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ADVISORS IN PUBLIC/PRIVATE REAL ESTATE DEVELOPMENT

MEMORANDUM

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REAL ESTATE
REDEVELOPMENT
AFFORDABLE HOUSING
ECONOMIC DEVELOPMENT

To: Anne Stedler
City of Los Altos

From: Tim Kelly

Date: June 30, 2009

Subject: Downtown Retail District
Downtown Los Altos Opportunity Study (3.3/1000)

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Pursuant to your request, we have prepared the following conceptual financial analysis with respect to the ability of the private sector to fund the cost of public parking spaces. Watry has provided conceptual estimates of the number of parking spaces that can be constructed in each Test Case and the approximate cost per space used to estimate the parking garage costs. We have evaluated three Test Case scenarios (all costs are in 2009 dollars).

1. Test Case A: 600 space public garage (200 net new) under Plazas 1/2/3. This public garage would be part of a single phased real estate project with approximately 200,000 sq.ft. of office space and 660 private parking spaces. The public and private parking would be contained in a 1,260 space underground garage constructed beneath Plaza 1/2/3. The cost of the 600 public spaces would be approximately \$27 million plus the cost of financing. The private real estate project would be approximately \$132.4 million at completion.
2. Test Case B: 600 space public garage (200 net new) within one stand alone garage on one of the plazas. For the purpose of this analysis, Plaza 2 is designated. The private real estate would be a multi phase project on Plazas 1 and 3 and would contain approximately 124,000 sq.ft. of office space. The cost of the stand alone public garage would be \$18.9 million plus the cost of financing. The private real estate project would be approximately \$79.4 million at completion.

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3. Test Case C: 600 spaces plus 112 replacement spaces in two locations (200 net new): a stand alone public garage on Plaza 7 (4 levels up and 1 level down) and public spaces on Plazas 1/2/3 as a component of private development on Plazas 1/2/3. Cost of the 712 public spaces would be approximately \$23.6 million plus the cost of financing. The private development would be a multi phased project with approximately 188,000 sq.ft. on Plazas 1/2/3. The private real estate project would be approximately \$120.1 million at completion.

Private Development Funds Public Parking

1. Land payment to the City for the existing parking lots (Plazas 1/2/3) would be in the form of funding the cost of the public parking garage. Construction of the public garage would be a condition for receiving development entitlements and would be completed in advance or as part of the initial private development. Due to the high cost of the public garage, no additional upfront land payment to the City is anticipated.
2. City could ground lease the plaza for private development. Given the preference for fee ownership of land by the development community, a ground lease form of land conveyance would reduce the pool of available development teams. The private sector upfront funding of the public garage would represent a prepayment of the ground lease rent. There would be no meaningful ground lease payments for a substantial period of time.
3. The long term intrinsic real estate value of property in Los Altos is looked upon favorably by the real estate industry. In this analysis, office land use is the primary land use (there could be a limited ground floor retail component, too). Ted Kokernak has researched the office market and the achievable rent and reports that the average rent could be in the range of \$5.50 per month, net, for new Class A office space development that is well designed and adequately parked to attract strong tenants. Office parking would be at 3.3 spaces per 1,000 sq.ft. of office space (3.3/1000).

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Summary of Findings

As explained below, private dollars will fund a significant portion of the new public parking garages. However, public dollars are expected to be needed to underwrite a portion of the cost. The amount of public dollars is estimated to be in the order of magnitude of \$4.7 million to \$6.3 million. To this amount, the cost of financing needs to be added. Key variables are the cost of the public spaces, the location of the spaces (above or below grade), and amount of private development allowed on Plazas 1/2/3. If a portion of the public parking can in part be located in a stand alone garage on another city owned site (Plaza 7 in this analysis as compared to all the public parking on Plazas 1/2/3), then funding of public dollars would be at the lower end of the cost range stated above (\$4.7 million plus the cost of financing).

	Test Case A	Test Case B	Test Case C
PUBLIC GARAGE(S)	600 Spaces	600 Spaces	712 Spaces
Public Land	Plaza 1/2/3	Plaza 2	Plaza 1/2/3 and 7
EST. COST	\$27 M	\$18.9 M	\$23.6 M
Private Funding	\$20.7 M	\$12.6 M	\$18.9 M
Public Funding	\$6.3 M	\$6.3 M	\$4.7 M

	Plazas 1/2/3	Plaza 1/3	Plaza 1/2/3
PRIVATE DEVELOPMENT			
Office	200,000	124,000	188,000
Parking	660	409	620

	Test Case A	Test Case B	Test Case C
PRIVATE FUNDING	<u>Single Phase</u>	<u>Multi Phased</u>	<u>Multi Phased</u>
Public Garage(s)	\$ 20,700,000	\$ 12,600,000	\$ 18,900,000
Improvements	<u>111,700,000</u>	<u>66,774,000</u>	<u>101,238,000</u>
Total Private Funding	\$132,400,000	\$79,374,000	\$120,138,000
NET INCOME	\$11,894,000	\$7,374,400	\$11,179,800
ANNUAL RETURN ON COST	9.0%	9.3%	9.3%

Test Case A envisions a 600 space subterranean public garage (200 net new spaces) as part of a single phase project with 200,000 sq.ft. of development rights. This project is dependent upon on the forward commitment by a strong credit tenant in order to obtain financing. The private investment is on the order of \$132.4 million. While possible, Test

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Case A is not recommended as the primary approach to fund the public garages given the size, complexity, and the need to construct as a single phased project. Additionally, there would need to be an interim replacement parking strategy due to the loss of all public parking on Plazas 1/2/3 during an extended construction period.

Test Case B allows for a stand alone 600 space public garage on Plaza 2 (200 net new spaces). The development rights are estimated to be approximately 124,000 sq.ft. This Test Case allows for phasing of the private real estate with individual developments on Plazas 1 and 3. At completion, the private investment is estimated to be \$79.4 million. Constructing the 600 space public garage on Plaza 2 is estimated to cost approximately \$18.9 million plus cost of financing. In our judgment, the City would need to invest approximately \$6.3 million of public funds in the public garage and the balance, \$12.6 million, of the cost would be funded by the private sector for public parking.

Test Case C allows for a stand alone garage to be constructed on Plaza 7 plus public parking spaces on Plazas 1/2/3 as a component of the private development also on Plazas 1/2/3. Total public spaces are 712 (200 net new). Test Case C allows for phasing of the private development on Plazas 1/2/3 with 188,000 sq.ft. At completion, the private investment is estimated to be \$120.1 million. The stand alone garage on Plaza 7 would be constructed in the initial phase. In our judgment, the City would need to invest approximately \$4.7 million of public funds and the private sector would fund \$18.9 million.

Real Estate Development Opportunity

Prior to the private sector committing substantial resources to pursue tenants and financing, the development team would seek an exclusive right to the development opportunity, City approval of entitlements, and an agreement on how the purchase and sale agreement or ground lease would be structured. During this process, the project definition and financial feasibility would be refined. The attached tables are presented to assess the initial feasibility on a conceptual level of the private sector Test Cases presented in this analysis. In all cases, it is assumed that private sector would fund the agreed upon public garage upfront.

This investment analysis focuses on office development as the primary land use (there could also be a limited ground floor retail component, too). A key input in the financial analysis is the conclusion that strength of the Los Altos location can attract office tenants paying rents averaging \$5.50 (net) per sq.ft. per month. The strong rent projection enables the private sector to support an investment in the office and construct public parking garages. As stated above, the rent projection reflects the long term intrinsic real

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estate value of property in Los Altos and independent research by Ted Kokernak that new Class A office space development that is well designed and adequately parked to attract strong tenants could achieve an average rent in downtown Los Altos in the range of \$5.50 per month, net.

The analysis is based on the private sector seeking an annual return on its investment of approximately 9% per year. We believe that this level of return is sufficient to attract financing and creates sufficient spread between the value supported by the capitalization rate and project cost.

Local real estate professionals also indicate that there could be a good opportunity to develop a mixed use configuration with office, retail and residential at this location. Going forward, residential condominiums should also be evaluated. Despite the current economic downturn, we believe that with the return of more normal market conditions in the future, residential could be an attractive test case.

**PUBLIC PARKING STRATEGY
PUBLIC / PRIVATE PARTNERSHIP
LOS ALTOS, CA**

CONCEPTUAL PRO FORMAS
June 30, 2009

TEST CASE A

PUBLIC GARAGE

600 Spaces Subterranean Garage
On Plaza 1/2/3

PRIVATE DEVELOPMENT

Rentable Area
Parking Subterranean

200,000 Sq.Ft. On Plazas 1/2/3
660 Spaces 3.3/1000

I. PUBLIC GARAGE / PRIVATELY FUNDED

			Est. Cost	PSF Rentable
Construction Cost	600	\$45,000	\$27,000,000	\$135
(Less) City of Los Altos Funding	140	\$45,000	(\$6,300,000)	
Private Funding of Public Garage	460		\$20,700,000	\$104

II. CONSTRUCTION COSTS / PRIVATE

Construction				
Shell	200,000		\$40,000,000	\$200
Private Parking - Subterranean	660	\$45,000	\$29,700,000	\$149
Tenant Improvement	200,000		\$8,000,000	\$40
Contingency	200,000		\$4,000,000	\$20
			\$81,700,000	\$409
Indirect Costs	200,000		\$18,000,000	\$90
Design, prof fees, gov'tal fees, leasing, etc.				
Construction Lender	200,000		\$12,000,000	\$60
Total Private Funding			\$132,400,000	\$662

III. NET INCOME

Rent - Office Space	200,000	\$5.50	\$13,200,000	
<Less> Vacancy		5%	(\$660,000)	
			\$12,540,000	
(Less) Management		3%	(\$376,000)	
(Less) Reserves - Structural		\$0.15	(\$30,000)	
(Less) TI & Leasing Commissions		\$1.20	(\$240,000)	
Total Expenses			(\$646,000)	
Net Income			\$11,894,000	

IV. ANNUAL RETURN ON COST
(NOI / Total Private Cost)

9.0%

**PUBLIC PARKING STRATEGY
PUBLIC / PRIVATE PARTNERSHIP
LOS ALTOS, CA**

CONCEPTUAL PRO FORMAS
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TEST CASE B

PUBLIC GARAGE

600 Spaces Stand Alone Garage
On Plaza 2

PRIVATE DEVELOPMENT

Rentable Area
Parking Subterranean

124,000 Sq.Ft. On Plazas 1/3
409 Spaces 3.3/1000

I. PUBLIC GARAGE / PRIVATELY FUNDED

Construction Cost

			Est. Cost	PSF Rentable
600	\$31,500		\$18,900,000	\$152
200	\$31,500		(\$6,300,000)	
400			\$12,600,000	\$102

(Less) City of Los Altos Funding

Private Funding of Public Garage

II. CONSTRUCTION COSTS / PRIVATE

Construction

Shell

124,000 \$24,800,000 \$200

Private Parking - Subterranean

409 \$45,000 \$18,414,000 \$149

Tenant Improvement

124,000 \$4,960,000 \$40

Contingency

124,000 \$2,480,000 \$20

\$50,654,000 \$409

Indirect Costs

124,000 \$11,160,000 \$90

Design, prof fees, gov'tal fees, leasing, etc.

Construction Lender

124,000 \$4,960,000 \$40

Total Private Funding

\$79,374,000 \$640

III. NET INCOME

Rent - Office Space

124,000 \$5.50 \$8,184,000

<Less> Vacancy

5% (\$409,200)

\$7,774,800

(Less) Management

3% (\$233,000)

(Less) Reserves - Structural

\$0.15 (\$18,600)

(Less) TI & Leasing Commissions

\$1.20 (\$148,800)

Total Expenses

(\$400,400)

Net Income

\$7,374,400

IV. ANNUAL RETURN ON COST

(NOI / Total Private Cost)

9.3%

**PUBLIC PARKING STRATEGY
PUBLIC / PRIVATE PARTNERSHIP
LOS ALTOS, CA**

CONCEPTUAL PRO FORMAS
June 30, 2009

TEST CASE C

PUBLIC GARAGE

712 Spaces Stand Alone Garage
On Plaza 7 and
Parking on Plazas 1/2/3

PRIVATE DEVELOPMENT

Rentable Area
Parking Subterranean

188,000 Sq.Ft. On Plazas 1/2/3
620 Spaces 3.3/1000

I. PUBLIC GARAGE / PRIVATELY FUNDED

Construction Cost
(Less) City of Los Altos Funding
Private Funding of Public Garage

			PSF
		Est. Cost	Rentable
712	\$33,146	\$23,600,000	\$126
		<u>(\$4,700,000)</u>	
		\$18,900,000	\$101

II. CONSTRUCTION COSTS / PRIVATE

Construction
Shell
Private Parking - Subterranean
Tenant Improvement
Contingency

Indirect Costs
Design, prof fees, gov'tal fees, leasing, etc.

Construction Lender

Total Private Funding

188,000		\$37,600,000	\$200
620	\$45,000	\$27,918,000	\$149
188,000		\$7,520,000	\$40
188,000		<u>\$3,760,000</u>	<u>\$20</u>
		\$76,798,000	\$409
188,000		\$16,920,000	\$90
188,000		<u>\$7,520,000</u>	<u>\$40</u>
		\$120,138,000	\$639

III. NET INCOME

Rent - Office Space
<Less> Vacancy

(Less) Management
(Less) Reserves - Structural
(Less) TI & Leasing Commissions
Total Expenses

Net Income

188,000	\$5.50	\$12,408,000	
	5%	<u>(\$620,400)</u>	
		\$11,787,600	
	3%	<u>(\$354,000)</u>	
	\$0.15	<u>(\$28,200)</u>	
	\$1.20	<u>(\$225,600)</u>	
		(\$607,800)	
		\$11,179,800	

IV. ANNUAL RETURN ON COST
(NOI / Total Private Cost)

9.3%