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RE: 8150 Sunset: Financial Feasibility Analysis

Nytzen, Michael <michaelnytzen@paulhastings.com>

Tue, Jul 5, 2016 at 6:05 PM

To: Luci Ibarra <luciralia.ibarra@lacity.org>, William Lamborn <william.lamborn@lacity.org>

Cc: "Haber, Jeffrey S." <jeffreyhaber@paulhastings.com>

Luci and Will:

Attached is RSG's peer review of the HR&A supplemental report on the financial feasibility of Alternative 9.

Please let us know if you have any questions or would like to discuss.

Regards,

Michael

From: Nytzen, Michael

Sent: Wednesday, June 29, 2016 6:21 PM

To: Luci Ibarra; William Lamborn

Cc: Haber, Jeffrey S.

Subject: RE: 8150 Sunset: Financial Feasibility Analysis

Luci and Will:

Attached is a supplement to the March 1, 2016 financial feasibility analysis, prepared for the Alternative 9 project design. We will forward the peer review report under separate cover when it has been completed, which should be within the next few days.

Please let us know if you have any questions or would like to discuss.

Regards,

Michael

From: Nytzen, Michael

Sent: Thursday, April 21, 2016 6:16 PM

To: Luci Ibarra; William Lamborn

Cc: Haber, Jeffrey S.

Subject: 8150 Sunset: Financial Feasibility Analysis

Luci and Will:

Attached please find the financial feasibility analysis for the 8150 Sunset Boulevard project prepared by HR&A Advisors, Inc., dated March 1, 2016, along with a peer review of the HR&A analysis prepared by RSG, Inc., dated April 21, 2016. These should be posted to the Planning Department's Website for the 8150 Sunset project.

Please let us know if you have any questions or would like to discuss.

Regards,

Michael



E. Michael Nytzen | Senior Land Use Project Manager

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RSG 8150 Sunset Blvd Alternative 9 Financial Feasibility Analysis Peer Review (7.1.2016).pdf

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Via Electronic Mail

Date: July 1, 2016
To: Tyler Siegel
AG-SCH 8150 SUNSET BOULEVARD OWNER, L.P.
From: Jim Simon, Principal
Dominique Clark, Associate
RSG, INC.

SUBJECT: 8150 SUNSET BLVD. PROJECT FINANCIAL FEASIBILITY ANALYSIS PEER REVIEW – ALTERNATIVE 9 (GEHRY PARTNERS DESIGN)

Per your request, RSG, Inc. (“RSG”) reviewed HR&A Advisors, Inc.’s (“HR&A”) supplemental financial feasibility analysis of a mixed-use density bonus project (“Project”) proposed by AG-SCH 8150 Sunset Boulevard Owner, L.P. (“Developer”). HR&A’s supplemental analysis evaluates “Alternative 9”, the Gehry Partners-designed alternative of the Project which incorporates a 3.0 floor area ratio (FAR) (“Project Alternative 9”). This analysis supplements HR&A’s March 1, 2016 comparative analysis of (1) a 1.0 FAR development scenario and (2) a 3.0 FAR development scenario not designed by Gehry Partners (“Original Project”). In addition to the architect, Project Alternative 9 differs from the Original Project primarily in that it includes for-sale condominiums as well as rental apartments, the projected apartment rents per square foot are slightly higher, and the retail square footage is reduced from 110,000 to 65,000 square feet. Our understanding is that the Developer has submitted proposals for both Project alternatives to the Los Angeles Department of City Planning (“Planning Department”).

The Project site consists of two parcels totaling 2.6 acres located at 8142-8148 West Sunset Boulevard in the City of Los Angeles (“City”). The parcels are currently improved with commercial buildings. The proposed development program entails the following components:

- 219 multi-family rental units, including 28 units restricted to very low-income households;
- 30 for-sale condominiums;
- 65,000 leasable square feet of commercial space;
- 820 parking spaces in a four-level subterranean garage;
- Various on-site amenities, including 4,000 square feet of recreation rooms for residents’ use and a 2,700-square-foot fitness center.

FISCAL HEALTH
ECONOMIC DEVELOPMENT
REAL ESTATE, HOUSING
AND HEALTHY COMMUNITIES

Our understanding is that the Developer has submitted a request to the Planning Department for an “off-menu” incentive allowing a 3.0 FAR, in lieu of the allowable 1.0 FAR. To comply with the City’s requirements for density bonus applicants requesting off-menu incentives, the Developer will provide the Planning Department (1) HR&A’s original and supplemental analyses, which demonstrate that the off-menu 3.0 FAR incentive is necessary for the inclusion of the 28 affordable housing units to be economically feasible, and (2) RSG’s memos summarizing the findings of our peer review of HR&A’s analyses.

Executive Summary

Based on our peer review of HR&A’s analysis, our conclusions are as follows:

- **We concur with HR&A’s finding that Project Alternative 9 is financially feasible with the requested off-menu 3.0 FAR incentive**, because it would yield a return on total development cost and a developer profit margin that we believe are sufficiently high to attract market investment.

Analysis

Development Programming

Summary of HR&A Assumptions. Project Alternative 9 consists of 333,903 square feet of new floor area, including 219 rental apartment units averaging 768 square feet each, 30 for-sale condominium units averaging 2,038 square feet each, and 65,000 square feet of retail. Of the 219 apartment units, 28 would be restricted to very low-income households. Project Alternative 9 would also include 820 parking spaces in a four-level subterranean garage, as well as various on-site amenities.

Findings of RSG’s Peer Review. RSG believes that the development programming assumptions are reasonable.

Development Costs

Summary of HR&A Assumptions. HR&A’s development cost estimates incorporate the following assumptions:

- Land Acquisition Costs: \$305 per square foot of land, which was the 2012 sale price as reported by the Developer
- Hard Construction – Building Costs: \$331 per square foot
- Hard Construction – Subterranean Parking Costs: \$42,500 per parking space

- Excavation and Exportation of Soil: \$75 per cubic yard of soil excavated
- Site Improvements: \$50 per square foot of open area
- Tenant Improvements Allowance: \$50 per net square foot of retail
- Hard Cost Contingency: 5% of other hard costs
- Soft Costs: Either calculated by line item as a percentage of total hard costs or provided by the Developer, with the exception of the leasing commissions, which HR&A estimated based on an assumption of a 3% broker commission on 5-year term commercial leases and 1.5% commission on 5-year lease renewals and marketing costs for both residential units and commercial space
- Soft Cost Contingency: 3% of other soft costs
- Construction Financing Costs Assumptions:
 - Construction Loan Principal: 80% loan-to-cost ratio
 - Construction Loan Fees: 2.0% of loan principal, 6.0% interest rate, 60% outstanding principal balance, two-year loan term, and 30-month construction period
 - Permanent Loan Points: 2.0%

Findings of RSG's Peer Review. RSG believes that HR&A's development cost estimates and assumptions are reasonable. HR&A assumes that the hard building costs per square foot would be 24% higher for Project Alternative 9 than the Original Project. Gehry Partners' fee amount is unknown to RSG, but we believe that this cost increase assumption is reasonable, because the design of Project Alternative 9 requires more complicated and costly construction than the Original Project.

Additionally, our review included an analysis of HR&A's methodology of differentiating between the hard and soft costs inherent in the residential and retail hard cost estimates sourced from Marshall & Swift Cost Estimate software ("Marshall and Swift"). In order to estimate soft costs independently from Marshall and Swift while preventing double counting, HR&A assumed that about 20% of Marshall & Swift's estimates are attributed to softs costs and then deducted this 20%. RSG believes that this approach yields development cost estimates that are reasonable.

Condominium Net Sales Revenue

Summary of HR&A Assumptions. HR&A's net sales revenue estimates for the condominiums incorporate the following assumptions:

- Sales Prices: \$1,450 - \$2,100 per square foot
- Marketing and Cost of Sale: 10% of total unit sales price
- Homeowners Association (HOA) Fees through Full Building Absorption: Based on assumption of average HOA fees of \$1,500 per month and pre-selling of 50% of units, with the remainder absorbed over a two-year period
- Warranties: \$1,000 per unit

Findings of RSG's Peer Review. RSG believes that HR&A's condominium net sales revenue estimates are generally reasonable. As explained in HR&A's memo, the projected condominium sale prices are based on their review of market comparables for the highest-end of newly constructed condominiums in prime submarket areas.

Net Operating Income

Summary of HR&A Assumptions. HR&A's net operating income estimates incorporate the following assumptions:

- Market-Rate Apartment Rents: \$6.10 - \$6.50 per square foot
- Very Low-Income Apartment Rents: Based on the City Housing and Community Investment Department's affordable rent limits schedule for density bonus projects (effective August 1, 2015) and net of select utility allowances per the City's Housing Authority utility allowance schedule for multi-family residential housing (effective December 1, 2015)
- Residential Miscellaneous Income: \$50 per unit per month
- Residential Vacancy Allowance: 5% of gross rental income
- Residential Operating Expenses: 35% of effective gross income
- Residential Replacement Reserve: \$250 per unit per year

- Retail Income: \$5.50 per triple net per rentable square foot per month
- Retail Vacancy Allowance: 5% of gross income
- Retail Management Fee: 3% of effective gross income

Findings of RSG's Peer Review. RSG believes that HR&A's net operating income estimates are generally reasonable. Two details worth noting, none of which are material to our conclusion that the Project is financially feasible, are as follows:

1. As explained in HR&A's memo, the assumptions regarding the market-rate rents are heavily weighted on the rents at one luxury property, 8500 Burton Way. Based on RSG's research, the rents at 8500 Burton Way are significantly higher than other apartments built since 2014 in the Hollywood submarket, but RSG believes that relying heavily on this comparable is defensible, given the rent premiums associated with buildings designed by high-profile architects like Gehry Partners.
2. The analysis does not include revenue from the retail parking spaces, based on the assumption that 100% of the retail parking will be validated by the associated businesses. This assumption may be understating some parking revenue for patrons that visit longer than a typical two to three-hour validation window, but this revenue would be modest and not affect the overall feasibility findings.

Financial Feasibility Analysis

Summary of HR&A Assumptions. HR&A's financial feasibility analysis incorporates the following assumptions:

- Threshold for Return on Total Development Cost: 5.6%
- Threshold for Development Profit Margin: 12.5%
- Cap Rate: 4.6%
- Cost of Sale: 1% of project value

Findings of RSG's Peer Review. RSG believes that the assumptions incorporated in HR&A's financial feasibility analysis are reasonable. RSG confirmed that these assumptions align with current market realities.