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DRAFT MEMORANDUM

To: Michael Yarne, City and County of San Francisco

From: Mary Smitheram-Sheldon, CBRE Consulting

Date: January 6, 2011

Subject: Parkmerced Pro Forma Review and Public Benefits Analysis

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INTRODUCTION

As requested by the City and County of San Francisco, CBRE Consulting has conducted an independent review of the development pro forma for the proposed Parkmerced Project, as well as a quantification of the package of public benefits proposed to be included in the Project that exceed existing Code and zoning requirements. These public benefits, which include substantial investment in new public infrastructure, parks and transportation improvements (the "Community Improvements")[1], the one-for-one replacement of up to 1,538 existing rent-controlled units with new permanently rent-controlled units (the "Rent-Controlled Replacement Units"), and a "best practices" stormwater management system (the "Stormwater Management Improvements"), have been negotiated with the City and County of San Francisco as part of the Development Agreement with the Project Sponsor. The purpose of this memorandum is to report CBRE Consulting's findings pertaining to this review.

As discussed below, the current Project pro forma generates an internal rate of return (IRR) that is slightly below the threshold required to attract the necessary private investment for a residential land development program. This means that, based on current and reasonably foreseeable short-term market conditions, the Project may not be economically feasible. However, given the fact that the Project incorporates an existing operating apartment complex, the existing 3,221 rental units generate "interim income" that reduces the Project's risk profile and allows the Project sponsor to accept a slightly lower IRR than the typical benchmark. The substantial costs of the proposed public benefits package – approximately $360 million – contribute to the Project's lower-than-market rate of return. Accordingly, there is little ability from a financial standpoint for the Project sponsor to provide for additional public benefits – either in the form of one-time capital expenditures or ongoing operational support – without engaging in a trade-off among the public benefits already proposed. Based on an independent review of the Project sponsor's cost data, as well as CBRE Consulting's own analysis of the financial impact of providing one-for-one replacement of all 1,538 existing rent-controlled Garden Apartment units, CBRE Consulting estimates the value of the proposed

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[1] The definition of Community Improvements, which is presented in its entirety in Appendix A, comprises Project amenities and improvements that are not required to address California Environmental Quality Act mitigations identified in the Project Draft Environmental Impact Report (DEIR) or required per City code, including the payment of existing impact fees.

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public benefits to be approximately $172.6 million in Community Improvements, $28.7 million in Stormwater Management Improvements, and $158.9 million in Rent Controlled Replacement Unit subsidies.

PRO FORMA DISCUSSION

CBRE Consulting staff conducted two extensive working sessions with representatives of the Project sponsor, Parkmerced Investors, LLC, that covered in considerable detail the financial pro forma for the Project. These working sessions occurred on August 18, 2010 and September 16, 2010. During these working sessions, CBRE Consulting was able to review the model structure, assumptions and inputs, and view certain calculations. We were not able to conduct a full calculations check, but after identifying a number of needed changes in calculations and viewing the impact of those changes on the pro forma, CBRE Consulting is reasonably satisfied with respect to the reliability of the pro forma. Subsequent working sessions consisted of performing sensitivity testing that evaluated the impact of certain project assumption changes on the internal rate of return.

It is important to note that financial pro formas are forecasts of future events made at a single point in time, based upon the best available information at that time. As such, pro formas are continually evolving as additional information is received, project refinements are incorporated, and perceptions about current and future market and economic conditions change. Therefore, CBRE Consulting expects that the Parkmerced Project financial pro forma will continue to change as it moves forward from approvals to preconstruction and actual construction.

In addition to the pro forma working sessions, CBRE Consulting reviewed a market study for the residential component prepared by The Concord Group, infrastructure and vertical building cost estimates provided by Webcor, and a transportation study prepared by Fehr & Peers. Parkmerced Investors, LLC commissioned all of these studies; however, the transportation study was scoped and peer-reviewed by staff at the SFMTA and the Planning Department. To ensure that the City receives the most objective financial analysis possible, CBRE Consulting conducted its own market research with respect to key revenue-generating components of the Project, such as projected apartment rents and vacancy rates, condominium sales prices, and office and retail rents and vacancy rates. In CBRE Consulting's professional opinion, many of the Project sponsor's pro forma revenue assumptions were aggressive. Accordingly, for this pro forma analysis, CBRE Consulting substituted slightly more conservative revenue assumptions (e.g., lower apartment and commercial rents, lower parking charges, lower condominium sales prices for certain product types, increased condominium absorption periods) into the pro forma model to ensure that the model represents CBRE Consulting's best estimate of future market conditions. These changes, as well as other corrections made to the model, generated an IRR lower than the Project sponsor's estimated IRR. Appendix B provides a summary of selected revenue and cost assumptions in the financial pro forma.

Risk Factors

As with any development, there are myriad risks associated with the Project. Given the magnitude and long-term build-out (20+ years) of the Project, the financial risks are even greater than smaller-scale, single-phase development. CBRE Consulting noted the following risk factors in its review of the Project's financial pro forma.

Market-Risk Factors

- Of the proposed 4,448 net new condominium units, nearly 65 percent are located in steel-frame buildings between 8 and 13 stories in height. This product is the most expensive to build, and consequently require the highest estimated sales prices. The market for high-rise condominium units is untested in Southwest San Francisco, which is more suburban in character, and thus the depth of market demand for this product type is unknown. Although CBRE Consulting accounted for this risk by lowering the estimated average sales prices for units in the tallest buildings, as discussed above, these sales revenues nonetheless represent a significant component of the Project's estimated future revenues. Appendix C presents a summary of units by construction type.
- While the Development Agreement provides for flexible build-out of all components of the proposed Project, the pro forma is based on the Project sponsor's Illustrative Development Phasing,[2] which calls for a substantial amount of the proposed neighborhood retail space be built relatively early in the projected 20-year Project build-out (mostly in years 5, 6, and 7). While this space will provide services to the existing and future residents of the first Illustrative Development Phase, this population may be insufficient to support the total amount of retail space proposed. On the other hand, the existing San Francisco State University student population may represent an untapped component of demand for the retail space.
- There has been no independent study of the market demand for the Project's proposed 80,000 square feet of office space. The depth of demand for this space is uncertain.
- Under the draft Development Agreement, the proposed community and fitness center, which is a significant amenity at 64,000 square feet, is not required until the construction of 3,500 net new units, about halfway through Project build-out. Although often expensive, this type of amenity, in addition to the proposed park and open space system, will be a major draw for future residents. Any delays or uncertainty in its delivery may hamper the Project's place-making and market demand, thus adversely affecting projected sales and/or rent revenues.
- A key component of Parkmerced's place-making from both a residential and commercial standpoint is the planned MUNI Realignment. This enhanced transit access is critical to making the Project a true "transit village." If the MUNI Realignment is not constructed, several pro forma revenue inputs and assumptions would need to be adjusted – for the commercial components: less retail and office space might be built, lower retail and office rents may be considered achievable, and stabilized vacancy might increase; for the residential components: lower rents and sales prices. The cumulative impact of these reductions in Project revenues may more than offset any cost savings resulting from eliminating the MUNI Realignment.

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[2] All references to phasing relate to the 20-year development projections set forth in the Project's Draft EIR. That document contained four "Illustrative Development Phases," which are based on the Developer's best estimates for the likely pace of the build-out of the private and public improvements contemplated in the Development Agreement. It should be emphasized, however, that the four Illustrative Development Phases are merely reasonable projections of the potential timing and scope of the Project build-out, and are not fixed development phases or schedules. On the contrary, the draft Parkmerced Development Agreement specifically provides the Developer flexibility in the order and timing of the proposed private development, including allowing discretion in what amount of net new development will be included in each Development Phase. The City, in turn, has the right to review and approve each Development Phase Application to ensure that any Community Improvements proposed for each Development Phase are provided in proportion to the cumulative amount of private development to occur in each Development Phase, and that the timing and phasing of the Community Improvements are consistent with the operational needs and plans of all affected City Agencies, and are phased in such a way as to not interfere with the utility and transportation systems operated and maintained by the City.

Construction Cost and Timing Factors

- The Project sponsor's pro forma construction budget includes only a 5 percent contingency for most items, which provides only a modest cushion in the event of inadequate cost estimating or unanticipated cost increases. For a project of this complexity and lengthy build-out period, a higher contingency would be expected. The impact of a higher contingency factor on the Project's IRR is discussed below.
- Many of the Project's renewable energy, conservation and storm-water management system components are relatively new with a limited track record in terms of estimating costs. (It is important to note that the evolving technologies associated with these components could also benefit the Project in that improved future technologies might actually result in a reduction in certain costs.) Accordingly, it is difficult to predict a reasonable contingency factor for these costs.
- Requiring that construction of the MUNI Realignment commence upon completion of 2,500 net new units is potentially risky because it imposes significant cost burdens on the Project's pro forma relatively early in the Project build-out. On the other hand, this substantial public amenity will add value to the Project and support higher rent and sale revenues needed to support the Project's long-term revenues.

Pro Forma Conclusions

CBRE Consulting's review of the Project pro forma, which included requested corrections to certain calculations and assumption changes, as well as sensitivity testing, generated a wide range of leveraged internal rates of return (IRR). Within this range CBRE Consulting concludes that the best estimate of the internal rate of return is 17.8 percent.

During sensitivity testing, two more conservative market scenarios were evaluated. The first consisted of higher-than-anticipated construction costs, which took the form of a 10 percent construction cost contingency factor. This reduced the IRR to 15.9 percent. To this scenario we added the potential for a weak housing market recovery, whereby revenues (i.e., condominium sales prices and apartment and commercial rents) grow by 2.0 percent in 2011 and 3.5 percent per year in 2012 and thereafter. The combination of these two "worst case" scenarios lowered the Project's IRR to 13.2 percent.[3]

A more optimistic market scenario was also tested. Project revenues were assumed to experience superinflationary growth in 2012 through 2014, before returning to a more stable long-term growth rate. Such growth could be the result of a stronger regional housing market recovery or the establishment of a market premium for the units at the Parkmerced community, or a combination of the two. The result of this test was an IRR of 23.9 percent. This testing indicates that the pro forma is relatively sensitive to modest increases in revenue growth rate assumptions. Table 1 on the following page summarizes the sensitivity testing results.

[3] The draft Development Agreement provides the owner of the Project site with maximum flexibility in terms of the timing of private development. Therefore, if the Project pro forma indicates such a low return, it is highly likely that the developer will delay construction until revenue estimates and construction costs are more favorably aligned.

Table 1
Parkmerced Pro Forma - Impact of Assumptions Changes on IRR

Scenario	*Assumption Change*	*Resulting IRR*
CBRE's Best Estimate of Market Conditions	N/App.	17.8%
Higher Construction Costs	Increase cost contingency to 10%	15.9%
Weak Housing Market Recovery & Higher Construction Costs	Revenue growth lowered to 2.0% in 2011, 3.5% in 2012 and thereafter (and increase cost contingency to 10%)	13.2%
Strong Housing Market Recovery	Revenue growth increased to 5.0% in 2012, 10.0% in 2013	23.9%

Again, based on its best professional judgment of local and regional market conditions, CBRE Consulting's adjusted pro forma assumptions generated an IRR of 17.8 percent. This IRR indicates that there is insufficient profit to permit additional increases in costs (or decreases in revenues) beyond those identified in this memorandum. This is due to the fact that a 17.8 percent IRR is below the 20 percent threshold typically deemed reasonable for a development project of this complexity and lengthy build-out period. However, as previously noted, the fact that the Project generates "interim income" from existing units reduces its market risk profile and may attract equity investment despite a slightly lower IRR. (In essence, the Project's existing income provides some cushion for the developer in terms of ongoing cash flow.) See Appendix D for a discussion regarding commercially reasonable market IRR thresholds.

Another market risk factor to consider is the Project's projected annual $14,400 per unit apartment operating expense, which is higher than typical operating expenses for most multifamily rental residential projects in San Francisco. The estimated annual expense reflects an increase of over 50 percent compared to Parkmerced's current annual operating expenses at $9,300 per unit – even after factoring in savings in categories such as repairs and maintenance and utilities due to greater efficiencies resulting from the new buildings. This increase is due to higher property taxes associated with new construction, and the inclusion of two new substantial operating expenses: the proposed Transportation Demand Management (TDM) program, which provides for a partial monthly Muni FastPass subsidy, a substantial high-frequency private shuttle system, and other ongoing programs to reduce traffic impacts (estimated at $584 per unit per year); and the projected operations and maintenance expenses for the Project's Community Improvements (e.g., the streetscape, open space, athletic fields and public realm improvements within the Project Site) and the Stormwater Management Improvements (estimated at $1,193 per unit per year). As a result, CBRE Consulting believes that the operating income of the rental apartments is insufficient to bear an added annual assessment or expense such as a hypothetical Mello-Roos Community Facilities District ("CFD"). There is simply no "room" in the apartment income statement for an additional expense, such as CFD bond debt service.

PARKMERCED PUBLIC BENEFITS ANALYSIS

Summary of Improvements Currently Specified in the Proposed Project

The proposed Project includes three categories of public benefits that exceed the standard benefits already required under the City's existing ordinances. They are defined in the draft

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Development Agreement as (i) Community Improvements, (ii) Stormwater Management Improvements, and (iii) the Rent-Controlled Replacement Units. The Community Improvements are defined as improvements or amenities accessible to the general public that are above and beyond what is required by the City's existing Codes (e.g., all open space and development impact fees requirements in Article 4 of the Planning Code, etc.) or identified as a mitigation measure in the EIR. (See complete definition in Appendix A.) A map that illustrates the proposed physical location of many of these Community Improvements is provided in Appendix E. The Stormwater Management Improvements, which are also defined in the draft Development Agreement, include the costs of all infrastructure proposed to meet the City's Stormwater Management Ordinance through application of "best practices" sustainable technology (e.g., the proposed bio-swale, Juan Batista Circle retention pond, and creek system). Finally, for purposes of this study, CBRE Consulting has also estimated the effective "subsidy" of providing permanent rent-controlled replacement units for all 1,538 existing "Garden Court" rent-controlled units. A summary of all three of these public benefits and their estimated costs is provided in Table 2 on the following page.

Table 2
Parkmerced Community Improvement and Rent Controlled Replacement Unit Subsidy Summary

Community Improvement	*Estimated Cost*[4]	*Sources/Comments*
Realignment of MUNI M Oceanview line into Parkmerced	$61,100,000	Webcor, Mitchell Engineers, Fehr & Peers, and SFMTA[5]
Cogeneration Plant	$9,490,000	Webcor
Intersection Improvements	$9,540,000	Webcor
TDM Capital Costs (excluding Bikes)	$3,260,000	AECOM
TDM Capital Costs (Bike Support)[6]	$2,400,000	AECOM
Athletic Fields	$4,850,000	Webcor; allocated
Organic Farm	$2,980,000	Webcor; allocated
Other Open Space and Parks[7]	$2,620,000	Webcor; allocated
Podium Neighborhood Commons	$8,550,000	Webcor; allocated; 6 Commons
Photovoltaics	$37,400,000	Developer; maximum commitment
Wind Farm	$15,000,000	Developer; maximum commitment
Hard Cost Subtotal	*$157,190,000*	
Soft Cost Subtotal	*$15,390,000*	Added to Hard Costs
Total Community Improvements	***$172,580,000***	
Stormwater Management Improvements[8]	$28,720,000	Webcor; allocated; includes $5.16 million in soft costs
Rent Controlled Replacement Unit Subsidy	$158,900,000	CBRE Consulting; present value of cash flow difference
Total	**$360,200,000**	

It is important to note that in the Community Improvements section of the Development Agreement between the City of San Francisco and the Project sponsor, the Project's community/fitness center and private school are included in the definition of Community Improvements. However, these two items are specifically excluded from CBRE Consulting's quantification of Community Improvements as they are revenue-generating items in the development financial pro forma.

Another important note regarding the Community Improvements, particularly those related to the MUNI Realignment and the parks and open space (athletic fields, organic farm, and other

[4] The estimated cost is as of 2010 and represents the hard, or direct, cost before contingency and soft costs. The estimated soft costs are presented as a subtotal.

[5] The estimated costs include new station construction ($57,880,000) and demolition, repaving, and replanting ($3,220,000).

[6] Includes off-street bicycle parking ($1,125,000), directional signage ($750,000), bike share program capital costs ($475,000), and establish bike routes ($50,000).

[7] Other open space and parks consists of Belvedere Garden, Community Gardens, Juan Bautista Circle, greenway space and the 13-acre Stream Corridor/"Recreation Area" (see Appendix E).

[8] This category includes the bio-swales and is a hybrid item; part of the costs are associated with meeting the Stormwater Management Ordinance while the remainder represent improvements over and above those required by Code. No breakdown of the costs between Code items and above-Code items is available.

open space), is the fact that the estimated costs presented on the preceding page do not include an imputed land value. If the City were to provide Community Improvements of equivalent size and quality on its own, it would have been required to purchase the land under these improvements, which is an added cost. Therefore, the value of these improvements to the City is actually higher than the estimated costs presented.

In addition to the one-time capital costs for the above items (excluding the rent-controlled units), there are ongoing operating expenses associated with the maintenance of the Community Improvements and Stormwater Management Improvements presented in the above table and discussed in the preceding section. These items have been factored into the operating expense budget for the rental apartments. For the Community Improvements, the annual operating expense is estimated at $6,700,000 annually, or $1,193 per net new unit per year. There is another $4,200,000 ($584 per unit per year) in annual TDM expenses included as an operating expense.[9] These operating expenses are spread across the new apartment units and the condominium units; therefore, the financial model assumes that a Master Homeowners' Association (HOA) incorporates these expenses in its annual operating budgets.

Value of Rent Controlled Replacement Unit Subsidy

The proposed Development Agreement requires that any of the existing 1,538 "Garden Court" rent-controlled units demolished will be replaced with an equivalent new unit that will also remain under rent control. This is a significant effective subsidy, as the Project is also satisfying the City's existing inclusionary Below Market Rate (BMR) housing requirements (including a commitment that 33 percent of the requirement will be met through provision of on-site BMR units and with the remainder likely being satisfied through payment of the in-lieu fee to the Mayor's Office of Housing).[10] CBRE Consulting prepared an analysis to quantify the impact of the effective developer subsidy for the Rent Controlled Replacement Unit program, assuming for the sake of simplicity that all such Replacement Units were constructed in 2010. This analysis considered the revenues associated with the Rent Controlled Replacement Units compared to what they would otherwise generate if they were allowed to increase at market rates (as well as a proportion of inclusionary BMR units). The difference in these rental revenues, which were adjusted for either typical regulatory increases or market-based increases over time, was calculated starting in 2010, plus a subsequent 30-year period (through 2040). Table 3 on the following page illustrates the breakdown of the units in CBRE Consulting's analysis.

[9] If these two annual expense items were capitalized at 7.0 percent, the present value of these ongoing expense burdens is $155.7 million.

[10] CBRE Consulting estimates that applying the City's existing BMR ordinance to all net new units would result in an approximate 17.6 percent inclusionary BMR ratio based on the Development Agreement condition that 1/3 of the Code BMR obligation be provided on-site (and reflecting the existing lower Code requirement for buildings taller than 120 feet – 12 percent) and assuming that 2/3 of the requirement would be satisfied by the in-lieu fee option. Of the net new units, 22.8 percent are in towers taller than 120 feet and the rest (77.2 percent) are in shorter buildings. The formula is as follows:
[1/3((.15 * .772) + (.12 * .228))] + [2/3((.20 * .772) + (.17 * .228))]

Table 3
Unit Breakdown

	Current "One for One" Rent-Controlled Unit Replacement Proposal	*No Rent-Controlled Replacement Units, but Inclusionary BMR Requirements Apply*
Existing Rent Controlled Units	1,683	1,683
New Rent Controlled Replacement Units	1,538	0
New Market-Rate Units	1,046	2,354
New Inclusionary BMR Units[11]	185	415
Total Rental Units on Project Site	4,452	4,452

Included in the analysis was a "rolling" of the rent-controlled units to market, assumed to be 10 percent per year, consistent with the Project sponsor's reported experience at the property and the Project financial pro forma.[12] Once these units roll to market, the revenues for those units were then inflated at the regulatory growth rate. It should be noted that the pro forma also assumes that the vast majority of existing tenants choose to relocate into the new Rent Controlled Replacement Units at their existing rents.

Due to the assumed rollover of rent controlled units to market (when then grow at the lower rent-controlled rate), the Rent Controlled Replacement Unit subsidy associated with these retained units diminishes over time. CBRE Consulting's analysis found that in 2010, the difference in revenues between the Current Proposal and the No Replacement Scenario is $20,200,000 (e.g., the revenues under the No Replacement Scenario are $20,200,000 higher than the Current Proposal scenario). By 2017, when less than half the units remain in the rent-controlled category at a rate substantially below market (1,541 versus 3,221 in 2010), the difference in revenues is reduced to $12,900,000. In 2021, the difference between the two cash flows reaches an inflection point, after which time, the difference grows through the end of the projection period.

Due to the changing difference in the revenue streams, CBRE Consulting calculated a present value of the difference in order to identify the value of this "revenue loss" to the Project sponsor. The present value is calculated by applying a discount rate to each year. In order to identify a reasonable discount rate, CBRE Consulting used the Korpacz Real Estate Investor Survey published by Pricewaterhouse Coopers LLP.[13] According to this survey, apartment investors in the Pacific Region use a discount rate in the range of 8.0 to 12.5 percent as of the third quarter of 2010, with an average response of 10.0 percent. CBRE Consulting used a rate slightly higher than the average, or 11.0 percent. Based on the 11.0 percent discount rate, CBRE Consulting calculated a present value of $158,900,000, which represents the estimated economic value of the proposed Rent Controlled Replacement Unit program.[14]

[11] For simplicity, the analysis assumes that the City's inclusionary requirement is satisfied through provision of 100 percent on-site BMR units.

[12] According to the Census ACS 2006-2008 PUMS, the average tenure for renter households is 7.4 years, which indicates a higher turnover of 14 percent per year.

[13] As discussed in Appendix D, the Korpacz Real Estate Investor Survey is the predominant source of real estate investment criteria used by professionals throughout the industry.

[14] If a discount rate of 10.0 percent were used, the present value would have been $171,900,000.

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Impact of Community Improvements and Rent Controlled Replacement Unit Subsidy on Pro Forma

In addition to quantifying the cost of the Community Improvements and the present value of the Rent Controlled Replacement Unit program, CBRE Consulting also evaluated the impact of these items on the development pro forma. Specifically, we tested scenarios removing these items in order to identify the change in the Project's IRR. In addition, we tested sensitivities assuming the Community Improvements costs increased by both 10.0 and 20.0 percent. Table 4 below presents the results of this sensitivity analysis, which illustrates the significant financial impact these negotiated items have on the Project's IRR.

Table 4
Parkmerced Pro Forma Community Improvement and Rent Controlled Replacement Unit
Impact of Subsidy Assumption Changes on IRR

Scenario	*Assumption Change*	*Resulting IRR*
Eliminate Community Improvements	Development Costs down by $203 million Apartment Operating Expenses reduced by $1,780 per unit per year	22.4%
Eliminate Rent Controlled Replacement Unit Program	1,538 Replacement Units roll to market rents but with on-site BMR units	19.1%
Eliminate Community Improvements & Rent Controlled Replacement Units	Both changes described above	23.6%
Community Improvements costs increase 10%	Development Costs up $20 million	17.5%
Community Improvements costs increase 20%	Development Costs up $40 million	17.2%

The contents of this report are subject to the appended Assumptions and General Limiting Conditions.

ASSUMPTIONS AND GENERAL LIMITING CONDITIONS

CBRE Consulting has made extensive efforts to confirm the accuracy and timeliness of the information contained in this study. Such information was compiled from a variety of sources, including interviews with government officials, review of City and County documents, and other third parties deemed to be reliable. Although CBRE Consulting believes all information in this study is correct, it does not warrant the accuracy of such information and assumes no responsibility for inaccuracies in the information by third parties. We have no responsibility to update this report for events and circumstances occurring after the date of this report. Further, no guarantee is made as to the possible effect on development of present or future federal, state or local legislation, including any regarding environmental or ecological matters.

The accompanying projections and analyses are based on estimates and assumptions developed in connection with the study. In turn, these assumptions, and their relation to the projections, were developed using currently available economic data and other relevant information. It is the nature of forecasting, however, that some assumptions may not materialize, and unanticipated events and circumstances may occur. Therefore, actual results achieved during the projection period will likely vary from the projections, and some of the variations may be material to the conclusions of the analysis.

Contractual obligations do not include access to or ownership transfer of any electronic data processing files, programs or models completed directly for or as by-products of this research effort, unless explicitly so agreed as part of the contract.

This report may not be used for any purpose other than that for which it is prepared. Neither all nor any part of the contents of this study shall be disseminated to the public through publication advertising media, public relations, news media, sales media, or any other public means of communication without prior written consent and approval of CBRE Consulting.

APPENDIX A
DRAFT DEFINITION OF COMMUNITY IMPROVEMENTS
(FROM DEVELOPMENT AGREEMENT)

"Community Improvements" shall mean any capital improvement or facility, on-going service provision or monetary payment required by the Basic Approvals and this Agreement for the public benefit that is not: (1) a mitigation measure for the Project required by the California Environmental Quality Act; (2) a public or private improvement or monetary payment required by Existing Standards or Uniform Codes (including, for example, utility connections required by Uniform Codes, the payment of Development Fees and Exactions, Planning Code-required open space); or (3) the privately-owned residential and commercial buildings constructed on the Project Site, with the exception of the fitness/community center and the school, which are Community Improvements and may be privately-owned. Furthermore, Community Improvements shall not mean: (1) any units constructed by the Developer of fee paid by Develop in compliance with the BMR Requirement, and (2) the Replacement Units, which also provide a clear public benefit, but are subject to provisions of Section 4 of this [Development] Agreement. [The Replacement Units are termed a "Rent Controlled Replacement Unit Subsidy."]

APPENDIX B

PARKMERCED PROJECT - SELECTED REVENUE AND COST ASSUMPTIONS AND INPUTS

Revenue Items		
Condominium Units - Average Sales Price Per Unit		
Market Rate Condominiums	$798,550	
BMR Inclusionary Condominiums	$268,600	
Apartments - Average Rent Per Square Foot Per Year		
Market Rate Apartments	$36.80	
BMR Inclusionary Apartments	$14.82	
In-Place (rent-controlled) Apartments	$19.72	
Commercial Rents (Per Square Foot Per Year, NNN)		
Retail	$32.00	
Office	$33.00	
Fitness Center	$15.00	
School	$30.00	
Parking Space Sale Price (Condominiums, Per Space)	$30,000	
Parking Space Rent (Apartments, Per Space Per Month)	$150	
Other Revenues (Per Unit Per Month)	$65	approximate
Sales Price and Rent Escalation Schedule		
2011	3.5%	
2012	3.5%	
2013	5.0%	
2014	5.0%	
2015 and Thereafter	3.5%	per year
Condominium Sales Deductions (From Revenue)		
Sales Commission/Closing Costs	5%	of revenue
Construction Defect Insurance	$14,000	per unit sold

Cost Items	
Hard Construction Costs (Per Gross Square Foot)	
Residential, Type I (Steel Frame)	$254
Residential, Type III (Concrete Frame)	$201
Residential, Type V (Wood Frame)	$198
Existing Units, Upgrades	$48
Retail (shell)	$115
Office (shell)	$152
Fitness Center	$250
School	$275
Office/Retail Tenant Improvements	$40
Parking for All Uses	$105
Government Fees (Inflated, Per New Built Unit = 7,217)	
Jobs/Housing Linkage Fee	$1,017
Child Care Fee	$21
Transit Impact Fee	$532
School Fee	$3,565
Water Capacity Charge	$4,363
Wastewater Capacity Charge	$2,195
BMR Inclusionary In-Lieu Fee/Off-Site Devt.	$56,305
Other Soft Costs (Inflated, Per New Built Unit = 7,217)	
Acrhitectural Fees	$24,564
Engineering Fees	$16,864
Owner's Representative/Const. Management	$14,372
Permits	$10,453
Development Fee	$20,905
Marketing Costs for Condominiums	$5,226
Other Soft Costs	$4,907

Sources: Parkmerced Investors, LLC; The Concord Group; S.F. Mayors Office of Housing; Webcor; and CBRE Consulting.

APPENDIX C
PARKMERCED UNIT CONSTRUCTION TYPE BREAKDOWN

Construction Type	Stories	No. Units	Percent
For Sale Units			
Wood Frame Buildings	3 and 4 Stories	796	17.9%
Concrete Frame Buildings	5 and 6 Stories	771	17.3%
Steel Frame Buildings (1)	8 to 13 Stories	2,881	64.8%
Subtotal For-Sale Units		***4,448***	***100.0%***
For Rent Units			
Wood Frame Buildings	3 and 4 Stories	1,199	43.3%
Concrete Frame Buildings	5 and 6 Stories	1,230	44.4%
Steel Frame Buildings	8 Stories	340	12.3%
Subtotal For-Rent Units		***2,769***	***100.0%***
Total New Construction		7,217	
Existing Towers		1,683	
Total		**8,900**	
Overall Summary by Construction Type			
Total Wood Frame		1,995	27.6%
Total Concrete Frame		2,001	27.7%
Total Steel Frame (1)		3,221	44.6%
Total New Construction		7,217	100.0%

(1) Of the total units in steel-frame buildings, 1,296 are in structures taller than 120 feet, thus qualifying for lower inclusionary BMR housing levels (12%/17%).

Sources: SOM; and CBRE Consulting.

APPENDIX D
INTERNAL RATE OF RETURN DISCUSSION

The Internal Rate of Return (IRR) measures the rate of return on capital that is capable of being generated over a period of development and ownership. This metric is a critical tool used by developers and their debt and equity partners to evaluate development opportunities. Generally, investments with greater levels of risk require higher IRR thresholds. As real estate development is a risky endeavor, required IRRs for vertical development (taking a finished site through building construction, occupancy stabilization, and disposition) tend to be in the teens. Thresholds for horizontal land development are higher due to the more speculative nature of the project with an unpredictable income stream. For a project as broad and complex as this project, a reasonable threshold is in the low 20 percent range.

Real estate appraisers and analysts usually use surveys of developers and their capital partners as a means of identifying reasonable ranges for investment criteria. There are several sources that report on capitalization rates and discount rates for investment properties (e.g., apartment complexes, office buildings, etc.). However, investment criteria for land development are not well tracked in the real estate industry. There is one main source, discussed below. Otherwise, appraisers and analysts often conduct their own surveys in order to identify reasonable criteria for use in their valuations.

A well-respected source of this type of information is the Korpacz Real Estate Investor Survey published by Pricewaterhouse Coopers LLP. This survey has been published for over 20 years and is an industry leader in the collection and dissemination of real estate investment criteria. This survey indicates that land developers and private investors require "free and clear" (i.e., no leverage) project IRRs in the 20 to 25 percent range.

Additionally, a 2010 developer survey, conducted by CB Richard Ellis Valuation and Advisory Services for its own use in land development appraisal reports, corroborates the range indicated by Korpacz. This survey of national, regional, and local homebuilders, which has been conducted since 2002, indicates an IRR range (without a specific pro forma line item for developer profit) of 20 to 30 percent.

APPENDIX E

PUBLIC IMPROVEMENTS

PUBLICLY MAINTAINED

A	STREETS	966,000sf
B	MUNI EASEMENT	141,600sf

FUTURE PUBLICLY MAINTAINED

C	FUTURE MUNI EASEMENT	19,000sf
	TOTAL PUBLICLY MAINTAINED	1,126,600sf

COMMUNITY IMPROVEMENTS

PUBLICLY ACCESSIBLE*, PRIVATELY MAINTAINED

1	SIDEWALK	1,619,600sf
2	BIKE PATHS	78,800sf
3	PEDESTRIAN PATH	42,200sf
4	PASEOS	105,700sf
5	ALLEY WAYS	119,600sf
6	PLAZAS	53,100sf
7	DRIVEWAYS	85,200sf
8	SWALES	126,600sf
9	MEDIANS	88,600sf
10	NEIGHBORHOOD COMMONS	90,000sf
11	COMMUNITY GARDENS	48,000sf
12	JUAN BAUTISTA CIRCLE	106,300sf
13	ORGANIC FARM	207,700sf
14	PLAYING FIELDS	127,900sf
15	DOG PARK, tentative location	10,000sf
16	RECREATION AREA	572,200sf
	TOTAL PRIVATELY MAINTAINED	5,777,500sf
17	COMMUNITY/ FITNESS CENTER, PRIVATELY MAINTAINED	64,000sf
18	SCHOOL, PRIVATELY MAINTAINED	25,000sf
	PROJECT BOUNDARY	6,743,400sf

*subject to reasonable maintenance, operations, repair and security rights

**all dimensions are approximate and subject to detailed design