KEYSER MARSTON ASSOCIATES

ADVISORS IN PUBLIC/PRIVATE REAL ESTATE DEVELOPMENT

MEMORANDUM

To: Talyn Mirzakhanian, City Planner
City of Calabasas

From: Julie Romey

Date: December 27, 2007

Subject: 4803 El Canon Avenue - Financial Gap Analysis

At your request, Keyser Marston Associates, Inc. (KMA) reviewed the December 17, 2007 proposal submitted by Thomas Safran & Associates (Developer). The Developer proposes to develop the 0.97-acre property located at 4803 El Canon Avenue (Site) with a 75-unit apartment complex targeted to low and very-low income senior citizens (Project). The purpose of the KMA analysis is to evaluate the estimated financial gap associated with the proposed Project.

EXECUTIVE SUMMARY

The Project includes 75 apartment units, 3,000 square feet of community and office space and 76 subterranean parking spaces. The Project is to be geared towards senior citizens (ages 55 and older). Fifty-two (52) of the units will be provided to very-low income households, while 22 units will be restricted to low income households and one unit will be provided to an on-site manager.

The primary funding sources for the Project are proposed to include:

1. A conventional permanent loan;
2. The federal Low Income Housing Tax Credits (Tax Credits) that are competitively awarded by the California Tax Credit Allocation Committee (TCAC);
3. The State of California (State) Infill Incentive Grant Program funds that will be competitively awarded from Proposition 1C funds;

4. A County of Los Angeles (County) HOME loan;

5. A grant from the Federal Home Loan Bank's Affordable Housing Program (AHP Grant); and

6. City of Calabasas (City) housing trust funds.

The following summarizes the results of the KMA analysis:

1. KMA estimated that the proposed Project has a $1.17 million financial gap, while the Developer is requesting $750,000 in financial assistance. Therefore, it is concluded that the Developer's request is warranted.

2. The following summarizes the outstanding issues identified by KMA:

    a. None of the funding sources have been awarded to the Project.

    b. The position of the proposed City loan is unclear.

    c. The timing of the City assistance is unclear.

3. There is a significant risk that one if not all of the proposed funding sources will not be awarded to the Project. Therefore, it is recommended that the City provide the Developer with $750,000, contingent upon the Project receiving the other proposed funding sources, in exchange for a residual receipts loan. The following describes the proposed terms of the residual receipts loan:

    a. The City would receive 50% of the residual receipts after the payment of the debt service payments, and partnership and asset management fees.

    b. The City loan should have a 3.0% simple interest rate applied.

    c. The present value of the projected residual receipts payments to the City is $322,000.

    d. The ending loan balance in Year 55 is estimated to total $8.36 million.

BACKGROUND STATEMENT

The Site is currently improved with an abandoned primary residential structure, two secondary residential structures and an empty above-ground pool. The scope of development being proposed can be described as follows:

1. The Project includes 75 units, which equates to a density of 77 units per acre.

2. The proposed unit mix according to the pro forma is as follows:

	Number of Units	Unit Size (Sf)
One-bedroom Units	74	560
Two-bedroom Units	1	1,150
Totals/Averages	75	

3. The Site is zoned Commercial, Old Town (CT) and designated in the General Plan as Business-Old Town (B-OT). By providing affordable housing, the Project is eligible for a density bonus to allow a 35% increase over the 1.0 maximum FAR. Thus the maximum allowable FAR is 1.35. The proposed Project anticipates a 1.25 FAR, which is below the maximum.

4. The 52,843 square feet of gross building area (GBA) located in two three-story buildings includes the following:

   a. Residential living area totaling 42,590 square feet;

   b. Community room and office space totaling 3,000 square feet; and

   c. Total building circulation totaling 7,253 square feet.

5. The 75 apartment units will be subject to the following income and affordability restrictions:

   a. Fifty-two (52) one-bedroom units will be restricted to very-low income households;

   b. Twenty-two (22) one-bedroom units will be restricted low income households; and

   c. One two-bedroom unit will be provided to an on-site manager. For Tax Credit purposes, the unit will be treated as a low income Tax Credit unit.

6. The Project will be served by one level of subterranean parking that will include the following:

Standard Spaces	74
Handicap Spaces	2
Bicycle Spaces	83

In addition to a request of $750,000 in financial assistance from the City, the Developer is also requesting the following changes to Chapter 17.22 of the City's Municipal Code (Code):

1. An increase in close on the subterranean garage ramp to 20% from the 8% maximum allowed by Code;

2. A decrease in pervious surface provided from the 28% minimum required by Code to 22%; and

3. A decrease in common open space provided from the 20,000 square foot minimum required by Code to 21,304 square feet, and the private open space to 60 square feet per unit from 150 square feet per two-bedroom units and 75 square feet per one-bedroom units as required by Code.

KMA prepared a pro forma analysis to assist in the evaluation of the Developer's proposal. The analysis is located at the end of this memorandum and is organized as follows:

Table 1:	Estimated Development Costs
Table 2:	Stabilized Net Operating Income
Table 3:	Financial Gap Calculation
Table 4:	Cash Flow Analysis

FINANCIAL GAP ANALYSIS

Estimated Development Costs (Table 1)

KMA reviewed the Developer's development cost estimates, and then independently prepared a pro forma analysis for the Project. The Developer anticipates that the Project will be subject to the prevailing wage requirements imposed by the State, and the direct construction cost estimates reflect this assumption. The land assemblage costs and direct construction cost estimates are based on the Developer's estimates, while the indirect and financing costs have been independently estimated by KMA. The resulting development costs are estimated as follows:

Land Assemblage Costs

The Developer purchased the Site in May 2007 for $3.00 million, or $71 per square foot of land area. The Site was appraised by RYMAR Appraisal Services Inc. at $3.135 million, or $75 per square foot of land area on May 10, 2007. According to the Purchase and Sale Agreement, the Developer provided a $100,000 cash deposit in February 2007 and a $2.90 million Century Housing acquisition loan (Acquisition Loan) at losing. The terms of the Acquisition Loan are as follows:

1. A two-year term; and

2. An 8.25% interest rate.

It should be noted that the Developer has not included the $100,000 deposit in the development cost estimate. Therefore, for purposes of this analysis, the acquisition costs total $2.90 million, or $69 per square foot of land area.

Direct Costs

Based on the assumption that the Project will be subject to prevailing wage requirements, KMA found the base construction cost estimates prepared by the Developer to fall within the appropriate range for the proposed scope of development. The direct costs applied in the analysis can be summarized as follows:

1. The off-site improvements are estimated to cost $250,000 and will include improvements to the cul-de-sac. City staff should verify the Developer's scope and cost estimate.

2. The on-site improvements are estimated to cost $1.42 million. This allowance equals $34 per square foot of land area.

3. The Site is located within a liquefaction zone and will require extraordinary soil improvements to be made. The Developer's contractor estimates that these costs will total $500,000.

4. The building shell costs are estimated as follows:

    a. The residential and community room shell costs are estimated at $130 per square foot of GBA.

    b. The Developer anticipates that the City will require an additional $1.06 million in landscaping, amenities and architecture upgrades, which will increase the construction costs by approximately $20 per square foot of GBA.

5. A $100,000 allowance is provided for common area furnishings and models.

6. The Developer provided a $1.79 million allowance for contractor's fees, general requirements and construction management, which is slightly higher than the

maximum allowed by TCAC at 14% threshold and estimated the contractor fees to total $1.77 million, or a $14,000 differential.

7. The Developer did not provide an estimate for construction bonds. KMA estimated these costs at $126,000, or 1% of construction costs.

8. A 5% contingency allowance is provided.

The direct costs are estimated by KMA to total $15.33 million, or $290 per square foot of GBA. There is a $165,000 difference between the KMA and Developer estimates of total direct costs, which is considered to be insignificant for a project of this magnitude.

Indirect Costs

KMA utilized the following assumptions for estimating the indirect costs:

1. The architecture, engineering and consulting fees are estimated at 6% of direct costs.

2. The Developer estimated the public permit and fees to be $10,187 per unit. City staff should verify the accuracy of this estimate.

3. The taxes, legal and accounting costs are set at 1.5% of direct costs.

4. The Developer estimated the insurance costs at $670 per square foot of GBA.

5. Marketing and leasing costs are estimated at $800 per unit as estimated by the Developer.

6. The Developer Fee is set at $1.33 million, or 7% of the Project's eligible cost basis. This amount is lower than the maximum Developer Fee of 15% as allowed by the Tax Credit guidelines.

7. A $168,000 soft cost contingency allowance has been provided.

KMA estimates the indirect costs to total $3.52 million, which is $7,000 lower than the Developer's estimate. This difference is also considered to be insignificant for a project of this size.

Financing Costs

KMA utilized the following assumptions for estimating the financing costs:

1. The capitalized reserves were estimated as follows:

    a. The operating capitalized reserves are based on three months of operating expenses and debt service payment.

    b. The replacement reserves are set at $300 per unit.

2. KMA estimated the Tax Credit costs as follows:

    a. A $2,000 application fee;

    b. A $410 per unit monitoring fee; and

    c. Four percent (4%) of the gross Tax Credit proceeds for one year.

3. The interest on the construction loan during the development period is estimated as follows:

    a. A construction loan of $12.61 million;

    b. An 8.0% interest rate;

    c. An 18-month construction period; and

    d. A 60% average outstanding balance.

4. The holding costs in relation to the acquisition of the Site are based on the Developer's current $2.90 million loan with Century Housing, which has an 8.25% interest rate. It is assumed that the Acquisition loan will be outstanding for 34 months.

5. Loan origination fees are estimated at 1.50 points for the construction loan and 2.0 points for the permanent loan.

KMA estimates the financing costs to total $2.31 million, which is $131,000 lower than the Developer's estimate.

Total Estimated Development Costs

As shown in Table 1, KMA estimated the total development costs at $24.07 million, or $455 per square foot of GBA. This estimate is approximately $27,000 higher than the Developer's $24.04 million estimate. While the KMA and Developer estimates vary on a line-by-line basis, the net difference is less than 1% and is considered to be inconsequential for a project of this magnitude.

Stabilized Net Operating Income (Table 2)

Income and Affordability Restrictions

The Developer is proposing to set-aside 69% of the units for very-low income households and 31% of the units for low income households, inclusive of one manager's unit. The rents for these units must comply with the affordability standards imposed by the Tax Credit program as well as the requirements imposed by the other proposed funding sources, in particular, the federal HOME program.

The Developer is proposing to set-aside units for the following income group:

1. The 52 very-low income units will have the following income restrictions:

   a. Seven (7) units will be restricted to 30% of the 2007 Los Angeles County median income (Median) rents in compliance with the requirements imposed by TCAC.

   b. Seven (7) units will be restricted to 40% of the Median rents in compliance with the requirements imposed by TCAC.

   c. Thirty-eight (38) units will be restricted to 50% of the Median rents in compliance with the requirements imposed by TCAC.

2. The 22 low income units will be restricted to 60% of the Median rents in compliance with the requirements imposed by TCAC.

3. One two-bedroom unit will be used as an on-site manager's unit and will not generate rental income. This unit will be treated as a low income Tax Credit unit.

The appropriate monthly utility allowances for the units must be deducted from the defined affordable housing cost to reach the allowable rents. The monthly utility allowances currently being applied in Los Angeles County are:

	Monthly Utility Allowances
One-bedroom Units	$75
Two-bedroom Units	$88

The following summarizes the rents applied in the analysis:

	Monthly One-bedroom Unit Rents
30% Median	$341
40% Median	$480
50% Median	$618
60% Median	$757

Net Operating Income

KMA and the Developer estimated the Project's gross income at approximately $562,000, which includes laundry and miscellaneous income averaging $13 per unit per month. When a 5% vacancy and collection allowance is deducted, the effective gross income (EGI) totals $534,500.

KMA and the Developer estimated the operating expenses as follows:

1. The general operating expenses are estimated at $3,267 per unit.

2. The Developer has indicated that the Project will be entitled to receive the property tax abatement that is accorded to non-profit housing organizations that own income restricted rental units. Also, the Developer assumed that the Project will incur no property tax assessment override expenses.

3. The social services provision costs are estimated at approximately $10,000 per year. The proposed scope of social services to be provided has not yet been defined.

4. The annual capital replacement reserve deposit is estimated at $300 per unit per year.

As shown in Table 2, the residential operating expenses are estimated to total $277,500. When the Project's EGI is reduced by the operating expenses, the stabilized net operating income (NOI) is estimated at $257,000.

Financial Gap Calculation (Table 3)

The following summarizes the proposed funding sources for the Project:

Supportable Debt

To estimate the maximum conventional permanent loan that can be supported by the Project, the Developer assumed that the loan would be underwritten at a 115% debt coverage ratio, a 7.00% interest rate (7.67% mortgage constant), and a 35-year amortization period. The resulting supportable debt, based on the $257,000 stabilized NOI, is estimated at $2.91 million.

Tax Credit Proceeds

<u>Tax Credit Basis</u>

It can be assumed that the Project's eligible Tax Credit basis is equal to the lesser of the depreciable costs for the 75 Tax Credit units, or the basis limits established by TCAC. The eligible Tax Credit basis is calculated as follows:

1. The Project's depreciable costs total $20.57 million.

2. The threshold basis limits applied by TCAC equal $14.53 million.

3. The eligible Tax Credit basis is set at the threshold basis limit of $14.53 million. However, the Developer, in order to submit a competitive Tax Credit application, will lower the eligible Tax Credit basis by an additional $2.80 million, which results in an eligible Tax Credit basis of $11.73 million.

<u>Net Tax Credit Proceeds</u>

The Developer plans to apply for Tax Credits in the July 2008 round. KMA estimated the net Tax Credit proceeds as follows:

1. The gross Tax Credit amount supported by the proposed Project is estimated to total $12.10 million based on the following assumptions:

   a. The Project is located in a designated "Difficult to Develop" census tract. This allows the eligible Tax Credit basis to be increased by 30%.

   b. The current Tax Credit application sets the annual Tax Credit rate at 8.10%. This rate is applied over the 10-year Tax Credit period.

2. The net syndication value supported by the Tax Credit is ultimately determined based on competitive market conditions and on the timing of the disbursements. Based on the Developer's assumptions that 33% of the proceeds will be funded at completion of construction, KMA estimated the proceeds at $0.95 per gross Tax Credit dollar.[1]

The Developer set the Tax Credit rate at 8.12%, and the Tax Credit proceeds at $0.98 per gross Tax Credit dollar. Based on these assumptions, and gross Tax Credits of $12.13 million, the Developer estimated the net Tax Credit proceeds at $11.89 million. This estimate is $393,000 higher than the KMA estimate of $11.50 million.

County HOME Loan

The Developer anticipates that the Project will be awarded $3.60 million in HOME funds from the County, which equates to $48,000 per unit. However, the next Notice of Funding Application (NOFA) for these funds is to be released in January 2008. Therefore, it is uncertain whether the County will change the parameters that will enable this Project to be competitive.

Proposition 1C Funds

The State has recently announced how the Proposition 1C funds will be distributed. As such, the State plans to make approximately $240 million available to affordable housing projects for infrastructure improvements to facilitate new infill housing developments (Infill Incentive Grant Program). These funds may be used for land assemblage and ground improvements. While the Developer anticipates this Project to be eligible for the program, the NOFA will not be released until sometime during the first quarter of 2008. The first round is expected to be competitive with awards announced in June 2008. The Developer proposes to request $4.48 million, or $59,700 per unit from the State.

AHP Grant

Once the other funding sources are in place, the Developer plans to apply for a $405,000 AHP Grant, which equates to $5,400 per unit. As such, it is anticipated that the application will be submitted during the fourth quarter of 2008.

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[1] Over the past year, projects have received over $1.00 per Tax Credit dollar from investors. However, there has been a significant change recently in the market. To provide for a conservative projection, KMA set the rate at $0.95 per $1.00. This is likely to be sustainable into the future.

Total Potential Funding Sources

KMA estimated the potential funding sources to total $22.90 million. This estimate is $393,000 lower than the Developer's estimate of $23.29 million due to KMA's more conservative estimate of Tax Credit proceeds.

Financial Gap Calculation (Table 3)

The Project's financial gap is equal to the difference between the potential funding sources, and the estimated development costs for the Project. Both KMA and the Developer's calculations are presented in the following table:

	KMA	Developer	Difference
Total Development Costs	$24,069,000	$24,042,000	$27,000
(Less) Potential Funding Sources	(22,899,000)	(23,292,000)	393,000
Financial Gap	$1,170,000	$750,000	$420,000
Per Unit	$16,000	$10,000	$6,000

CASH FLOW ANALYSIS (TABLE 4)

KMA assumed that the City assistance totaling up to $750,000, as requested by the Developer, will be provided to the Project in the form of a residual receipts loan that carries a 3% simple interest rate. To estimate the present value of the loan repayment that may be produced, KMA prepared a cash flow projection for the Project. The following describes the basic assumptions applied in the cash flow projection:

1. Year 1 is based on the pro forma rent and expense assumptions presented in the stabilized NOI analysis (Table 2).

2. The restricted rents and miscellaneous income are increased by 2.5% per year.

3. A 5% vacancy and collection allowance is provided.

4. The general operating expenses are increased at 3.5% per year.

5. The replacement reserve deposits remain flat over the 55-year cash flow period.

6. The debt service for the conventional loan is estimated at $234,909 annually over a 35-year term.

7. Asset management and partnership fees are assumed to total $15,000 per year over the 55-year period. If cash flow is insufficient to fund these expenses, it is

assumed that the unpaid amounts will be accrued and repaid as funds become available.

8. The following illustrates the assumed residual receipts distribution:

   a. Fifty percent (50%) of the residual receipts are applied to the City loan; and

   b. The remaining 50% of the residual receipts will be allocated to the Developer.

The following summarizes the results of the KMA cash flow analysis:

1. The payments to the City over the 55-year loan term are estimated to have a present value of $322,000, assuming a 10% discount rate.

2. The outstanding principal and interest balance of the City loan is projected at $8.36 million in Year 55.

CONCLUSIONS

The following summarizes the findings of the KMA analysis:

1. The Developer's request of $750,000 in financial assistance is warranted.

2. The total warranted financial assistance will increase or decrease on a dollar for dollar basis if the following occurs:

   a. There is a change in the anticipated Tax Credit proceeds; and

   b. The Project is not awarded Tax Credits, Proposition 1C funds, County HOME loan funds or an AHP grant.

3. The present value of the residual receipts payments over the 55-year City loan term is estimated at $322,000.

4. None of the potential funding sources are secured; therefore, the proposed Project will require additional financial assistance if any of the proposed funding sources are not awarded to the Project.