



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

MEMORANDUM

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REAL ESTATE
AFFORDABLE HOUSING
ECONOMIC DEVELOPMENT

To: Chris Burton, Office of Economic Development

From: Keyser Marston Associates, Inc.

Date: September 27, 2018

Subject: Downtown High-Rise Residential Incentive Analysis

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Introduction

It has been a long-standing goal of the City of San Jose to increase the number of residents living in the downtown by encouraging high-rise residential development. In support of this goal, the City Council approved a temporary incentive program in 2016 for high-rise residential projects, which included a partial suspension of parkland fees and construction taxes for projects of 12 or more stories located in the Downtown Core. While the City Council subsequently adopted a new permanent parkland fee category for downtown residential towers, projects breaking ground after July 2018 no longer qualify for the partial suspension of construction taxes. Given perceived challenges with financing and building downtown residential towers, the City is now considering extending this incentive to projects that initiate construction over the next several years.

The purpose of this analysis is to provide an understanding of the development economics of high-rise apartment development in downtown San Jose based on current market conditions, and the extent to which incentives are needed to increase the likelihood that projects of this type can be financed and built in the near term.

Construction Tax and Proposed Incentive

The City's construction taxes include the Building and Structure (B&S) tax and the Commercial, Residential, Mobile Home Park (CRMP) tax, which are assessed at a combined rate of 3.96% of the building permit value. The incentive under consideration for high-rise residential projects breaking ground over the next several years is a 50% suspension of B&S and CRMP taxes, from approximately \$6,000 per unit to \$3,000 per

unit. High-rise projects eligible for the partial suspension would continue to pay several other construction-related taxes totaling approximately \$200 per unit.

High-rise projects are subject to several other development-related fees including park dedication fees and development services fees described below. Changes to these fees are not considered as part of the proposed incentive program.

Key Considerations of Conceptual Pro Forma Analysis

Before describing the approach to the conceptual apartment pro forma analysis, it is important to put the analysis into perspective by explaining how it can be useful and where limitations exist in the ability to inform a longer-term policy direction:

a. Near-Term Time Horizon

The analysis presents a snapshot of the current downtown real estate market as of late 2018. Real estate development economics are fluid and are impacted by constantly changing conditions with regard to rent potential, construction costs, land costs, and costs of financing. A year or two from now, conditions will undoubtedly be different, so the pro forma conclusions are not expected to hold over a longer-term time horizon.

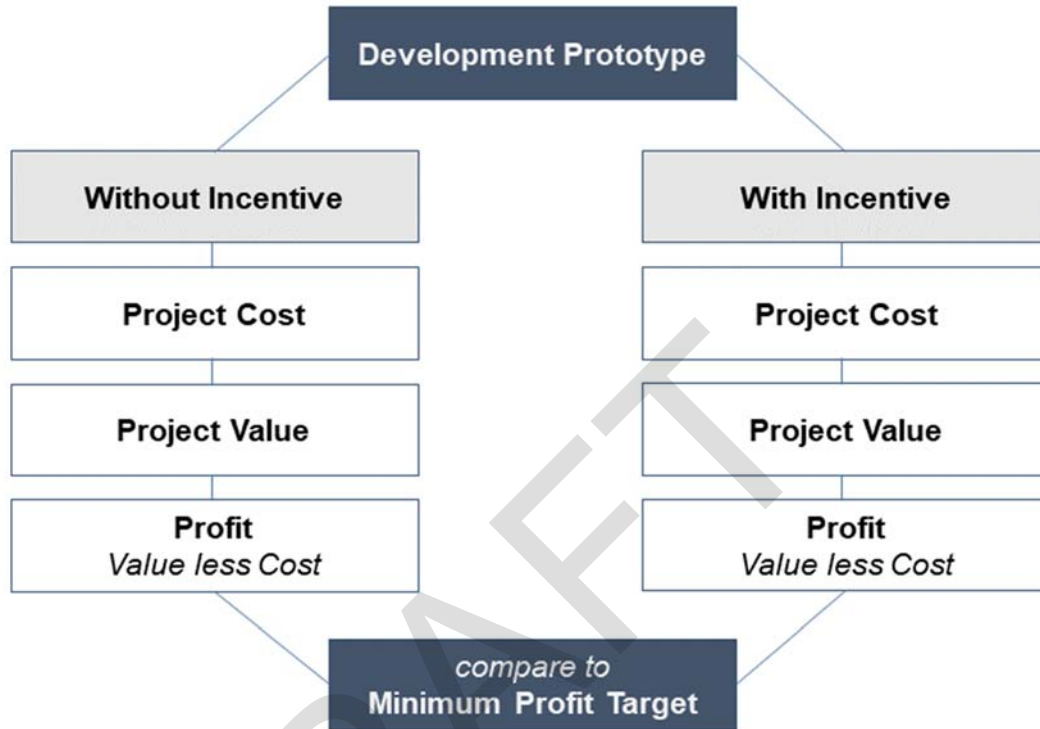
b. Prototypical Nature of Analysis

This analysis is intended to reflect an “average” or “typical” high-rise residential apartment project, as defined below. By its nature the conceptual analysis can only provide an overview-level assessment of real estate development economics. The development economics may be better or worse when a specific project is proposed, due to any number of unique circumstances, such as site configuration and conditions, construction efficiencies, project design, land cost basis, and financing approach. As a result, all financial and programmatic estimates are preliminary in nature.

Approach to Assignment

The pro forma analysis utilizes a static financial model to evaluate the development economics of a prototypical high-rise apartment project in the downtown with and without the proposed construction tax incentive. As illustrated below, profit is calculated as the difference between the total estimated cost of the project and the value supported by rents in the project’s first stabilized year. The estimated profit is compared to a minimum profit target as an indication of whether the prototypical project would be likely to meet the return expectations of capital partners.

Project Approach



There are numerous ways to calculate the financial return in the real estate development industry. KMA has found that a static financial model is the most appropriate for evaluating the development economics of a class of projects (in this case, high-rise residential) because the approach is easily understood by City staff and decision makers and allows for the comparison of local policy alternatives. In addition, in KMA's experience, developers expect that a project first meet a static test of financial viability prior to proceeding with a multiyear cash flow model, which involves a variety project- and developer-specific assumptions that tend to be established at a more advanced planning stage.

Conceptual Development Prototype

The following conceptual development prototype reflects the predominant height, density, and unit mix of recently approved or built downtown high-rise projects, based on a review of downtown project applications (see appendix tables). The development prototype is assumed to be rental as this is the predominant tenure of recently proposed high-rise projects in the downtown.

Downtown High-Rise Residential Prototype

Prototype	Building Height	Density	Avg. Unit Size
Apartments	22 stories	320 du/acre	900 SF

While high-rise residential projects may be required to provide a minimum amount of on-site commercial space, this analysis focuses on the development economics of apartments and assumes that commercial development will pay for itself. It is recognized that each specific project will have its own unique set of conditions and that the development economics of commercial may be better or worse for that project.

Financial and Market Assumptions

Financial and market assumptions are based on information provided by real estate professionals, developers, and investors actively participating in San Jose development. Data was also collected from published sources, such as land sales transactions and apartment rental rates. This information was adjusted to reflect the prototype being evaluated. Key assumptions are summarized below and detailed in the attached tables.

Project Costs

a. Direct Construction Costs

Bay Area construction costs continue to increase, reportedly at a rate of 5% to 10% per year. Direct construction costs for a to-be-built apartment tower are estimated to be approximately \$420 per square foot of gross building area based on third party cost data from Marshall & Swift Valuation Service, which estimates costs for a variety of building types in varying locales. The cost estimate reflects many variables, including a parking ratio of at least one parking space per unit. The estimate assumes quality construction, architecture, and finishes but does not assume any extraordinary costs that would be atypical for the market.

b. Indirect Costs

Indirect costs (architecture and engineering, fees, taxes, insurance, financing, and overhead) are estimated to add approximately 25% to direct construction costs, based on KMA's experience and current market conditions. A detailed breakout of indirect costs can be found in the attached appendix.

c. *Land*

Land values are informed by recent land transactions within or near the downtown that represent comparable sales. Comparable sales include land with commercial improvements or land with high-rise development potential. Based on recent sales, land values are in the range of \$40,000 per entitled apartment unit. Per square foot of land area, land values are in the range of \$10 million to \$15 million per acre, depending on the density. If land owners have limited options, i.e. accepting a lower value versus continuing to hold for investment, land owners may be willing to accept a lower price. Alternatively, the land owner can wait for the next cycle.

d. *City Fees*

City fees are based on the current master fee schedule and City staff input. As noted above, high-rise residential projects are subject to construction taxes estimated at \$6,200 per unit without the proposed incentive and \$3,200 per unit with the 50% suspension of B&S and CRMP taxes. Aside from construction taxes, the City has three other types of development-related fees. These fees are not affected by the proposed incentive program:

- *Park Dedication Fees* – The City Council adopted a new permanent park fee category for high-rise residential projects in the Downtown Core of \$14,600 per unit. Developers can satisfy up to half of the parkland requirement by providing on-site amenities, such as swimming pools, plazas, and picnic areas. For the conceptual pro forma, it is assumed that developers of high-rise projects offset 20% of the parkland requirement through private recreation credits and pay the in-lieu fee to satisfy the remainder of the requirement (estimated at \$11,700 per unit).
- *Affordable Housing* – Downtown high-rise apartment projects completed prior to June 30, 2021 are exempt from San Jose's Inclusionary Housing Ordinance. Residential projects covered by the ordinance are required to provide 15% of housing units at rents affordable to low- and moderate-income households or pay an in-lieu fee based on 20% of the units at \$125,000 (for rental projects), which equates to \$25,000 per market rate unit.
- *Development Permitting Fees* – Downtown high-rise apartment projects are subject to development permitting fees aimed at recovering City costs associated with entitlement, plan check, permit review, inspection, and public improvements. Based on the experience of recently built projects, development permitting fees are estimated to total \$6,500 per unit.

The following table summarizes the development fees and taxes per unit for high-rise projects with and without the proposed construction tax incentive. School fees (about \$4,000 per unit) are not shown below but are included in the estimate of other indirect costs.

City Fees Per Unit

	High-Rise Apartments	
	Without Incentive	With Incentive
Affordable Housing	Exempt*	Exempt*
Parks (net)	\$11,700	\$11,700
Construction Taxes	\$6,200	\$3,200
Development Permits	<u>\$6,500</u>	<u>\$6,500</u>
Total	\$24,400	\$21,400

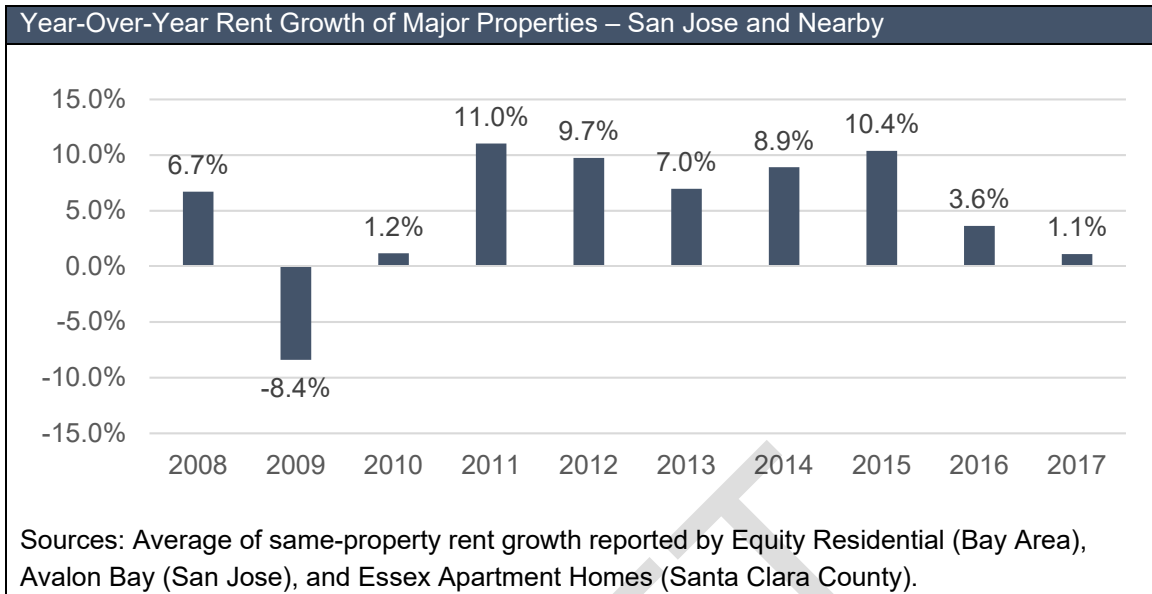
* High-rise apartment projects completed prior to June 30, 2021 are exempt from inclusionary housing requirements.

Project Value

a. Apartment Rents

The estimated average monthly rent of the high-rise apartment prototype is \$3,330 per unit or \$3.70 per square foot based on asking rents of recently built apartment projects in the downtown, as reported by Costar Group. (See appendix for a list of projects and their asking rents.) The average rent is net of concessions, such as a month of free rent offered at lease signing

Apartment rents enjoyed very strong growth for several years from 2011 through 2015 but have flattened over the past two years. As shown in the figure below, average rents of major properties in San Jose and the Bay Area grew by approximately 1% in 2017—less than the rate of inflation—compared to an average growth rate of over 9% from 2011 to 2015. Consistent with recent trends, the conceptual pro forma assumes current market rents remain stable over the near-term horizon of the analysis.



b. Vacancy, Operating Expenses, and Miscellaneous Revenues

Apartment rents are adjusted by vacancy, operating expenses, property taxes, and miscellaneous revenues (parking, pets, laundry) to estimate the project’s net operating income. The conceptual analysis assumes apartment vacancy of 4%, annual operating expenses of \$5,500 per unit, annual property taxes of \$6,300 per unit, and annual miscellaneous revenues of \$1,200 per unit. These assumptions are based on KMA’s experience with real estate development projects in the Bay Area and published market data.

c. Capitalization Rate Used to Determine Project Value

The project value supported by estimated rents is determined by capitalizing the net operating income, i.e. net operating income divided by the capitalization rate. The capitalization rate is based on developer inputs and upon benchmarks published by nationally recognized research firms. The conceptual pro forma estimates that the capitalization rate for Downtown projects is in the range of 4.25%.

Capitalization Rate Benchmarks and Pro Forma Assumption

	Integra Realty Resource	CBRE	Real Estate Research Corp	Pro Forma Assumption
Apartments	4.52%	3.75% - 4.25%	5.00%	4.25%

Minimum Profit Target

Profit is calculated as the difference between project costs and the value supported by projected rents upon completion. The estimated minimum profit target is 10% to 15% of costs. This threshold is used by equity partners in determining if the project is worth pursuing. Equity partners weigh the projected return on a downtown high-rise tower with investment opportunities in other geographic locations and elsewhere in the capital markets.

Conceptual Pro Forma Findings

Estimated Project Cost

The total estimated project cost of the high-rise apartment prototype is estimated to be \$668,000 per unit without the construction tax incentive and \$665,000 per unit with the construction tax incentive of \$3,000 per unit. The project cost consists of land acquisition, development costs (direct construction, professional services, and financing) and City fees.

Estimated Project Cost Per Unit

	High-Rise Apartments	
	Without Incentive	With Incentive
Land	\$40,000	\$40,000
Development Costs	\$603,900	\$603,900
City Fees	<u>\$24,400</u>	<u>\$21,400</u>
Total Project Cost	\$668,300	\$665,300
<i>Rounded</i>	<i>\$668,000</i>	<i>\$665,000</i>

Estimated Project Value

Based on an average monthly apartment rent of \$3,330 per unit, the annual net operating income of the apartment prototype is estimated to be \$27,000 per unit, after accounting for operating costs and property taxes, vacancy, and miscellaneous income.

The project value is determined by capitalizing the net operating income, i.e. dividing net operating income by the capitalization rate. The resulting value per unit supported by current rents is in the range of \$650,000 based on the capitalization rate of 4.25%.

Estimated Project Value Per Unit

	High-Rise Apartments
Monthly Apartment Rent (900 SF)	\$3,330
Miscellaneous Income Per Month	\$100
Vacancy	4%
Operating Expenses & Property Taxes Per Year	\$11,800
Net Operating Income Per Year	\$27,000
Capitalization Rate	4.25%
Project Value	\$652,000

Estimated Profit

Per the table below, the estimated value per unit is currently less than the estimated cost to build a high-rise apartment unit and is therefore insufficient to generate a profit. The analysis indicates that the development economics improve with the partial suspension of construction taxes but remain significantly below the minimum profit target of 10% to 15% of costs.

Estimated Profit Per Unit

	High-Rise Apartments	
	Without Incentive	With Incentive
Total Project Cost	\$668,000	\$665,000
Project Value	\$652,000	\$652,000
Estimated Profit	(\$16,000)	(\$13,000)
Estimated Profit %	None	None
Min. Profit Target %	10%-15%	10%-15%

The challenges facing downtown towers are due in large part to the high cost of Type I (steel and concrete) construction and the inability to project future apartment rent growth to offset rising costs. To fall within the minimum profit target range, direct construction costs would need to decrease by 15% to 20% or average rents would need to increase by 10% to 15% (or some combination of the two). Recent trends appear to be moving in the opposite direction, with construction costs outpacing rent growth of newly built projects. The potential construction tax incentive, equivalent to a 0.4% reduction in total project costs, would create a positive impact, but other factors would need to shift to bring costs and values into balance.

Notwithstanding the above, specific projects may perform better or worse than the “typical” prototype shown here. Despite challenges in the current market, unique circumstances could enable projects to proceed, such as projects with a low land basis due to long-term ownership, or projects viewed as a longer-term investment. Moreover,

real estate development economics are constantly changing with respect to construction costs, land values, rent potential, and cost of capital. If, for example, market values improve relative to costs, more projects would be able to achieve an acceptable return.

Options Available to Improve Development Feasibility

The following section reviews the options available to the City and project developers to increase the likelihood that high-rise projects move forward in the near term.

Partial Suspension of Construction Taxes

As described above, the City is considering a partial suspension of B&S and CRMP taxes for high-rise residential projects breaking ground over the next several years. While the proposed tax incentive of \$3,000 per unit represents less than half of 1% of the total development cost, it would marginally improve the development economics of high-rise projects and increase the likelihood that projects can move forward, provided that other important variables (e.g., construction costs and rents) are also addressed.

Pursuant to City policy, projects that receive a tax incentive would be required to comply with community workforce standards including prevailing wage and local hire unless City Council determines that the incentive is in the public interest and is necessary to support financial feasibility.

Deferral of Fee Payment

In addition to the partial suspension of construction taxes, the City may consider deferral of the timing for the payment of development fees for high-rise projects in the downtown. By deferring the fee payment, there can be significant savings to the developer, since fees are typically financed with equity, which requires a return once it is funded.

The carrying cost with equity during the construction period effectively increases the cost of development fees by nearly 25% over two years, based on a 12% rate of return. The effect is that City fees of \$21,400 per unit (net of the construction tax incentive) become \$26,500 per unit when the cost of capital is included.

As illustrated in the table below, if fees were paid at, say, the certificate of occupancy, which might be two or more years after when the fee would normally be paid, then the developer does not have to fund the return on equity for the fee payment during the construction period. The cost savings to the developer would be approximately \$5,100 per unit.

Estimated Financing Cost Savings Provided by Fee Deferral

Units	Fees/ Unit	Total Fee	Financing Cost Savings Over 2 Years		
			Annual	2 Years	Per Unit
300	\$21,400	\$6,420,000	\$770,000	\$1,550,000	\$5,100

Deferral of fees enhances the return over time to the developer and investors. To the extent dollars can be invested on a deferred basis, then the return over time is higher when compared to investing the same dollars up front, say two years earlier at issuance of permits.

Conclusion

Downtown apartment towers face challenges in 2018 owing to the high cost of construction and the inability to project future apartment rent growth to offset rising costs. The partial suspension or deferral of City taxes and fees or similar incentives would increase the likelihood that projects can move forward, provided that other key variables are also addressed.

Supporting Tables

The analysis is presented in the following tables (attached to this memorandum):

- Table 1 Pro Forma Summary: High-Rise Apartments
- Table 2 Sensitivity Analysis: High-Rise Apartments
- Table 3 Pro Forma Detail: High-Rise Apartments
- Table 4 Pro Forma Assumptions: High-Rise Apartments

- Appendix 1 Downtown Rental Residential Projects: Asking Rents
- Appendix 2 Map of Downtown High-Rise Residential Projects - Built and Proposed
- Appendix 3 Development Programs: Downtown High-Rise Residential Projects
- Appendix 4 Land Costs: Downtown High-Rise Residential Projects
- Appendix 5 Land Costs: Downtown Commercial Projects
- Appendix 6 Construction Cost Estimate (Marshall & Swift)
- Appendix 7 Governmental Fees Detail

Table 1
Pro Forma Summary: High-Rise Apartments
Downtown High-Rise Residential Incentives; San Jose, CA

9/27/2018

See Table 3 for detail

PROGRAM

Construction Type	Type I tower
Building Stories	22
Density	320 du/acre
Average Unit Size	900 SF/unit
Building Efficiency	78% efficiency
Parking Ratio	1.0 /unit

DEVELOPMENT COSTS

		\$/Unit
Land	\$12.8M /acre	\$40,000
Direct Costs	\$420 /GSF	\$484,600
Indirect Costs	17% of direct costs	\$81,400
City Fees (see below)		\$24,400
Construction Financing	5.5% interest 2.5 years 55% avg drawdown	\$37,900
Total Cost Per Unit		\$668,300

OPERATING INCOME

Weighted Average Rent Per Month	\$3.70 PSF/mo.	\$3,330
Other Income Per Month	\$1,200 /year	\$100
Vacancy		4%
Operating Exp. (incl. Prop. Tax) Per Yr.		\$11,800

ESTIMATED PROFIT

Net Operating Income		\$27,700	
Capitalized Value	4.25% cap rate	\$652,100	
(Less) Development Costs		-\$668,300	
Est. Profit Before Constr. Tax Incentive		-\$16,200	0% profit
Est. Profit After Constr. Tax Incentive	\$3,000 /unit	-\$13,200	0% profit

CITY FEES DETAIL

Affordable Housing	exempt	\$0
Parks (net)		\$11,700
Construction Tax (CRMP, B&S)		\$6,000
Other Construction Tax		\$200
Development Svcs Fees		\$6,500
Total		\$24,400

Table 2
Sensitivity Analysis: High-Rise Apartments
Downtown High-Rise Residential Incentives; San Jose, CA

9/27/2018

PROGRAM

Construction Type	Type I tower	Average Unit Size	900 SF/unit
Building Stories	22	Building Efficiency	78% efficiency
Density	320 du/acre	Parking Ratio	1.0 /unit

ESTIMATED PROFIT

	Assumption		Before Tax Incentive		After Tax Incentive	
	Base	Adjustment	\$ profit	% profit	\$ profit	% profit
Baseline (Table 1)			-\$16,200	0%	-\$13,200	0%
-20% Decrease in Land Costs	\$12.8M/acre	\$10.2M/acre	-\$8,200	0%	-\$5,200	0%
-20% Decrease in Direct Costs	\$420/GSF	\$336/GSF	\$80,720	14%	\$83,720	15%
+15% Increase in Rents	\$3,330/mo	\$3,830/mo	\$119,200	18%	\$122,200	18%

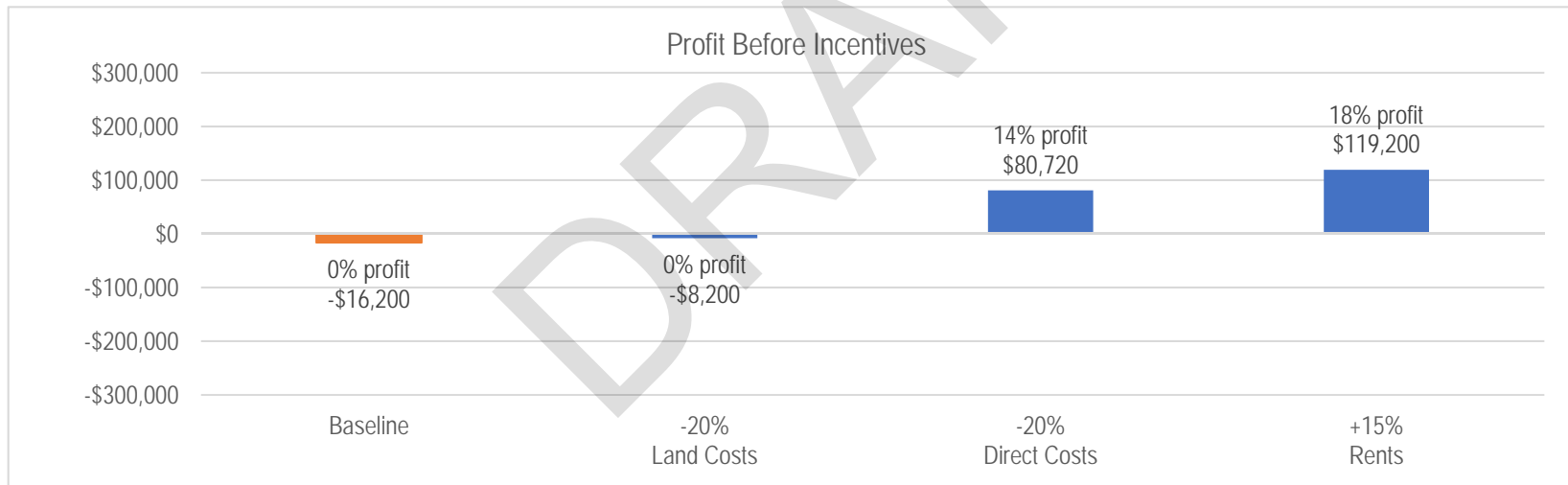


Table 3
Pro Forma Detail: High-Rise Apartments
Downtown High-Rise Residential Incentives; San Jose, CA

9/27/2018

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Program				
Land Area	1.5	acres	Avg. NSF/Unit	900
Density	320	du/acre	<u>Gross Bldg. Area</u>	
Residential Units	480	units	Retail (net)	0
Building Type	Type I	tower	Residential (net)	432,000
Stories	22		Common/Circ.	<u>122,000</u>
Efficiency	78%		Total, GBA	554,000
Parking Ratio (Residential)	1.0	per unit	Parking Spaces	480
Parking Ratio (Retail)	1.0	per 1,000 SF		
Development Costs				
	Factor		Total	Per Unit
Land	\$294	/SF land	\$19,200,000	\$40,000
<u>Direct Costs</u>				
Residential	\$380	/SF resid.	\$210,520,000	\$438,600
Retail	\$250	/SF retail	\$0	\$0
Parking	\$46,000	/space	\$22,080,000	\$46,000
Site Work	\$0	/SF site	\$0	\$0
Retail TI Allowance	\$100	/SF retail	\$0	\$0
Total Direct Costs	\$420	/SF GBAXP	\$232,600,000	\$484,600
<u>Indirect Costs</u>				
Predevelopment/Entitlement	\$500,000	LS	\$500,000	\$1,000
Professional Fees	6%	of direct	\$13,956,000	\$29,100
Management Fee	3%	of direct	\$6,978,000	\$14,500
Legal/Accounting	0.35%	of direct	\$814,100	\$1,700
Marketing	\$2,000	/unit	\$960,000	\$2,000
Taxes/Insurance	1.0%	of direct	\$2,326,000	\$4,800
City Fees & Permits: Resi.	\$24,400	/unit	\$11,712,000	\$24,400
School Fees: Resi.	\$4,000	/unit	\$1,920,000	\$4,000
Constr. Tax: Retail	\$6.15	/SF retail	\$0	\$0
School Fees: Retail	\$0.56	/SF retail	\$0	\$0
Contingency	5%	of direct	\$11,630,000	\$24,200
Retail Leasing	\$12	/SF retail	\$0	\$0
Total Indirect Costs	\$92	/SF GBAXP	\$50,800,000	\$105,800
<u>Financing Costs</u>				
Points and Fees	1%	(loan)	\$2,124,000	\$4,400
Construction Interest	5.5%	(loan)	\$16,062,750	\$33,500
Total Financing Costs	\$33	/SF GBAXP	\$18,186,750	\$37,900
Total Development Costs	\$579	/SF GBAXP	\$320,780,000	\$668,300

Table 3
Pro Forma Detail: High-Rise Apartments
Downtown High-Rise Residential Incentives; San Jose, CA

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Operating Income

	Factor	Total	Per Unit
<u>Residential Net Income</u>			
Monthly Rent	\$3,330 /unit/mo.	\$19,180,800	\$40,000
Annual Misc. Income	\$1,200 /unit/year	\$576,000	\$1,200
<Less> Vacancy Allowance	4% of gross	-\$790,272	-\$1,600
<Less> Operating Expenses	\$5,500 /unit/year	-\$2,640,000	-\$5,500
<Less> Property Taxes	\$6,300 /unit/year	-\$3,024,000	-\$6,300
Net Operating Income		\$13,302,528	\$27,700
<u>Retail Net Income</u>			
Monthly Rent (NNN)	\$3.50 /SF/mo.	\$0	
<Less> Vacancy Allowance	5% of gross	\$0	
<Less> Operating Expenses	4% of gross	\$0	
Net Operating Income		\$0	\$0

Investment Analysis

	Factor	Total	Per Unit
<u>Capitalized Value</u>			
Residential	4.25% cap rate	\$313,000,659	\$652,100
Retail	6.50% cap rate	\$0	\$0
Total Capitalized Value		\$313,000,659	\$652,100
(less) Development Costs		-\$320,780,000	-\$668,300
<u>Estimated Profit</u>			
Before Constr. Tax Exemption		-\$7,779,341	-\$16,200
After Constr. Tax Exemption	\$3,000 /unit	-\$6,339,341	-\$13,200

Governmental Fees

	Factor	Total	Per Unit
<u>Residential</u>			
Parks (net)	\$11,700 /unit	\$5,616,000	\$11,700
Affordable Hsg	\$0 /unit	\$0	\$0
Construction Tax:	\$0 /unit	\$0	\$0
CRMP, B&S	\$6,000 /unit	\$2,880,000	\$6,000
All Other	\$200 /unit	\$96,000	\$200
Other City Permits and Fees	\$6,500 /unit	\$3,120,000	\$6,500
School Fees	\$4,000 /unit	\$1,920,000	\$4,000
Total		\$13,632,000	\$28,400
Excluding School Fees		\$11,712,000	\$24,400

Table 4

Pro Forma Assumptions: High-Rise Apartments

Downtown High-Rise Residential Incentives; San Jose, CA

9/27/2018

Development Costs		Income/Revenues (Appendix 1)	
<u>Land Costs (Appendix 4 - 5)</u>	\$12.8M /acre	<u>Market Apartment Rents</u>	
		Average Rent (900 SF)	\$3,330 /Unit/Month
<u>Direct Construction Costs (Appendix 6)</u>		<u>Nonresidential Rents</u>	
Apartments: Type I*	\$380 /GSF	Retail (NNN)	\$3.50 /SF/mo.
Retail (Warm Shell)	\$250 /GSF	<u>Misc. Income</u>	
Parking**	\$46,000 /space	Misc. - Apartments	\$100 /Unit/Month
Add'l Site Work	\$0 /SF site		
*Type I = Concrete/ steel; 2-3-hr fire-resistance rating			
** 50% above grade, 50% below grade.			
		Operating Expenses	
<u>Indirect Construction Costs</u>		<u>Vacancy</u>	
Entitlement	\$500K LS	Residential Vacancy	4.0%
Professional Fees	6.0% of directs	Retail Vacancy	5.0%
Taxes	0.5% of directs	<u>Apartment OpEx</u>	
Insurance	0.5% of directs	Operating Expenses	\$5,500 per unit
Legal/Accounting	0.4% of directs	Property Taxes	1.20% of AV
Developer Fee	3.0% of directs	<u>Non-Residential OpEx</u>	
Retail Leasing	\$12 /SF retail	Retail OpEx	4.0% of gross
Contingency	5.0% of directs		
Marketing	\$2,000 /unit	Investment Thresholds	
<u>Financing</u>		<u>Capitalization Rates</u>	
Loan-to-Cost	65% LTC	Apartments	4.25%
Interest Rate	5.5% /year	Retail	6.50%
Term	30 months	<u>Targeted Profit</u>	15% of costs
Avg Outstanding Balance	55% loan		
Points and Fees	1% loan		
		Sensitivity Analysis (Table 2)	
<u>Residential</u>		Construction Costs (low)	-20% of base
Parks (net)	\$11,700 /unit	Land Costs (low)	-20% of base
Affordable Hsg	\$0 /unit	Rents (high)	+15% of base
Construction Tax:			
CRMP, B&S	\$6,000 /unit		
All Other	\$200 /unit		
School Fees	\$4,000 /unit		
Other Permits and Fees	\$6,500 /unit		
<u>Retail</u>			
Construction Tax	\$6.15 /SF retail		
School Fees	\$0.56 /SF retail		

Appendix 1

Downtown Rental Residential Projects: Asking Rents

Downtown High-Rise Residential Incentives; San Jose, CA

9/27/2018

Source: Costar, apartment websites

Rental Project	Sq. Ft.	Rent /Month	\$/ SF	% Promo ¹	Comments
1. Centerra					
<i>77 N Almaden Blvd</i>					
1BR	891	\$3,099	\$3.48	0.50%	Built in 2015; 2.9% vacant 20 stories, 347 units
2BR	1,166	\$3,967	\$3.40	0.50%	1.4 pkg. spaces / unit (free)
3BR	1,467	\$4,869	\$3.32	1.00%	Retail: \$3.50/SF NNN
Average	1,001	\$3,447	\$3.44	0.50%	
2. One South Market					
<i>1 S Market St</i>					
1BR	792	\$2,946	\$3.72	0.40%	Built in 2015; 2.2% vacant 23 stories, 312 units
2BR	1,141	\$3,471	\$3.04	0.40%	1.0 pkg. spaces / unit (free)
3BR	1,359	\$4,316	\$3.18	0.40%	
Average	900	\$3,141	\$3.49	0.40%	
3. 360 Residences					
<i>350-360 S Market St</i>					
1BR	967	\$3,052	\$3.15	0.50%	Built in 2008; 2.4% vacant 23 stories, 213 units
2BR	1,511	\$4,529	\$3.00	0.50%	1.1 pkg. spaces / unit (free)
3BR	2,878	\$9,145	\$3.18	0.50%	Sold 2018 for \$630K/unit
Average	1,479	\$4,534	\$3.07	0.50%	
4. The Pierce					
<i>60 Pierce Ave</i>					
Studio	636	\$2,477	\$3.90	1.00%	Built in 2016; 6.0% vacant 7 stories, 232 units
1BR	774	\$2,874	\$3.71	1.00%	1.4 pkg. spaces / unit
2BR	1,137	\$3,614	\$3.18	1.00%	Retail: \$3.25/SF NNN
Average	939	\$3,200	\$3.41	1.00%	
5. Modera²					
<i>787 The Alameda</i>					
Studio	616	\$2,889	\$4.69	0.00%	Built in 2018; 49.4% vacant 5 stories, 168 units
1BR	848	\$3,224	\$3.80	0.00%	1.5 pkg. spaces / unit
2BR	1,173	\$3,989	\$3.40	0.00%	Outside DT boundary
3BR	1,526	\$5,288	\$3.46	0.00%	
Average	879	\$3,338	\$3.80	0.00%	

¹ Leasing promotions as % of gross asking rent. Rents presented net of leasing promotions (except as noted).

² Apartment website indicates that some units are eligible for 6 weeks of free rent. Rents have not been adjusted to reflect these concessions.

Appendix 3

Development Programs: Downtown High-Rise Residential Projects

Downtown High-Rise Residential Incentives; San Jose, CA

9/27/2018

Source: Project applications, City of San Jose

Project	Height/ Stories	Undergrnd. Levels	Units	Acres (Gross)	Density (Gross)	NSF /Unit	Commerc. SF	Efficiency Factor	Pkg. Ratio	SF/ Space	Tenure ¹
Completed											
1 The 88	22	3	197	1.3	150	1,075	32,455	77%	1.4	391	For Sale
2 Axis	22	3	329	1.2	265	1,124	0		1.5	370	For Sale
3 360 Residences	23	1	213	1.0	209	1,479	11,160		1.1	443	For Rent
4 City Heights	16	1	124	0.8	161	1,050	0		1.3		For Sale
5 One South Market	23	3	312	1.0	322	900	6,660	76%	1.0	333	For Rent
6 Centerra	20	2	347	1.3	275	1,001	11,353		1.4		For Rent
Under Construction											
7 Silvery Towers ²	20/22	3	643	1.9	338	970	18,765		1.3	372	For Sale
8 NSP Tower 3	18	1	313	1.5	206	785	1,390	75%	1.2	429	For Rent
9 The Graduate	19	1	260	1.5	179	1,146	14,430		1.0		For Rent
10 SJSC (Miro)	28/28	3	630	1.4	450	949	22,824		1.0		For Rent
Approved											
11 Parkview Tower ²	12/19	2	220	1.5	145	1,142	13,673		1.3		For Rent
12 Gateway Tower	25	3	300	0.5	600	784	4,850		1.0		For Rent
13 Greyhound ²	23/24	4	781	1.7	459	1,082	17,912		1.0	395	For Sale
14 Aviato	18	4	302	0.8	392		10,146				For Sale
15 Museum Place	24	3	306	2.3	131		Major				Mixed
Pending											
16 Block Three	24		393	1.3	293						TBD
17 27 West	22	1	342	0.6	600	675	17,628		0.9	149	TBD
18 CityView Plaza	24		259	0.6	432						TBD
19 Post & San Pedro	20	3	228	0.5	485	785	8,395	76%	0.9	456	TBD
20 Garden Gate Tower	27		285	0.4	713						TBD
21 Davidson Plaza	17		653	1.8	367						TBD
22 4th St Metro Station	12		101	0.5	202		11,566				TBD

¹ Per City of San Jose. Intended tenure may change based on market conditions.

² Average NSF per unit estimated based on reported gross square feet assuming an 80% efficiency ratio.

Appendix 4**Land Costs: Downtown High-Rise Residential Projects****Downtown High-Rise Residential Incentives; San Jose, CA****9/27/2018**

Source: Costar, RealQuest, KMA research

Project	Acres (Gross)	SF Land (Gross)	Units	Land Price (\$M)	Purchase Year	Price / Land SF	Price / Unit	Notes
<u>Completed</u>								
1 The 88	1.3	57,209	197					
2 Axis	1.2	54,080	329					
3 360 Residences	1.0	44,431	213					
4 City Heights	0.8	33,541	124					
5 One South Market	1.0	42,253	312	\$16.0M	2013	\$379	\$51,386	
6 Centerra	1.3	54,886	347					
<u>Under Construction</u>								
7 Silvery Towers	1.9	82,764	643	\$44.9M	2014	\$542	\$69,810	Per assessed value
8 NSP Tower 3	1.5	66,211	313	\$10.0M	2017	\$151	\$31,949	
9 The Graduate	1.5	63,162	260	\$18.1M	2017	\$286	\$69,469	Student housing
10 SJSC (Miro)	1.4	60,984	630	\$12.8M	2015	\$210	\$20,317	
<u>Approved</u>								
11 Parkview Tower	1.5	66,211	220	\$8.0M	2017	\$121	\$36,364	
12 Gateway Tower	0.5	21,780	300					
13 Greyhound	1.7	74,052	781	\$39.0M	2016	\$527	\$49,936	
14 Aviato	0.8	33,541	302	\$4.0M	2017	\$119	\$13,245	
15 Museum Place	2.3	101,495	306					
<u>Pending</u>								
16 Block Three	1.3	58,370	393	\$5.1M	2011	\$87	\$12,977	Excl. enviro. cleanup
17 27 West	0.6	24,829	342	\$2.0M	2003	\$81	\$5,848	
18 CityView Plaza	0.6	26,136	259	\$28.4M	2018	N/A	N/A	Sold w/ office bldgs.
19 Post & San Pedro	0.5	20,473	228	\$8.8M	2015	\$430	\$38,596	
20 Garden Gate Tower	0.4	17,424	285	TBD	2018			
21 Davidson Plaza	1.8	77,537	653					
22 4th St Metro Station	0.5	21,780	101	\$4.0M	2007	\$185	\$39,950	

Appendix 5**Land Costs: Downtown Commercial Projects****Downtown High-Rise Residential Incentives; San Jose, CA****9/27/2018***Source: Costar, RealQuest, Silicon Valley Business Journal*

Project	Acres (Gross)	SF Land (Gross)	Land Price (\$M)	Year	Price / Land SF	Price / Acre (\$M)
<u>Adobe</u>						
333 W San Fernando St	1.5	65,340	\$68M	2018	\$1,041	\$45M
<u>Google/ Diridon</u>						
374 W Santa Clara St	9.1	397,098	\$59M	2015	\$147	\$6M
450 W Santa Clara St	0.6	25,264	\$11M	2017	\$435	\$19M
74 S Autumn St	0.1	5,662	\$1M	2017	\$177	\$8M
557-587 Cinnabar St	6.1	264,104	\$52M	2017	\$195	\$8M
559/573 W Julian St	0.7	32,412	\$4M	2017	\$112	\$5M
140 S Montgomery St	0.6	26,079	\$6M	2017	\$211	\$9M
92 S Montgomery St	0.2	6,795	\$1M	2017	\$167	\$7M
City Land - Diridon	<u>6.5</u>	<u>283,140</u>	<u>\$67M</u>	<u>2018</u>	<u>\$237</u>	<u>\$10M</u>
Total, Google/Diridon	23.9	1,040,554	\$199M		\$191	\$8M
<u>Gary Dillabough</u>						
Fntn Alley Pkg. (35 S 2nd St)	1.3	54,450	\$26M	2018	\$472	\$21M
Valley Title (300 S 1st St)	2.8	122,839	\$62M	2018	\$501	\$22M
<u>VTA</u>						
Mitchell block	3.6	156,816	\$40M	2017	\$253	\$11M

Appendix 6

Construction Cost Estimate (Marshall & Swift)

Downtown High-Rise Residential Incentives; San Jose, CA

9/27/2018

Source: Marshall & Swift

Prototype Assumptions

Stories	22		
GSF Residential	554,000 SF	78% efficiency	
Residential Units	480 units	900 NSF/unit	
Parking Spaces/ SF (below)	240 spaces	96,000 SF	
Parking Spaces/ SF (above)	240 spaces	96,000 SF	

	Factor	Basis	Total
Residential			
Residential/SF (Class A)	\$255 /SF res	554,000 SF	\$141,270,000
Sprinklers (wet) /SF	\$3 /SF res	554,000 SF	\$1,440,400
Floor adjustment (less) A&E fees	0.5% /fl above 3 6.5% of directs	19 floors	\$13,557,488 -\$10,157,413
Appliances allowance	\$4,575 /unit	480 units	\$2,196,000
Total	\$268 /GSF res	554,000 SF	\$148,306,475

Adjustments

Inflation (to Sept. 2018)	1.05		\$155,721,799
Regional (San Jose)	1.35		\$210,224,429
Total Cost/GSF Residential Or Say	\$379 /GSF res \$380 /GSF res	554,000 SF	\$210,224,429

Parking

Parking Below Grade/SF	\$94 /SF pkg	96,000 SF pkg	\$9,024,000
Parking Above Grade/SF	\$73 /SF pkg	96,000 SF pkg	\$6,960,000
Sprinklers (wet) /SF (less) A&E fees	\$3 /SF pkg 6.5% of directs	192,000 SF pkg	\$499,200 -\$1,071,408
Total	\$80 /SF pkg	192,000 SF pkg	\$15,411,792

Adjustments

Inflation (to Sept. 2018)	1.06		\$16,336,500
Regional (San Jose)	1.35		\$22,054,274
Total Parking Per Space	\$115 /SF pkg \$46,000 /space	192,000 SF pkg 480 spaces	\$22,054,274

Appendix 7

Governmental Fees Detail

Downtown High-Rise Residential Incentives; San Jose, CA

9/27/2018

Residential Fees

	Factor		Assumption/Unit
			1,155 GSF/unit
Parkland Requirement			
Base Fee Schedule			
Downtown Highrise	\$14,600 /unit	20% credit	\$11,700 /unit
Private Recreation Credit			
Affordable Housing			
Impact Fee	\$25,000 /unit	100% exempt	\$0 /unit
Construction Taxes			
<u>Subject to Incentives</u>			
CRMP	2.42% BP valuation	\$131 value/SF	\$3,700 /unit
B&S	1.54% BP valuation	\$131 value/SF	\$2,300 /unit
	3.96% BP valuation	\$131 value/SF	\$6,000 /unit
<u>Other City Constr. Taxes</u>			
Constr. Tax (4.54)	\$75 /unit		\$75 /unit
Residential Tax (4.64)	\$90 /unit		\$90 /unit
SMIPA	0.010% BP valuation	\$131 value/SF	\$15 /unit
BSARSF	0.004% BP valuation	\$131 value/SF	\$5 /unit
Total, Other Constr. Taxes		(rounded)	\$200 /unit
School Fees			
Residential Fee	\$3.48 /SF		\$4,000 /unit
Other Permits and Fees			
Entitlement	\$400 /unit		
Improvement Plan	\$1,300 /unit		
Permit Review Fees	\$2,700 /unit		
Offsite/ Public Works	\$2,100 /unit		
CEQA Mitigation	\$0 TBD		
Total, Other Permits & Fees	\$6,500 /unit		\$6,500 /unit

Retail Fees

	Factor		Assumption/SF
Construction Taxes			
CRMP	3.0% BP valuation	\$134 value/SF	\$4.02 /SF
B&S	1.5% BP valuation	\$134 value/SF	\$2.01 /SF
Construction Tax	\$0.08 /SF		\$0.08 /SF
SMIPA	0.028% BP valuation	\$134 value/SF	\$0.04 /SF
BSARSF	0.004% BP valuation	\$134 value/SF	\$0.01 /SF
Total, Construction Taxes			\$6.15 /SF
School Fees			
Commercial Fee	\$0.56 /SF		\$0.56 /SF