Planning Commission Report

Planning Commission Meeting: September 2, 2020

Agenda Item: 9-A

To: Planning Commission

From: Jing Yeo, City Planning Division Manager

Subject: Miramar Hotel Project Development Agreement 11DEV-003
Local Coastal Program Land Use Plan Amendment
Environmental Impact Report 13ENT-003
Vesting Tentative Tract Map 20ENT-0153

Address: 1133 Ocean Avenue (Miramar Hotel site)
Applicant: Ocean Avenue, LLC

Executive Summary

This supplemental staff report transmits (i) a peer review of the developer's financial feasibility analysis and (ii) additional information provided by the developer comparing estimated contribution for the affordable housing project based on scenarios of 9% tax credits, 4% tax credits, or no tax credits (Attachment A).

Financial Feasibility Review of Proposed Project

Community benefits achieved through development agreements have a long-standing history in Santa Monica, dating back to 1982. Negotiated community benefits can fund or provide a number of different improvements, ranging from affordable and middle-income housing to targeted streetscape enhancements. Negotiated benefits may be used in conjunction with other funding and financing mechanisms where appropriate. Within the Downtown Community Plan, development agreements are required for projects within the Established Large Site Overlay.

As development agreements are negotiated on a case by case basis, financial and economic analyses are prepared to help understand how the negotiated community benefits affect the financial feasibility of proposed projects. The location, size and type of project, and its mix of uses can vary widely and therefore, the financial feasibility, range, and magnitude of benefits will similarly vary. Financial feasibility analyses are only one consideration in the overall approach to evaluating community benefits. The analyses are intended as an informational tool for decision-making and are not intended to be used for establishing a set dollar value scale of required community benefits based on entrepreneurial profit. It is also important to note that the analyses are rough approximations contingent on various assumptions. Therefore, to the maximum extent possible, the Downtown Community Plan seeks to establish a policy-based approach to setting transparent and consistent expectations for negotiated community benefits.

The City contracted HR&A Advisors to conduct a peer review of the developer's confidential financial feasibility analyses. The financial feasibility analysis attached to this supplemental staff report (Attachment B) provides an assessment of project feasibility using the developer's profit margin metric. It should be noted that HR&A's analysis represents the state of negotiations at the time the review was completed and so it does not incorporate all aspects of the recommended community benefits in the draft development agreement.

The financial feasibility analysis provided by Developer, even without the specified community benefits, shows a profit margin that is well below the minimum acceptable real estate industry benchmark for a development of this type (estimated at 12%). As further discussed below, HR&A's independent review of the Developer's financial feasibility analysis supports a higher profit margin investment return threshold than presented by the Developer. HR&A's conclusion is based on questioning assumptions that had the greatest impact on project feasibility with respect to:

- Valuation of the Current Asset
    - Developer has inflated the value of the asset and included lost net operating income as a development cost
- Condo Sales Price
    - Potential for higher condo sale prices than assumed
- Cap Rates
    - Use of conservative cap rates

Revising any of these factors would result in reduced development cost and a resulting increase in project value. This in turn would result in project margins that are higher than represented by the developer and exceeding the industry-accepted profit margin threshold for a development of this type. As a result, HR&A's review shows that the project is feasible and can support the recommended community benefits in the draft development agreement.

Affordable Housing Gap Financing Scenarios

One of the most significant community benefits being offered is the Developer's donation of property and provision of gap financing for a minimum of 42 affordable units on the donated property, as detailed in the staff report. The affordable housing partner and developer have indicated that they intend to pursue 9% tax credits but are providing additional information regarding 4% tax credits and no tax credits if the application for the 9% tax credits is unsuccessful due to the fact that 9% tax credits are allocated by the state on a competitive basis. While 4% tax credit financing would be a default scenario, it is also possible that the laws regarding allocation of tax credits may change. The table indicates the Developer's gap financing contributions, based upon the occurrence of each of these scenarios.

Attachments

A. Developer's Comparison of Affordable Housing Contribution Scenarios
B. HR&A Advisors, Inc. Financial Feasibility Review of the Miramar Hotel Redevelopment Project