	$178	$240	$303	$365	$427
0%	$143	$206	$268	$330	$393
5%	$109	$171	$233	$296	$358
10%	$74	$136	$199	$261	$323
15%	$39	$101	$164	$226	$288

% Change in Land Value (between Current and Proposed)[b]

Percent Change in Hard Construction[c]	Percent Change in Sales Price[c]				
	-10%	-5%	0%	5%	10%
-5%	25%	24%	23%	23%	23%
0%	25%	24%	23%	23%	22%
5%	24%	23%	22%	22%	22%
10%	23%	22%	22%	22%	21%
15%	19%	20%	21%	21%	21%

Table 2--Existing Residential/Commercial Zones, 2 story height increase, density increase[a]

Land Value per Lot Square Foot (under Proposed)[b]

Percent Change in Hard Construction[c]	Percent Change in Sales Price[c]				
	-10%	-5%	0%	5%	10%
-5%	$120	$198	$277	$356	$434
0%	$72	$151	$229	$308	$387
5%	$25	$103	$182	$260	$339
10%	-$23	$56	$134	$213	$291
15%	-$71	$8	$87	$165	$244

% Change in Land Value (between Current and Proposed)[b]

Percent Change in Hard Construction[c]	Percent Change in Sales Price[c]				
	-10%	-5%	0%	5%	10%
-5%	-19%	3%	17%	27%	34%
0%	-41%	-10%	9%	21%	29%
5%	-75%	-28%	-3%	13%	23%
10%	-131%	-53%	-17%	3%	16%
15%	-244%	-92%	-37%	-9%	8%

a. Table numbers and prototype analyses correspond to tables included in 5/22/08 memorandum. Please see attached tables and memorandum for detailed assumptions and policy options.
b. Boxed value is result presented in 5/22/08 analysis.
c. Percent increases or decreases in sales prices and hard construction costs applied to both current and proposed zoning. Dollar equivalents of these changes depend on the initial assumptions, which depend on building height, unit size, parking ratio, etc.

Table 1a
Residual Land Value
Tier 1, Existing Residential/Commercial Zones, Onsite IH
San Francisco Eastern Neighborhoods

	Current Zoning NC	Proposed Zoning NCT	Difference
Site Area and Zoning			
Lot Size	20,000 Square Feet	20,000 Square Feet	
Lot Acreage	0.46 Acres	0.46 Acres	
Ground Floor Lot Coverage[a]	100%	100%	
Maximum Residential Lot Coverage (Above Ground Floor)	75%	75%	
Maximum Residential Density	600 Lot Sq. Ft. per Unit	N/A	**Density Increase**
Development Program			
Description	Low Rise Podium	Low Rise Podium	
Maximum Height	50 Feet	55 Feet	**5 Feet**
Maximum Total Floors	5 Floors	5 Floors	**0 Floors**
Building Efficiency	80%	80%	
Residential			
Average Unit Size[b]	1,200 Square Feet	925 Square Feet	
Units per Floor[c]	10 Units	13 Units	
Maximum Units[d]	33 Units	52 Units	**19 Units**
Unit Mix	0% 1 BR	60% 1 BR	
	80% 2 BR	30% 2 BR	
	20% 3 BR	10% 3 BR	
Number of Market Rate Units	28 Units	44 Units	**16 Units**
Number of BMR Units[e]	5 Units	8 Units	**3 Units**
Parking			
Average Parking Ratio[f]	1 Space per Unit	0.85 Space per Unit	
Revenue			
Market Rate Sales Price[g]	$717 Per Net Square Foot	$754 Per Net Square Foot	
	$859,891 Per MR Unit	$697,718 Per MR Unit	
Average MR Sales Price Adjusted for Parking[h]	$859,891 Per MR Unit	$690,987 Per MR Unit	
Base Price of BMR Units[i]	$242,771 Per BMR Unit	$223,134 Per BMR Unit	
Sales Expense	4.0%	4.0%	
Sales Net of Sales Expense	**$24,413,318**	**$31,086,739**	**$6,673,421**
	$739,798 Per Unit	**$597,822 Per Unit**	
	$616 Per NSF	**$646 Per NSF**	
Building Costs[g]			
Hard Construction (incl. parking)	$276 Per NSF	$289 Per NSF	
Governmental Fees	*$8 Per NSF*	*$19 Per NSF*	
Permits and Processing Charges	$6,000 Per Unit	$6,000 Per Unit	
Additional 2007 Water and Sewer Impact Fees	$508 Per Unit	$508 Per Unit	
Inclusionary Housing In-Lieu Fee[j]	$0 Per Unit	$0 Per Unit	
School Impact Fee	$2.24 Per NSF	$2.24 Per NSF	
Eastern Neighborhoods Impact Fee[k]	$0 Per NSF	$10.00 Per NSF	**$10 Per NSF**
Other Soft Costs	$100 Per NSF	$100 Per NSF	
Construction Financing	$28 Per NSF	$28 Per NSF	
Total Building Costs	**$16,295,730**	**$20,941,517**	**$4,645,787**
	$493,810 Per Unit	**$402,721 Per Unit**	
	$412 Per NSF	**$435 Per NSF**	
Residual Land Value			
Return on Net Sales[l]	15.4%	15.4%	
Developer Margin	$ 3,759,651	$ 4,787,358	**$1,027,707**
	$113,929 Per Unit	$92,065 Per Unit	
Land Value			
Per Unit	$132,059 Per Unit	$103,036 Per Unit	-$29,023 Per Unit
Per Net Residential Square Foot	$110 Per NRSF	$111 Per NRSF	$1 Per NRSF
Per Gross Residential Square Foot	$88 Per GRSF	$89 Per GRSF	$1 Per GRSF
Per Lot Square Foot	$218 Per LSF	$268 Per LSF	$50 Per LSF
Per Acre of Land	$9,491,587 Per Acre	$11,669,429 Per Acre	$2,177,842 Per Acre
Representative Site Land Value	$4,357,937	$5,357,865	$999,928
Site value increase as a percent of current zoning base			22.9%

a. Ground floor contains parking, entryway/lobby space, and potential neighborhood retail space in the remaining square footage. No costs or revenues are assumed for the ground floor other than those related to parking.
b. Standard average unit size is 925 sf per recent development proposals. Average unit size increases up to 1,200 sf when density restrictions limit unit count under current zoning.
c. Unit per floor estimates are based on gross unit square footage and estimated floor area; estimates round up when unit calculations are within 0.25 of the next full unit.
d. Maximum units under current zoning is constrained by density controls rather than building envelope limits.
e. Onsite Below Market Rate (BMR) units equal 15% of total units, rounded to the nearest whole number.
f. Parking ratio under current zoning is 1:1 for all units. Parking ratio under proposed zoning reflects 1:1 for 2+ bedroom units (40%) and .75:1 for 0-1 bedroom units (60%).
g. Market rate sales prices and building costs based on Citywide Inclusionary/KMA building prototypes, adjusted to reflect current market conditions and variations in unit sizes.
h. Market price of units without a parking space assumed to be $50,000 less than units with parking. Average market price adjusted in proportion to the building's parking ratio.
i. BMR prices based on MOH 2008 sales prices and building unit mix. Actual BMR price adjusted according to MOH unbundled parking policy.
j. In-Lieu fee $0, as development is meeting housing requirements with onsite production.
k. EN Impact Fee to be charged under proposed zoning only. Proposed fee amount is $8 per gross residential square foot, or $10 per net residential square foot with 80% efficiency.
l. Return on net sales targets based on Citywide Inclusionary/KMA building prototypes.

Table 2
Residual Land Value
Tier 2, Existing Residential/Commercial Zones, Onsite IH
San Francisco Eastern Neighborhoods

	Current Zoning RM-2	Proposed Zoning RTO	Difference
Site Area and Zoning			
Lot Size	20,000 Square Feet	20,000 Square Feet	
Lot Acreage	0.46 Acres	0.46 Acres	
Ground Floor Lot Coverage[a]	100%	100%	
Maximum Residential Lot Coverage (Above Ground Floor)	75%	75%	
Maximum Residential Density	600 Lot Sq. Ft. per Unit	N/A	**Density Increase**
Development Program			
Description	Low Rise Podium	Mid Rise Podium 1	
Maximum Height	40 Feet	65 Feet	**25 Feet**
Maximum Total Floors	4 Floors	6 Floors	**2 Floors**
Building Efficiency	80%	80%	
Residential			
Average Unit Size[b]	1030 Square Feet	925 Square Feet	
Units per Floor[c]	11 Units	13 Units	
Maximum Units[d]	33 Units	65 Units	**32 Units**
Unit Mix	60% 1 BR	60% 1 BR	
	30% 2 BR	30% 2 BR	
	10% 3 BR	10% 3 BR	
Number of Market Rate Units	28 Units	55 Units	**27 Units**
Number of BMR Units[e]	5 Units	10 Units	**5 Units**
Parking			
Average Parking Ratio[f]	1 Space per Unit	0.85 Space per Unit	
Revenue			
Market Rate Sales Price[g]	$754 Per Net Square Foot	$780 Per Net Square Foot	
	$776,919 Per MR Unit	$721,778 Per MR Unit	
Average MR Sales Price Adjusted for Parking[h]	$776,919 Per MR Unit	$714,854 Per MR Unit	
Base Price of BMR Units[i]	$223,134 Per BMR Unit	$223,134 Per BMR Unit	
Sales Expense	4.0%	4.0%	
Sales Net of Sales Expense	**$22,088,777**	**$40,111,054**	**$18,022,276**
	$669,357 Per Unit	**$617,093 Per Unit**	
	$650 Per NSF	**$667 Per NSF**	
Building Costs[g]			
Hard Construction (incl. parking)	$289 Per NSF	$317 Per NSF	
Governmental Fees	*$9 Per NSF*	*$24 Per NSF*	
Permits and Processing Charges	$6,000 Per Unit	$6,000 Per Unit	
Additional 2007 Water and Sewer Impact Fees	$508 Per Unit	$508 Per Unit	
Inclusionary Housing In-Lieu Fee[j]	$0 Per Unit	$0 Per Unit	
School Impact Fee	$2.24 Per NSF	$2.24 Per NSF	
Eastern Neighborhoods Impact Fee[k]	$0 Per NSF	$15.00 Per NSF	**$15 Per NSF**
Other Soft Costs	$100 Per NSF	$100 Per NSF	
Construction Financing	$28 Per NSF	$33 Per NSF	
Total Building Costs	**$14,460,577**	**$28,504,743**	**$14,044,166**
	$438,199 Per Unit	**$438,535 Per Unit**	
	$425 Per NSF	**$474 Per NSF**	
Residual Land Value			
Return on Net Sales[l]	15.4%	17.5%	
Developer Margin	$ 3,401,672	$ 7,019,434	**$3,617,763**
	$103,081 Per Unit	$107,991 Per Unit	
Land Value			
Per Unit	$128,077	$70,567	-$57,509 Per Unit
Per Net Residential Square Foot	$124	$76	-$48 Per NRSF
Per Gross Residential Square Foot	$99	$61	-$38 Per GRSF
Per Lot Square Foot	$211	$229	$18 Per LSF
Per Acre of Land	$9,205,380	$9,990,216	$784,837 Per Acre
Representative Site Land Value	$4,226,529	$4,586,876	$360,347
Site value increase as a percent of current zoning base			8.5%

a. Ground floor contains parking, entryway/lobby space, and potential neighborhood retail space in the remaining square footage. No costs or revenues are assumed for the ground floor other than those related to parking.
b. Standard average unit size is 925 sf per recent development proposals. Average unit size increases up to 1,200 sf when density restrictions limit unit count under current zoning.
c. Unit per floor estimates are based on gross unit square footage and estimated floor area; estimates round up when unit calculations are within 0.25 of the next full unit.
d. Maximum units under current zoning is constrained by building envelope limits rather than density controls.
e. Onsite Below Market Rate (BMR) units equal 15% of total units, rounded to the nearest whole number.
f. Parking ratio under current zoning is 1:1 for all units. Parking ratio under proposed zoning reflects 1:1 for 2+ bedroom units (40%) and .75:1 for 0-1 bedroom units (60%).
g. Market rate sales prices and building costs based on Citywide Inclusionary/KMA building prototypes, adjusted to reflect current market conditions and variations in unit sizes.
h. Market price of units without a parking space assumed to be $50,000 less than units with parking. Average market price adjusted in proportion to the building's parking ratio.
i. BMR prices based on MOH 2008 sales prices and building unit mix. Actual BMR price adjusted according to MOH unbundled parking policy.
j. In-Lieu fee $0, as development is meeting housing requirements with onsite production.
k. EN Impact Fee to be charged under proposed zoning only. Proposed fee amount is $12 per gross residential square foot, or $15 per net residential square foot with 80% efficiency.
l. Return on net sales targets based on Citywide Inclusionary/KMA building prototypes.

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MEMORANDUM

To: San Francisco Planning Department & Seifel Consulting

From: Lynn Sedway, Courtney Pash, Jonathan Kuperman

Date: July 17, 2008

Subject: Review of Final Eastern Neighborhoods Feasibility Analysis

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At the request of Pillsbury Winthrop Shaw Pittman LLP, which is representing the Barrett Block Partnership, CBRE Consulting reviewed the Eastern Neighborhoods Impact Fee and Affordable Housing Analysis ("Fee Analysis") by Seifel Consulting. The Fee Analysis is dated May 22, 2008, but was made public after that and received by us on Friday, May 30. Although presented as a final report, we understand that this study was based in part on a 2006 Keyser Marston Associates report, the update of which is soon to be issued.

The purpose of our review was to evaluate whether the proposed zoning changes, policies, and fees associated with the Eastern Neighborhoods Rezoning and Public Benefits Program would result in financially feasible development on affected parcels.

Seifel Consulting is a fine firm, and they did a creditable job analyzing the potential financial impacts of the proposed Eastern Neighborhoods plan. Many of the policies about which we have concerns apparently evolved from this lengthy process, and we do not attribute them to Seifel.

We also understand that the concept of peer review was questioned. In our experience, peer reviews are the norm today, regardless of whether the study in question was commissioned by the public or private sector. In accordance with traditional peer reviews, CBRE Consulting reviewed the approach and assessed the reasonableness of the conclusions in Seifel's report, as opposed to performing an independent analysis.

CBRE Consulting reviewed the Fee Analysis and identified a few significant issues that will negatively impact the financial feasibility of development in the affected areas of San Francisco. Our areas of concern are enumerated on the following page. Because the Seifel Fee Analysis fails to address these concerns, it finds artificially high residual land values. When these assumptions are adjusted to market, they have a negative impact on financial feasibility and result in residual land values well below market, as indicated by actual market sales data from 2005 to the present.

CBRE Consulting recognizes the complexity of the Planning Commission's work on the Eastern Neighborhoods plan and appreciates its consideration of the above issues in finalizing a workable, market-driven program.

Areas of Concern

1. Building costs
    a. Dated construction costs
        i. Published in 2006 but more likely 2004 to 2005 levels; KMA report notes construction cost estimates from 2001 through 1Q 2006 (Table 13: Construction Cost Indices)
    b. The Fee Analysis escalated the construction costs in KMA's report by 10.25%—an insufficient reflection of recent cost increases
    c. Actual building costs understated by $20 to $30 per square foot due to absence of inflation escalation to midpoint of construction begun today
    d. Below market building costs plus overestimated efficiency results in an understated net cost of $50 per square foot or $45,000 per unit
    e. Residual land value scenarios should include sensitivity analysis showing the effect of different building cost levels
2. Absorption rates
    a. Residual land value scenarios should include sensitivity analysis showing the effect of different rates of absorption
    b. Absorption rates influenced by market conditions and project-specific characteristics (e.g., parking, unit mix, floorplans, amenities)
3. Developer returns
    a. Higher risk-adjusted returns demanded by investors in today's capital market (versus 1Q 2006 assumptions in the Fee Analysis)
        i. Developers wanting to initiate projects cannot secure debt or equity financing
            1. Construction and mezzanine loans are costly and have tighter underwriting standards; lenders insist on more project equity
            2. Investors demand higher return on equity due to greater perceived risk
    b. Developer margins used in the residual land models are well below current thresholds
    c. KMA report assumes 75% construction loans; however, today 60% is the norm, which impacts developers' return on equity
    d. KMA report provides sensitivity analyses, not shown in the Fee Analysis, based on sales prices and construction costs (Table 16 & 17: Potential Future Cost and Price Scenarios)
4. Parking
    a. Ratio of 0.85 lower than standard; market desires and expects at least 1:1 parking
        i. Sales of units without parking create false impression of market demand, as buyer typically secure parking in nearby garage (sometimes at developer expense); example of The Montgomery, which has 10-year lease on stalls at The Paramount, or SoMa Grand, which leases stalls at the Federal Building
        ii. Buyers of condominiums priced above $500,000 have at least one car, excepting some foreign investors and vacation home buyers

   b. "At grade parking is strongly discouraged" in East SoMa Area Plan (Objective 3.2); City encourages subterranean parking so ground floor can house neighborhood retail
   c. Below average parking ratio will slow absorption and reduce unit prices
      i. Discount for units without parking far exceeds unbundled stall price
   d. Below rather than above grade parking adds substantially to building costs
5. Construction type
   a. Challenging to achieve 80% efficiency on 15,000 square foot floorplate
      i. Decreasing efficiency can dramatically affect financial feasibility
   b. 52 residential units in low rise, wood frame podium structures with 15,000 square foot floorplates is dense for wood frame
   c. Financial feasibility more difficult on small sites; differentiated building heights desirable on larger parcels
   d. Evaluation of parcels currently zoned industrial that would receive a 3 to 4 story height increase were excluded
      i. Construction type would shift from wood frame to steel
6. Site conditions
   a. Many parcels in eastern neighborhoods are not "virgin" sites
   b. May be added cost for demolition, hazardous materials, shoring/excavation
7. Unit mix
   a. Restricted unit mix requiring 40% two-bedroom or larger units
   b. Regulated unit mixes and bedroom counts reduce developer's flexibility
8. Sales prices
   a. Rely on residential values close to or at the latest peak
   b. Likely sales price for low-rise, non-view condominiums approximately $100 per square foot lower than $754 to $792 assumed range
   c. Unit sales from recent and current projects in South Beach and Mission Bay are not representative; other areas of Eastern Neighborhoods cannot achieve equal pricing

Selected Supporting Sources

   a. Leland Saylor Associates
   b. Alan Mark, The Mark Company
   c. Paul Zeger, Pacific Marketing Associates
   d. Keyser Marston Associates, "Summary Report: Inclusionary Housing Program San Francisco Sensitivity Analysis", July 2006
   e. Clifford Associates, "Land Value in Eastern Neighborhoods", April 2008
   f. East SoMa Area Plan (April 2008)
   g. RealQuest (part of First American)
   h. Hanley Wood, LLC (Market Intelligence Division)
   i. San Francisco Association of Realtors