

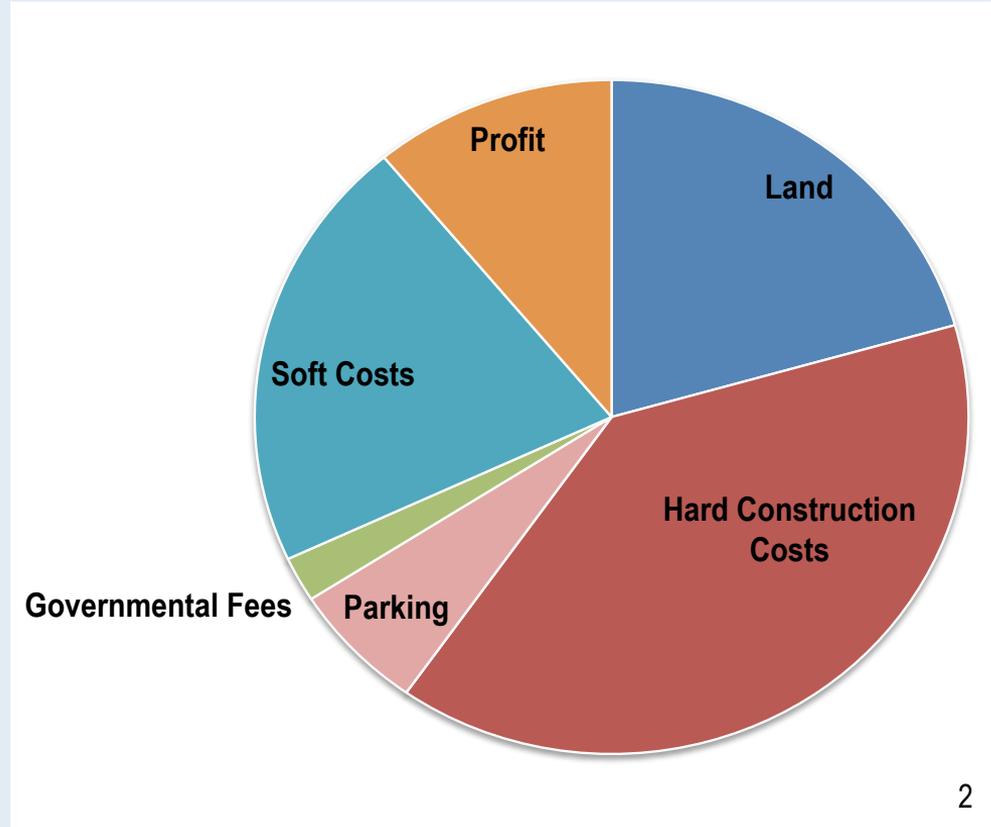
Why Does Housing Cost So Much? *(And what can we do about it?)*



SPUR
May 30, 2017

What Contributes to Development Costs?

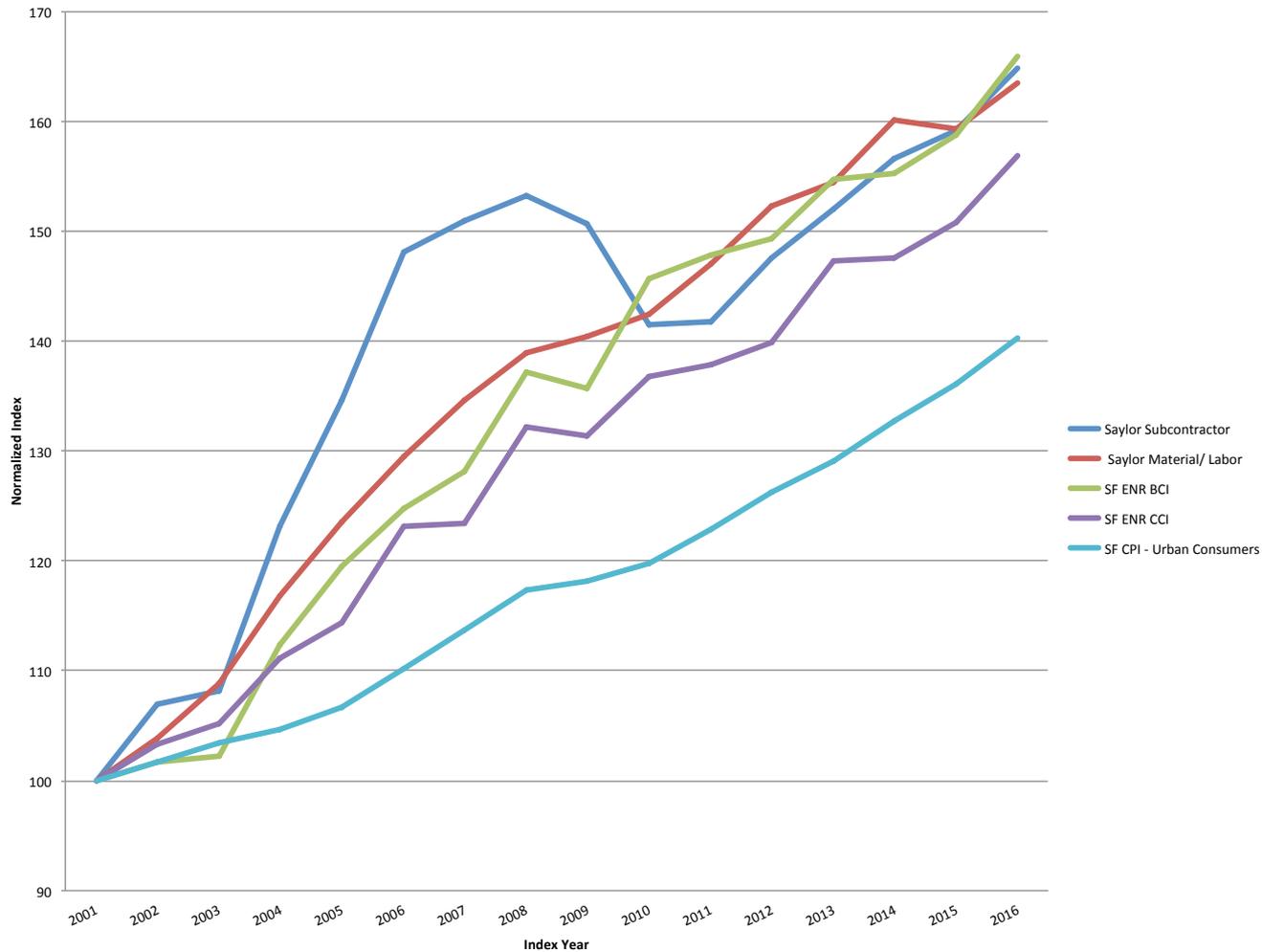
- **Land (Cost/Residual Value)**
- **Hard Construction Costs**
 - Labor
 - Materials
 - Construction Type/Design
- **Parking Costs**
 - Number of spaces
 - Stackers
 - Construction type
- **Soft Costs**
 - Predevelopment
 - Construction Period
 - Sales/Lease up Period
- **Governmental fees**
 - Vary significantly
- **Profit (Developer Margin/Returns)**



Construction (Hard Cost Trends)



Historical Growth in
San Francisco
Construction Costs
Compared to Inflation





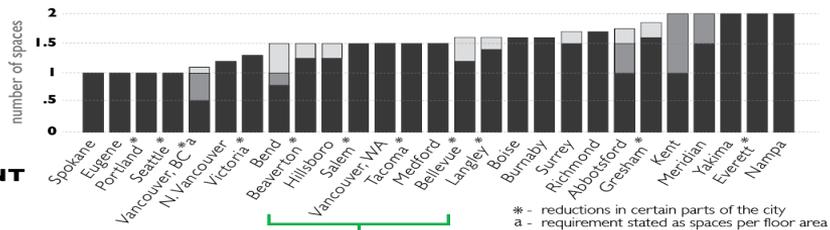
LIVING VS PARKING SPACE



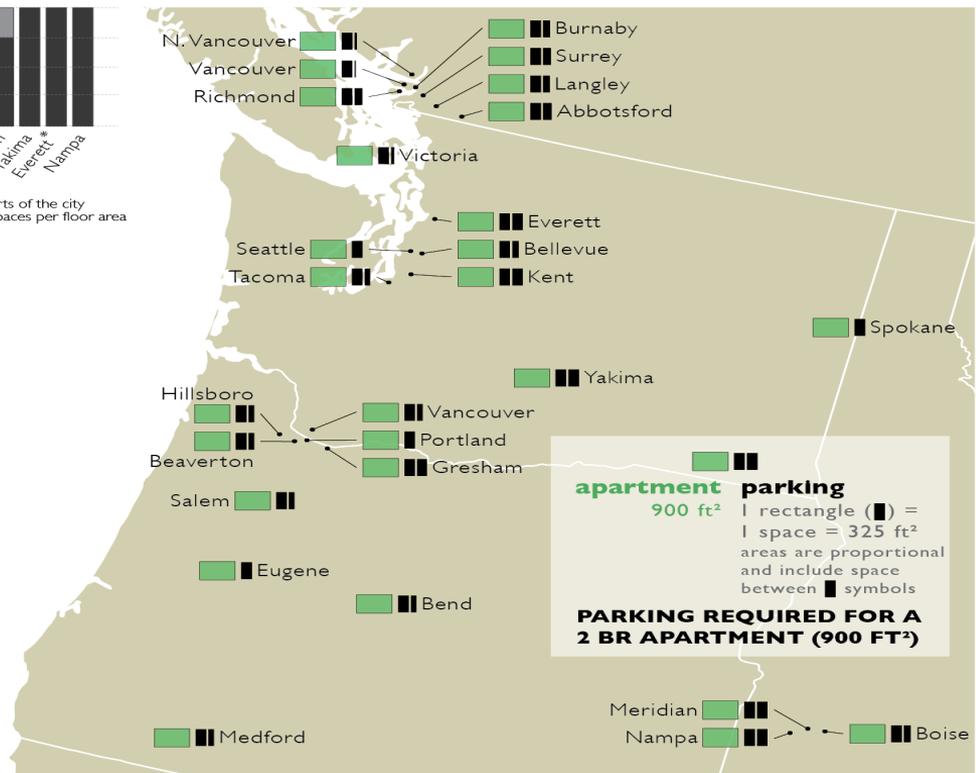
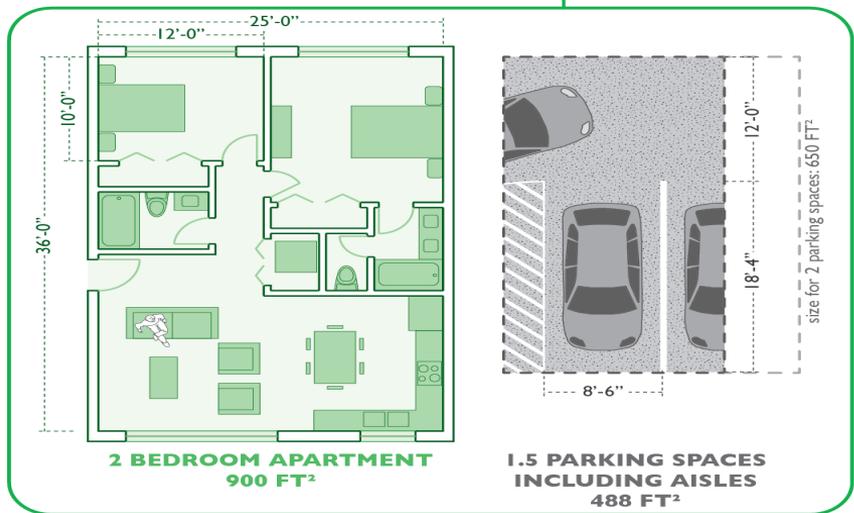
parking required by city laws across Cascadia

2 bedroom
 1 bedroom
 studio apartment

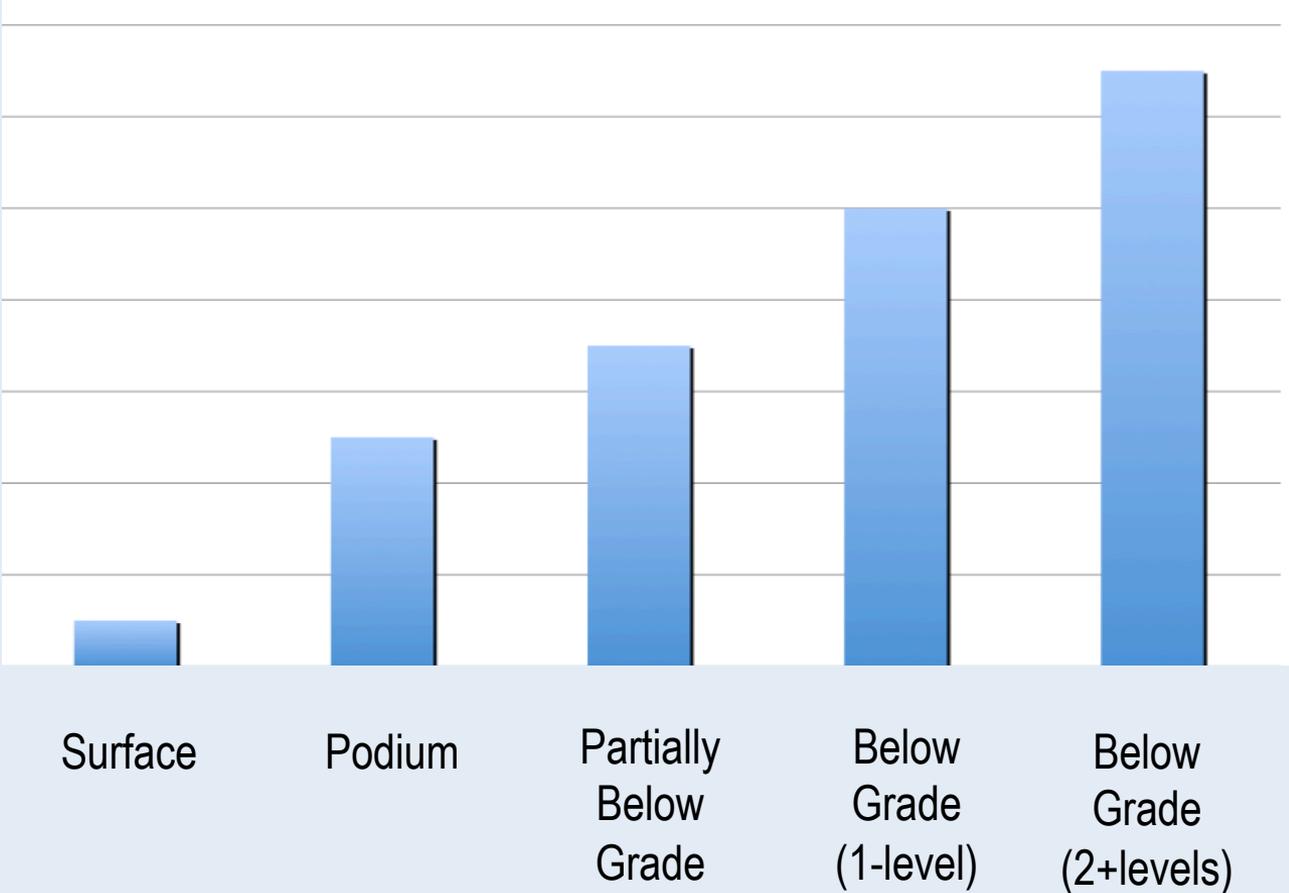
MIN. PARKING PER APARTMENT FOR VARIOUS UNIT SIZES



* - reductions in certain parts of the city
 a - requirement stated as spaces per floor area
median requirement:
1.5 spaces : 2 bedroom apartment



Illustrative Parking Cost Per Space



New American Transit

young Americans shift away from a car-driven culture

“There’s a **cultural change** taking place... younger consumers are viewing an automobile with a jaundiced eye. They don’t view the car the way their parents did & they don’t have the money that their parents did.” ~ **John Casesa** auto industry veteran

The average annual number of vehicle miles traveled 16 to 34-year-olds **decreased** by

2001



23%



7,900 miles per capita



10,300 miles per capita

2009

62% of
18 to 29-year-olds
prefer to live in

MIXED-USE COMMUNITIES



average
cost of driving
\$8,946
per year.

80%

of 18 to 34-year-olds stated
the cost of gasoline,
parking & maintenance
made owning a car difficult



in **2009**

16 to 34-year-olds

24% ↑



bike trips



16% ↑



walking trips

40% ↑



transit
miles

than in

2001

16 to 34 year-olds
in households with incomes
earning more than

\$70,000

per
year

are increasingly
choosing to **not** drive,

instead increasing use of...



transit by
100%



cycling by

122%



walking by

37%

Housing + Transportation (H+T) costs may be better way to measure costs in San Francisco

San Francisco CNT Score

Neighborhood Characteristic Scores (1-10)

As compared to neighborhoods in all 955 U.S. regions in the Index

Job Access
9

Very high access to a variety of jobs

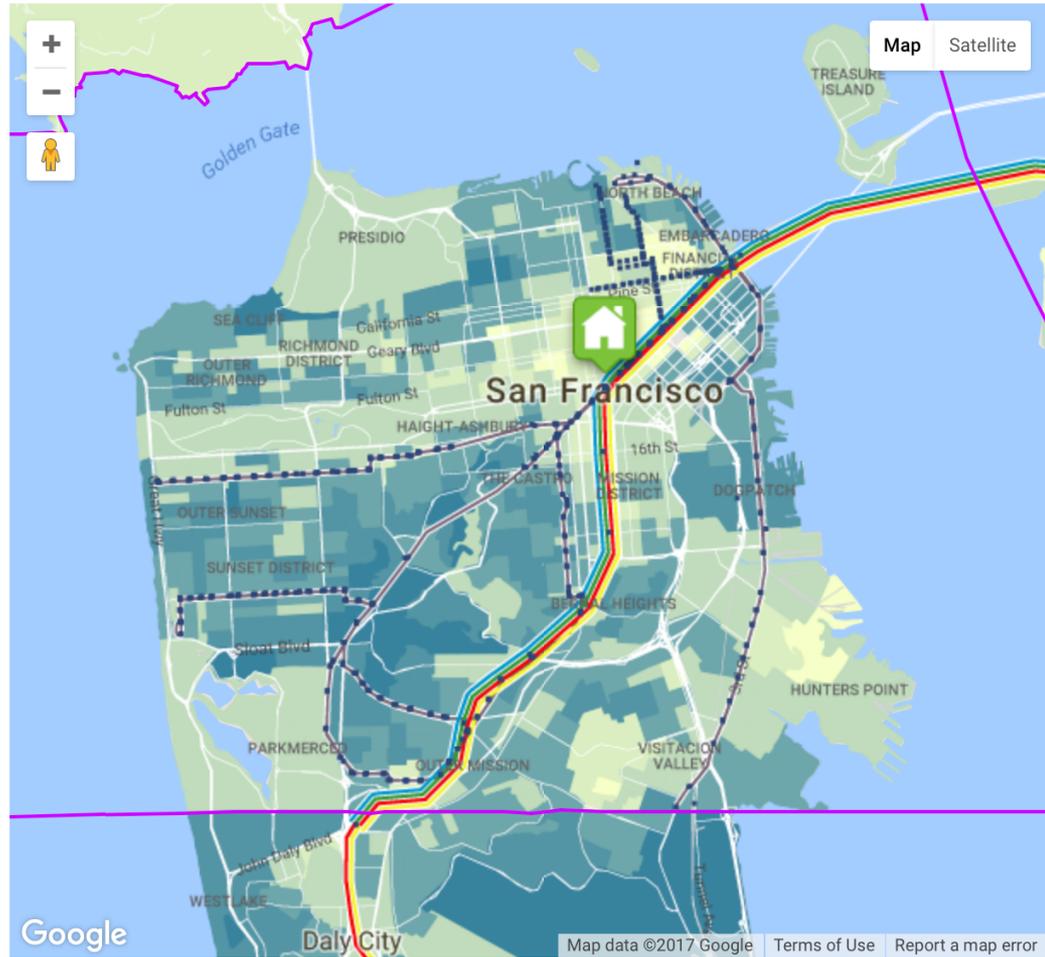
Transit Access
9.6

World-class public transportation

Compact Neighborhood
9.0

Very high density and very walkable

Source: CNT H+T Fact Sheet



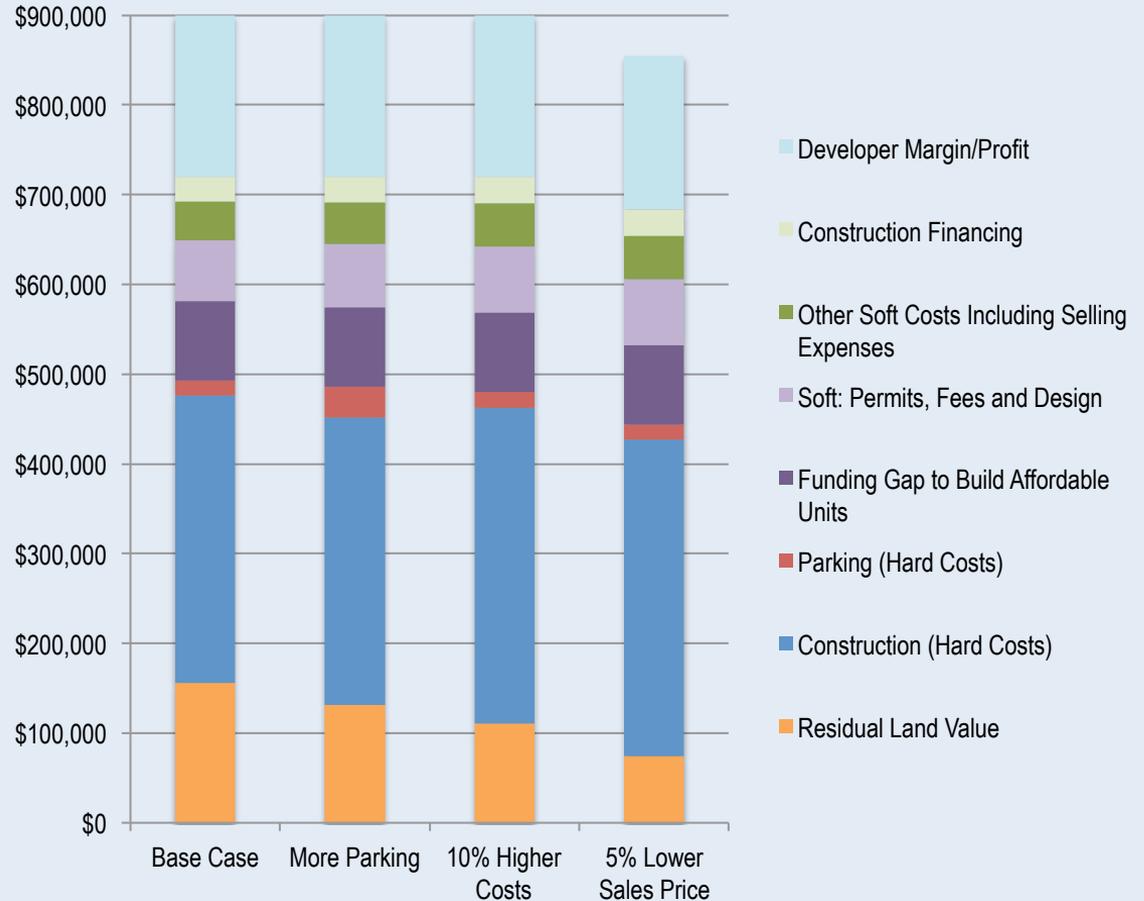
Housing + Transportation Costs % Income **44%**

■ < 24%
 ■ 24-36%
 ■ 36-45%
 ■ 45-54%
 ■ 54-66%
 ■ 66-78%
 ■ 78-87%
 ■ 87%+

Land Costs – Based on Current Income Generation and Allowable Use



Residual Land Value (What a Developer Can Pay)





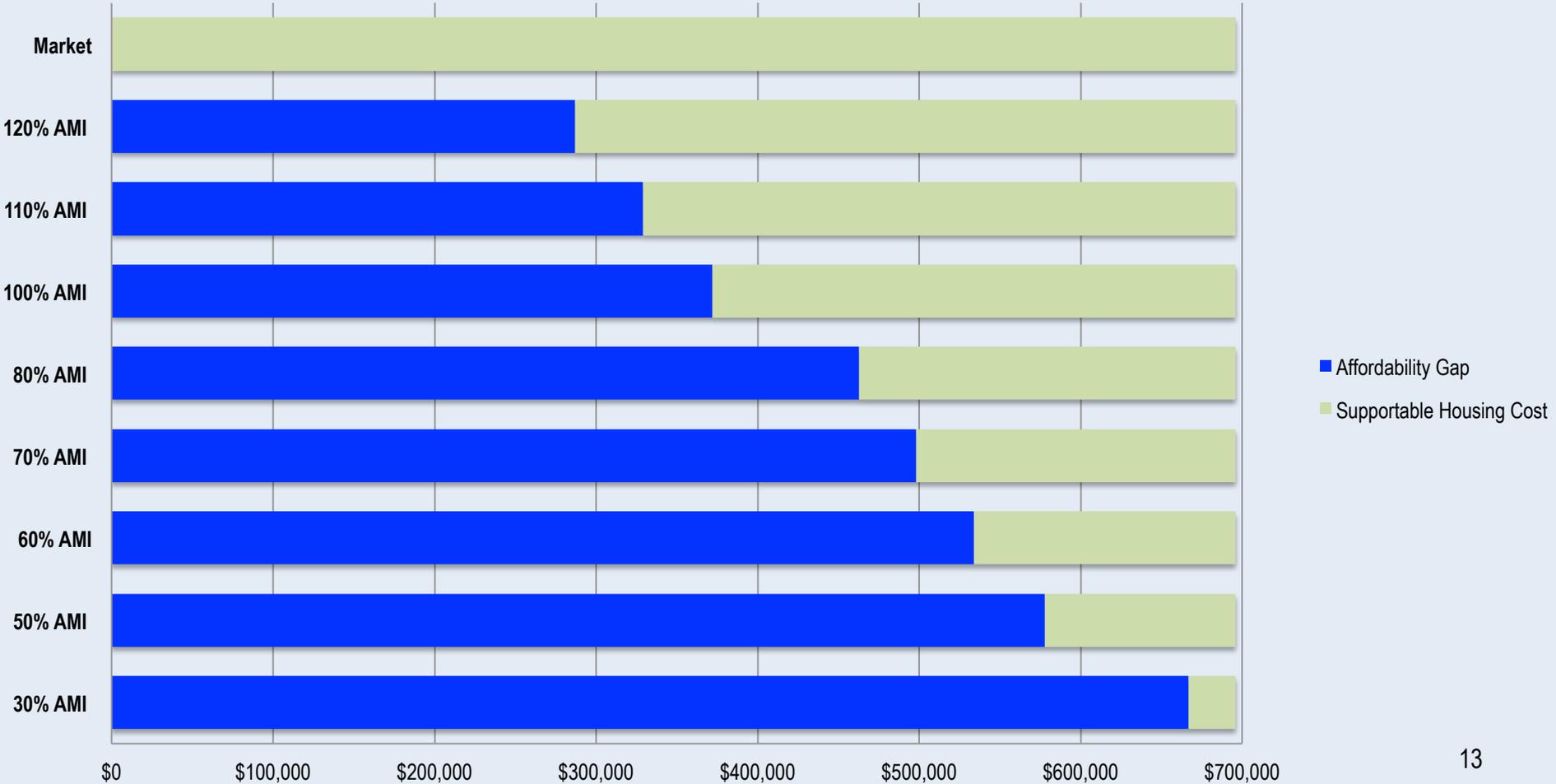
Housing Affordable
to Broad Spectrum
of People



Illustrative Condominium Affordability Gap



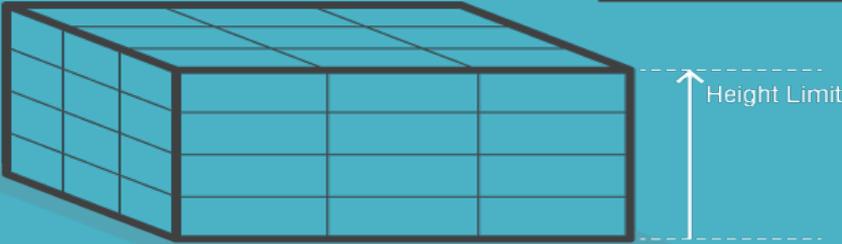
Illustrative Apartment Affordability Gap



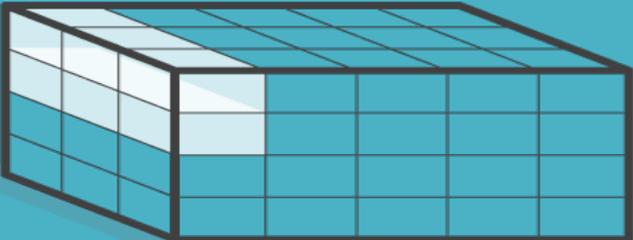
WHAT IS A DENSITY BONUS?

Building Envelope

MAX DEVELOPMENT POTENTIAL

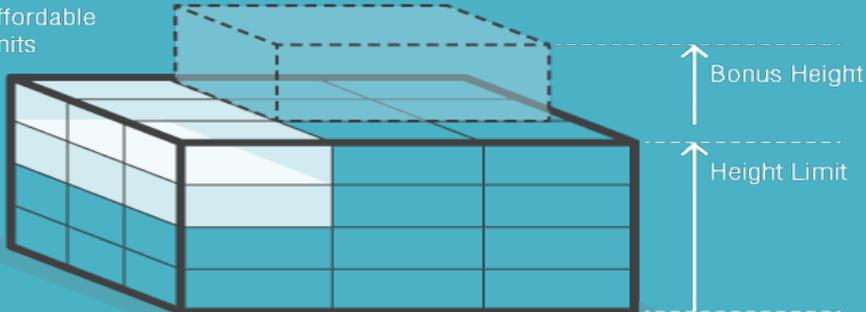


Affordable Units



DENSITY BONUS - WITHIN ENVELOPE

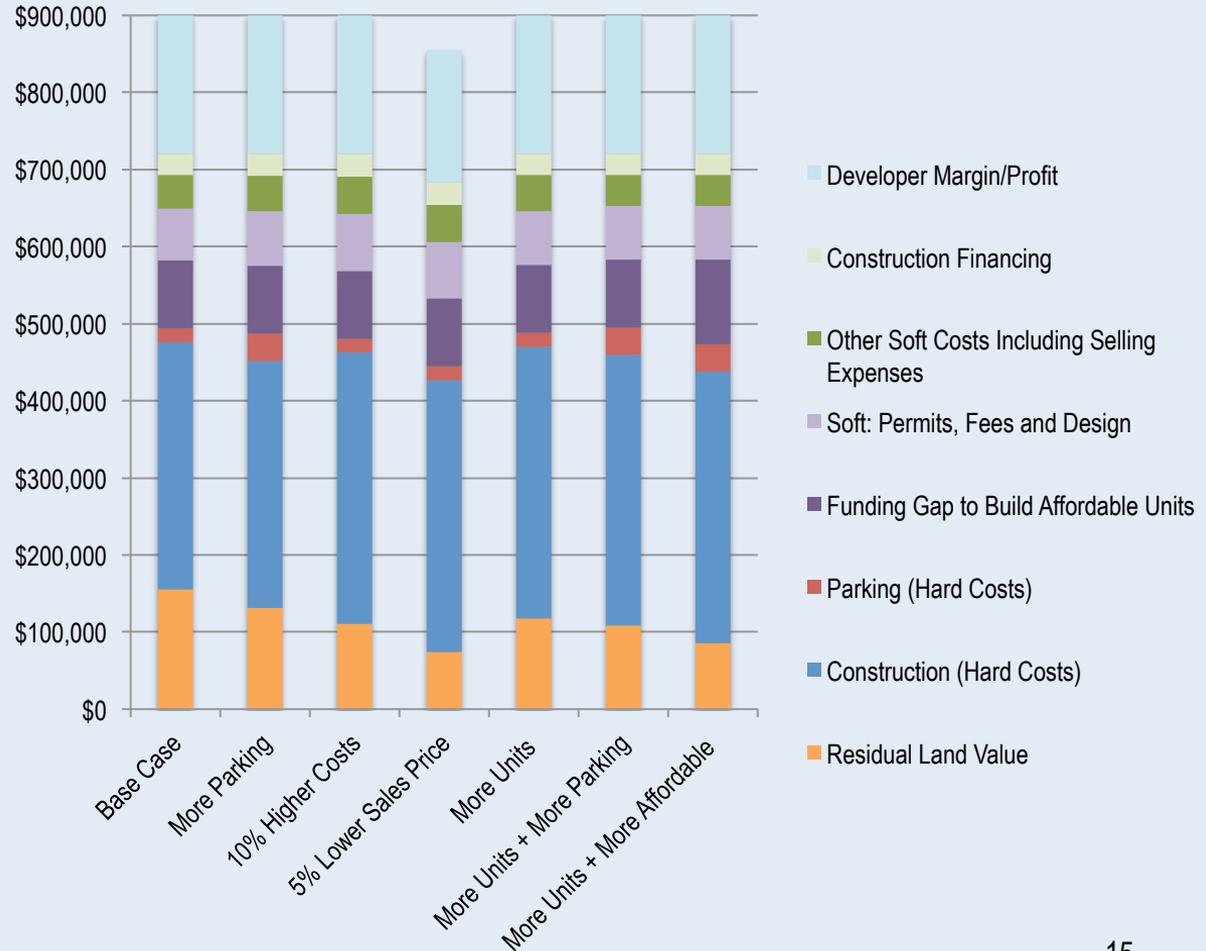
Affordable Units



DENSITY BONUS - HEIGHT

Density Bonus Financial Considerations

- Height?
- Construction type?
- How many more units?
- Less or more parking?
- Will it be faster to process?
- Will design costs decrease?
- Will other costs decrease?
- How much more affordable housing will be required and at what target incomes?





HOME-SF

EVERYBODY DESERVES A HOME



Money makes the world go around...



Predevelopment: Time = Money



Capital Stack



- Developer co-invests
- Preferred and promotional return
- Target return and upside

The value-add play pays out based on value creation

- DCR
- LTV
- LTC
- Performance guarantees with recourse for:
 - Project completion
 - Cost estimates
 - Lease up

Typical Return Requirements

Equity

Mezzanine or
performing debt

Debt

- Preferred 8%-12%
- Target 15%-20, higher for predevelopment
- Total potential 25% or greater

Projected 20% or greater

- 15-40 year amortization
- 2-15 year repayment (“balloon”)
- 4.5%-8% interest

“Waterfall” of Equity Return

Cash Flow after paying loans and costs

1st Dollars out

Return of principal

Preferred return (including
developer co-investment)

2nd Dollars out

Promotional return “pari passu” to investors to
meet target total returns

Some percentage distribution to developer

3rd Dollars out

Larger percentage return to developer

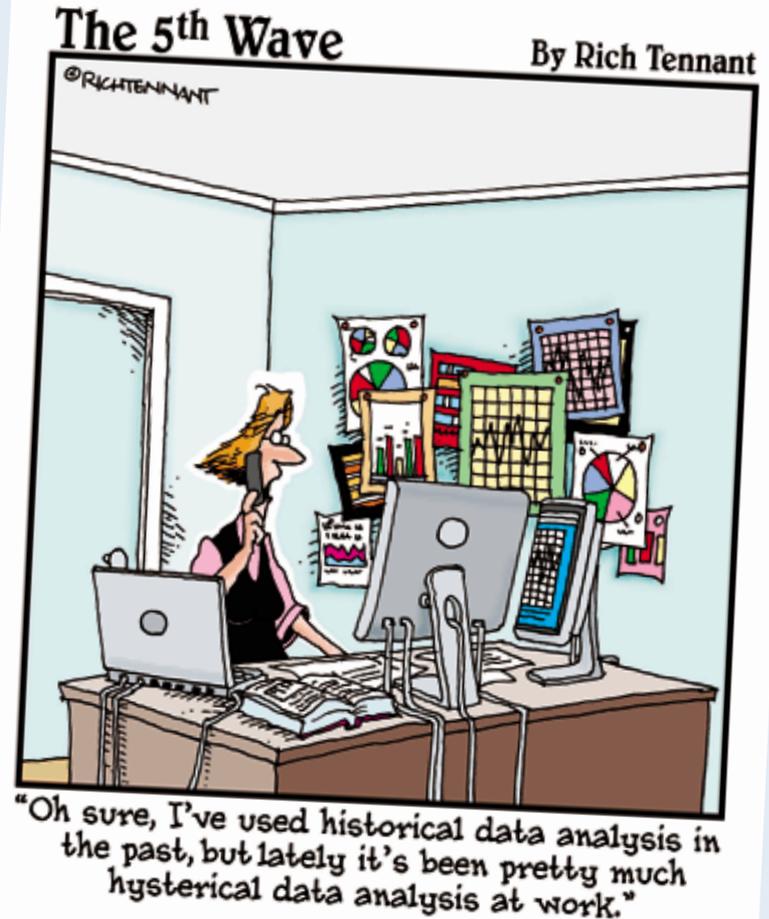
Ongoing smaller percentage distribution to investors

Interest Rates, Cap Rates and Values Move Together

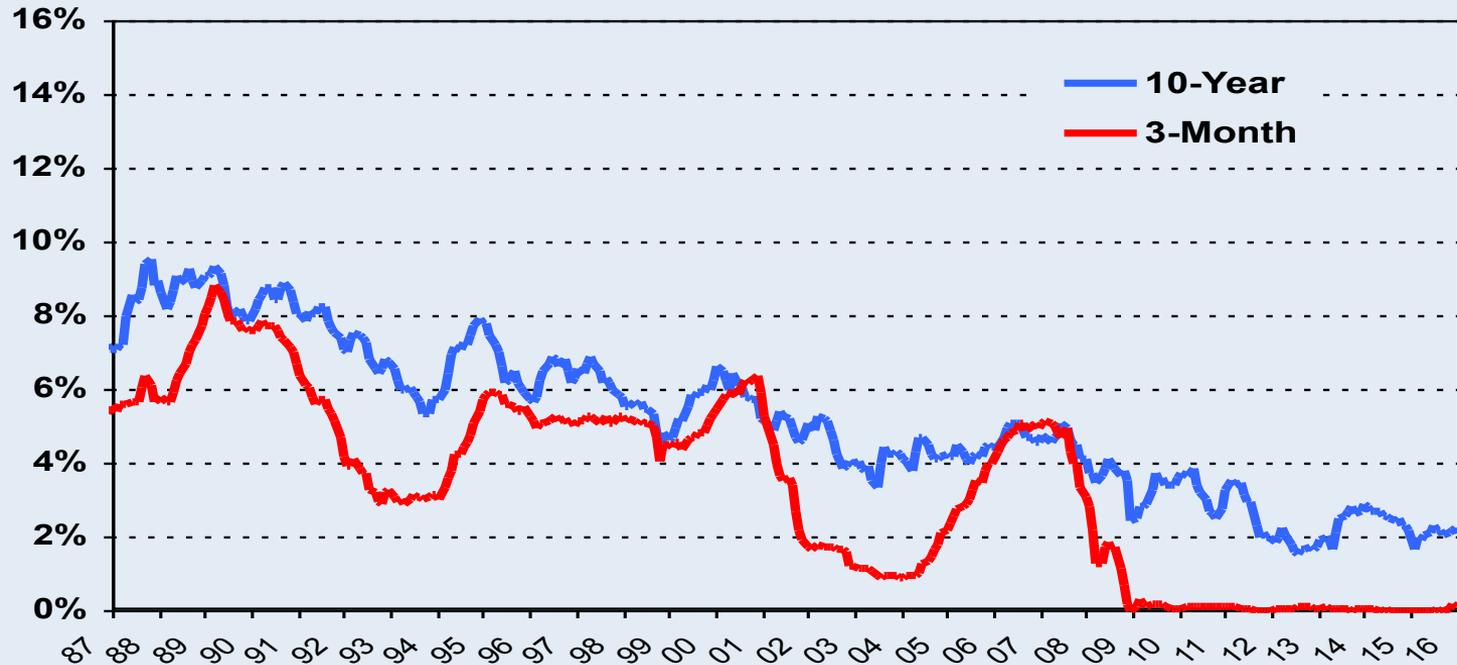
A basic principle of finance is that prices are the present value of future expected cash flows....

*As interest rates fall, the rate at which the cash flows on commercial properties are discounted also falls, **pushing commercial real estate prices up.** ↑*

Commercial Real Estate and Low Interest Rates,
John Krainer, FRBSF Economic Letter (4/22/13)



Historical Treasury Rates



Source: REIS , CBRE

Cap Rate is Indicator of Value/Market Strength

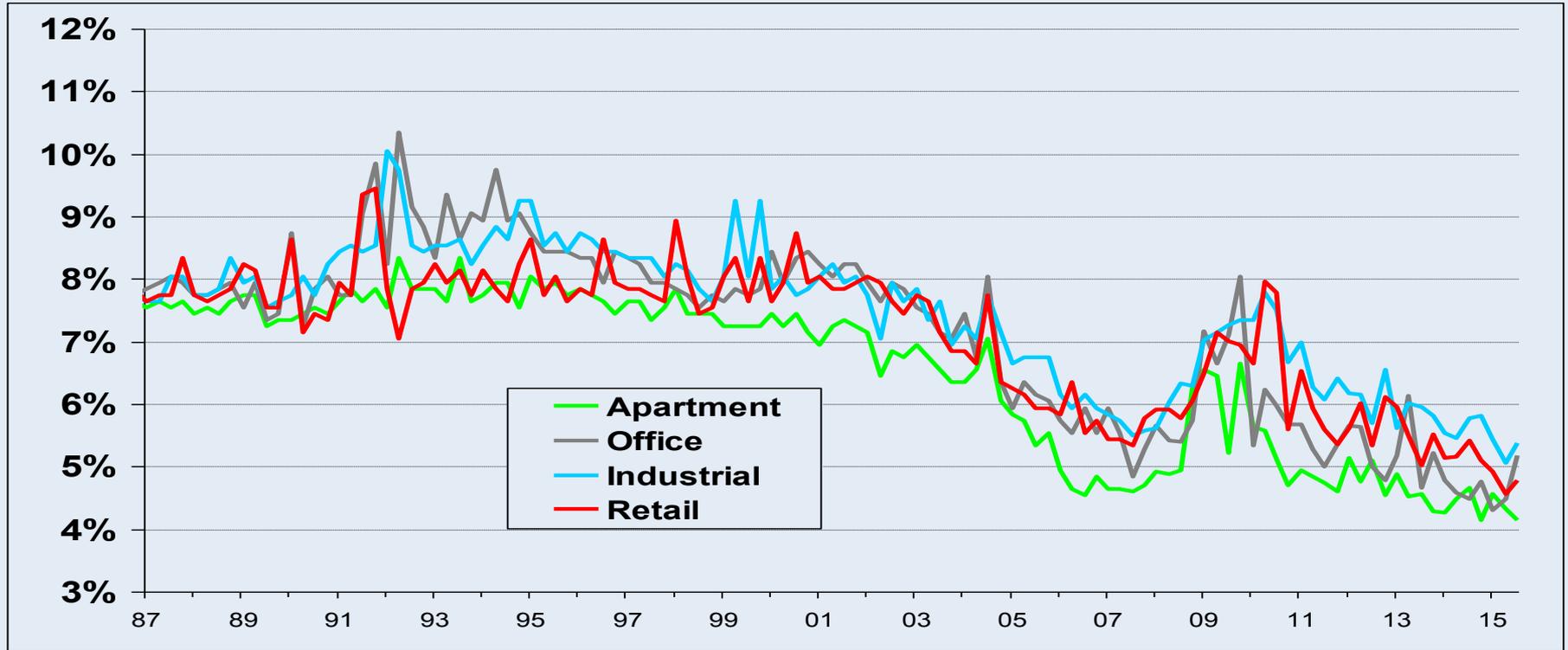
$$\text{Cap Rate} = \frac{\text{Net Operating Income (NOI)}}{\text{Project Value}}$$

$$\text{Project Value} = \frac{\text{NOI}}{\text{Cap Rate}}$$

High cap rate indicates market weakness/high cost of financing

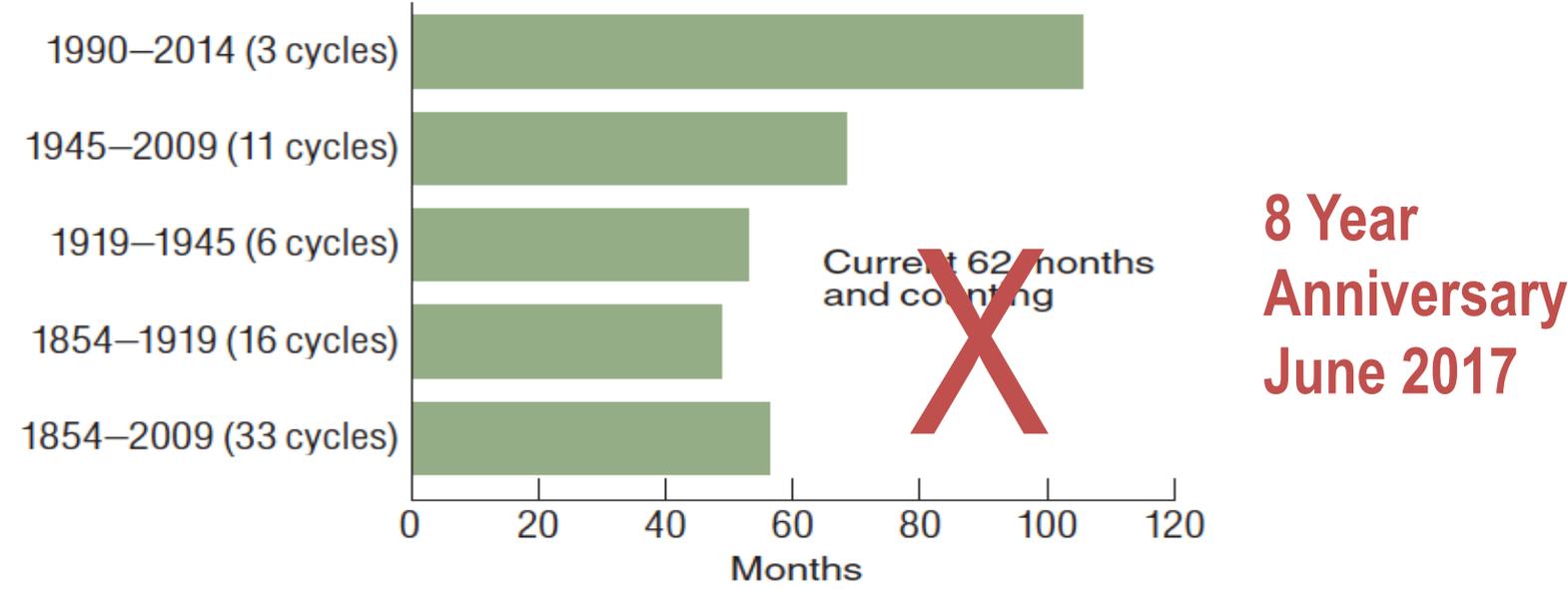
Low cap rate indicates market strength/low cost of financing

Cap Rate Trends by Asset



Source: REIS, CBRE

Exhibit 1-18 Average Length of Economic Cycles, Trough to Trough



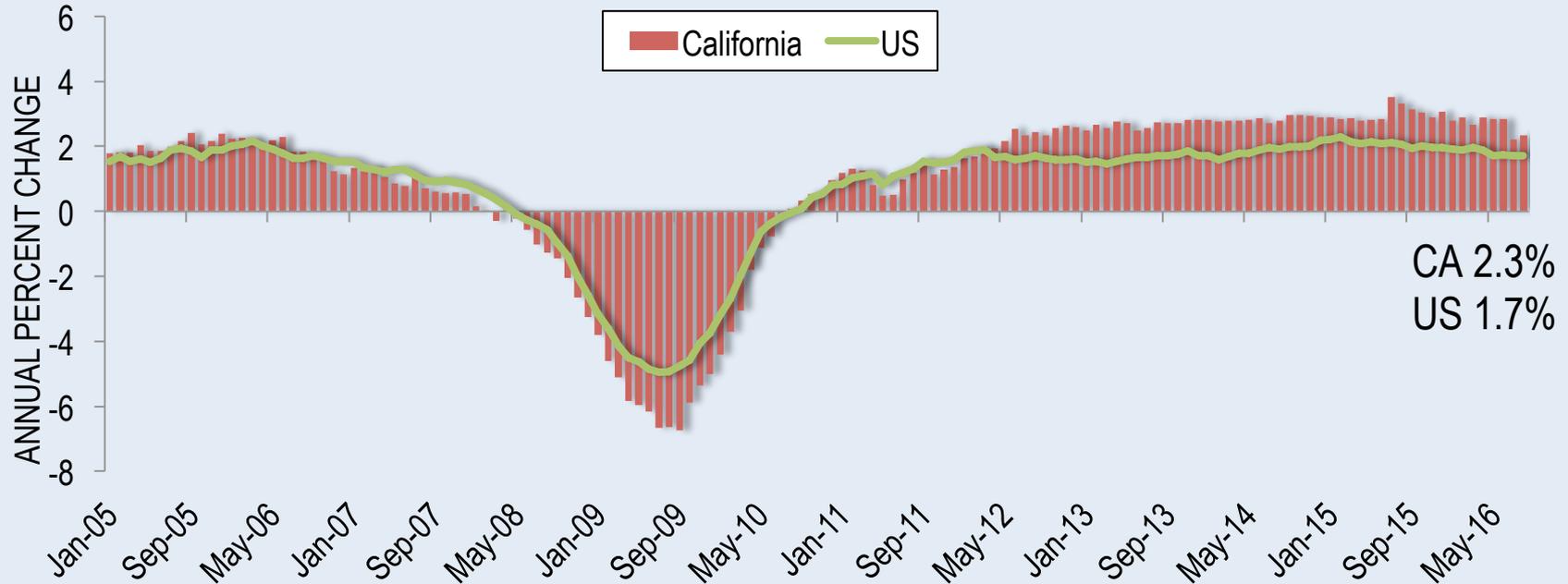
Source: National Bureau of Economic Research.

Source: ULI Emerging Trends 2015

Demand and Supply Imbalance



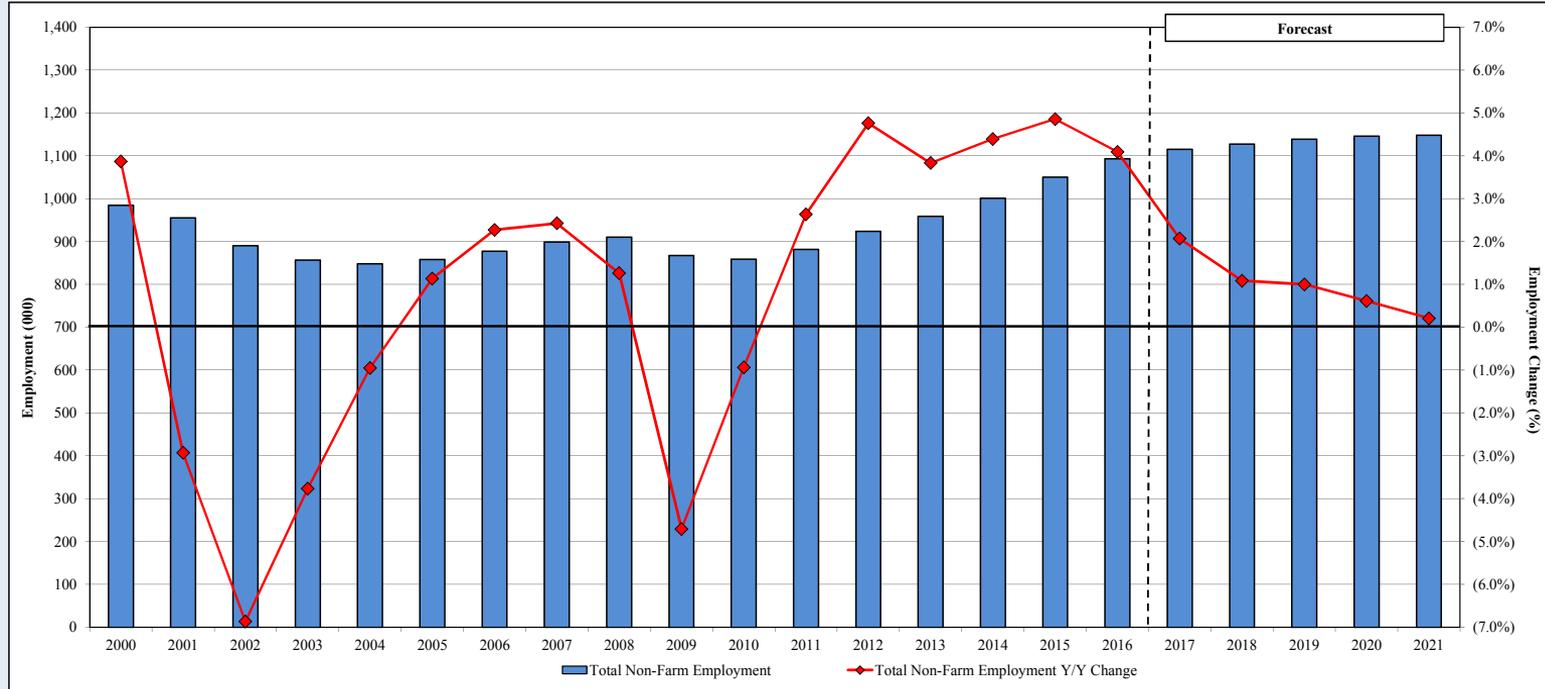
CA Jobs Growing Faster Than Nation



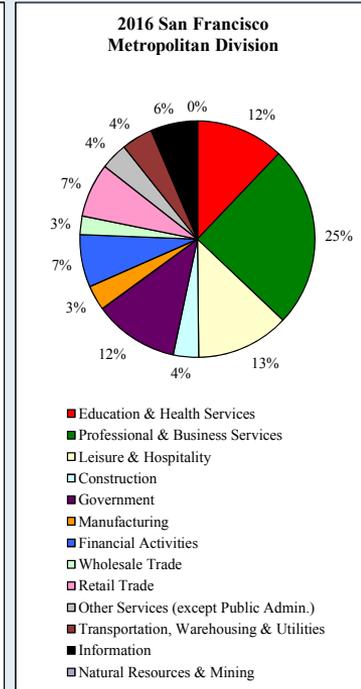
SOURCE: US Bureau of Labor Statistics, CA Employment Development Division
SERIES: Total Nonfarm Employment

Source: CAR 2016

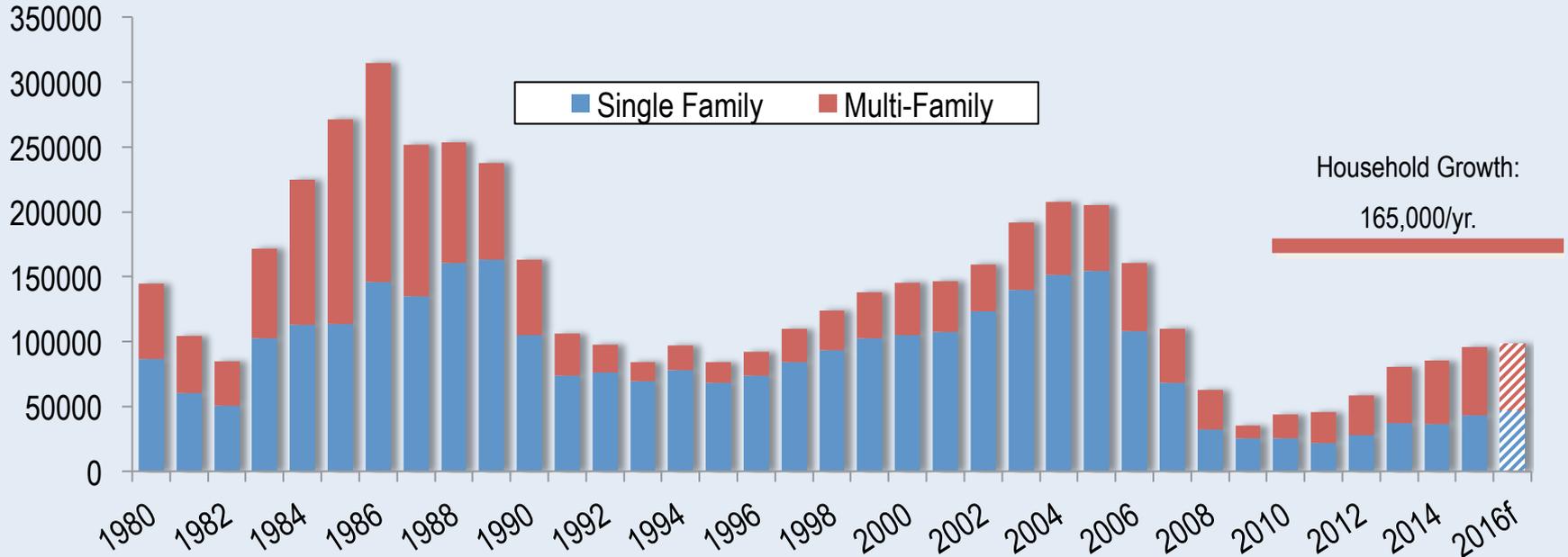
Employment Trends, San Francisco Metropolitan Division 2000 to 2021



Source: Bureau of Labor Statistics; Moody's (updated May 2017); The Concord Group



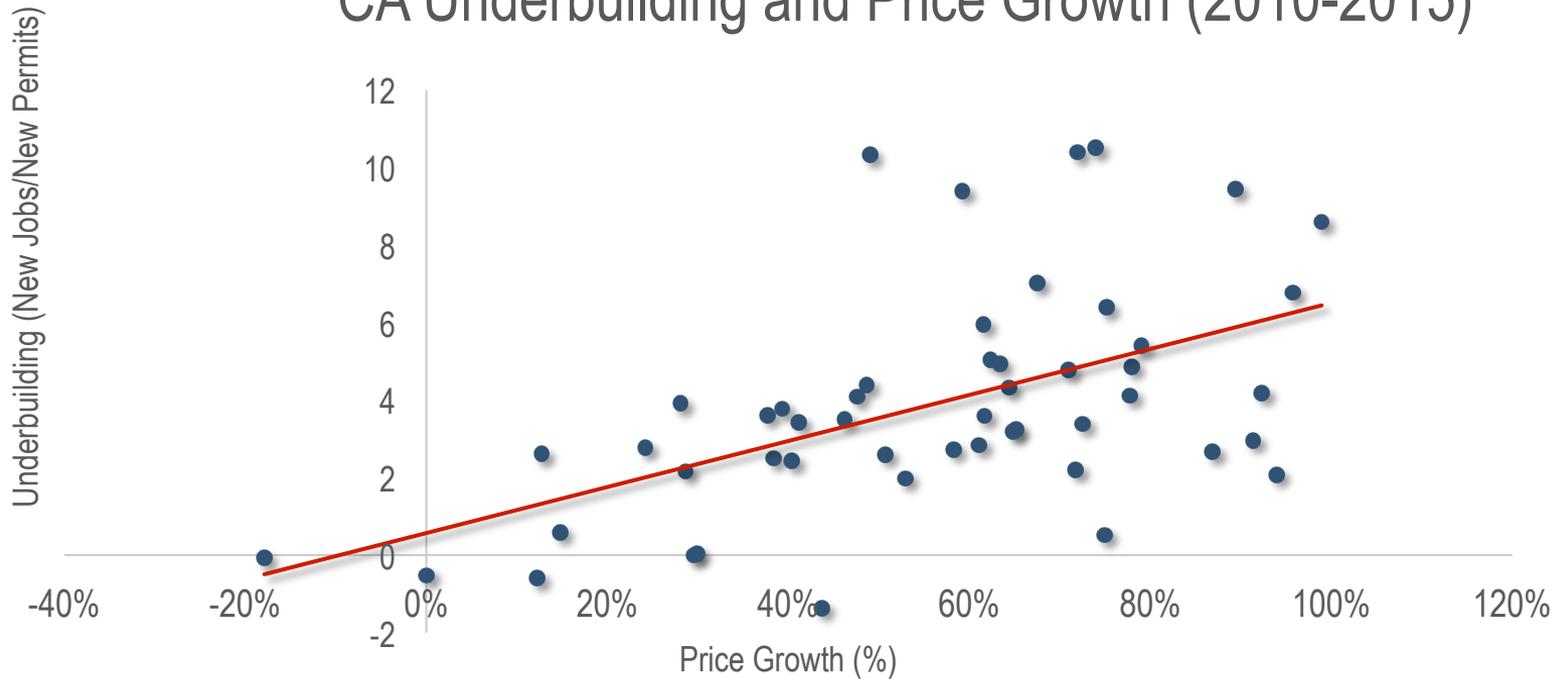
“Missing” 65,000 New Units Annually



SERIES: California New Housing Permits
SOURCE: Construction Industry Research Board

Source: CAR 2016

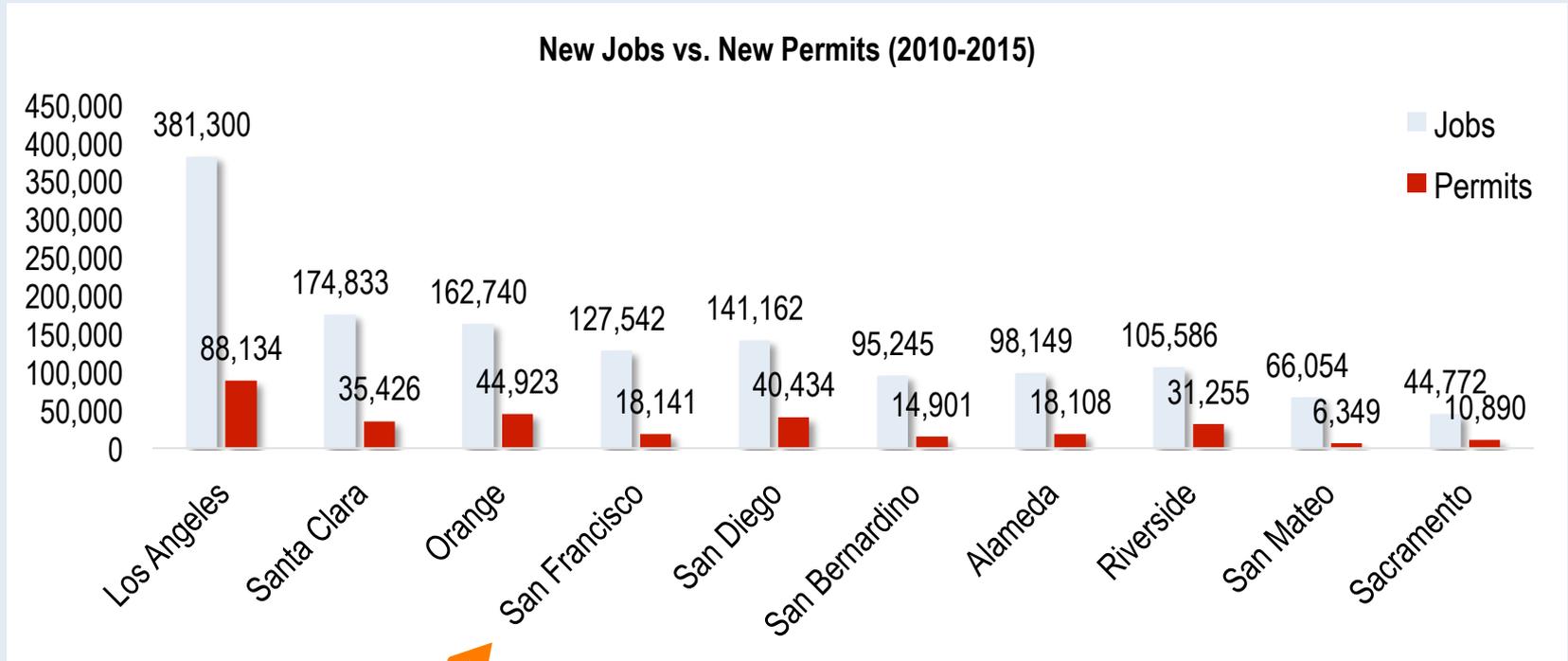
CA Underbuilding and Price Growth (2010-2015)



SERIES: Nonfarm Job Growth, New Housing Permits, Existing Median Prices

SOURCE: CA EDD, C.A.R., Construction Industry Research Board

Most Underbuilt Counties in California

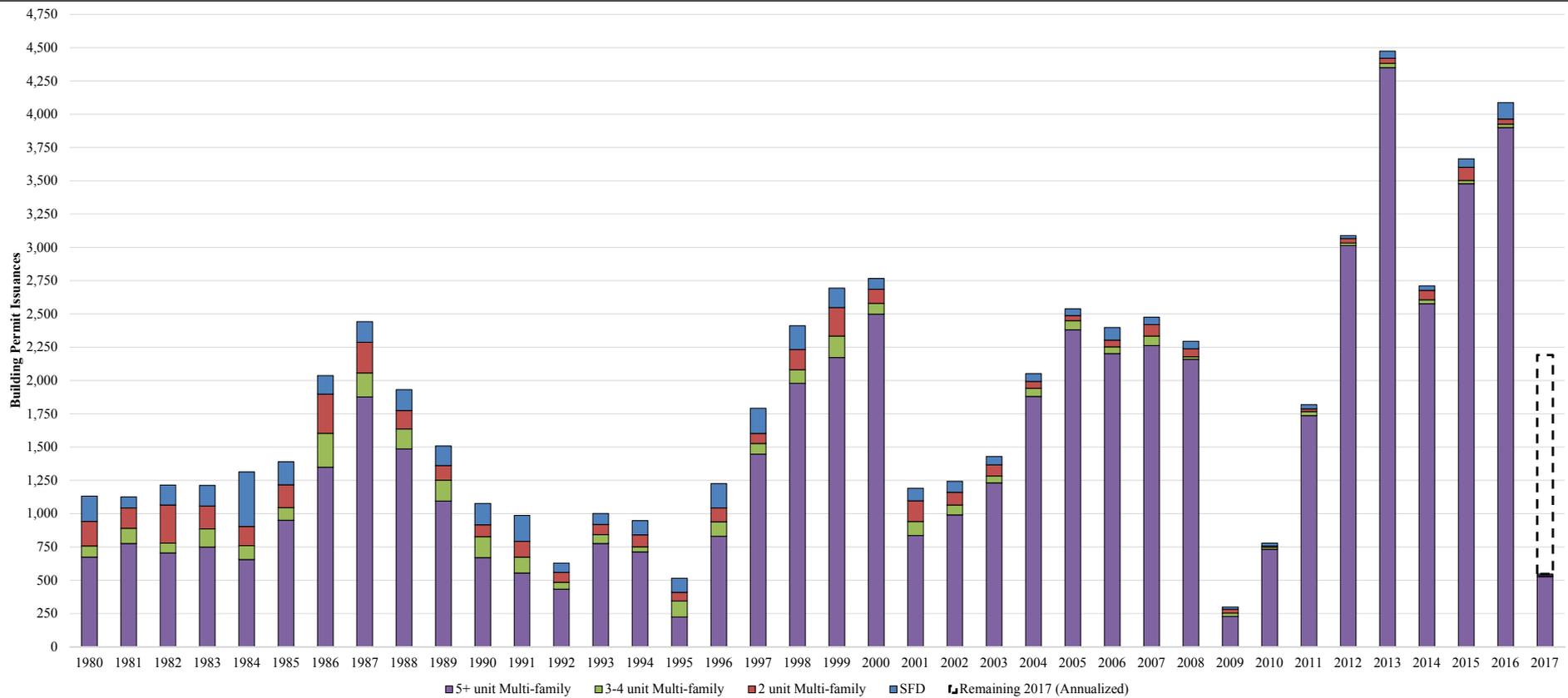


SOURCE: California Employment Development Department, Construction Industry Research Board

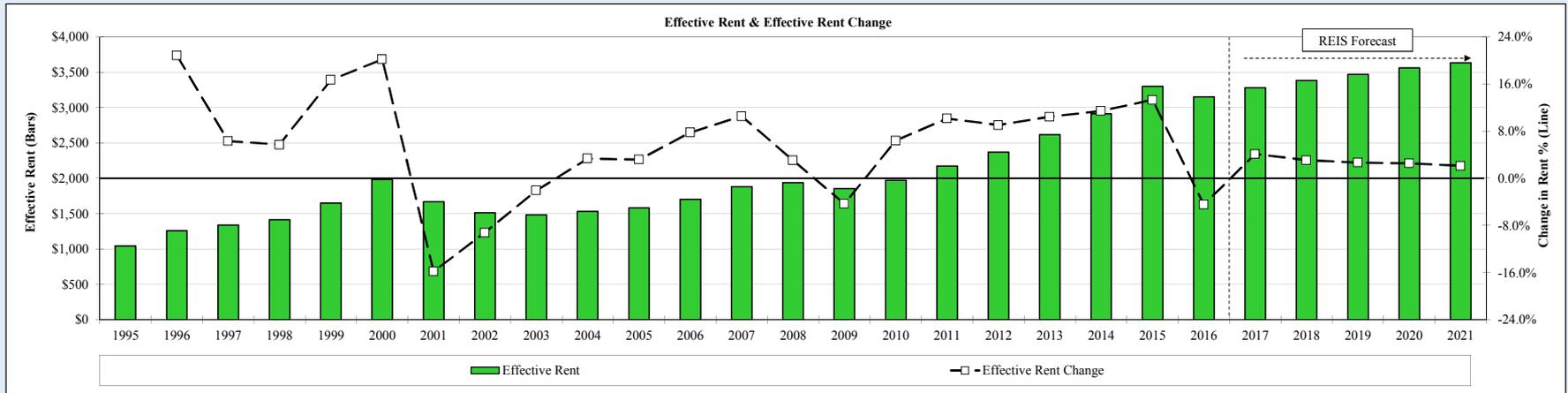
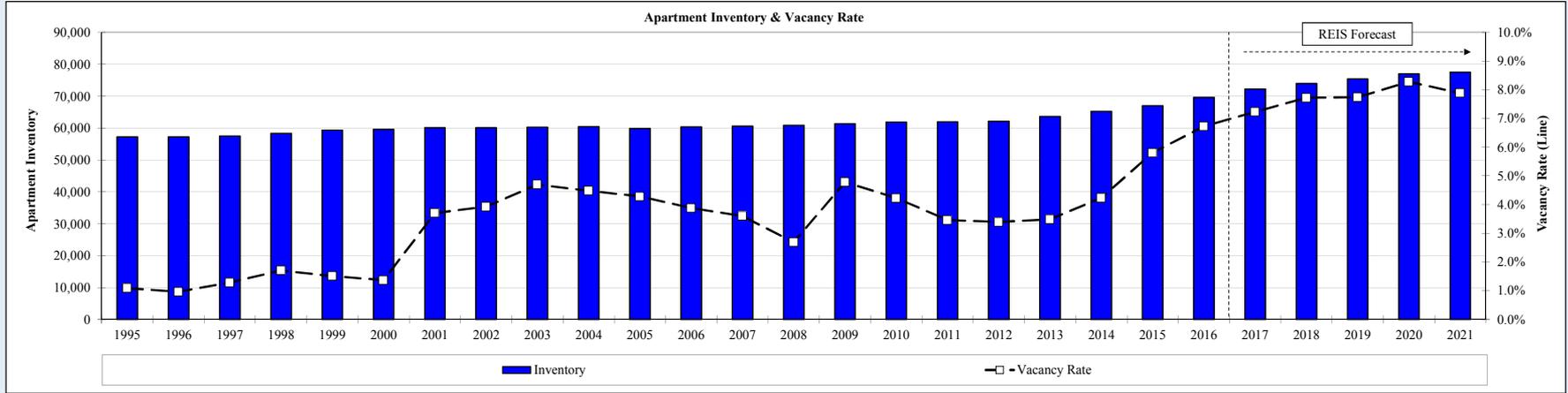
Source: CAR 2016



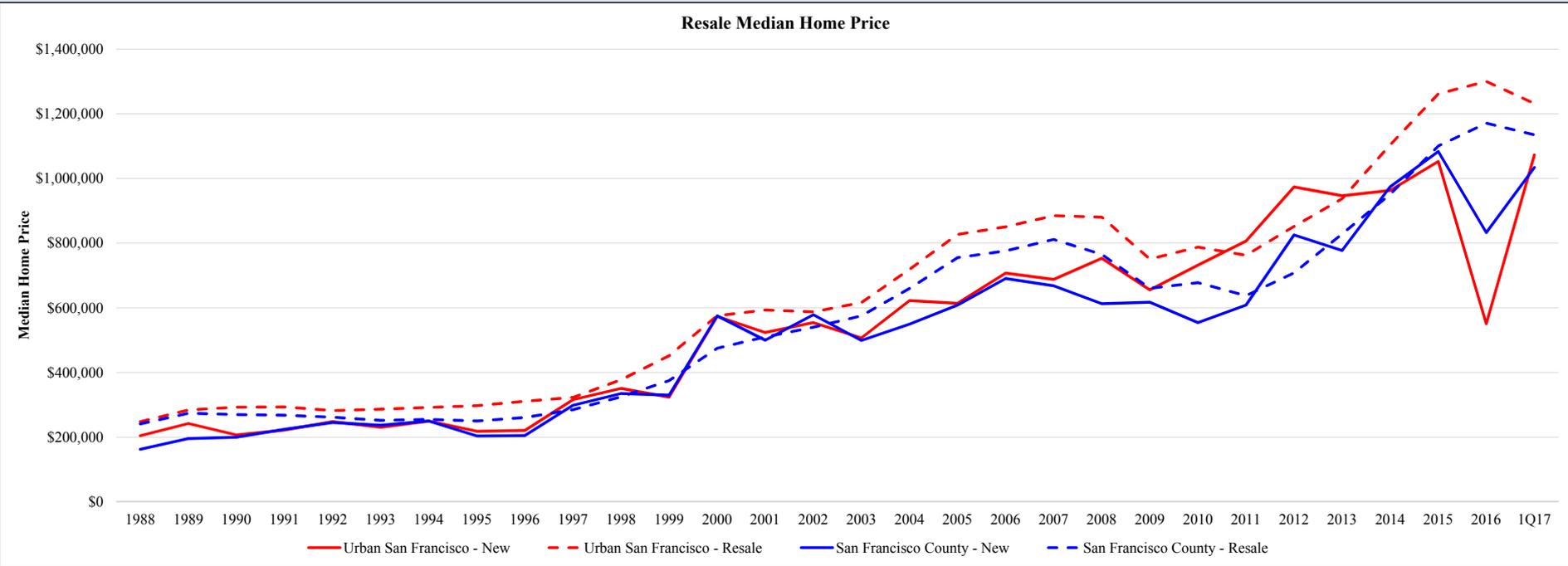
Residential Building Permit Issuances in San Francisco 1980 through March 2017



Apartment Market Performance in Urban San Francisco, 1995 through 2021



Historical Home Sales and Price Trends in San Francisco 1988 through Q1 2017



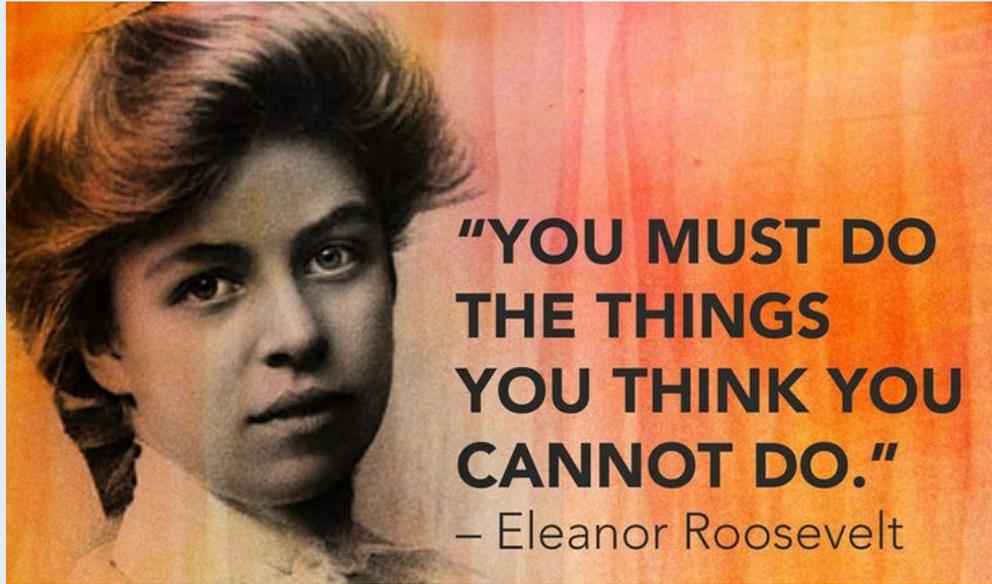
If we can go
to Mars,
why can't we
build a house
better,
cheaper,
faster?





**What can we
do about it?**

- Reduce construction costs
- Require less parking
- Streamline development process
- Encourage greater “coziness” (density)
- Test financial impact of new City requirements on development feasibility and modify as needed
- Build more housing as soon as we can!



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