Century | Urban

Impact Fee Analysis Review

Presented to:

City of South San Francisco

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IMPACT FEE ANALYSIS REVIEW

TO: City of South San Francisco

FROM: Century Urban, LLC

SUBJECT: Impact Fee Analysis Review

DATE: August 6, 2020

Century Urban, LLC ("Century | Urban") has been engaged by the City of South San Francisco (the "City") to review certain analysis conducted on the City's impact fees with respect to commercial and residential development. With Baird + Driskell in 2018, Century | Urban analyzed the estimated impact of potential inclusionary housing requirements on the economic feasibility of prototype residential development projects. Separately, as part of a project for 21 Elements including seven cities in the County of San Mateo, Century | Urban analyzed the impact of different commercial linkage fee amounts on the economic feasibility of certain office and biotechnology development prototypes. Per the request of the City, Century | Urban has modified and updated portions of this work and has additionally prepared a hotel development prototype. The methodology and findings of these analyses are described below.

Disclaimer

For this project analysis, Century | Urban utilized data and information provided by the City as well as other reputable sources and market participants. However, while Century | Urban collected the most timely information available, its research was conducted primarily in the fourth quarter of 2019 and first quarter of 2020, and economic changes driven by the impact of coronavirus have affected supply-demand elements that underpin key operating income and construction assumptions. As of this writing, substantial uncertainty remains on both the demand and supply side of residential and commercial development, which policy makers should consider before implementing new policy.

The methodology and conclusions regarding residential project feasibility described below are based on research and analysis originally completed in 2018 and updated per the City 's direction for the purpose of evaluating potential impact fees. Per the City's direction, limited market research was conducted in the first quarter of 2020 as part of this update, and certain underwriting assumptions including hard costs were adjusted based on cost indexing to account for the time that has elapsed since 2018.

Methodology

The purpose of these analyses is generally to assess the economic feasibility of certain types of development projects based on certain inclusionary or impact fee requirement assumptions. To prepare the analyses, prototype projects were defined for each type of development that the City wished to evaluate. Century | Urban then researched pro-forma underwriting assumptions for each prototype including income and expense projections, land costs, "hard" construction costs[1], impact fees, "soft" costs including architectural and engineering costs, and return metrics for purposes of evaluating project feasibility.

Market research revealed a range of rents, expenses, and feasibility metrics, even within a small geographic area and among similar projects. This range is due in part to the general sentiment about the comparable risk associated with development in different submarkets. Given these ranges, Century | Urban selected data that appeared most generally relevant to new development. Finally, while the generic parameters established for each project prototype are intended to be generally representative of development projects in the City's pipeline, any policy changes proposed by the City may need to be adjusted based on the parameters of actual City pipeline projects.

To review the feasibility of prototype projects, Century | Urban modeled each project's stabilized return on cost ("ROC") and compared this ROC to a threshold market range. The ROC is a metric commonly used to evaluate project economic feasibility by project sponsors, lenders, and investors. In conjunction with other valuation metrics, the ROC indicates whether a project's estimated value at completion is greater than the cost to develop it, and, if so, provides an estimate of the amount of additional value created.[2]

The ROC is calculated by estimating the project's annual pro-forma net operating income and dividing it by the estimated total project development cost. The appropriate target ROC is established based on the project's perceived risks, which include the uncertainty of ultimate project costs, rents and economic conditions upon completion, and project development/construction duration. Typically, if a project's estimated ROC does not fall within the market threshold range targeted for the project's risks, the project is considered infeasible and not pursued. While this decision is made primarily by a project developer, the project's investors and lenders, often banks, typically also provide input to the developer with regard to feasibility and project status.

With market research establishing target ROC metrics, Century | Urban compared the projected ROC for project prototypes with the target range. An ROC lower than the target range would suggest an infeasible project, while an ROC above the target range would suggest a feasible

[1] Per the City's direction, the analyses are based on project costs that do not reflect prevailing wage (project costs can be adjusted to reflect prevailing wage upon request). Generally, project costs based on prevailing wage would be higher reducing project economic feasibility assuming all other underwriting assumptions remain constant.

[2] While many real estate project sponsors, lenders, and investors use ROC or similar metrics to evaluate economic feasibility, certain types of project sponsors, such as companies building facilities for their own use, may evaluate feasibility based on different metrics.

project, as well as the potential to adjust City impact fees without affecting project feasibility. In principle, impact fees could be increased until the prototype's projected ROC falls within the target range.

Residential Housing Assumptions

The residential rental prototype analysis is based on the City's current inclusionary housing requirements, which requires that 15% of units be affordable to "Low" and "Very Low" income households based on maximum affordable rents published in San Mateo County's form: "2020 San Mateo County Income Limits." As noted above, other assumptions from the 2018 inclusionary housing analysis have been updated per the City's direction.

As requested by the City, the impact fees used in each scenario of the analysis below include: 1) current impact fees for the prototype totaling approximately $25,850 per unit 2) staff proposed impact fees totaling approximately $31,240 per unit and 3) a scenario in which no impact fees were assumed.

Biotechnology Assumptions

The biotechnology prototype assumes a 150,000-square-foot project developed speculatively East of 101 in South San Francisco. The scenario shown in the analysis projects the estimated ROC range generated by a range of potential total impact fees charged by the City.

Hotel Assumptions

For the hotel development prototype, Century | Urban utilized a hotel prototype generated for other nearby cities in the north San Francisco Peninsula in late 2019, performed high-level research to update revenue and expense assumptions, and revised other underwriting inputs to reflect a hotel development project in the City. The prototype assumes a 175-room select service hotel with medium quality finishes and a medium level of sitework. Per the City's direction, hotel rents and occupancy were set based on estimated "stabilized" room rates and occupancy during the recent pre-coronavirus period. As noted, other costs are also based on pre-coronavirus estimates. Per the City's request, the impact fees highlighted in the attached hotel prototype exhibit reflect fees proposed by City staff or a range of potential total impact fee amounts, not current fees.

Prototype Results

Exhibit A: Prototype Results summarizes the analysis for each of the residential and commercial project prototypes. Each prototype exhibit lists the size and type of the prototype, the estimated total development costs, the estimated net operating income, and the resulting projected ROC

based on existing in-place impact fee amounts, proposed impact fee amounts, or a range of potential impact fee amounts.

For the residential prototype, Century | Urban reviewed a 150-unit apartment rental project that was assumed to be increased to 180 units pursuant to the State Density Bonus program and reflects the City's current inclusionary housing requirements. The analysis indicates that the estimated ROC of the prototype, with or without current or proposed impact fees, falls below the target range.

Fee Scenarios		
Product Type:	Residential Rental	
Total Units	180	
Prototype	150 DU with Density Bonus	
Target Return on Cost	5.0% to 5.5%	
Type	Return on Cost	Feasibility
Return On Cost - Existing Fee Structure	3.58%	Below Target Range
Return on Cost - Staff Recommended Fees	3.55%	Below Target Range
Return on Cost - No Impact Fees	3.75%	Below Target Range

For the biotechnology prototype, if current impact fees of approximately $26.43 per square foot are underwritten, an ROC of 7.04% is projected, which is above the target range of 6.5% to 7.0%. One critical assumption in this analysis is the impact of the East of 101 Sewer and Traffic Fees. Based on an example provided by the City, $7.00 per square foot for these fees has been applied to the biotechnology prototype. However, a large range of fees per square foot is observed in other examples provided by the City for this fee, so any conclusions regarding the ROC would depend on the specific fee that is applicable to a particular project. It should also be noted that as an "average" project, the prototype represents a middle-of-the-road cost structure, and examples of more and less costly projects were observed in the course of this research.

In the table below, all current impact fees for the biotechnology prototype were assumed to be zero in order to identify the maximum total impact fee amount per square foot supportable by the prototype. Assuming a target ROC of 6.77% (the approximate midpoint of the target ROC range), the maximum supportable amount of total impact fees is approximately $55 per square foot.

Fee Scenarios		
Product Type:	Biotechnology	
Size Category, SF:	150,000	
Construction Type:	Type III	
Target Return on Cost	6.5% to 7.0%	
Fee Per Square Foot	Return on Cost	Feasibility
$45 PSF Total Impact Fees	6.86%	Within Target Range
$50 PSF Total Impact Fees	6.82%	Within Target Range
$55 PSF Total Impact Fees	6.77%	Within Target Range
$60 PSF Total Impact Fees	6.73%	Within Target Range
$65 PSF Total Impact Fees	6.68%	Within Target Range
$70 PSF Total Impact Fees	6.64%	Within Target Range

A potential range of total impact fees is reviewed in the hotel prototype. The summary table below shows that the hotel prototype does not reach the target ROC range under any of the potential impact fee amounts examined in the range. The City is currently proposing impact fees of $16.74 per square foot for hotel projects[3], and, based on this proposed fee amount, the prototype projects an ROC of 5.20%.

Fee Scenarios		
Product Type:	Hotel	
Prototype:	175 Room Select Service Hotel	
Construction Type:	Type III	
Target Return on Cost	7.75% to 8.25%	
Fee Per Square Foot	Return on Cost	Feasibility
$0 PSF Total Impact Fees	5.31%	Below Target Range
$5 PSF Total Impact Fees	5.28%	Below Target Range
$10 PSF Total Impact Fees	5.25%	Below Target Range
$15 PSF Total Impact Fees	5.21%	Below Target Range
$16.74 PSF Total Impact Fees	5.20%	Below Target Range
$20 PSF Total Impact Fees	5.18%	Below Target Range
$25 PSF Total Impact Fees	5.15%	Below Target Range

Summary

As described above, the effects of a range of impact fee assumptions on the economic feasibility of certain development project prototypes were analyzed. The results of this analysis should be considered within the economic context of the City's overall development objectives and the degree to which continually evolving conditions affect costs, rents, and business activity.

Generally, the residential and hotel prototype analyses indicate that the estimated ROC of new development projects as modeled falls below the target ROC range. The biotechnology prototype analysis indicates that the projected ROC would be approximately equal to the midpoint of the target ROC range with approximately $55 per square foot of total impact fees.

[3] Based on proposed fees provided by City Staff.

The City should consider any potential impact fee adjustments in concert with the City's development goals and the impact of the East of 101 Sewer and Transportation Fees, as well as any additional potential adjustments to other project requirements.

Exhibit A: Prototype Results

City of South San Francisco - Impact Fee Analysis

Product Type:	Residential
Prototype	150 Unit Apts with Density Bonus
Total Units	180

Item	**Amount**
Building Gross SF	166,275
Building Net Rentable SF	133,020
Building Efficiency	80%
Construction Costs	
Hard Costs	
Building Hard Costs	$70,643,690
Total Hard Costs Per GSF	**$70,643,690**
Soft Costs	
Total Impact Fees	$4,652,960
Other Soft Costs	$21,193,107
Total Soft Costs Per GSF	**$25,846,067**
Soft Costs as % of Hard Costs	$0
Land Cost	
Land Cost	**$6,000,000**
Total Development Cost	**$102,489,757**
Total Development Cost Per Unit	$569,388
Net Operating Income	
Revenue	
Rental Income	$5,761,474
Other Income	$180,000
Vacancy Rate	5%
Vacancy	$297,074
Total Annual Rental Revenue	$5,644,400
Total Annual Operating Expenses	$1,975,540
TOTAL NET OPERATING INCOME	**$3,668,860**
Return Analysis	
Target Return on Cost Range	5.0% to 5.5%
Return on Cost - Existing Fee Structure	3.58%
Return on Cost - Staff Recommended Fees	3.55%
Return on Cost - No Impact Fees	3.75%

City of South San Francisco - Impact Fee Analysis

Product Type:	Biotechnology	
Construction Type:	Type III	
Item		**Amount**
Building Gross SF		150,000
Building Net Rentable SF		127,500
Building Efficiency		85%
Construction Costs		
Hard Costs		
Building Hard Costs PSF	$	333
TIs/Contingency/Other PSF	$	157
Total Hard Costs Per GSF	$	490
Soft Costs		
Total City Fees PSF	$	-
Other Soft Costs PSF	$	88
Financing Costs PSF	$	22
Leasing Commissions PSF	$	11
Soft Cost Contingency PSF	$	6
Total Soft Costs Per GSF	$	128
Soft Costs as % of Hard Costs		26%
Land Cost		
Land Cost Per GSF/Building	$	130
Total Development Cost PSF	$	747
Total Development Cost	$	112,123,038
Net Operating Income		
Revenue		
Office Annual Rent per NRSF	$	69.00
Office Rent Type For Underwriting		NNN
Reimbursements	$	21.00
Parking Revenue Per NRSF	$	-
Vacancy Rate		5%
Total Annual Rental Revenue	$	10,901,250
Operating Expenses		
Average Operating Expense PSF	$	21.00
Capital Expense PSF	$	0.25
Total Annual Operating Expenses	$	2,709,375
TOTAL NET OPERATING INCOME	$	8,191,875

Max Fee Burden Analysis

Target Return on Cost Range	6.5% to 7.0%
Underwritten Return on Cost	
$45 PSF Total Impact Fees	6.86%
$50 PSF Total Impact Fees	6.82%
$55 PSF Total Impact Fees	6.77%
$60 PSF Total Impact Fees	6.73%
$65 PSF Total Impact Fees	6.68%
$70 PSF Total Impact Fees	6.64%

City of South San Francisco - Impact Fee Analysis

Product Type:	Hotel	
Prototype:	175 Room Select Service Hotel	
Construction Type:	Type III	
Proposed Total Impact Fees:	$	16.74
Item		**Amount**
Building Gross SF	$	87,500
Rooms		175
Avg GSF Per Room		500
Construction Costs		
Hard Costs		
Building Hard Costs PSF	$	465
FF&E/Contingency/Other PSF	$	97
Total Hard Costs Per GSF	$	562
Soft Costs		
Total City Fees PSF	$	-
Other Soft Costs PSF	$	101
Financing Costs PSF	$	25
Soft Cost Contingency PSF	$	6
Total Soft Costs Per GSF	$	133
Land Cost		
Land Cost Per GSF/Building	$	150
Total Development Cost PSF	$	845
Total Project Cost	$	75,482,947
Total Project Cost per Room	$	431,331
Pro-Forma - Daily Revenue Assumptions		
Revenue		
Average Daily Rate Per Room	$	209
Average Occupancy		80%
Total Other Revenue (F&B, other)	$	38
Total Revenue, incl F&B and Other	$	205
Annual Total Gross Revenue	$	13,086,199
Operating Expenses		
Property Taxes (% of value)		1.06%
Total Operating Expenses	$	142
Total Annual Operating Expenses	$	9,058,334
Operating Margin		*31%*
Daily Net Operating Income Per Room	$	63
Annual Net Operating Income Per Room	$	22,909
Total Net Operating Income	$	4,008,997
Impact Fee Analysis		
Target Return on Cost Range		7.75% to 8.25%
$0 PSF Total Impact Fees		5.31%
$5 PSF Total Impact Fees		5.28%
$10 PSF Total Impact Fees		5.25%
$15 PSF Total Impact Fees		5.21%
$16.74 PSF Total Impact Fees		5.20%
$20 PSF Total Impact Fees		5.18%
$25 PSF Total Impact Fees		5.15%