

Administrative Draft Memorandum

To: Tom Smith, Kyle Perata, and Payal Bhagat, City of Menlo Park

From: Stephanie Hagar, Associate Principal
Chelsea Guerrero, Vice President

Date: June 3, 2021

Re: Evaluation of Revised Menlo Uptown Community Amenities Proposal

Purpose

This memorandum provides BAE's assessment of the value of the applicant's revised community amenities proposal for the proposed Menlo Uptown Project. The City-approved appraisal for the project site identified a required amenity value of \$8,900,000, and the project applicant has submitted a community amenities proposal that provides two alternative amenity packages. In Alternative 1, the applicant would provide space in the project to Samaritan House and make a financial contribution to Valley Community Land Trust (VCLT). In Alternative 2, the applicant would provide space in the project for the Ravenswood Family Health Network for use as either an express care clinic or an urgent care clinic. In Alternative 2, the applicant would also make a financial contribution to the Ravenswood Family Health Network to support the organization's operations. The applicant has provided an assessment of the value of the community amenities alternatives that estimates that either alternative would have a value of \$8.9 million. This memorandum does not assess whether the proposed amenity falls within the current amenity list adopted by the City Council, or whether the same amenity has already been provided by another applicant. This memorandum evaluates the methodology and key assumptions that the applicant used to determine the value of the proposed community amenity and provides BAE's determination of the value.

Key Findings

Table 1 below provides a summary of the value of the two community amenities proposal alternatives that the project applicant has proposed as part of a request for bonus level development for a proposed project located at 141 Jefferson Drive and 180-186 Constitution Drive in Menlo Park. As shown, BAE found that the value of both alternatives is \$300,000 lower than the required \$8.9 million value.

The value of providing the commercial space to Samaritan House or the Ravenswood Family Health Network will depend on the terms under which the property owner utilizes the space.

San Francisco

2560 9th St., Suite 211
Berkeley, CA 94710
510.547.9380

Sacramento

803 2nd St., Suite A
Davis, CA 95616
530.750.2195

Los Angeles

448 South Hill St., Suite 701
Los Angeles, CA 90013
213.471.2666

Washington DC

1140 3rd St. NE, 2nd Floor
Washington, DC 20002
202.588.8945

New York City

234 5th Ave.
New York, NY 10001
212.683.4486

ADMINISTRATIVE DRAFT

BAE's valuation estimates in the table below reflect an assumption that the space would be used by Samaritan House or the Ravenswood Family Health Network at no cost to the tenant for the life of the project. This means that the property owner will not charge the tenant for any rent or operating expenses at any point throughout the tenancy.

It should be noted that some aspects of the valuation of the community amenities proposals may vary substantially based on project specifics and the particular needs of the organization that occupies the commercial space. Therefore, BAE recommends that the City request verification of the project applicant's actual costs for interior space build-out, set up costs (in the Samaritan House alternative), and special equipment costs (in the urgent care scenario) following project completion. Should actual costs differ from the applicant's estimates, the City could adjust the direct financial contribution associated with each scenario as appropriate.

ADMINISTRATIVE DRAFT

Table 1: Summary of Community Amenity Proposal Valuation for Proposed Menlo Uptown Project

		Commercial Space Provided for Nonprofit Use	Interior Build-Out Costs	Less: Build-Out Costs Covered by Standard TI Allowance	Specialty Equipment Costs	Set Up Costs	Direct Financial Contribution	Total	Shortfall (Compared to \$8.9 million required)
Samaritan House Alternative	Applicant Valuation	\$4,534,624	\$745,070	N/A	N/A	\$150,000	\$3,470,306	\$8,900,000	\$0
	BAE Evaluation	\$4,455,124	\$745,070	(\$220,500)	N/A	\$150,000	\$3,470,306	\$8,600,000	(\$300,000)
Ravenswood Family Health Network Alternative, Express Care Scenario	Applicant Valuation	\$4,534,624	\$2,058,000	N/A	N/A	N/A	\$2,307,376	\$8,900,000	\$0
	BAE Evaluation	\$4,455,124	\$2,058,000	(\$220,500)	N/A	N/A	\$2,307,376	\$8,600,000	(\$300,000)
Ravenswood Family Health Network Alternative, Urgent Care Scenario	Applicant Valuation	\$4,534,624	\$2,058,000	N/A	\$882,000	N/A	\$1,425,376	\$8,900,000	\$0
	BAE Evaluation	\$4,455,124	\$2,058,000	(\$220,500)	\$882,000	N/A	\$1,425,376	\$8,600,000	(\$300,000)

ADMINISTRATIVE DRAFT

Project Description

The proposed Menlo Uptown project consists of 441 multifamily rental units and 42 townhomes along with a 2,940 square foot commercial space on the ground floor of one of the multifamily rental buildings. The project site is located at 141 Jefferson Drive and 180-186 Constitution Drive, within the Bayfront Area of Menlo Park. The project applicant is seeking approvals to construct the project at the bonus level density pursuant to the City's community amenities program for the Residential Mixed Use Bonus (R-MU-B) zoning district. The R-MU-B zoning district allows a project to develop at a greater level of intensity with an increase in density, floor area ratio, and/or height in exchange for providing community amenities, which are intended to address identified community needs that result from the effect of the increased development intensity on the surrounding community. Community amenities also enable the surrounding community to benefit from the substantial increase in project value that is attributable to the increase in density, floor area, and/or height. Full project details are available on the City of Menlo Park website (<https://www.menlopark.org/1576/Menlo-Uptown>).

Community Amenities Proposal

Because the proposed project would be built at the bonus level of development, the project applicant is required to provide community amenities in exchange for the additional development potential that is allowable under the bonus level density. In the case of the subject project, an appraisal commissioned by the City (available at the link shown above) determined that the value of the community amenity must equal \$8,900,000. The project applicant has proposed two alternatives for meeting the community amenities requirement, as described below.

Alternative 1: Building Space and Build-Out Costs for Samaritan House and Financial Contribution for Valley Community Land Trust. Alternative 1 would reserve the approximately 2,940 square foot ground floor commercial space in the project for use by Samaritan House, dedicate funds to offset Samaritan House's build-out and startup costs, and provide a lump sum financial contribution to the VCLT. The applicant's proposal states that the property owner will fully subsidize all typical rental costs for the commercial space and cover the costs to build out the space for Samaritan House's use. The applicant would also contribute additional funds to offset Samaritan House's set up costs, such as computers and other supplies. In addition, the applicant has proposed a lump sum financial contribution totaling \$3,470,306 to the VCLT. This financial contribution is equal to difference between the required \$8.9 million community amenity contribution and the applicant's estimate of the value of the proposed contribution to Samaritan House.

Alternative 2: Building Space, Build-Out Costs, and Financial Contribution for Ravenswood Family Health Network. Alternative 2 would reserve the approximately 2,940 square foot ground floor commercial space in the project for use by Ravenswood Family Health Network, provide additional funds to offset Ravenswood Family Health Network's build-out and startup

ADMINISTRATIVE DRAFT

costs, and provide a financial contribution to Ravenswood Family Health Network to support ongoing operations. As in Alternative 1, in Alternative 2 the property owner would fully subsidize all rental costs and cover the cost to build out the space for the Ravenswood Family Health Network's use. The applicant's proposal considers two potential uses for the commercial space: an urgent care clinic and an express care clinic. In Alternative 2, the applicant would also provide a financial contribution to the Ravenswood Family Health Network to support the organization's operations. The direct financial contribution would total \$1,425,376 in the urgent care scenario or \$2,307,376 in the express care scenario. In both scenarios, the amount of the proposed direct financial contribution is equal to the difference between the required \$8.9 million community amenity contribution and the applicant's estimate of the value of providing the space to the Ravenswood Family Health Network and covering the build-out costs.

Applicant Valuation of Community Amenities Proposal

The project applicant has provided an assessment of the two alternative community amenities contributions described above. The applicant's valuation for each alternative relies in part on a memorandum that BAE completed on December 23, 2020, which evaluated a community amenities proposal that the applicant had previously submitted for the proposed project. The prior proposal included providing the commercial space in the project to either VCLT or another nonprofit organization for use as office space, at no cost to the tenant. The December 23 memorandum includes BAE's determination of the value of providing this commercial space to a nonprofit tenant. The applicant used BAE's determination of this value to determine the value of providing the space to either Samaritan House or the Ravenswood Family Health Network under the applicant's current community amenities proposal. In addition, the applicant's valuation includes: the full cost to build out the interior of the commercial space for use by either Samaritan House or the Ravenswood Family Health Network, the proposed contribution toward Samaritan House's set-up costs (Samaritan House alternative only), and the proposed direct financial contribution to VCLT (in the Samaritan House alternative) or the Ravenswood Family Health Network (in the Ravenswood Family Health Network Alternative). The applicant's assessment of the value of both alternatives is shown in Table 2 below.

ADMINISTRATIVE DRAFT

Table 2: Applicant Valuation of Community Amenity Proposal Alternatives

	Samaritan House Alternative	Ravenswood Family Health Network Alternative	
		Urgent Care Scenario	Express Care Scenario
Value of Providing 2,940 SF commercial space at no cost to tenant (a)	\$4,534,624	\$4,534,624	\$4,534,624
Build-Out Costs (per SF / Total for 2,940 SF Space)	\$253.43 / \$745,070	\$700.00 / \$2,058,000	\$700.00 / \$2,058,000
Specialty Equipment Costs (per SF / Total for 2,940 SF Space)	N/A	\$300.00 / \$882,000	N/A
Set Up Costs	\$150,000	N/A	N/A
Direct Financial Contribution	\$3,470,306 to VCLT	\$1,425,376 to Ravenswood Family Health Network	\$2,307,376 to Ravenswood Family Health Network
Total Estimated Community Amenity Contribution Value	\$8,900,000	\$8,900,000	\$8,900,000

Note:

(a) Equal to BAE's determination of the value of providing the commercial space, according to the memorandum that BAE completed on December 23, 2020.

Source: Greystar, 2021; BAE, 2021.

Analysis of Value of Community Amenities Proposal

This section details BAE's analysis of the value of the two alternatives described in the applicant's community amenities proposal.

Value of Providing Commercial Space at No Cost to the Tenant

To assess the value of providing the commercial space in the project to a nonprofit tenant at no cost to the tenant, the project applicant used the value from the analysis that BAE presented in the December 23, 2020 memorandum. The applicant's community amenity proposal notes that BAE's determination of the value includes the net present value of the commercial space subsidy (i.e., foregone rent revenues) and the net present value of the subsidized operating costs, which would be covered by the property owner. However, in addition to these two components, BAE's valuation for the space also included \$79,500 in tenant improvement costs, which was included in the total \$4,534,624 valuation for providing the commercial space. In a typical office lease, the property owner provides new tenants with a tenant improvement allowance to cover a portion of the cost to build out the interior of the space. The total cost of tenant improvements often exceeds the tenant improvement allowance provided by the property owner, and the tenant bears the remainder of the cost.

ADMINISTRATIVE DRAFT

The \$79,500 tenant improvement allowance value from BAE's December 23 memorandum was based on the applicant providing the tenant with a relatively large (\$300,000) tenant improvement allowance. The \$79,500 amount represents the difference between the \$300,000 tenant improvement allowance that the applicant had proposed for the prior community amenities proposal for the project and a tenant improvement allowance toward the lower end of the standard range (\$220,500, or \$75 per square foot).

The applicant's valuation of the current community amenities proposal includes the full cost of building out the space in each scenario, which would be inclusive of standard tenant improvement costs, in a line item that is separate from the \$4,534,624 valuation for providing the commercial space. As a result, the applicant's valuation essentially double-counts \$79,500 in tenant improvement costs – once in the value of providing the commercial space and again in the actual cost of building out the interior space in each scenario. BAE's assessment of the value of the community amenities proposal adjusts the value of providing the commercial space by including only the value of the rent and operating cost subsidy, as determined in the December 23 memorandum, and excluding the \$79,500 tenant improvement cost. Instead, this evaluation includes all tenant improvement costs as a line item that is separate from the rent and operating cost subsidy, consistent with the applicant's valuation of the current community amenities proposal.

Build-Out Costs

For both alternatives, the applicant plans to cover all build-out costs for the tenant that would occupy the commercial space. This would include hard and soft construction costs associated with adding finished flooring, interior glazing, wall covering and finishing, lighting fixtures, fire sprinklers, a security system, HVAC, ceiling diffusers, bathroom accessories, and plumbing fixtures to the commercial space.

Build-Out Costs for Samaritan House Alternative. The project applicant estimated that total build-out costs for the Samaritan Housing Alternative would total \$745,070, or \$253.43 per square foot. The applicant referenced the JLL 2017 U.S. Fit Out Guide to estimate build-out costs and inflated the figures from the 2017 Fit Out Guide based on the Turner Building Cost Index. The JLL Fit Out Guide is an accepted source for office build-out cost estimates, while the Turner Building Cost Index is generally appropriate for estimating construction cost inflation over time. BAE reviewed both sources and found that the applicant's estimated build-out cost for the Samaritan House alternative is consistent with these sources. Therefore, BAE did not make any adjustments to the applicant's estimated build-out costs for this alternative. It should be noted that the JLL cost estimate and the applicant's cost estimate include audio/visual and information technology systems costs; furniture, fixtures, and equipment (FF&E); and moving costs. The estimated value of this alternative is dependent on the project applicant covering each of these costs.

ADMINISTRATIVE DRAFT

Build-Out Costs for Ravenswood Family Health Network Alternative. In general, build-out costs for a health clinic tend to be significantly higher than office build-out costs due in part to the need for additional plumbing fixtures, cabinetry, and other interior finishes. Health clinics may also require more interior walls than a standard office space to create private exam rooms, whereas office spaces may have a higher ratio of open area or cubicle space. In addition, the applicant's community amenities proposal states that the urgent care and express care scenarios would include a healthcare grade HVAC filtration system.

The project applicant estimated that total build-out costs for the Ravenswood Family Health Network alternative would total \$2,058,000, or \$700 per square foot. The applicant's estimate is based on a construction cost budget that the Ravenswood Family Health Network provided for a 38,300 square foot clinic that the organization recently constructed in East Palo Alto. The construction costs provided in that budget are approximately six years old. The applicant totaled the hard and soft costs per square foot for the clinic in East Palo Alto and assumed 10 percent average annual cost inflation (i.e., a 60 percent total increase in cost) to bring the figures up to current construction costs. According to the project applicant, the cost inflation estimate is based on information provided by the Ravenswood Family Health Network. This is a significantly higher rate of construction cost inflation than is typical. For example, the Turner Building Cost Index indicates that construction costs increased by 24 percent between 2015 and the first quarter of 2021, while the historical cost index provided by 2021 *Square Foot Cost with RSMeans Data* (Gordian) indicates that construction costs increased by 25 percent between 2015 and January 2021. Nonetheless, BAE did not adjust the cost inflation assumption because the inflation rate is based on information provided to the applicant by a professional that is knowledgeable in medical clinic construction costs, which may have increased at a faster rate than construction cost increases more generally. This results in a cost estimate of \$1,043 per square foot, which includes both the building shell and interior buildout. Approximately four percent of this cost is comprised of costs for a consultant, legal services, and financial analysis related to New Markets Tax Credits (NMTC), as well as a Primary Care Development Corporation (PCDC) financing fee. While BAE assumes that the proposed project will not receive NMTC or PCDC funding and therefore will not incur these costs, this has a relatively small impact on the overall cost estimate given that the applicant has provided a relatively high-level cost estimate for the interior buildout. The applicant approximates that, after removing the cost of the building shell, the cost of the interior buildout alone would be equal to approximately \$700 per square foot.

To provide another point of comparison, BAE reviewed data provided in the Cummings Insights Q1 2021 Construction Market Analysis report. This report includes total build-out cost estimates for acute care facilities, medical office buildings, and specialty clinics in various locations. The construction cost data provided in the report include the structure shell and interior build-out but do not include land acquisition, permits, FF&E, or soft costs. For this analysis, BAE used the costs that the report provides for San Francisco, the closest city to Menlo Park that is included in the report. According to these data, hard construction costs for

ADMINISTRATIVE DRAFT

healthcare uses in San Francisco, including building shell and interior build-out, range from \$612 to \$734 per square foot for a medical office building and \$765 to \$918 per square foot for a specialty clinic. Assuming soft costs are equal to 20 percent of hard costs, the total hard and soft costs for the building shell and interior buildout would range from \$734 to \$881 per square foot for a medical office building and \$918 to \$1,102 per square foot for a specialty clinic. BAE then adjusted these costs to exclude the cost of the building shell, based on medical office hard construction costs estimates provided by the 2021 RSMeans Data, plus a 20 percent soft cost assumption. This resulted in an estimated hard and soft interior build-out construction cost ranging from \$496 to \$642 per square foot for a medical office building and \$680 to \$863 for a specialty clinic. These data indicate that the \$700 per square foot cost provided by the applicant could potentially be within a reasonable range, particularly if the build-out of the space is similar to a specialty clinic. Moreover, the interior buildout cost for a clinic in the proposed space in the project may be slightly higher than is typical due to the small size of the space, which could reduce efficiencies in the construction process and require that more components of the interior buildout are customized to fit within the space.

Because the project applicant's cost estimate generally falls within the range of potential build-out costs for a clinic use, BAE did not make any adjustments to these costs. However, it should be noted that build-out costs for clinics can vary widely and would depend in part on the full list of specific cost items that are included in the costs that the project applicant intends to cover. If the City and the project applicant choose to move forward with this alternative, BAE recommends that the City request that the applicant provide verification of the actual build-out costs for the space upon completion and adjust the direct financial contribution to the Ravenswood Family Health Network to account for any differences between the costs estimated by the applicant and the actual build-out costs.

Tenant Improvement Allowance Included in Base Rent

As noted above, a standard lease for the commercial space in the project would include a tenant improvement allowance, which would likely range from \$75 to \$100 per square foot. A tenant improvement allowance is typically included as part of the tenant's base rent and is included when determining total project development costs. The value of providing the commercial space at no cost to the tenant – as determined in BAE's December 23 memorandum and used in the project applicant's estimate of the value of the current community amenities proposal – includes the value of the property owner's rent subsidy. Because the base rent amount would include a standard tenant improvement allowance, this standard allowance is incorporated into the value of providing the space to Samaritan House or the Ravenswood Family Health Network. For the purpose of the December 23 analysis, BAE assumed that the base rent would include a standard tenant improvement allowance of \$75 per square foot, or \$220,500 total. This amount is in addition to the \$79,500 tenant improvement allowance discussed above, which captured an additional allowance in excess of the standard \$220,500 amount. In the case of the current community amenities proposal,

ADMINISTRATIVE DRAFT

there is an overlap between the standard tenant improvement allowance, which is included in the base rent subsidy, and the total build-out costs for each alternative as described above. Therefore, BAE's evaluation of the value of the community amenities proposal nets out a standard tenant improvement allowance of \$75 per square foot (\$220,500 total) from the total build-out cost in each scenario to avoid double-counting the value of the standard tenant improvement allowance.

Set Up Costs (Samaritan House Alternative Only)

The applicant's community amenity package for the Samaritan House alternative includes a \$150,000 contribution toward Samaritan House's set up costs, including but not limited to computers and supplies. While it is difficult to evaluate this estimate without detailed knowledge of Samaritan House's specific needs related to set-up costs, it is likely that Samaritan House could use these funds for various equipment costs. However, as noted above, the build-out costs for the Samaritan House alternative include an allowance for FF&E, which could potentially overlap with these set up costs. If the City and the project applicant choose to move forward with this alternative, BAE recommends that the City verify that set up costs included in this \$150,000 allowance do not overlap with the cost of FF&E that is included in the build-out cost. In addition, BAE recommends that the City request verification of the actual contribution to Samaritan House for set up costs. Should the actual set up costs covered by the applicant vary from the applicant's estimate, the City could adjust the required direct financial contribution to VCLT as appropriate.

Specialty Equipment Costs (Ravenwood Family Health Network, Urgent Care Scenario Only)

In the urgent care scenario for the Ravenswood Family Health Network alternative, the project applicant's valuation estimate includes a \$300 per square foot cost for specialty equipment, or \$882,000 in total. According to the applicant's community amenities proposal, these costs could include but would not necessarily be limited to x-ray/imaging equipment, a pharmacy, and a lab, though the applicant has not developed a detailed list of the items that would be included in this total. This cost estimate may be within a reasonable range for specialty equipment for an urgent care center, though these costs can vary widely. According to 2021 RSMeans Data, x-ray equipment can range from \$18,800 to \$106,000 for a mobile unit or \$306,500 for a stationary unit, while radiation shielding for a radiography room can range from \$19,650 to \$25,925. RS Means estimates that medical sterilizing equipment ranges from \$12,900 to \$278,500 each and examining tables range from \$2,025 to \$9,950 each. RS Means estimates that laboratory cabinets range from \$295.50 to \$767.50 per linear foot and that laboratory countertops range from \$73.45 to \$264.95 per square foot. While these cost estimates suggest that specialty equipment for the urgent care center scenario could potentially total \$882,000, the actual cost of specialty equipment would be heavily dependent on the type and quantity of each piece of equipment. If the City and the project applicant choose to move forward with this alternative, BAE recommends that the City request verification of all special equipment costs and ensure that these costs are not duplicative of any costs included in the total build-out cost as described above. Should the actual cost of

ADMINISTRATIVE DRAFT

special equipment vary from the applicant's estimate, the City could adjust the required direct financial contribution as appropriate.

Summary of Determination of Community Amenity Value

Table 3 below provides a summary of BAE's determination of the value of the two community amenity proposals. The value shown includes the value of providing the commercial space to either Samaritan House or the Ravenwood Family Health Network, the total cost to build out the interior space in each alternative, set-up costs for the Samaritan House alternative, special equipment costs for the urgent care center scenario, and the direct financial contribution in each alternative. As shown, this analysis estimates that the value of each alternative is equal to \$8.6 million, \$300,000 less than the required amenity value. This \$300,000 is equal to the project applicant's proposed contribution toward tenant improvements in the prior community amenities proposal for the proposed project, which was incorporated into BAE's December 23 estimate of the value of providing the commercial space to a nonprofit tenant. In the December 23 valuation, \$220,500 of the total \$300,000 contribution was included in the value of the base rent subsidy as a standard tenant improvement allowance, while the remaining \$79,500 was included as an additional contribution that the developer would make in addition to the standard tenant improvement allowance. Because the project applicant used BAE's valuation of the commercial space from the December 23 memorandum, this \$300,000 was carried forward in the applicant's estimate of the value of the current community amenities proposal. However, the applicant's valuation of the current proposal includes build-out costs for each alternative, including standard costs for tenant improvements, as line items that would be separate from the value of providing the commercial space. Therefore, BAE's determination of the value of the community amenities proposal results in a value that is \$300,000 lower than the applicant's valuation to avoid double-counting \$300,000 of the total build-out cost.

ADMINISTRATIVE DRAFT

Table 3: BAE Valuation of Community Amenity Proposal Alternatives

	Samaritan House Alternative	Ravenswood Family Health Network Alternative	
		Urgent Care Scenario	Express Care Scenario
Value of Providing 2,940 SF Commercial Space at No Cost to Tenant (a)	\$4,455,124	\$4,455,124	\$4,455,124
Build-Out Costs (per SF / Total for 2,940 SF Space)	\$253.43 / \$745,070	\$700.00 / \$2,058,000	\$700.00 / \$2,058,000
Less: Standard Tenant Improvement Allowance Included in the Value of Providing the Commercial Space	(\$220,500)	(\$220,500)	(\$220,500)
Specialty Equipment Costs (per SF / Total for 2,940 SF Space)	N/A	\$300.00 / \$882,000	N/A
Set Up Costs	\$150,000	N/A	N/A
Direct Financial Contribution	\$3,470,306 to VCLT	\$1,425,376 to Ravenswood Family Health Network	\$2,307,376 to Ravenswood Family Health Network
Total Estimated Community Amenity Contribution Value	\$8,600,000	\$8,600,000	\$8,600,000
Excess / (Shortfall) Community Amenity Value	(\$300,000)	(\$300,000)	(\$300,000)

Source: Greystar, 2021; BAE, 2021.