



KEYSER MARSTON ASSOCIATES  
ADVISORS IN PUBLIC/PRIVATE REAL ESTATE DEVELOPMENT

MEMORANDUM

**To:** Cecilia V. Estolano, Chief Executive Officer  
Community Redevelopment Agency of the City of Los Angeles

**From:** Keyser Marston Associates, Inc.

**cc:** ILUP Team

**Date:** January 17, 2007

**Subject:** Industrial to Residential Land Use Conversion –  
Comparative Land Value Analysis

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Pursuant to the request of the Industrial Land Use Policy Team, Keyser Marston Associates, Inc. (KMA) examined the likely impact on land values if industrial zoning is replaced with zoning which permits residential development. This review was undertaken by both gathering recent land sale data for industrial and residentially zoned properties in the greater downtown area as well as through the preparation of prototypical development pro formas for a residential project, and a light industrial project. Through the pro forma analysis, KMA has estimated the “residual land value”<sup>1</sup> supportable by industrial or residential development.

### Land Sale Comparables

KMA conducted a survey of land sales comparables that have transacted within the past two years in the greater downtown area. The location of the sales comparables are shown on Map 1. KMA compiled these sales based on data obtained from the Costar

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<sup>1</sup> “Residual land value” is the value of land determined by deducting from the value of an improved property, the costs of development and a market rate profit. The methodology is often used where direct land sale comparables are not available without substantial adjustment for the use and development conditions.

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Group and from land sale appraisals provided by the CRA and others. However, it should be noted that industrial and residential sales comparables are generally limited in this area. The industrial sales include three sites in Vernon. The survey revealed that the weighted average sales price per square foot for land intended for residential and industrial uses was \$290 and \$41, respectively (refer to Appendices A and B).

### **Residual Land Value**

Given the lack of residential sales in the industrial areas of the downtown, KMA has prepared a residual land value analysis to estimate the supportable land value for residential and industrial development. To estimate the residual land value, KMA has prepared development cost and income estimates ("development pro formas") for two hypothetical projects on an assumed 2-acre site in the industrial areas of downtown Los Angeles.

#### ***Residential Development Assumptions***

- The parcel size is assumed to be 2.0 acres.
- The residential project is comprised of 100 ownership units, at a density of 50 units per acre. This represents an FAR of approximately 1.5 : 1
- The residential project is assumed to be wood frame construction, "Type 5" of 4 stories or less.
- Residential parking is structured, at a ratio of 2.0 spaces per unit.
- The housing is limited to for-sale, market rate condominiums.

#### ***Industrial Development Assumptions***

- The parcel size is assumed to be 2 acres.
- The building is assumed to contain 52,272 square feet of gross leaseable area equaling a floor area ratio of .60 inclusive of mezzanine space.
- Parking is all surface at a ratio of 2.0 spaces per 1,000 square feet of gross building area.

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- The development is assumed to be developed for an owner/user thereby reducing the minimum required return.
- Construction type is concrete tilt-up with office limited to 10% of the building.

### **Findings and Implications**

As reflected in the attached Appendices C and D, KMA's analysis resulted in the following residual land values:

Comparison of Residual Land Values

	Residential	Industrial
Residual Land Value	\$15,424,000	\$3,282,000
Per Square Foot of Land Area	\$177	\$38

The disparity between downtown industrial and residential land values indicated in the residual land values of prototypical projects is supported by the market land sale data discussed above.

As demonstrated above, a change in land use zoning from industrial to residential would confer substantial additional land value. This enhancement in land value can accrue to the existing owner of minimally improved industrial land, allowing the sale of the property at prices substantially in excess of its current value as industrial land. These prices are such a premium over existing industrial land values that potential industrial users of the property cannot compete to purchase or lease. Under current market conditions, the likely result of a granting by the City of residential entitlement from industrial will be a conversion of industrial to residential uses.

Alternatively, residential condominium developers who purchase industrially zoned property at industrial land values and subsequently receive residential entitlement will see a substantial increase in development profit. Using the residential pro forma discussed above, the profit as a percentage of development cost, would increase from 18% to 54% as shown below, a \$12 million increase in the example provided:

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### Comparison of Enhanced Profit Due to Entitlement Change

	Acquisition of Residentially Zoned Land	Acquisition of Industrially Zoned Land If Rezoned
Residential Sales Proceeds	\$60,240,000	\$60,240,000
Imputed Land Costs <sup>(1)</sup>	\$15,424,000	\$3,282,000
Other Development Costs	\$35,780,000	\$35,780,000
Total Development Costs	\$51,204,000	\$39,062,000
Profit	\$9,036,000	\$21,178,000
Profit as % of Total Costs	18%	54%

<sup>(1)</sup>Assumes residual land values as determined in prototypical analyses above.

This increase in value of approximately \$12 million is directly attributable to the granting of residential entitlement.

The extent of the enhanced land value or extraordinary developer profit will be a function of a number of variables including the building type and density of the residential developed, the cost and time period require to obtain residential entitlements, market conditions, etc. Under current market conditions, there is a substantial premium created as a result of a change in land use entitlements.

There have been fewer transactions of residential land for apartment development in the downtown area. Based upon current construction costs and rent levels, it is unlikely residential land values for apartment development approach the values achieved for condominium land in the South Park area. Based solely upon the land costs for the Orcini project at Figueroa and Caesar Chavez, land values of \$100 to \$125 per square foot are indicated for residential rental development. This is substantially in excess of the established industrial land values discussed above.

With respect to adaptive reuse of existing industrial zoned properties to residential uses, no clear generalize conclusions can be drawn. The economics of each adaptive reuse project are unique, and the underlying property values for residential conversion are a function of the extent to which the building must be rehabilitated, the costs of conversion, parking requirements and the like. However, given the interest in conversion of existing industrial buildings to residential uses, the market suggests that there is enhanced return through a change in use to residential.

We hope this review is helpful and are available to discuss this analysis with you at your convenience.

## **APPENDIX A**

**APPENDIX A - TABLE 1**

**LAND SALE COMPARABLES - RESIDENTIAL  
RESIDUAL LAND VALUATION ANALYSIS  
LOS ANGELES, CA**

<b>No.</b>	<b>Location &amp; Cities</b>	<b>Sale Date</b>	<b>Land SF</b>	<b>Sales Price</b>	<b>\$/Land SF</b>
1	Multi Family - Units Site Los Angeles, CA	07/18/06	411,642	\$70,500,000	\$171
2	Residential Land Property <sup>1</sup> Los Angeles, CA	10/27/06	57,934	\$30,000,000	\$518
3	Condominium Site Los Angeles, CA	01/24/06	41,075	\$14,800,000	\$360
4	5-Story Hotel/Apts-Low Income <sup>2</sup> Los Angeles, CA	09/08/06	10,454	\$1,155,000	\$110
5	214 unit residential development Los Angeles, CA	07/11/05	29,801	\$17,000,000	\$570
6	156 unit residential development Los Angeles, CA	10/15/05	21,632	\$8,400,000	\$388
7	105 unit residential development Los Angeles, CA	10/04/05	19,500	\$11,040,000	\$566
8	321 unit residential development Los Angeles, CA	10/06/05	64,253	\$20,000,000	\$311
9	651 unit residential development Los Angeles, CA	02/09/05	130,315	\$38,500,000	\$295
10	1,378 unit residential development Los Angeles, CA	12/14/05	275,747	\$70,000,000	\$254
11	700 unit residential development Los Angeles, CA	08/15/06	200,812	\$84,604,773	\$421
Value Range (PSF)					\$110 - \$570
Weighted Average Sales Price Per Sf of Land Area			\$290		

Source: The CoStar Group (10/7/06), CB Richard Ellis, KMA

<sup>1</sup> Transaction is in progress, and has not been closed.

<sup>2</sup> SRO units - affordable

## **APPENDIX B**

**APPENDIX B - TABLE 1**

**LAND SALE COMPARABLES - INDUSTRIAL  
RESIDUAL LAND VALUATION ANALYSIS  
LOS ANGELES, CA**

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<b>No.</b>	<b>Location &amp; Cities</b>	<b>Sale Date</b>	<b>Land SF</b>	<b>Sales Price</b>	<b>\$/Land SF</b>
1	M3 Zoned Acreage Los Angeles, CA	09/19/05	172,933	\$6,000,000	\$35
2	M3 Zoned Acreage Los Angeles, CA	02/14/06	72,000	\$2,767,000	\$38
3	M2-2D Zoned Land Los Angeles, CA	11/17/05	36,590	\$2,925,000	\$80
4	MR2-1 Zoned Land Los Angeles, CA	July 2006	547,550	\$25,000,000	\$46
5	M3-1 Zoned Land Los Angeles, CA	06/17/05	520,899	\$20,000,000	\$38
6	Vernon Industrial Los Angeles, CA	03/24/06	67,518	\$2,900,000	\$43
7	Warehouse/Distribution Site Vernon, CA	07/24/06	118,862	\$3,942,500	\$33
8	Single Tenant Industrial Site Vernon, CA	01/28/05	101,120	\$4,350,000	\$43
Value Range (PSF)					\$33 - \$80
Weighted Average Sales Price Per Sf of Land Area			\$41		

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Source: The CoStar Group (10/7/06), CB Richard Ellis, KMA

## **APPENDIX C**

APPENDIX C - TABLE 1

**ESTIMATED CONSTRUCTION COSTS  
RESIDENTIAL PROTOTYPE PROFORMA  
100 RESIDENTIAL OWNERSHIP UNITS - 50 UNITS/ACRE  
RESIDUAL LAND VALUATION ANALYSIS  
LOS ANGELES, CALIFORNIA**

**I. Direct Costs<sup>1</sup>**

On-Site Improvements	87,120 Sf Land	\$5 /Sf	458,000
Extraordinary Improvements			-
Parking			
Residential (Structured)	220 Spaces	\$17,800 /Space	3,916,000
Residential Building Costs			
Building Shell Costs	120,000 Sf GBA	\$142 /Sf	17,050,000
Common Area	21,200 Sf GBA	\$31 /Sf	668,000
<b>Total Direct Costs</b>	<b>141,200 Sf GBA</b>	<b>\$156 /Sf</b>	<b>\$22,092,000</b>

**II. Indirect Costs**

Architecture, Engineering & Consulting	6.0% Direct Costs		\$1,326,000
Public Permits & Fees <sup>2</sup>	100 Units	\$16,000 /Unit	1,600,000
Taxes, Legal & Accounting	2.0% Direct Costs		442,000
Insurance	100 Units	\$15,000 /Unit	1,500,000
Marketing	100 Units	\$2,500 /Unit	250,000
Development Management <sup>3</sup>	3% Sales Revenues		1,807,000
Indirect Contingency Allowance	5% Other Indirect Costs		346,000
<b>Total Indirect Costs</b>			<b>\$7,271,000</b>

**III. Financing/Closing Costs**

Interest & Loan Origination Fees <sup>4</sup>	100.0% Financed		\$4,109,000
Resid Closing, Comm & Warranties <sup>5</sup>	3.8% Sales Revenues		2,308,000
<b>Total Financing/Closing Costs</b>			<b>\$6,417,000</b>

<b>IV. Total Construction Costs</b>	<b>141,200 Sf GBA</b>	<b>\$253 /Sf</b>	<b>\$35,780,000</b>
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<sup>1</sup> These costs assume Type V with Structured Parking construction, a 5% direct cost contingency allowance; and assumes no prevailing wage requirements are imposed.

<sup>2</sup> These costs should be verified by the City staff.

<sup>3</sup> See Table 2 for the sales revenue estimate.

<sup>4</sup> Reflects a 7.0% interest cost for debt; a 15 month construction period; and a 15 unit/month absorption period; 30% of the units are presold and close during first month after completion; and 2.0 points for loan origination fees.

<sup>5</sup> See Table 2 for residential sales revenue estimates. Assumes 2.0% and 1.5% of residential sales revenues for commissions and closing costs, respectively. Also includes \$2,000/unit for warranties.

APPENDIX C - TABLE 2

REVENUE PROJECTIONS  
RESIDENTIAL PROTOTYPE PROFORMA  
100 RESIDENTIAL OWNERSHIP UNITS - 50 UNITS/ACRE  
RESIDUAL LAND VALUATION ANALYSIS  
LOS ANGELES, CALIFORNIA

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I.	<b>Residential Sales Revenues</b> <sup>1</sup>			
	Plan 1 -2-Bdrms - 1,200 Sf - Flats	100 Units	\$602,400 /Unit	\$60,240,000
II.	<b>Total Project Sales Revenues</b>	100 Units	602,400 /Unit	<b>\$60,240,000</b>

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<sup>1</sup> Based on KMA market survey of housing comparables located in or near downtown Los Angeles industrial areas. Reflects a sales price of \$502/Sf.

**APPENDIX C - TABLE 3**

**RESIDUAL LAND VALUE CALCULATION  
RESIDENTIAL PROTOTYPE PROFORMA  
100 RESIDENTIAL OWNERSHIP UNITS - 50 UNITS/ACRE  
RESIDUAL LAND VALUATION ANALYSIS  
LOS ANGELES, CALIFORNIA**

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<b>I.</b>	<b>Sales Revenues</b>	See Appendix A - Table 2	<b>\$60,240,000</b>
<b>II.</b>	<b><u>Development Costs</u></b>		
	Construction Costs	See Appendix A - Table 1	(\$35,780,000)
	Threshold Developer Profit <sup>1</sup>	15.0% Sales Revenues	(9,036,000)
	<b>Total Development Costs</b>		<b>(\$44,816,000)</b>
<b>III.</b>	<b>Residual Land Value</b>	<b>100 Units      \$154,200 /Unit</b>	<b>\$15,424,000</b>
	Value per Square Foot	<b>87,120 Sf Land      \$177 /Sf Land</b>	

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<sup>1</sup> Represents minimum proforma profit required to attract investment interest, expressed as a percentage of sale revenues per residential development practice

## **APPENDIX D**

APPENDIX D - TABLE 1

**ESTIMATED CONSTRUCTION COSTS  
INDUSTRIAL PROTOTYPE PROFORMA  
52,272 SF BUILDING - 0.6 FAR  
RESIDUAL LAND VALUATION ANALYSIS  
LOS ANGELES, CALIFORNIA**

**I. Direct Costs**<sup>1</sup>

Off Site Improvements <sup>2</sup>	Allowance			\$0
Building Shell Costs <sup>3</sup>	52,272 Sf of GBA	\$50 /Sf GBA		2,614,000
Tenant Improvement Costs	5,227 Sf of GLA	\$15 /Sf GLA		78,000
Contingency	5% of Other Direct Costs			161,000
<b>Total Direct Costs</b>	<b>52,272 Sf of GBA</b>	<b>\$55 /Sf GBA</b>		<b>\$2,853,000</b>

**II. Indirect Costs**

Arch., Eng. & Consulting	5% of Direct Costs			\$143,000
Public Permits & Fees <sup>4</sup>	52,272 Sf of GBA	\$2 /Sf GBA		105,000
Taxes, Ins., Legal & Acctng.	2% of Direct Costs			57,000
Marketing				
Leasing Commissions	\$2 Sf of GLA			104,544
Development Management	3% of Direct Costs			86,000
Contingency <sup>5</sup>	5% of Other Direct Costs			20,000
<b>Total Indirect Costs</b>				<b>515,544</b>

**III. Financing Costs**

Land <sup>6</sup>	\$3,282,000	Financed @	7.2% Interest	\$237,000
Construction Loan <sup>7</sup>	\$3,902,544	Financed @	7.2% Interest	153,000
Loan Points & Fees	\$7,185,000	Supp. Value	2.0 Points	144,000
<b>Total Financing Costs</b>				<b>534,000</b>

**IV. Total Construction Costs**      52,272 Sf of GBA      \$75 /Sf GBA      **\$3,902,544**

<sup>1</sup> Assumes prevailing wage payments are not required.

<sup>2</sup> City staff should estimate this cost.

<sup>3</sup> Includes on-site improvements. Also assumes parking ratio of 2.0 spaces per 1,000 sq.ft., as per LA City Department of Building and Safety Zoning Code.

<sup>4</sup> Based on KMA's experience with similar projects.

<sup>5</sup> Excludes Development Management.

<sup>6</sup> Assumes a 12-month development period and an average outstanding loan balance of 100%.

<sup>7</sup> Assumes a 10-month construction period and an average outstanding loan balance of 65%.

APPENDIX D - TABLE 2

ESTIMATED STABILIZED NET OPERATING INCOME  
 INDUSTRIAL PROTOTYPE PROFORMA  
 52,272 SF BUILDING - 0.6 FAR  
 RESIDUAL LAND VALUATION ANALYSIS  
 LOS ANGELES, CALIFORNIA

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I. Rental Income

Base Rental Income <sup>1</sup>	52,272 Sf of GLA	\$10 / Sf GLA	<u>\$502,000</u>
<b>Potential Gross Income</b>			\$502,000
(Less) Vacancy & Collections	3% Potential Gross Income		<u>(15,000)</u>
<b>Effective Gross Income</b>			\$487,000

II. Operating Expenses

Management	3% of EGI		(\$14,600)
Operating & Capital Reserves	52,272 Sf of GBA	\$0.10 / Sf GBA	<u>(5,200)</u>
<b>Total Expenses</b>			(20,000)

<b>III. Stabilized Net Operating Income</b>			<b>\$467,000</b>
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<sup>1</sup> Based on Colliers International Los Angeles Basin Industrial Market Report (2Q06), CB Richard Ellis Los Angeles Industrial Market Report (3Q06), and Grubb & Ellis Industrial Market Trends Report (3Q06). Rents equate to \$0.80 per square foot per month.

APPENDIX D - TABLE 3

RESIDUAL LAND VALUE CALCULATION  
 INDUSTRIAL PROTOTYPE PROFORMA  
 52,272 SF BUILDING - 0.6 FAR  
 RESIDUAL LAND VALUATION ANALYSIS  
 LOS ANGELES, CALIFORNIA

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I. Supportable Private Investment

Net Operating Income	See APPENDIX D - TABLE 2	\$467,000
Threshold Return on Investment <sup>1</sup>		6.5%
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Supportable Private Investment		\$7,185,000

II. Residual Land Value Calculation

Supportable Private Investment		\$7,185,000
(Less) Total Construction Costs	See APPENDIX D - TABLE 1	(3,902,544)
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III. <b>Residual Land Value <sup>2</sup></b>				<b>\$3,282,000</b>
Value per Square Foot	87,120	Sf of Land	\$38 /Sf Land	

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<sup>1</sup> Assumes an owner-occupied project resulting in a reduction of the typical developer return requirement and a resulting increase in supportable land value.

<sup>2</sup> Excludes off site improvement costs.

MAP 1  
 Land Sales Comparables  
 Residual Land Valuation Analysis

