



## MEMO TO THE BOARD OF SUPERVISORS

November 21, 2022

Board File Number: 220811 (Automotive Uses to Housing Uses)

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### Background

The Board of Supervisors is currently considering an ordinance to allow increased residential density on certain parcels citywide that contain automotive uses. The ordinance, originally introduced as Board File Number 211092 by Mayor Breed in October 2021 and recommended for approval with modifications by the Planning Commission on December 9, 2021. The file was duplicated at the Board of Supervisors Land Use Committee and the content that is the subject of this analysis is now in Board File No. 220811. During deliberations at the Board's Land Use & Transportation Committee, Board members requested financial feasibility analysis of development projects allowable under the proposed ordinance to understand the relative changes to feasibility relative to existing zoning and whether the proposed ordinance's increased density allowances would create feasibility for increased exactions (such as higher inclusionary housing rates). In response, the San Francisco Planning Department contracted with real estate economics consulting firm Century Urban to analyze the financial feasibility of multi-family development under both existing zoning and the proposed ordinance. This memo highlights key findings and assumptions from this high-level financial analysis.

### Assumptions

In September 2022 Century Urban analyzed potential for development of multifamily buildings on sites on lots with characteristics typical of those eligible under the proposed ordinance. For this analysis, Century Urban reviewed prototype developments using general market assumptions for unit types, costs, rents, sale prices, financing, and other factors that shape feasibility and likelihood of development. The financial feasibility (discussed more below) was assessed using metrics typically used by housing developers that would undertake projects of such scales in San Francisco.

## Development Prototypes: Lot size, Height Limit, Neighborhoods, Tenure, and Neighborhoods

Century Urban analyzed two distinct lot size and zoning conditions to bracket the most prevalent conditions that would be potential development sites under the proposed ordinance. These two scenarios are (1) small lots of 6,000 square feet that have a height limit of 40 feet, and (2) larger lots of 20,000 square feet with a height limit of 65 feet. While the 508 potential eligible lots identified by the Planning Department's analysis of the ordinance in Fall 2021 are characterized by a range of lot sizes and height limits, the two scenarios chosen combine the most prevalent factors citywide.<sup>1</sup>

Century Urban further analyzed prototypes for both of these two lot scenarios using the following further differentiating characteristics:

- Existing zoning (density limits) vs Proposed Ordinance
- Rental vs Ownership
- Projects using State Density Bonus (SDB) and projects not using SDB
- Two neighborhood sub-markets, one with relatively higher rent/sales prices versus the other

The combinations of these four pairs of factors with the two lot/zoning scenarios resulted in the analysis of a total of 32 different development prototype scenarios. The housing program and physical envelope varies to some extent for each scenario depending on the combinations of these various factors, with the small lot prototypes ranging from 10 to 20 units in buildings that range from 4 to 6 stories, and the larger lot prototypes ranging from 33 to 104 units in buildings ranging from 4 to 8 stories. All prototypes have some amount of ground floor retail.

All prototypes have some amount of off-street parking with denser rental projects having somewhat lower per-unit ratios than projects with fewer units and condos. The parking ratios ranged from a low 0.67 spaces per unit to a high 1.0 space per unit under the least dense prototypes allowed under existing zoning, with all parking accommodated above grade except for the largest projects with the most units. In order to compare roughly apples-to-apples without dramatically changing program or marketability assumptions between projects, the ratios of parking per unit were kept relatively stable (within the range described above). However given the expense of constructing parking, especially underground parking (as provided for in the two largest prototypes), should a project sponsor feel that substantially less parking (and less retail) be viable or preferable, then project economics could be improved to some degree.

Based on the geographic distribution of the prevailing height limits and lot sizes, the smaller lot 40-foot height limit scenarios were modelled for the Marina and Sunset neighborhood market conditions, and the larger lot 65-foot height limit scenarios were modelled for Russian Hill and the Excelsior neighborhoods.

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<sup>1</sup> Lot sizes of identified eligible lots range from less than 1,000 square feet to over 200,000 square feet. The median lot size is 8,261 square feet; 20% of lots are less than 3,500 square feet and 20% are larger than 19,000 square feet, with 60% between 3,500 and 19,000 square feet. Height limits of eligible lots range from 26' to 130', but by far the most prevalent are 40'/45' (69%) with 65' (12%) as the next most common. With the third most common of 50'/55' (8%), falling in between the two selected, the choice of 40' and 65' brackets more than 82% of all lots.

## Defining Costs and Financial Feasibility

The analysis was informed by updated and current construction costs provided by a cost sub-consultant to Century Urban in September 2022. Other typical construction costs and standard industry benchmarks returns for typical projects in San Francisco were used in the analysis. Construction hard costs assumed labor is paid prevailing wages. Given that someone must be compensated for their time spent developing a project as well as for the inherent risk associated with investing money in property development, the analysis assumes a return to the property owner/developer of 20% of hard and soft costs for for-sale projects and a return on cost of 5.25% for rental, both real estate industry standards.

Given that existing conditions and uses on the subject eligible lots vary widely, from surface parking lots and garages to automotive repair buildings to commercial buildings with small amounts of accessory parking, the analysis does not include any costs for potential site remediation or significant costs related to demolition of existing structures or relocation of retail tenants. The analysis also assumes no significant “carrying costs” that might be necessary in some instances to account for lack of revenue stream or necessary financing for the ownership of a property during a prolonged period. The analysis assumes all projects can receive relatively straight-forward entitlement, including a Categorical Exemption from CEQA analysis and no significant entitlement or legal costs other than routine fees and costs for generally code-compliant projects.

The analysis assumes the existing Section 415 inclusionary requirements continue unchanged for the foreseeable future and uses the applicable percentages for the year 2025 to account for some portion of the mandated continuing “ramp up” of the inclusionary requirements through 2027. The inclusionary rates for small projects (<25 units) will reach their highest levels in 2023, while larger projects will reach their maximum in 2027. The cost of providing Below Market Rate units was reflected in the analysis through a reduction in the rent or sales prices of those units and not as a direct project “cost”. Note that the Controller’s Office has recently initiated the Triennial Economic Feasibility Analysis of the existing inclusionary housing requirements, supported by consultants and in consultation with an Inclusionary Housing Technical Advisory Committee, as required by Planning Code Section 415.10. This study may or may not recommend changes to the existing inclusionary requirements.

The financial metric used in this analysis to evaluate and compare financial feasibility is the residual value per residential unit of new development. This metric is a commonly used standard to compare potential projects, both in terms of their individual internal feasibility as well as relative to each other as potential projects, and to determine whether the project can reach a positive overall residual value to provide value to justify the purchase of land. If per unit residual is positive (and therefore the total residual is positive), the next step would be to compare the total residual to land prices to determine feasibility. If per unit residual is negative, the prototype is infeasible regardless of land price.

## Key Findings

Below are key findings from the financial feasibility analysis performed by Century Urban.

### **Financial Feasibility Varies Substantially by Neighborhood and For-sale Projects Are Stronger Than Rental Projects**

The for-sale scenarios resulted in better feasibility than the rental versions. Sale prototypes with density decontrol in the higher priced submarkets had the least negative estimated per-unit residual values, while the rental projects under existing zoning in the lower rental rate submarkets had the most negative residual values. While all prototypes were shown infeasible under the cost, regulatory and revenue factors, prototypes for both small and larger lots are much closer to feasibility in pricier neighborhoods given the higher rents and sales prices and consistent costs and requirements in all neighborhoods.

### **At Current Construction Costs, City Requirements, and Rental/Sales Rates, all Prototypes Studied are Infeasible, Though Prototypes Under the Proposed Ordinance Are Generally Closer to Feasibility than Existing Zoning**

In the scenarios analyzed, estimated residual values per unit were negative in all cases under both Existing Zoning and the Proposed Ordinance. This indicates that under the scenarios analyzed, potential projects wouldn't support purchase of land at any price since all showed negative values per unit. However, under the proposed ordinance that provides for density decontrol and thus more units per parcel, prototypes across the board generally improved in feasibility by +10-60% over existing zoning scenarios. This suggests that more modest cost reductions or revenue increases could provide for positive feasibility sooner than would be the case under existing zoning.

### **The Proposed Ordinance Does Not Create Conditions for Additional "Value Capture", such as Higher Inclusionary Rates**

Since all prototypes analyzed indicated negative per-unit residual values, the evidence indicates that there is not only no revenue available for purchase of land but also that the ordinance does not create surplus value to dedicate to new or increased exactions or other requirements.

### **Attachment:**

Century Urban Feasibility Analysis, October 19, 2022



**Century | Urban**

**Strategic  
Real Estate  
Advisory Services**

**Housing Density on Automotive Use Sites  
Residential Development Prototypes  
Conceptual Analysis**

**Presented to:**

**City & County of San Francisco,  
Planning Department**

**October 19, 2022**



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## AUTOMOTIVE USE SITES - CONCEPTUAL ANALYSIS

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**TO:** City & County of San Francisco, Planning Department  
**FROM:** Century | Urban  
**SUBJECT:** Housing Density on Automotive Use Sites – Residential Development Prototypes  
Conceptual Analysis  
**DATE:** October 19, 2022

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### Summary

The City & County of San Francisco (the “City”) has engaged Century Urban, LLC (“Century | Urban”) to support the analysis of potential residential development on sites in the City which previously allowed automotive uses. The City is considering changes to its planning code to allow development of greater housing density on automotive use sites and would like to evaluate the potential effect of such changes on the feasibility and attractiveness of new residential project development.

To accomplish this, the City provided sixteen for-rent and for-sale residential development prototype scenarios for two different lot sizes, and Century | Urban was asked to prepare high-level conceptual feasibility analyses for these prototype scenarios. The scenarios were evaluated in four submarkets: the Marina and the Sunset for the smaller lot size, and Russian Hill and the Excelsior for the larger lot size. The prototype scenarios, which are summarized in [Exhibit A: Prototype Analysis Summary](#), reflect varying unit counts based on lot size, existing zoning, potential density decontrol, and potential use of the California State Density Bonus.

The conceptual analyses indicate that residential development economics for all prototype scenarios are challenging under current market conditions. The most challenged were the existing zoning without use of State Density Bonus prototype scenarios (which were the smallest by unit count) for the Excelsior and Sunset submarkets. The least but still challenged scenarios were certain density decontrol prototypes in the Marina and Russian Hill submarkets.

### Analysis Qualifications

The prototype conceptual analyses referenced in this memorandum were based on prototypical projects that represent high-level average or median types of projects and high-level project assumptions at the time of analysis preparation. The prototypical projects do not correspond to any particular project or actual economics. Any actual project may reflect different costs, rental rates, sale prices, or other details driven by the circumstances of that project such as its sponsor,



history, site conditions, contractor, business plan, and/or other factors. Moreover, the criteria and assumptions utilized in selecting and analyzing the prototypes are specific to the time the analysis was prepared and research was conducted and will likely change over time as potential variables such as rental rates, sale prices, development costs including land and financing costs, and investor return targets change over time based on market conditions.

### **Key Assumptions**

To prepare the conceptual analyses, research was conducted regarding development costs, and rental rate and sale price comparables, among other assumptions.

Key assumptions utilized in the conceptual analyses are shown in Exhibit B: Prototype Assumptions including estimated rents, sale prices, hard costs and soft costs. Prototypes were assumed to meet inclusionary housing requirements by including on-site affordable units, and for prototype scenarios utilizing the State Density Bonus, soft costs include the payment of statutory in-lieu fees based on the additional density bonus units. Onsite inclusionary percentages are based on inclusionary requirements in 2025. Estimated apartment rental rates and condominium sale prices are based on rental rate and sale price comparables from each submarket. Hard cost estimates, which assume prevailing wage, reflect estimates provided by a third-party cost-estimator.

For simplicity, the analysis assumes that lots are entitled for their intended development when purchased, no demolition is required, and any environmental remediation costs are borne by the land seller.

### **Residual Value**

The residual value for each prototype scenario is estimated by deducting estimated development costs from 1) in the case of for-rent scenarios, projected supportable costs based on capitalizing net operating income utilizing estimated return-on-cost targets, and 2) in the case of for-sale scenarios, net sales proceeds after developer profit. The estimated residual values represent the amount, which a developer could pay for land and still achieve its target return. Where the market value of a potential development site (land) exceeds the projected residual value, proceeding with development would typically not be considered feasible.

### **Conclusions**

- ❖ All prototype scenarios result in negative residual values. The conceptual analysis indicates that the estimated residual values per unit for the rental scenarios range from negative \$93,000 to negative \$635,000 and for the sale scenarios from negative \$82,000 to



negative \$539,000. The least negative residual values per unit are projected in the Marina and Russian Hill submarkets for density decontrol prototype scenarios that utilize the State Density Bonus.

- ❖ The estimated negative residual values across the prototype scenarios indicate that development of projects similar to the prototype scenarios in the current market may be challenging regardless of land cost.





Exhibit A: Prototype Analysis Summary

Century | Urban

Housing Density on Automotive Use Sites - Residual Value

**Prototypes**

Rental/Sale

Existing Zoning  
State Density Bonus

**Small Lot Scenario - 6,000 SF**

Total Units  
Affordable Units %  
Affordable Units #  
  
Residual Value Per Unit  
Sunset  
% change versus existing zoning  
Marina  
% change versus existing zoning

**Large Lot Scenario - 20,000 SF**

Total Units  
Affordable Units %  
Affordable Units #  
  
Residual Value Per Unit  
Excelsior  
% change versus existing zoning  
Russian Hill  
% change versus existing zoning

	Rental Existing No	Rental Existing Yes	Rental Density Decontrol No	Rental Density Decontrol Yes	Sale Existing No	Sale Existing Yes	Sale Density Decontrol No	Sale Density Decontrol Yes
Total Units	10	15	13	20	10	13	13	17
Affordable Units %	20%	13%	15%	10%	20%	15%	15%	12%
Affordable Units #	2	2	2	2	2	2	2	2
Residual Value Per Unit								
Sunset	(\$635,000)	(\$508,000)	(\$504,000)	(\$377,000)	(\$452,000)	(\$336,000)	(\$294,000)	(\$205,000)
% change versus existing zoning			21%	26%			35%	39%
Marina	(\$369,000)	(\$218,000)	(\$235,000)	(\$93,000)	(\$259,000)	(\$193,000)	(\$170,000)	(\$82,000)
% change versus existing zoning			36%	57%			34%	58%
Total Units	33	50	74	104	33	41	74	92
Affordable Units %	24%	18%	23%	18%	24%	20%	26%	21%
Affordable Units #	8	9	17	19	8	8	19	19
Residual Value Per Unit								
Excelsior	(\$634,000)	(\$487,000)	(\$428,000)	(\$430,000)	(\$539,000)	(\$429,000)	(\$363,000)	(\$394,000)
% change versus existing zoning			32%	12%			33%	8%
Russian Hill	(\$380,000)	(\$259,000)	(\$211,000)	(\$202,000)	(\$138,000)	(\$101,000)	(\$91,000)	(\$107,000)
% change versus existing zoning			44%	22%			34%	-6%

Per unit residual values are rounded to the nearest \$'000, total residual values are rounded to the nearest \$'00,000



Exhibit B: Prototype Assumptions

Century | Urban  
Housing Density on Automotive Use Sites - Residual Value

**Key Prototype Assumptions**

Rental/Sale	Rental Existing No	Rental Existing Yes	Rental Density Decontrol No	Rental Density Decontrol Yes	Sale Existing No	Sale Existing Yes	Sale Density Decontrol No	Sale Density Decontrol Yes
Existing Zoning State Density Bonus								
<b>Rents, Sale Prices, Returns</b>								
Average Market Rental Rate PSF								
Sunset		\$4.26	\$4.43	\$4.44				
Marina	\$6.30	\$6.34	\$6.56	\$6.60				
Excelsior	\$3.60	\$3.78	\$3.85	\$3.85				
Russian Hill	\$5.25	\$5.54	\$5.82	\$5.81				
Average Market Sale Price PSF								
Sunset					\$1,219	\$1,255	\$1,260	\$1,263
Marina					\$1,469	\$1,453	\$1,449	\$1,459
Excelsior					\$856	\$856	\$856	\$856
Russian Hill					\$1,461	\$1,438	\$1,440	\$1,439
Returns								
Target Return on Cost	5.25%	5.25%	5.25%	5.25%				
Target Profit Margin					20%	20%	20%	20%
<b>Development Cost</b>								
Total Hard Costs PSF	\$533	\$533	\$538	\$529	\$545	\$543	\$551	\$541
City Fees	\$23	\$33	\$23	\$34	\$23	\$29	\$23	\$30
Other Soft Costs	<u>\$153</u>	<u>\$155</u>	<u>\$155</u>	<u>\$153</u>	<u>\$157</u>	<u>\$156</u>	<u>\$159</u>	<u>\$156</u>
Total Soft Costs PSF	\$176	\$188	\$178	\$187	\$180	\$185	\$182	\$186
Total Hard and Soft Costs PSF	\$709	\$721	\$716	\$716	\$725	\$728	\$733	\$726