E KMA Memorandum

KEYSER MARSTON ASSOCIATES
ADVISORS IN PUBLIC/PRIVATE REAL ESTATE DEVELOPMENT

MEMORANDUM

To: Conal McNamara, Director of Community Development
City of Whittier

From: James Rabe, CRE

cc: Yolanda M. Summerhill, Esq.
Margit Allen

Date: January 16, 2015

Subject; Peer Review – Fred C. Nelles Facility Analyses

At your request Keyser Marston Associates, Inc. (KMA) has reviewed a number of documents and analyses related to the proposed development at the former Fred C. Nelles Youth Correctional Facility (Nelles). Analyses and/or documents reviewed include:

- Fiscal analyses prepared by David Taussig & Associates, Inc. (DTA)
- Reuse Feasibility Study prepared by Economic & Planning Systems, Inc. (EPS)

With respect to the Reuse Feasibility Study, KMA was retained by the City of Whittier (City) to perform two functions:

1) Perform a peer review of the financial feasibility study methodology (August 2014), and its Addendum (December 2014) prepared by EPS related to historical structures within the closed Nelles facility as part of Brookfield's proposed Lincoln Specific Plan project; and

2) Preparation of an independent analysis of the financial feasibility of retaining the base case and additional historical structures for historic preservation and adaptive reuse within the Lincoln project, using the same scenarios as in the EPS Addendum dated December 2014. The scenarios analyzed a base case with retention of the two original buildings (Administration Building and Superintendent's Residence), a scenario which added the two additional buildings required by the project EIR's mitigation (the Chapels Building and

Assistant Superintendent's Residence), and additional scenarios which incrementally added buildings. This analysis evaluated the following:

- Cost to bring the historic buildings up to code, based on accepted and peer-reviewed cost analysis prepared by Spectra as part of the August 2014 Reuse Feasibility Study prepared by EPS.
- Comparison of cost with new construction costs and evaluation of supportable rent/lease values based on Whittier data.
- Evaluation of Brookfield's likely return on investment based on KMA's analysis of value, infrastructure cost, and lost development opportunity, resulting in an estimate of return on investment for a land development project for each scenario.

KMA's review and analysis of the above topics addressed the methodologies employed, underlying assumptions and computations. In undertaking this review, KMA relied upon its experience in the industry, project data in its files, published information, and discussions with the City, developer and other consultants.

SUMMARY

KMA has reviewed both the fiscal analyses prepared by DTA for the proposed Project and the historic reuse analysis prepared by EPS. With respect to the fiscal analysis, DTA has used the standard methodology that fiscal consultants use for this type of project. The assumptions, and revenue and expense factors that they used are reasonable.

With respect to the EPS analysis, the approach and methodology used by EPS is reasonable and acceptable. KMA has used the costs and values from the EPS report in its analysis.

The typical benchmark for a land development project is a 20% to 25% internal rate of return (IRR) and a 35% to 50% profit margin. Under certain circumstances, some projects will go forward at significantly lower returns. This below market, minimally acceptable return threshold is estimated to be a 15% profit margin or 20% return on cost.

The Baseline project including the preservation and reuse of two buildings exceed these thresholds. Alternative 1 with the preservation and reuse of two additional buildings somewhat exceeds the profit margin threshold, but is somewhat below the return on cost threshold. This Alternative might be considered feasible. The remaining Alternatives fall

significantly below the minimum thresholds and are not considered economically feasible.

FISCAL ANALYSIS

KMA reviewed draft versions of the fiscal analyses in August and September 2014.

The methodology and approach used by DTA is the standard methodology used by other fiscal impact consultants for projects such as the Nelles Project. The key assumptions related to property tax and sales tax generation are reasonable. The methodology for the allocation of other revenues is reasonable. The allocation methodology for City expenses is reasonable.

EPS REPORT

KMA reviewed the various reports prepared by EPS related to costs to preserve and to restore several existing buildings on the Nelles site, and the value to a developer of retaining the buildings. The general approach used by EPS to (1) estimate the rehabilitation and restoration costs and (2) compare that to the value of the restored buildings is acceptable. EPS's approach to the loss in development value and their discussion of rates of return is acceptable. KMA, however, would approach the rates of return and loss of development value somewhat differently as explained below.

Project Rates of Return

KMA's experience with land development projects and land developers, and information from reports indicates that the typical feasibility requirement for a residential land development project is an unleveraged, internal rate of return between 20% and 25%. An unleveraged rate of return excludes consideration of financing.

The IRR is not the same thing as a profit margin or a return on cost. The profit margin is usually expressed as a percentage of the sale price. Return on cost represents the profit as a percentage of project costs. So if something sells for $100 and the profit is $10 and the costs are $90, then the profit margin is 10% (10 divided by 100) and the return on cost is 11.1% (10 divided by 90).

Land development projects normally take a number of years to complete, anywhere from say, five years to 20 years. This project is at the lower end of that range. Even with the short duration, the profit associated with a 20% to 25% internal rate of return requirement is substantially above 20% to 25%. The profit margin associated with a 20% to 25% internal rate of return could be, say 35% to 50% of sale proceeds.

While the market rate of return is an IRR in the 20% to 25% range, under certain circumstances some developers may elect to go forward with little as a 10% projected IRR. KMA would characterize this as a below market, minimally acceptable return. In terms of profit margin and return on cost, this below market, minimally acceptable internal rate of return could be associated with a below market, minimally acceptable profit margin of 15% and a return on cost of 20%.

KMA is using this below market, minimally acceptable return in this review analysis.

Lost Development Value

The restoration of buildings at this site can affect development value in two ways. First, if the building is on land that is designated for residential use then the number of units that can be developed is reduced, which reduces the amount that a buyer will pay for the property. Further, to the extent that the restored buildings are used for commercial use, it reduces the amount of new commercial development that is available, also reducing the price that a commercial developer is willing to pay.[1]

REUSE FEASIBILITY

Land Sales Revenue and Profit

KMA has estimated land sale revenues from a combination of sources, including information received in the fiscal analysis review, information received in the evaluation of residential and commercial projects in Southern California and comparable sale information for the Whittier area. The land sale estimate is provided in Table 1.

The largest part of the revenues for the project is the for sale residential component. The fiscal analysis contemplates 454 for sale units. From the fiscal analysis, the projected sales revenue from the units is $222,424,000. KMA estimates that the finished lot cost for the single- family detached units represents 44% of sale price, and for the attached row house units, the ratio is 38%. The estimated finished lot value is $89,871,800.

Based on the specific plan information incorporated into the fiscal analysis, the Project will have 296 multi-family units. Reviewing comparable sales and other multi-family

[1] In the EPS analysis, the value of the restored buildings is computed to offset the costs of restoration. Their analysis would generate the same results had they shown the building values as land revenue.

projects, KMA estimates the finished lot price for the apartment component to be $65,000 per unit. The value of the apartment area is estimated at $19,240,000.

According the site plan information, the commercial parcel is 19.7 acres with 208,350 square feet of development potential. For a site at this location that has the potential for development of 208,350 square feet of commercial space including the two restored buildings, a developer might pay $15,446,400 or $18.00 per square foot for the 19.7 acre site. The purchase amount is slightly less than $75 per building square foot.

As shown in Table 1, the estimated finished lot value is approximately $124,558,200. Brookfield and EPS provided KMA with a current estimate of costs to complete the land development project. The cost estimate is consistent with the land development cost estimate that KMA reviewed in 2011 and includes approximately $3,800,000 for renovation of the Administration Building and the Superintendent's Residence. In reviewing the current estimate with Brookfield, Brookfield indicated that the land acquisition costs do not include a parcel of land that is located in the eastern portion of the commercial site. KMA has included an allowance for the purchase of that parcel for an overall land development cost estimate of $102,087,000.

Based on the above, the land development profit is estimated at $22,471,400, as shown in Table 1. This represents the Baseline Alternative, which includes the restoration of the Administration Building and the Superintendent's Residence. The profit margin is 18.0% and the return on cost is 22.0%. These returns are significantly below market, but are above a minimum acceptable return for certain developers in certain cases.

Restoration Costs and Lost Development Opportunity

KMA has reviewed the EPS estimates for building restoration costs, new construction costs and building valuation. It is KMA's understanding that other consultants have reviewed the restoration costs and have found the costs contained in the EPS report to be reasonable. EPS's estimates of new construction costs based on RS Means data and Craftsman National Building Cost Manual data are also reasonable. EPS's estimates of indirect costs are also reasonable.

With respect to completed building valuation, KMA believes that the EPS estimates are at the upper end of market. Individual buildings may achieve the values used by EPS, but it seems unlikely that all of the buildings will achieve top of market values. In addition, it has been KMA's experience that the first tenants in historic buildings usually require a reduced rent for some or all of the initial term. To be conservative, KMA is using the EPS values in its analysis.

As discussed above, the restoration of the existing buildings reduces the new commercial space that can be developed. In addition, the buildings are located in areas that reduce the amount of residential units that can be constructed. In its analysis, KMA examined the location of the buildings, the site area they occupy (as determined in the EPS report), and then estimates the number of residential units eliminated and the reduction in commercial space that can be developed.

The computations of the net cost to the land development project of each of the six additional historic structures are shown in Table 2.

Building Restoration Cost

The "Re-use Subsidy with Tax Credits" column is taken from the EPS study. For this analysis, the Re-use Subsidy for the Assistant Superintendent's residence is based on the building being used for a commercial use rather than a residential use.

If all buildings are preserved, the cost is $7,300,600.

Lost Residential Development Potential

The location of three of the buildings (Maintenance building, Auditorium and Infirmary) are in locations that will reduce the number of residential units that can be developed. The area allocated to the Maintenance Building is projected to displace 16 apartment units and the Auditorium 24 apartment units. The land related to the apartment units is valued at $65,000 per unit. The lost residential development opportunity associated with these two buildings is $1,040,000 for the Maintenance Building and $1,560,000 for the Auditorium. The Infirmary is located in the area slated for row house development. The area allocated for the Infirmary will eliminate 18 for sale units. The row house units have a finished lot value of $162,700, so the residential development loss is $2,928,600.

If all of the buildings are preserved, the residential land development loss is $5,528,600.

Lost Commercial Development Potential

All of the buildings except the Chapel reduce the commercial development potential. The Chapel is located in a park area and it is KMA's understanding that this is a public building and will not count against the commercial development potential.

For the remaining buildings, their commercial square footage takes away from the potential for new commercial development. The commercial land is valued at $75 per building square foot. The lost commercial value ranges from $118,000 for the Assistant Superintendent's residence to $847,000 for the Maintenance Building.

If all buildings are preserved, the commercial development loss is $2,548,125.

Inclusion of Additional Structures

There are six additional structures on the Nelles site that are being considered for historic restoration. The six structures are discussed in detail in the EPS reports. The EPS reports consider the six buildings, and include a number of alternatives for preservation. For simplicity, this analysis uses the same alternative structure, as set out below.

Baseline (Specific Plan):	Administration Building Superintendent's Residence
Alternative 1: (Baseline + 2 buildings)	Administration Building Superintendent's Residence Chapels (mitigation) Assistant Superintendent's Residence (mitigation)
Alternative 2a: (Baseline + 3 buildings)	Administration Building Superintendent's Residence Chapels (mitigation) Assistant Superintendent's Residence (mitigation) Gymnasium
Alternative 2b: (Baseline + 3 buildings)	Administration Building Superintendent's Residence Chapels (mitigation) Assistant Superintendent's Residence (mitigation) Auditorium
Alternative 2c: (Baseline + 3 buildings)	Administration Building Superintendent's Residence Chapels (mitigation) Assistant Superintendent's Residence (mitigation) Maintenance Garage
Alternative 2d: (Baseline + 3 buildings)	Administration Building Superintendent's Residence Chapels (mitigation) Assistant Superintendent's Residence (mitigation) Infirmary
Alternative 3: (Baseline + 4 buildings)	Administration Building Superintendent's Residence Chapels (mitigation) Assistant Superintendent's Residence (mitigation) Gymnasium + Auditorium

Alternative 4: (Baseline + 5 buildings)	Administration Building Superintendent's Residence Chapels (mitigation) Assistant Superintendent's Residence (mitigation) Gymnasium + Auditorium+ Maintenance Garage
Alternative 5: (Baseline + 6 buildings)	Administration Building Superintendent's Residence Chapels (mitigation) Assistant Superintendent's Residence (mitigation) Gymnasium + Auditorium +Maintenance Garage + Infirmary

The costs to the project associated with the various alternatives are shown in Table 3.

As discussed above, the Baseline project has a project profit of $22,471,200 which generates an 18.0% profit margin and a 22.0% return on cost. Alternative 1 which adds the Chapel and the Assistant Superintendent's residence increases cost by approximately $2.8 million and decreases the profit to $19,674,275. The profit margin falls to 15.8% and the return on cost is 19.3%. The profit margin is somewhat above the minimum threshold but the return on cost is below the minimum threshold. This alternative might be economically feasible.

The remaining alternatives substantially increase costs and reduce the profit margin and the return on cost. All of these are substantially below the minimum thresholds of a 15.0% profit margin and a 20.0% return on cost. None of these alternatives can be considered to be feasible.

Comparison to EPS Conclusions

Table 4 provides a comparison of the KMA estimates of project returns and the EPS estimates. The first difference is the computation of land development profit. KMA's estimate of land development revenues is approximately $4.3 million greater and KMA's costs are $1.1 million higher. KMA's profit estimate is approximately $3.2 million higher than the EPS estimate.

The differences in KMA costs and the EPS costs for the various alternatives is the result of the different methodology used to compute the loss of land development potential. The EPS approach used an average price approach to loss of development potential, while the KMA approach looks at the specific building locations and the use that is removed. Both approaches are valid. At this location and in this market, the residential land is significantly more valuable than is the commercial land. Thus, in most cases the KMA estimates of cost for the alternatives are higher than the EPS estimates. The higher profit estimated by KMA, however, offsets the higher costs.

While the computations are somewhat different, the KMA conclusions and the EPS conclusions are similar. The proposed Project meets a minimum threshold test. Alternatives 2 through 5 do not meet a minimum threshold test and are infeasible. KMA believes Alternative 1 might be feasible.

Attachments

TABLE 1

FINISHED / IMPROVED LOT VALUES
FRED C. NELLES SITE
WHITTIER, CALIFORNIA

For Sale Units						**TOTAL**
Sale Price[1]	$595,000	$640,700	$410,200	$443,000		$222,424,700
Finished Lot as % of Price[2]	44%	44%	38%	38%		
Finished Lot Cost	$261,800	$281,900	$155,900	$168,300		
# of Units[3]	52	91	140	171	454	
Finished Lot Value	$13,613,600	$25,652,900	$21,826,000	$28,779,300		$89,871,800
Apartments (includes perimeter road and utilities)						
Number of Units[3]	296					
Improved Lot / Unit[2]	$65,000					
Finished Lot Value	$19,240,000					$19,240,000
Commercial (includes 11,000 SF improved space and entry road)						
Land Area (acres)[3]	19.7					
Improved Value[2]	$18					
Finished Lot Value	$15,446,400					$15,446,400
Total FINISHED Lot Value						**$124,558,200**
Less Land Acquisiton and Land Development Costs						($102,087,000)
Land Development Profit						$22,471,200
Profit Margin as % of Price						18.0%
Profit Margin as % of Cost						22.0%

1 Pricing information underlying the David Taussig & Associates (DTA) Fiscal Impact Analysis

2 KMA estimate

3 Unit counts and acreage allocations from Lincoln Specific Plan and DTA Fiscal Impact Analysis

Prepared by: Keyser Marston Associates, Inc.
Filename: Nelles HRC Land Sales; 1/16/2015; jar

TABLE 2

COSTS ASSOCIATED WITH BUILDING PRESERVATION
FRED C. NELLES SITE
WHITTIER, CALIFORNIA

	Re-use Subsidy with Tax Credits[1]	Lost Residential Development Units or SF[2]	Value[3]	Lost Commercial Space Building SF[1]	Value[4]	TOTAL
Chapel	$2,364,600					$2,364,600
Gymnasium	$1,776,100			10,800	$810,000	$2,586,100
Maintenance Building	$1,597,700	16 apts	$1,040,000	11,300	$847,500	$3,485,200
Assistant Superintendents Building	$314,200			1,575	$118,125	$432,325
Auditorium	$905,500	24 apts	$1,560,000	5,700	$427,500	$2,893,000
Infirmary	$342,500	18 for sale	$2,928,600	4,600	$345,000	$3,616,100
Totals	**$7,300,600**		**$5,528,600**	**33,975**	**$2,548,125**	**$15,377,325**

1. From Reuse Feasibility Analysis prepared by EPS
2. KMA estimate based upon proposed unit developments in the Lincoln Plan
3. From Table 1, $65,000 per apartment unit and $162,700 for for sale unit.
4. Based on land cost allocation of $75 per square foot of building area.

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Filename: Nelles HRC Rehab cost; 1/16/2015; jar

TABLE 3

ALTERNATIVES RETURN COMPARISON
FRED C. NELLES SITE
WHITTIER, CALIFORNIA

		Restoration[1]	Value Loss[1]	Profit	Profit Margin	Return on Cost
Baseline	Administration Building	$0	$0			
	Superintendent's Residence	$0	$0			
		$0	$0	$22,471,200	**18.0%**	**22.0%**
Alternative 1	Baseline	$0	$0			
	Chapel	$2,364,600	$0			
	Asst. Superintendent's Residence	$314,200	$118,125			
		$2,678,800	$118,125	$19,674,275	**15.8%**	**19.3%**
Alternative 2a	Alternative 1	$2,678,800	$118,125			
	Gymnasium	$1,776,100	$810,000			
		$4,454,900	$928,125	$17,088,175	13.7%	16.7%
Alternative 2b	Alternative 1	$2,678,800	$118,125			
	Auditorium	$905,500	$1,987,500			
		$3,584,300	$2,105,625	$16,781,275	13.5%	16.4%
Alternative 2c	Alternative 1	$2,678,800	$118,125			
	Maintenace Building	$1,597,700	$1,887,500			
		$4,276,500	$2,005,625	$16,189,075	13.0%	15.9%
Alternative 2d	Alternative 1	$2,678,800	$118,125			
	Infirmery	$342,500	$3,273,600			
		$3,021,300	$3,391,725	$16,058,175	12.9%	15.7%
Alternative 3	Alternative 1	$2,678,800	$118,125			
	Gymnasium	$1,776,100	$810,000			
	Auditorium	$905,500	$1,987,500			
		$5,360,400	$2,915,625	$14,195,175	11.4%	13.9%
Alternative 4	Alternative 3	$5,360,400	$2,915,625			
	Maintenance Building	$1,597,700	$1,887,500			
		$6,958,100	$4,803,125	$10,709,975	8.6%	10.5%
Alternative 5	Alternative 4	$6,958,100	$4,803,125			
	Infirmary	$342,500	$3,273,600			
		$7,300,600	$8,076,725	$7,093,875	5.7%	6.9%

1. From Table 2

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TABLE 4

COMPARISON OF EPS AND KMA RESULTS
FRED C. NELLES SITE
WHITTIER, CALIFORNIA

		KMA Analysis[1]		EPS Analysis[2]	
			Return on Cost		Return on Cost
Land Sale Revenues		$124,558,200		$120,249,257	
Less: Land Acquisition and Development Costs		($102,087,000)		($100,961,937)	
Baseline Profit		**$22,471,200**	**22.0%**	**$19,287,320**	**19.1%**
Alternative 1	Cost	$2,796,925		$3,198,000	
	Adjusted Profit	$19,674,275	19.3%	$16,089,320	15.9%
Alternative 2a	Cost	$5,383,025		$6,146,900	
	Adjusted Profit	$17,088,175	16.7%	$13,140,420	13.0%
Alternative 2b	Cost	$5,689,925		$5,647,400	
	Adjusted Profit	$16,781,275	16.4%	$13,639,920	13.5%
Alternative 2c	Cost	$6,282,125		$5,796,000	
	Adjusted Profit	$16,189,075	15.9%	$13,491,320	13.4%
Alternative 2d	Cost	$6,413,025		$5,186,100	
	Adjusted Profit	$16,058,175	15.7%	$14,101,220	14.0%
Alternative 3	Cost	$8,276,025		$8,596,300	
	Adjusted Profit	$14,195,175	13.9%	$10,691,020	10.6%
Alternative 4	Cost	$11,761,225		$11,195,000	
	Adjusted Profit	$10,709,975	10.5%	$8,092,320	8.0%
Alternative 5	Cost	$15,377,325		$13,183,100	
	Adjusted Profit	$7,093,875	6.9%	$6,104,220	6.0%

1. From Table 3
2. From EPS Report dated December 16, 2014

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