MEMORANDUM

To: Lor Shepard, Shepard Family Holdings, LLC

From: David Zehnder and Amy Lapin

Subject: Site Evaluation for 3820 Chiles Road, Davis; EPS #162128

Date: March 10, 2017

The property owner (Client) of the site at 3820 Chiles Road in Davis, California (Project), retained Economic & Planning Systems, Inc. (EPS) to conduct a high-level evaluation of the highest and best use of the Project site. The approximately 7.4-acre Project site contains an existing structure and is zoned to accommodate commercial uses. While the Client and City of Davis (City) have explored options related to adaptive reuse of the existing structure and new construction of commercial uses, these uses are fraught with feasibility challenges. Because of these challenges and because of favorable market conditions for residential uses, the Client is proposing to develop the site with rental and ownership multifamily housing.

This memorandum describes the Project site, including historical uses, redevelopment efforts, and site characteristics. In addition, this memorandum provides an overview of national and local market conditions, focusing on the office, research and development (R&D)/Flex, and multifamily housing sectors to provide context for development of these uses in the City.

EPS also independently evaluated the financial viability of developing specific land uses on the Project site. This memorandum includes static residual land value pro forma analyses of the following development scenarios:

- Adaptive reuse of the existing structure to accommodate office/R&D.
- Demolition and development of new office/R&D.
- Demolition and development of new community retail.
- Demolition and development of proposed market-rate, rental, and ownership multifamily uses.

The Economics of Land Use

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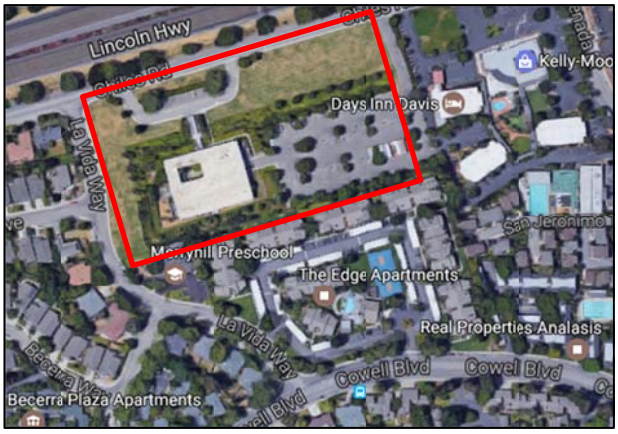
This analysis does not evaluate all permitted or conditionally permitted uses associated with the site's current zoning designation. Based on discussions with the Client, this analysis focuses on potential uses that are consistent with previous marketing efforts (adaptive reuse), broadly defined uses permitted under the site's zoning designation (office/R&D and community-serving retail), or can be supported by demonstrated market demand (multifamily residential uses). Other uses permitted under the site's zoning designation may be viable but were not analyzed, as directed by the Client. These uses are perceived to be in conflict with adjacent residential uses, as described later in this memorandum.

This memorandum concludes with key findings regarding each of these development options.

Site Background and Characteristics

The Client is interested in developing a 7.43-acre parcel located south of Interstate 80 (I-80) in the City (refer to **Map 1** for site context). The Project site is located on Chiles Road, a freeway frontage road, approximately 1 mile west of the Mace Boulevard interchange and about 2 miles east of the Richards Boulevard interchange.

Existing Zoning Designation



Aerial view of Project Site. Source: Google, February 2017.

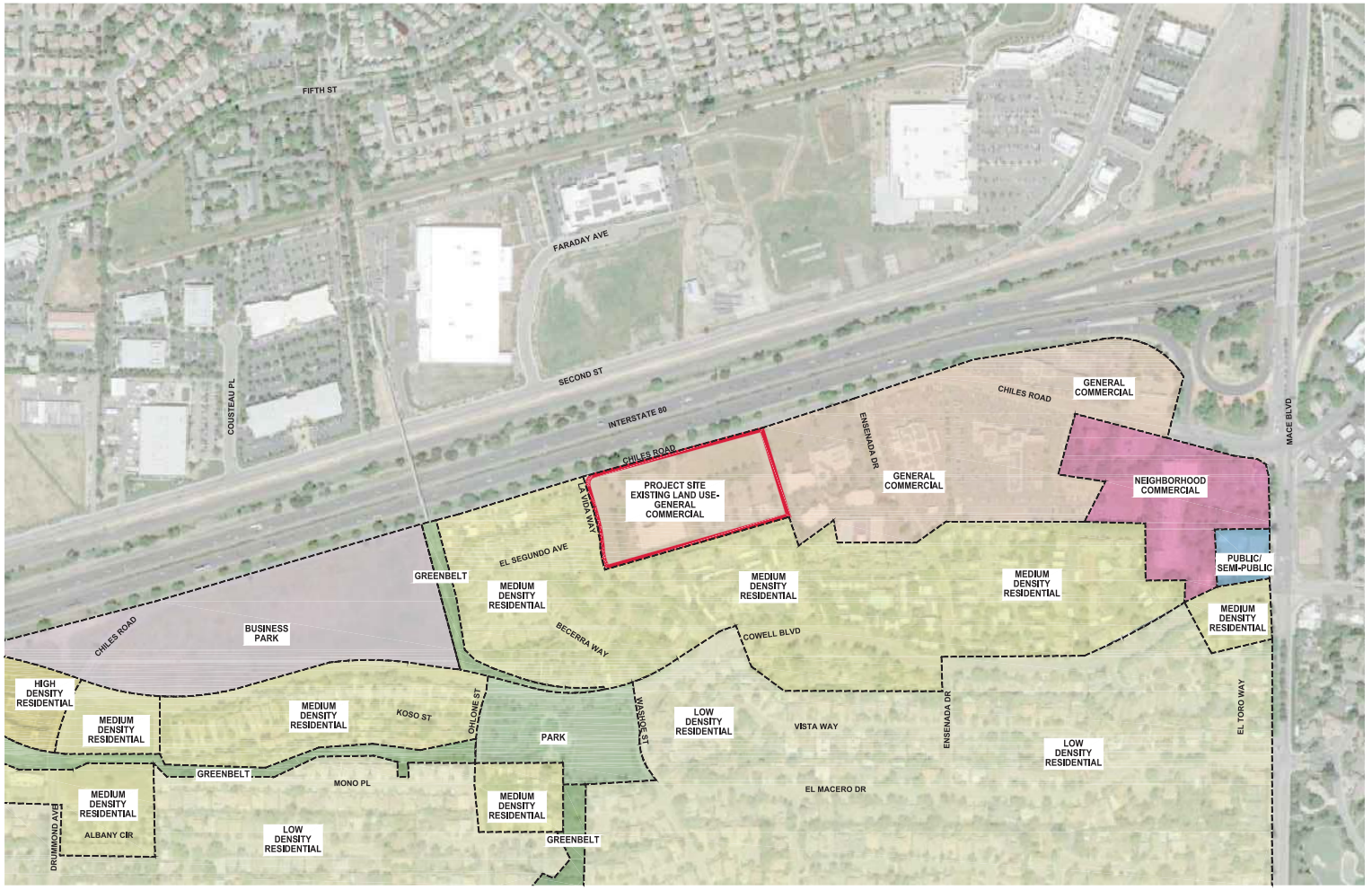
The site is zoned Commercial Mixed Use (CMU), which permits several commercial uses, including automotive and motorcycle sales (within an enclosed structure), automotive repair/supply, agricultural supplies/services, professional office, custom light manufacturing, light wholesale/distribution, research services, and service commercial. Current zoning also allows for the following conditional uses: automobile dealerships (not confined to an enclosed structure), service stations, restaurants, public and semipublic uses, commercial recreation, communication services, and community retail. Based on City municipal code, the purpose of CMU zoning,

> "is to provide for a broad range of uses that are intended to serve the internal needs of Davis residents as well as the traveling public. These sites are located in the immediate vicinity of a freeway on- or off-ramp or along a service drive that is directly accessible to the highway."[1]

Note that City code permits office uses limited to 10,000 building square feet and retail uses limited to 30,000 building square feet, with a minimum lot size of 10,000 square feet and a maximum lot coverage of 25 percent.

[1] Article 40.18, CMU District, Davis Municipal Code.

Map 1



LEGEND:

- LAND USE BOUNDARIES
- PROJECT SITE

0 100 200 400 600
SCALE IN FEET

NOTES:

1. SITE AERIAL IMAGERY TAKEN IN APRIL 2015 AND WAS ACQUIRED AUGUST 1, 2016 FROM GOOGLE EARTH PRO. COPYRIGHT GOOGLE, 2015.

CHILES ROAD
CONTEXT MAP
LAND USES

DAVIS CALIFORNIA

SHEET 1 OF 1

DATE: 1/17/17

JOB NO: 1579

Adjacent Land Uses

The Project site is surrounded by residential and commercial uses. There are single-family dwelling units to the west, multifamily apartments to the south, southwest, and southeast, a preschool to the south, and a Days Inn Davis hotel and neighborhood-serving retail (paint store, pizza restaurant) to the east. East of the hotel and neighborhood retail are two automobile dealerships and neighborhood-/highway-serving commercial uses. Of note, these uses are mirrored east of Mace Boulevard, with additional automobile dealerships (including a recreational vehicle dealership), other automobile uses, and neighborhood-/highway-serving commercial uses located along Chiles Road and multifamily and single-family residential uses located to the south.

Site History and Conditions

The Project site contains an existing 51,000 gross-building-square-foot structure and 2 disconnected parking lots: a small parking lot to the north of the structure containing about 15 spaces and a large parking lot to the east of the structure containing about 150 spaces.[2] [3] Although I-80 lies directly to the north, the structure has poor visibility from the freeway because it is set back from Chiles Road approximately 200 feet and is obscured partially by landscaping, a 12-foot high earthen berm, and a concrete structure flanked on either side by stairways to the primary building entrance.

View of existing structure, facing south from front parking lot.
Source: EPS, February 2017.

The existing structure formerly housed office uses. The building, constructed in 1965, served as a corporate headquarters for a life insurance company. Following dissolution of the company, the California Department of Insurance owned the building until it was purchased in 1995 by a group of investors, including the Client. The Regents of the University of California (UC) then entered into a 20-year lease until, in 2014, they notified the property owners that they would not renew the lease. At that time, the ownership group transitioned to comprise only the Client, who commenced pursuit of an adaptive reuse strategy.

Redevelopment Efforts and Analysis

In 2015, the Client, in collaboration with an international real estate brokerage firm and a commercial construction contractor, proposed a multitenant Office/R&D project, intending to

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[2] Assuming a floor area ratio of 0.25 and 1 parking space per 400 gross square feet, a new commercial structure would require about 200 spaces, more than currently provided on site, requiring reconfiguration and expansion of the existing parking lots.

[3] The existing structure, at 51,000 square feet, does not comply with current CMU zoning specifications (i.e., office building square footage greater than 10,000 square feet, given the single lot), although reuse of the existing structure would be grandfathered.

reuse the existing structure. However, the team ceased these efforts because the project was deemed financially infeasible. The Client also explored a scenario in which the existing building was demolished and new Office/R&D space was developed. This scenario, however, also was determined to be financially infeasible.

Adaptive reuse of the existing structure poses several challenges for housing office/R&D space. There may be years of vacancy before a suitable tenant is found because of the size of the tenant needed to occupy the amount of space available. Specifically, the size of the existing structure would be attractive to an organization with about 200 to 250 employees.[4] Although Davis is on the cusp of fundamental market improvements, the City has struggled to demonstrate consistent demand for commercial space. Previous research conducted for the proposed Innovation Centers in the City indicated, over the past decade, there has been 1 business per year, on average, that expressed interest in a Davis location. However, in most cases, these businesses were seeking between 100,000 and 150,000 square feet of space.[5]

Even with a tenant interested in 50,000 square feet of space in this location, the building's existing interior is functionally obsolete—a ground floor with few windows and numerous areas obstructed by ductwork, and the ground and second (primary) floors compartmentalized by several rooms surrounding a central open-air atrium. This layout would require significant investment to modernize. Further, the parcel requires substantial site and landscaping improvements (e.g., reconfigured parking, grading to remove the berm), representing additional development costs. The scope and associated expenses related to these improvements likely will deter many prospective tenants. In addition, a site of this size would compete with other sites in and outside the Sacramento Region. To attract and retain employees, office users—of this size, in particular—seek highly amenitized sites with connectivity to an array of commercial and service uses (e.g., restaurants, coffee shops, fitness centers) and transportation options, which are limited in this location.[6]

Within the last year, redevelopment efforts included collaboration between the Client, the City's Economic Development Department, and the Greater Sacramento Economic Council Chief Executive Officer. This team endeavored to market the property to a technology-sector tenant. However, after a full year, there was not a single interested party, and the team decided to abandon these marketing efforts.

Real estate brokers familiar with the Project and the Davis market indicate the site would not be a suitable location for several land uses under a new construction scenario. Highway-serving commercial uses do not appear to be realistic because of the site's distance from freeway interchanges, the amount of existing highway-serving commercial uses surrounding the interchanges that bookend the site, and limited demand, as measured by broker solicitations from potential tenants.[7] Some specific highway-serving uses (e.g., gas station, hotel) may be

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[4] Assumes a square-foot-per-employee assumption ranging from 200 to 250.

[5] Interview with Bob Burris, Greater Sacramento Area Economic County, March 27, 2015. Excerpted from the "Economic and Fiscal Impact Analysis of Proposed Innovation Centers in Davis" report, prepared by EPS, September 8, 2015.

[6] Interview with Jim Gray, Cushman and Wakefield, January 18, 2017.

[7] Ibid.

financially viable and supported by market demand. However, a detailed evaluation and analysis of these uses is not included in this memorandum, as directed by the Client. As part of public outreach efforts surrounding redevelopment of the Project site, the Client understands these uses are perceived to be in conflict with adjacent residents' quality of life.

New office/R&D space is not well-suited for the site's location because of the limited connectivity to commercial, services, and transportation options. New community-serving retail space is not well-suited for the site's location because there is low demand for a 7.4-acre parcel that is not clustered with other community-serving retail uses. Retail tenants thrive in clusters of 1 or more large anchor tenants and multiple smaller in-line and retail pad tenants. The parcel size, location, and amount of existing, adjacent retail space are not a sufficient critical mass of space to attract many retail tenants. In addition, and of key importance, new office/R&D and community-serving retail space both appear to experience development feasibility challenges, as discussed later in this memorandum.

Instead, the site's size, geographical location relative to freeway interchanges, adjacent land uses, and existing market conditions in the City designate the site as appropriate for a few select uses that require demolition of the existing structure and new construction. These distinct development options include an automobile dealership and multifamily residential.

Over the years, local real estate brokerage firm, Cushman and Wakefield, has received inquiries from automobile and recreational vehicle dealers seeking sites in the City, although there have been only a few inquiries recently. The majority of these inquiries have been from unaffiliated and used car merchants seeking a low-cost site with freeway visibility. None of the potential buyers have been prequalified for financing, indicating a lack of urgency in finding a site. Further, modern, new dealerships are very disciplined in their site-selection criteria. For example, dealerships require colocation with other dealerships; sufficient lighting for nighttime business activities; areas to test drive vehicles; and architectural, urban design, and signage features to promote their brand. The brokerage community is not confident the Project site meets all of the site criteria considered by dealerships, nor are they confident they would spend the capital to create an attractive and modern facility for their business. Although currently permitted as an allowable or conditionally allowable use on the site, it appears there is limited interest from potential tenants, and capital cost requirements for demolition and new construction may be too high. Furthermore, a dealership on the Project site may create undesired lighting and traffic impacts on the adjacent residential neighborhood.

The other potential use, multifamily residential, is in high demand in the City. Cushman and Wakefield's inquiries overwhelmingly comprise users seeking sites in the City to accommodate this land use. Furthermore, multifamily residential market performance indicators in the City confirm very low vacancy rates and rising rents, indicative of a tight market and pent-up demand. Because of this high demand for multifamily development, the Client is proposing to develop a market-rate, multifamily housing project, consisting of approximately 130 rental apartments and 45 ownership townhomes, developed in 2 phases. Refer to **Map 2** for the

Map 2

		5	1	2	
BLDG 1					
1		0	6	4	10
2		1	11	14	26
3		1	11	14	26
		2	28	32	62
BLDG 2					
1		0	7	5	12
2		1	11	16	28
3		1	11	16	28
		2	29	37	68
		4	57	69	130
		3%	44%	53%	

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PROGRESS: 12 | 19 | 2016

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proposed site plan.[8] Developing market-rate housing targeted toward non-students of UC Davis meets a niche that is significantly underserved in the City. Further, these product types may have particular relevance to the City's larger challenge of attracting a more substantive labor force across age cohorts, as the City has had a particular challenge retaining highly qualified young professionals.

Underlying National and Local Market Conditions

This section provides a concise summary of national and local commercial and residential market conditions to provide context for developing these uses in the City. **Table 1** provides an overview of market performance indicators in the City relative to proximate cities and the larger region. In addition, given the City's previous desire to attract an office/R&D tenant, this section provides a high-level synthesis of available land in the City currently zoned to accommodate future office/R&D uses and discusses the implications of removing the Project site acreage from this inventory, assuming an office/R&D use was determined to be feasible.

National Commercial Market Conditions

National macroeconomic indicators have been strong. While the first half of 2016 was somewhat volatile, the last half of the year resulted in a notable expansion of real gross domestic product (GDP) and the United States (U.S.) emerging as the most stable growing economy in the world. With the recent transition of national governance in January 2017, however, uncertainties surround forthcoming domestic and international policies and their resulting impacts. That said, economic growth in key markets, such as San Francisco, has been well above historic peaks and likely will continue to drive growth in the U.S. The growth largely is being driven by technology enterprises, which will in turn continue to drive demand for tech-oriented office/R&D space.[9]

Local Commercial Market Conditions

The City is a desirable place to reside and supports several competitive advantages that can be leveraged for continued economic vitality, including a technically skilled, predominantly knowledge-based labor force; proximity to the Bay Area with generally lower average price points; a major research university with renowned academic programs and research initiatives; and a high quality of life for residents and businesses, including a thriving downtown retail district, numerous park and recreation amenities, and well-regarded public schools. With these competitive advantages, it is not surprising the Davis market is expected to perform in alignment with the national market, with both markets projected to record declining vacancy rates, positive absorption, and increased rental rates.

The City is in a prime position to accommodate future office/R&D demand, especially as it relates to capitalizing on UC Davis research strengths and industry clusters present in the City (i.e., clean energy technology, agriculture and food production, life sciences and health services,

[8] The unit totals and site plan submitted by the Client for City entitlement approvals may vary from what is included in this memorandum.

[9] "Economic and Fiscal Impact Analysis of Proposed Innovation Centers in Davis," prepared by EPS, September 8, 2015.

Table 1
City of Davis Commercial Rezone Analysis
Regional Market Performance Indicators

Item	City of Davis	City of Woodland	City of West Sacramento	Yolo County	Greater Sacramento Region [1]
Office [2]					
2016 Q4 Leasable Sq. Ft.	1,747,338	1,221,748	2,193,067	5,192,804	104,407,330
Annual Avg. Change in Sq. Ft.	31,026	(17,963)	40,887	76,650	1,097,440
2016 Q4 Vacancy Rate	8.1%	6.2%	8.1%	7.7%	11.0%
Annual Avg. Vacancy	8.6%	8.7%	13.1%	10.9%	13.4%
2016 Q4 Lease Rate (Full Service)	$1.98	$1.47	$1.77	$1.61	$1.74
Annual Avg. Change in Lease Rt.	0.60%	4.92%	1.85%	0.75%	0.21%
Annual Avg. Absorption	34,348	(16,829)	35,332	107,148	1,063,480
Annual Avg. Sq. Ft. Constructed	36,983	5,570	41,454	85,780	1,431,441
Flex [2] [3]					
2016 Q4 Leasable Sq. Ft.	519,327	254,317	1,510,576	2,284,220	20,552,378
Annual Avg. Change in Sq. Ft.	6,148	(500)	12,410	18,059	128,174
2016 Q4 Vacancy Rate	14.1%	2.1%	16.1%	14.1%	13.8%
Annual Avg. Vacancy	14.6%	17.6%	13.3%	14.1%	17.2%
2016 Q4 Lease Rate (Triple Net)	$1.04	$0.70	$0.65	$0.66	$0.75
Annual Avg. Change in Lease Rt.	0.78%	5.25%	(0.22%)	(0.43%)	(0.64%)
Annual Avg. Absorption	4,742	1,597	36,119	14,365	162,468
Annual Avg. Sq. Ft. Constructed	6,148	0	18,294	24,443	175,974
Multifamily Residential [2]					
2016 Q4 Multifamily Units	11,486	5,250	4,948	22,051	188,758
Annual Avg. Change in Units	85	32	111	0	1,444
2016 Q4 Vacancy Rate	2.9%	2.2%	3.0%	2.7%	3.7%
Annual Avg. Vacancy	3.7%	5.2%	6.1%	4.5%	5.8%
2016 Q4 Lease Rate	$1,535	$947	$1,017	$1,297	$1,122
Annual Avg. Change in Lease Rt.	2.74%	1.82%	3.76%	2.52%	2.32%
Annual Avg. Absorption	81	39	110	230	1,667
Annual Avg. Units Constructed	86	33	111	229	1,666

market sum

Source: CoStar; EPS.

[1] Includes counties of El Dorado, Placer, Sacramento, Sutter, Yolo, and Yuba.
[2] Annual average items analyzed from 2002-2016.
[3] Reflects a number of use subcategories ranging from industrial-oriented space to office/R&D-oriented space.

information and communications technology, and advanced manufacturing and materials). However, two proposed large-scale innovation centers that were slated to increase land supply and fulfill future office/R&D demand fell short of receiving sufficient public approval. The removal of these projects from the supply pipeline—for the time being—likely will contribute to an increasingly tight market for accommodating a range of future office/R&D space needs (e.g., medium- to large-floor plate space).

The City also has significant pent-up demand for all types of multifamily rental housing (e.g., housing oriented toward students, seniors, and non-students). Recent data suggest the existing multifamily ownership and rental markets virtually have no vacancy.[10] [11] Further, there are only two resale listings and one new multifamily project in the City—attached townhomes at The Cannery—with ownership units currently on the market.[12] Of the 72 new townhomes planned, fewer than 30 units remain unsold. Although not currently a permitted use, market-rate multifamily housing on the Project site provides an opportunity to meet a portion of this demand, which will help to retain and attract a predominantly knowledge-based labor force.

The following sections provide additional context on market performance indicators for the office, R&D/Flex, and multifamily housing markets in the City relative to proximate cities and the larger region.

Office Market Performance Indicators

The office sector in the City has and continues to be a strong sector. Over the past 15 years (2002–2016), the office market has grown from 1.3 million square feet to nearly 1.8 million square feet, adding more than 465,000 square feet over the period at an average annual growth rate of 2.2 percent. It is noteworthy, however, that no new office space was added during the last calendar year (2016). Local real estate brokers note a tightening market, with plentiful choices for small businesses but few buildings for lease that can accommodate medium and large companies. By the end of 2016, the City had 27 buildings with 35 suites on the market for lease, 20 of which comprise suites of 2,500 square feet or smaller.[13] There are no offerings of space larger than 25,000 square feet, and there are no speculative office buildings under construction or being planned.[14]

Nevertheless, Davis has struggled to demonstrate consistent demand.[15] Previous research conducted for the proposed Innovation Centers in the City indicated that over the past decade, there has been 1 business per year, on average, that expressed interest in a Davis location, but

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[10] U.S. Census Bureau, 2015 American Community Survey 1-Year Estimates, Table CP04: Comparative Housing Characteristics. This source lists the homeowner vacancy rate as 0 percent and the rental vacancy rate at 1.9 percent.

[11] "2016 Apartment Vacancy and Rental Rate Survey," Bay Area Economics. The 2016 survey captured about 83 percent of total multifamily housing stock in the City.

[12] Redfin Web site (resale listings), accessed February 22, 2017, and The Gregory Group Web site (new multifamily home listings), accessed February 20, 2017.

[13] "Davis Office & Commercial Real Estate Report, 2016 Year in Review," Cushman and Wakefield.

[14] Ibid.

[15] Ibid.

in most cases was not able to find suitable available space. Each of these deals required between 100,000 and 150,000 square feet of space.[16] In many instances, these deals had some unique tie to UC Davis, either through research or alumni relationships. While this prospective activity demonstrates steady interest in Davis, the history of large completed projects in the community suggests that additional economic development attention on established small and medium enterprises will be necessary to generate a notable uptick in the demand for space.[17] Of course, sites must be financially feasible and meet a user's desired site and location characteristics to attract this demand.

The City has incurred positive net absorption totaling approximately 515,000 square feet (an average of 34,000 square feet annually) since 2002. During the period from 2002 to 2016, the vacancy rate has averaged 8.6 percent, significantly lower than average vacancy rates for office space in the greater region. The current vacancy rate of 8.8 percent indicates a healthy, stabilized market and is consistent with vacancy rates throughout Yolo County (County). Current average office lease rates in the City are approximately $2.00 per gross square foot for a full-service lease, about $0.25 higher than average lease rates in the Greater Sacramento Region, and approximately $0.40 higher than average lease rates in the County. At this time, lease rates are approaching levels that could justify new construction, though appreciation may be necessary depending on the attractiveness of the site.

R&D/Flex Market Performance Indicators[18]

R&D/Flex uses in the City, the County, and the Greater Sacramento Region are much less prevalent than office space and have incurred modest growth since 2002. As of the fourth quarter of 2016, the City contains about 519,000 square feet of R&D/Flex space, representing about 23 percent of total R&D/Flex space in the County. Since 2002, the City has added about 92,000 square feet of R&D/Flex space, equaling approximately 6,100 square feet annually. And, similar to the office market, no new R&D/Flex space was added to the City's inventory in 2016.

Considering the limited R&D/Flex space in the City and the County, any loss of significant tenants dramatically affects the sector's vacancy rate. As such, vacancy rates in the City have been volatile over the last 15 years. As of fourth quarter of 2016, the City's R&D/Flex market experienced a vacancy rate of about 14 percent, on par with West Sacramento, the County, and Greater Sacramento Region. In the City, much of the vacant space reportedly is substandard

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[16] Interview with Bob Burris from the Greater Sacramento Area Economic Council, March 27, 2015. Excerpted from the "Economic and Fiscal Impact Analysis of Proposed Innovation Centers in Davis" report, prepared by EPS, September 8, 2015.

[17] Interviews with Bob Burris from the Greater Sacramento Area Economic Council, March 27, 2015, Scott Ragsdale from Davis Roots, April 28, 2015, and Kirk Uhler from the Sacramento Regional Area Technology Alliance, April 8, 2015.

[18] R&D/Flex market performance indicators encompass all subcategories of this land use, ranging from industrial-oriented space to office-oriented space. It should be noted that lease rates are likely to be higher and in alignment with office market metrics for office-oriented space than what is summarized in this memorandum.

construction quality or located on the second floors of structures. In the latter case, such spaces are less appealing to users because of increased cost and inconvenience, with these users often seeking ground floor space.

The City incurred positive absorption of nearly 5,000 square feet per year since 2002, with a majority of this positive absorption occurring from 2006 to 2010. The City experienced negative net absorption in recent years (2011–2014), but the R&D/Flex market has shown signs of recovery, marked by positive net absorption in 2015 and 2016. In contrast, R&D/Flex space in the Greater Sacramento Region as a whole has experienced massive positive net absorption in the last 6 consecutive years, beginning in 2011, with net absorption of more than 1.6 million square feet of space.

Currently, R&D/Flex lease rates are approximately $1.00 per gross square foot for a triple-net lease in the City.[19] Over the last 15 years, average lease rates in the City have reflected lease trends in the Greater Sacramento Region. Lease rates generally increased from 2002 to mid-Great Recession, then sharply declined in the following years, and only recently have begun to match prerecession rates.

Estimated Office & R&D/Flex Supply and Demand Synthesis

Based on the City's desire for the Project site to accommodate an office/R&D tenant, this memorandum provides a high-level analysis of projected supply and demand for office/R&D space, as shown in **Table 2**. The analysis provides additional context regarding the impacts of removing the Project site from the land supply that potentially could support future office/R&D space, assuming office/R&D uses on the Project site have the potential to be financially feasible.

According to historical, annual absorption of office and R&D/Flex space, the City could experience future absorption of about 39,000 square feet annually, or about 2.2 to 3.7 acres per year, based on Floor Area Ratios (FARs) ranging from 0.25 to 0.40.[20] The City has about 153 net acres of vacant land to accommodate future office and R&D/Flex development (including the Project parcel).[21] As such, it is estimated the City has an approximately 43- to 69-year supply of vacant land for future office and R&D/Flex development. Note that inclusion of the Project site envisions demolition of the existing structure and new construction of office/R&D use, which uses the site more efficiently than the current structure.

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[19] A triple net lease (NNN) is a lease agreement on a property where the tenant or lessee agrees to pay all real estate taxes, building insurance, and maintenance on the property in addition to any normal fees that are expected under the agreement (rent, utilities, etc.).

[20] This analysis estimates future absorption is similar to historical, long-term absorption unless a large-scale project, such as the potential Nishi or Mace Ranch Innovation Center, is approved. If such "game-changing" projects are approved, the City could experience substantially higher absorption of office/R&D space although it would be localized in these projects, which are excluded from the total estimated land supply.

[21] Net vacant acreage derived from the August 2015 Mace Ranch Innovation Center Project Draft EIR. Section 4.10 (Land Use and Urban Decay) and discussions with City staff, conducted in March 2017, to obtain the most recent information pertaining to vacant, undeveloped land in the City.

Table 2
City of Davis Commercial Rezone Analysis
Estimated Commercial Office and R&D/Flex Land Supply in the City

Item	Historical Absorption [1]	Average Annual Growth in Acreage [2] 0.25 FAR	Average Annual Growth in Acreage [2] 0.40 FAR	Estimated Land Supply in Years (Incl. Project) [3] Low	Estimated Land Supply in Years (Incl. Project) [3] High	Estimated Land Supply in Years (Excl. Project) [4] Low	Estimated Land Supply in Years (Excl. Project) [4] High
Office	34,348	3.2	2.0	-	-	-	-
R&D/Flex	4,742	0.4	0.3	-	-	-	-
Total (Rounded)	**39,000**	**3.6**	**2.2**	-	-	-	-
Estimated Shovel-Ready Vacant Net Acres in City [5]				52 vacant acres		45 vacant acres	
				14.6	**23.4**	**12.6**	**20.1**
Estimated Total Vacant Net Acres in City [5]				153 vacant acres		146 vacant acres	
				42.8	**68.5**	**40.8**	**65.2**

supply

Source: City of Davis; CoStar; Cushman & Wakefield; EPS.

[1] Data obtained from CoStar and reflects average, annual absorption between 2002-2015. Assumes future absorption in the City would be similar unless a large-scale project, such as the proposed Nishi or Mace Ranch Innovation Parks, is approved. In this case, increased absorption would be localized in these projects (excluded from the estimated land supply).
[2] Low and high acreage estimate based on 0.25 and 0.40 floor area ratios, respectively.
[3] Estimates land supply given current estimate of vacant acres in the City.
[4] Estimates land supply if the Project rezone is approved and 7.4 acres are removed from total land supply.
[5] Shovel-ready and total vacant net acres available for new office and R&D/Flex space as of March 2017, based on information provided in the August 2015 Mace Ranch Innovation center Project Draft Environmental Impact Report augmented by changes in available land per discussions with City staff.

If the proposed Project is approved to accommodate multifamily residential development and 7.4 acres are removed from the office and R&D/Flex land supply, the City is estimated to have a 41- to 65-year land supply, all other assumptions held equal. Thus, removing the Project decreases the land supply by 2 to 4 years, which is not significant given the long-term land supply. It should be noted that this conclusion assumes the Project site is attractive to and can feasibly support a new office/R&D tenant.

Table 2 also estimates the City's land supply to accommodate office/R&D uses, based on shovel-ready (i.e., readily developable) vacant land. Including the Project site, the City has an approximately 15- to 23-year land supply. Excluding the Project site, the City's land supply is estimated to be about 13 to 20 years. Regardless of whether the Project site is rezoned, the City will soon face a limited supply of shovel-ready land and should engage with the public regarding methods to accommodate future office/R&D uses beyond a 20-year horizon.

This land supply and demand analysis excludes the approximately 163,000 square feet of vacant commercial office and R&D/Flex space currently for lease on the market.[22] At the absorption rate noted above and assuming a portion of this space may be obsolete, this existing, for-lease space adds approximately 2 to 3 years to the estimated office/R&D inventory.

Local Multifamily Residential Market Conditions

The residential market in Davis is strong, evidenced by average single-family ownership home prices that are above the California average and an extraordinarily tight multifamily ownership and rental market. In fact, numerous published articles and local real estate professionals note Davis has been experiencing a multifamily housing *crisis* in recent years.[23]

Demand for multifamily rental housing in the City is and historically has been greatly influenced by the presence of UC Davis, home to many university professors and schoolteachers in addition to the tens of thousands of students and employees associated with the university. UC Davis shares in the responsibility to supply housing to meet this demand through development of a variety of housing options, both on and off campus. According to the university's Long Range Development Plan, UC Davis plans to house 40 percent of students in campus housing by 2027–2028, representing an increase from the 30 percent of students who live on campus currently. To achieve this goal, UC Davis plans to build additional units and densify existing multifamily housing projects.

The other component of demand for multifamily housing is derived from non-students. In addition to the university-related non-students, the City's employment sector has expanded, capitalizing on UC Davis research strengths and associated clusters and industries, including technology-related start-ups. To attract and retain a labor force to support the City's desired expansion of its knowledge-based employment sector, it is important that public and private entities collaborate to provide a range of housing options for non-students as well, including

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[22] "Davis Office & Commercial Real Estate Report, 2016 Year in Review," Cushman and Wakefield.

[23] "Commentary: Rental Housing Crisis in Davis," The Davis Vanguard, February 20, 2015; "Analysis: Will Davis Rental Crisis Change City Politics?" The Davis Vanguard, March 9, 2016; "Council Candidates Take on the Housing Crisis," The Davis Enterprise, May 11, 2016; and "Housing is a Shared Responsibility for City and Campus," The Davis Enterprise, December 18, 2016.

multifamily ownership *and* rental units. On a national level, a range of well-documented reasons, including stagnant incomes, tougher mortgage credit requirements, and lingering financial stress on household budgets from the Great Recession has made it more difficult for more households to buy a home today than at any other time in recent memory.[24] Added to those factors, relatively high single-family detached new and resale values and demand for multifamily ownership and rental housing in the City has surged.

The tight multifamily market in the City also is dictated by constrained supply. Over the last 12 years, very few market-rate multifamily rental residential projects have been delivered in the City. **Table 3** shows multifamily rental projects built in the City from 2005 to the present. Since 2005, a total of 10 multifamily rental projects have been built in Davis, totaling 1,186 units and 3,140 bedrooms.[25] [26] Market-rate housing accounts for 56 units or just 5 percent of total units constructed since 2005.[27] In contrast, student units account for about 60 percent of total units, and affordable units account for about 35 percent of total units. Although there is a need for continued development of student and affordable housing, market-rate housing in Davis appears to be particularly underserved.

Indeed, a recent assessment of the multifamily rental market in the City confirms an extraordinarily tight market, with vacancy rates falling to nearly 0 percent (0.3 percent) for unit leases and rental rates substantially increasing several years in a row.[28] Vacancy rates ranged from 0 percent for studio apartments to between 0.1 and 0.6 percent for 1-, 2-, 3-, and 4-bedroom apartments. Multifamily vacancy rates historically have been low, but the 2016 vacancy rate is the lowest vacancy rate experienced in the City in at least the last 15 years, if not in the City's history.[29] Further, vacancy rates for ownership units (combination of single-family and multifamily ownership units) are estimated to be 0 percent, according to the U.S. Census. These vacancy rates, coupled with increasing rental rates and sales prices, indicate strong demand for additional multifamily residential units in the City.

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[24] Stockton Williams, Preserving Multifamily Workforce and Affordable Housing: New Approaches for Investing in a Vital National Asset, Washington, DC: Urban Land Institute, 2015, p. 2.

[25] Multifamily rental projects do not include for-sale properties (e.g., condominiums), assisted living senior facilities, or student dormitories.

[26] Note that this total includes the currently underway Heirloom at The Cannery market-rate attached project. As of this memorandum, about 60 percent of the total units planned have been sold, with about 30 units remaining to be offered.

[27] One of the market-rate projects, Da Vinci Apartments, comprises 31 4-bedroom units. Although marketed as market-rate, these units likely are targeting students. If these units are indeed overwhelmingly rented to students, the number of market-rate units available for non-students is less than estimated in this report.

[28] The 2016 multifamily housing market survey, completed by Bay Area Economics, requested information from nearly 12,000 apartment units. The survey received responses from 9,905 of those units (an approximately 83-percent response rate).

[29] Based on published data collected from CoStar starting in 2002. No vacancy rate data is available from this source before that date.

Table 3
City of Davis Commercial Rezone Analysis
Davis Multifamily Rental Projects Completed Since 2005 [1]

Year Completed	Project Name	Address	Units	Bedrooms	Type
Student Housing					
2011	West Village	1580 Jade St.	663	1,980	Student
2014	8th and Wake	1440 Wake Forest Dr.	60	238	Student
Subtotal Student Housing			**723**	**2,218**	
Affordable Housing					
2005	Moore Village	2444 Moore Dr.	59	126	Affordable
2005	Eleanor Roosevelt Housing	675 Cantrill Dr.	59	59	Affordable
2006	Windmere	3100 Fifth St.	106	227	Affordable
2008	Cesar Chavez Place	1220 Olive Dr.	52	52	Affordable
2013	New Harmony	3030 Cowell Blvd.	69	156	Affordable
2017	Bartlett Commons/The Cannery	900 Cannery Loop	62	127	Affordable
Subtotal Affordable Housing			**407**	**747**	
Market-Rate Housing					
2005	Da Vinci Apartments	1666 Da Vinci Ct.	51	160	Market
2005	Russell 5-Unit	319 Russell Blvd.	5	15	Market
Subtotal Market-Rate Housing			**56**	**175**	
Total Housing Units (2005-2017 to date)			**1,186**	**3,140**	
Student Units as a Percent of Total			61%	71%	
Affordable Units as a Percent of Total			34%	24%	
Market Rate Units as a Percent of Total			5%	6%	

Davis MF

Source: "Housing is a shared responsibility for city and campus" by Jim Gray, published by The Davis Enterprise on December 18, 2016; The Gregory Group; EPS.

[1] Excludes dorms, for-sale, and assisted-living units.

Multifamily Residential (Rental) Market Performance Indicators

As shown in **Table 1**, the City's multifamily inventory grew by more than 1,200 multifamily rental units in the period from 2002 to 2015, amounting to an average annual percentage change of 0.8 percent, which is lower than the County's average of 1.2 percent. There have been periods of consecutive years where the multifamily inventory remained unchanged (2008–2010, 2011–2013, and 2014–2015).

Vacancy for multifamily units in Davis has remained low since 2016, consistently hovering around or below 4 percent. As of fourth quarter of 2016, the multifamily vacancy rate is estimated to be 3.7 percent. Note that this vacancy rate is higher than the vacancy rate estimated in the 2016 study conducted by Bay Area Economics (BAE). However, this difference does not alter the conclusion that the multifamily housing market is extraordinarily tight.

Average asking lease rates in the City are $1,535 per unit in the fourth quarter of 2016, 18.4 percent higher than the County average. Average lease rates in Davis, Woodland, West Sacramento, the County, and the Greater Sacramento Region grew from 2002 and into the years of the Great Recession, at which point lease rates began to decline. Lease rates began to rise in the post-recession years, and by the fourth quarter of 2013, multifamily lease rates for the aforementioned study areas had recovered to prerecession levels.

Financial Feasibility Analysis

EPS prepared a pro forma feasibility analysis to test the viability of different development scenarios on the Project site, including:

- Adaptive reuse of the existing structure to accommodate office/R&D.
- Demolition and development of new office/R&D.
- Demolition and development of new commercial retail.
- Demolition and development of proposed market-rate, multifamily uses.

Table 4 presents the financial model that compares the feasibility of these development scenarios. This type of analysis, called a residual land value analysis, models the revenues achieved by operating and selling a particular building to arrive at an estimated building value. The residual land value analysis also models the cost of constructing the building, including hard construction costs, soft costs, and associated municipal fees. To arrive at the residual land value, the total costs are subtracted from the total building value, reflecting the portion of the building's total value that can be attributed to the land on which it stands. The resulting residual land value analysis, if positive, can be compared to comparable recent land sales to determine if a development plan would be attractive in the marketplace.

The attached analysis provides the development scenario land use assumptions and revenues and incomes, based on current, average market rents and other assumptions, including an assumed vacancy rate and ongoing operating expenses. The building's value is derived by dividing its net operating income (NOI) by an assumed market capitalization rate.

Project costs also are calculated, taking into account the hard and soft costs associated with demolition, retrofitting, new construction, site improvements, and tenant improvements. The model also includes contingency assumptions, with contingency for the adaptive reuse scenario higher than that for new construction, given the complexities and unknowns associated with

Table 4
City of Davis Commercial Rezone Analysis
Pro-Forma Feasibility: Residual Land Value Analysis and Comparable For Sale Land Listings

Item	Source	COMMERCIAL USES			MULTIFAMILY RESIDENTIAL USES		
		Adaptive Reuse	New Construction		New Construction [1]		
		Office/R&D	Office/R&D	Retail	Rental	Ownership	Total
DEVELOPMENT PROGRAM ASSUMPTIONS							
Site Acres	[2]	7.4	7.4	7.4	4.4	3.0	7.4
Existing Structure (Square Feet)	[2]	51,064	51,064	51,064	51,064	51,064	51,064
Density (Floor Area Ratio [FAR] or Dwelling Units/Acre)		0.16	0.25	0.25	30	15	24
Average Dwelling Unit Size (Square Feet)		NA	NA	NA	1,050	1,450	901
Total Dwelling Units		NA	NA	NA	130	45	175
Gross Building Area (Square Feet)		51,064	80,586	80,586	160,588	65,250	225,838
Efficiency Ratio	[3]	80%	90%	95%	85%	100%	89%
Gross Leasable Area (Square Feet)		40,851	72,527	76,557	136,500	65,250	201,750
REVENUE ASSUMPTIONS							
		per square foot			*per unit*		
Avg. Gross Lease Rate/Month	[4]	$1.75	$2.00	$2.10	$1,628	NA	$1,628
Avg. Gross Lease Rate/Year		$21.00	$24.00	$25.20	$19,530	NA	$19,530
Avg. Sale Price/Unit	[5]	NA	NA	NA	NA	$435,000	$435,000
Avg. Sale Price/SF		NA	NA	NA	NA	$300	$300
Gross Potential Income/Year		$857,875	$1,740,658	$1,929,229	$2,538,900	NA	$2,538,900
Less Vacancy	[6]	10.0%	10.0%	10.0%	3.0%	NA	3.0%
Effective Gross Income (EGI)		$772,088	$1,566,592	$1,736,306	$2,462,733	NA	$2,462,733
Less Operating Expenses (% of EGI)	[7]	50.0%	25.0%	25.0%	25.0%	NA	25.0%
Total Operating Expenses		($386,044)	($391,648)	($434,076)	($615,683)	NA	($615,683)
Net Operating Income (NOI)		**$386,044**	**$1,174,944**	**$1,302,229**	**$1,847,050**	**NA**	**$1,847,050**
NOI/Gross Building Square Foot		**$7.56**	**$14.58**	**$16.16**	**$11.50**	**NA**	**$11.50**
Capitalization Rate	[8]	7.61%	6.61%	6.11%	5.04%	NA	NA
Building Value		$5,072,849	$17,788,704	$21,313,085	$36,684,206	$19,575,000	$56,259,206
Less Disposition Cost (Perc. of Building Value)		3.0%	3.0%	3.0%	3.0%	3.0%	3.0%
Net Building Value		**$4,920,664**	**$17,255,043**	**$20,673,692**	**$35,583,679**	**$18,987,750**	**$54,571,429**
Value/Gross Building Square Foot		**$96.36**	**$214.12**	**$256.54**	**$221.58**	**$291.00**	**$241.64**

Table 4
City of Davis Commercial Rezone Analysis
Pro-Forma Feasibility: Residual Land Value Analysis and Comparable For Sale Land Listings

Item	Source	COMMERCIAL USES			MULTIFAMILY RESIDENTIAL USES		
		Adaptive Reuse	New Construction		New Construction [1]		
		Office/R&D	Office/R&D	Retail	Rental	Ownership	Total
COST ASSUMPTIONS							
Hard Costs							
Demolition Costs/Existing Building Square Foot	[9]	NA	$4.72	$4.72	$2.36	$2.36	$4.72
Total Demolition Costs		NA	$241,000	$241,000	$120,500	$120,500	$241,000
Retrofitting of Existing Building	[9] [10]	$90.00	NA	NA	NA	NA	NA
Total Retrofitting Costs		$4,595,760	NA	NA	NA	NA	NA
Direct New Building Construction Costs/Gross Building SF	[11]	$0.00	$125.00	$120.00	$120.00	$165.00	NA
Total Direct Building Construction Costs		$0	$10,073,250	$9,670,320	$19,270,588	$10,766,250	$30,036,838
Direct Site Improvement and Intract Costs/Acre	[9]	$173,514	$173,514	$173,514	$173,514	$173,514	$173,514
Total Direct Site Improvement Costs		$1,284,000	$1,284,000	$1,284,000	$763,459	$520,541	$1,284,000
Tenant Improvement Costs/GLA SF (net of tenant responsibility)	[9]	$60.00	$60.00	$60.00	$10.00	NA	NA
Total Tenant Improvement Costs		$2,451,072	$4,351,644	$4,593,402	$1,365,000	NA	NA
Total Hard Costs		**$8,330,832**	**$15,949,894**	**$15,788,722**	**$21,519,548**	**$11,407,291**	**$32,926,838**
Soft Costs							
Marketing/Leasing (4% of Hard Costs)		$333,233	$637,996	$631,549	$860,782	$456,292	$1,317,074
Other Soft Costs (11% of Hard Costs)		$916,392	$1,754,488	$1,736,759	$2,367,150	$1,254,802	$3,621,952
Total Soft Costs (15% of Hard Costs)		**$1,249,625**	**$2,392,484**	**$2,368,308**	**$3,227,932**	**$1,711,094**	**$4,939,026**
Subtotal Hard and Soft Costs		**$9,580,457**	**$18,342,378**	**$18,157,030**	**$24,747,480**	**$13,118,384**	**$37,865,864**
Contingency Costs							
Contingency as % of Hard and Soft Costs		10%	5%	5%	5%	5%	5%
Total Contingency Costs		**$958,046**	**$917,119**	**$907,852**	**$1,237,374**	**$655,919**	**$1,893,293**
Municipal Fees							
Nonresidential Permit and Processing Fees (per SF)		$4.03	$4.03	$4.96	NA	NA	NA
Nonresidential Development Impact Fees (per SF)		$0.00	$4.23	$20.54	NA	NA	NA
Total Nonresidential Fees (per SF)	[12]	$4.03	$8.26	$25.50	NA	NA	NA
Total Residential Payments and Fees (per Dwelling Unit)	[13]	NA	NA	NA	$34,000	$48,000	NA
Total Municipal Fees		**$205,788**	**$665,640**	**$2,054,540**	**$4,420,000**	**$2,160,000**	**$6,580,000**
Subtotal Costs (Hard, Soft, Contingency, Fee Costs)		**$10,744,290**	**$19,925,137**	**$21,119,422**	**$30,404,854**	**$15,934,303**	**$46,339,157**
Developer Profit (7% of Subtotal Costs)		**$752,100**	**$1,394,760**	**$1,478,360**	**$2,128,340**	**$1,115,401**	**$3,243,741**
Total Costs		**$11,496,391**	**$21,319,897**	**$22,597,781**	**$32,533,194**	**$17,049,705**	**$49,582,898**
Cost/Gross Building Square Foot		**$225.14**	**$264.56**	**$280.42**	**$202.59**	**$261.30**	**$219.55**

Table 4
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Item	Source	COMMERCIAL USES			MULTIFAMILY RESIDENTIAL USES		
		Adaptive Reuse	New Construction		New Construction [1]		
		Office/R&D	Office/R&D	Retail	Rental	Ownership	Total
FINISHED LAND VALUE							
Residual Land Value (Total Building Value less Total Costs)		($6,575,727)	($4,064,854)	($1,924,089)	$3,050,486	$1,938,045	$4,988,531
Per Acre		**($888,612)**	**($549,305)**	**($260,012)**	**$693,292**	**$646,015**	**$674,126**
Per SF of Land		**($20.40)**	**($12.61)**	**($5.97)**	**$15.92**	**$14.83**	**$15.48**
Comparable Land Sales	[14]						
Per Acre		**$551,756**	**$551,756**	**$551,756**	**$640,941**	**$640,941**	**$640,941**
Per SF of Land		**$12.67**	**$12.67**	**$12.67**	**$14.71**	**$14.71**	**$14.71**

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Source: Shepard Family Holdings, LLC; ParcelQuest; Cushman & Wakefield; BAE; Andy Plescia/Goodwin Consulting Group; EPS.

[1] Reflects the proposed site plan, including a combination of multifamily rental and ownership land uses.
[2] Obtained from ParcelQuest, based on Yolo County assessor records as of January 2017.
[3] Efficiency ratio for adaptive reuse scenario obtained from current property owner, based on the large amount of unusable space on the ground level. Efficiency ratios for other scenarios based on prototypical development standards.
[4] Commercial lease rates from Cushman & Wakefield Commercial Real Estate Report, Q3 2016 Davis Submarket. Lease rates for adaptive reuse scenario assumed to be lower because of the limitations of ground floor layout, which is likely to attract a cost-sensitive user, even with substantial interior improvements. Multifamily rental rates based on average rents for 1- to 2-bedroom, market-rate apartments in Davis.
[5] Based on estimated multifamily ownership housing values for the Nishi Gateway Innovation District, prepared by Andy Plescia and Goodwin Consulting Group in July 2015. Adjusted downward to reflect project site location relative to Nishi.
[6] Commercial vacancy rates based on data provided in the Cushman & Wakefield Commercial Real Estate Report, Davis Submarket, Q3 2016. Multifamily rental vacancy rate based on data provided in the BAE 2015 Apartment Vacancy and Rental Rate Survey.
[7] Operating expense assumption for the adaptive reuse scenario based on actual data provided by the current property owner; assumptions for other scenarios based on typical operating expense assumption.
[8] Integra Realty Resources, Inc. 2017 Annual Viewpoint Commercial Real Estate Trends Report. Assumes West Region capitalization rates for Suburban Class A/B Office, Community Retail, and Suburban Class A/B Multifamily sectors. Higher capitalization rate assumed for adaptive reuse scenario due to the age and other characteristics of the existing structure.
[9] Estimated by MarketOne Builders, Inc., September 14, 2016.
[10] Includes seismic retrofitting of $750,000, which represents the lower end of estimated construction costs. Actual costs may be up to $1.5 million or more but require detailed engineering reports to determine a more refined cost estimate.
[11] Based on RSMeans Online Square Foot Estimator for commercial uses. Residential cost estimates based on the assumption that the cost of construction accounts for about 60 percent of the market value per unit, according to the National Association of Homebuilders.
[12] Nonresidential fee estimates per square foot for commercial uses in Davis based on information collected for EPS's September 2015 Innovation Center report.
[13] Residential fee estimates per unit for residential uses in Davis based on January 2016 Analysis of Funding Alternatives for Nishi Property, prepared by Andy Plescia and the Goodwin Consulting Group.
[14] Comparable land sales sourced from LoopNet, CoStar, and ParcelQuest for commercial and residential properties in and surrounding Davis (2015-2017). Refer to **Table A-1** for detailed information on included properties.

renovations and retrofitting older buildings such as the existing structure, which was built in 1965. Of particular concern are the seismic retrofitting costs that can be difficult to predict accurately. Permit and development impact fees also are calculated. New construction will be subject to both permit and development impact fees, while the adaptive reuse scenario will be required only to pay for permit and processing fees because this scenario does not add new square footage or alter the footprint of the existing structure.

The total project costs are subtracted from the building's value to arrive at a residual land value. The residual land value then is compared to the cost of comparable land. **Table A-1** details the information of properties included in the comparable set. The adaptive reuse and new commercial development scenarios produce negative land values, meaning costs exceed the estimated building value.

The model demonstrates that under current market conditions, lease rates for office and retail uses are not high enough to support the significant costs associated with renovation and new construction. It should be noted that the property's size does not warrant potential cost savings associated with economies of scale achievable for much larger projects, and the adaptive reuse scenario bears the risk of unforeseen costs from renovating an older building. These scenarios would require a significant increase in achievable rents to result in a financially feasible project.

The pro forma feasibility analysis indicates the multifamily housing project, including 130 apartment rental units and 47 multifamily ownership units, may be achievable under current market conditions. As shown, the residual land value is both positive and exceeds comparable land sale values.

Key Findings

The following section highlights key findings from EPS's high-level highest and best use evaluation, identifying the advantages, disadvantages, and a final assessment of each development scenario evaluated.

Adaptive Reuse: Office/R&D

This scenario envisions the adaptive reuse of the existing 51,000-square-foot structure to accommodate an office/R&D/Flex tenant:

- **Advantages.** Adaptive reuse of the existing structure would retain the prior use, although this use is not consistent with the parcel's existing zoning designation. If a suitable tenant is located, the absorption of this existing space would add about 1 year to the City's total remaining supply to accommodate office/R&D uses. In addition, absorption of this space would occupy the currently vacant building, adding to the City's employment base. Although rehabilitating the site and existing structure is costly, it is not projected to be as costly as new development (refer to **Table 4**). Net new tenant employees would support proximate retail establishments, increasing the City's sales tax base.

- **Disadvantages.** Foremost, this scenario is estimated to result in a negative residual land value. The site and interior of the existing structure require significant investment to modernize for a contemporary office/R&D tenant. Further, the limitations of the existing structure's layout, coupled with the site's location and distance from campus, retail, and service amenities, all have a significant impact on the building's achievable lease rate. Lease

rates above $5 per gross leasable area (GLA) would be required to match comparable land sale values. This lease rate would not be achievable in this area for many decades to come. It is noteworthy to mention that UC Davis, which leased the structure for 20 years, no longer saw value in using the space as they did not renew their lease. And, the City, the Greater Sacramento Economic Council, and the Client spent a year marketing the building to a technology-oriented tenant and were unsuccessful in attracting any interest.

- **Final Assessment.** Without significant one-time capital and ongoing operational public subsidies, the financial pro forma analysis results alone render the adaptive reuse scenario infeasible. And the lack of interest from UC Davis and other office/R&D users indicates the existing structure likely would sit vacant for years. Refer to **Appendix B** for a listing of factors that support the successful development of office/R&D/Flex space. As discussed, one reason the site is not viable for office/R&D/Flex development is that it is not located in a larger innovation or research park or district, such as the Interland Research Park or along 2nd Street. The City will be better able to attract new office/R&D/Flex users in available space in these existing or new innovation park/districts.

New Construction: Office/R&D

This scenario envisions demolition of the existing structure and new construction of nearly 81,000 square feet of office/R&D space. The new space would comprise multiple office/R&D buildings with associated parking, under the rules for lot size, building size, setbacks, and other conditions specified by City code:

- **Advantages.** National and local office market fundamentals are strong, and the technology sector will continue to drive demand for office/R&D space. The City is in a prime position to accommodate future office/R&D demand, especially as it relates to capitalizing on UC Davis research strengths and industry clusters currently present in the City. New construction will allow for better use of the Project site, increasing the amount of leasable space and commanding a higher lease rate relative to the adaptive reuse scenario. New construction of multiple buildings would be attractive to contemporary office/R&D tenants and has the potential to meet demand for larger suite sizes currently limited or absent in the City. Tenant employees would support proximate retail establishments, increasing the City's sales tax base. This scenario would not require rezoning the Project site.

- **Disadvantages.** Similar to the adaptive reuse scenario, this scenario is estimated to result in a negative residual land value. Lease rates of approximately $2.90 per GLA would be required to match comparable land sale values. This lease rate represents a nearly 50-percent increase over estimated achievable lease rates in this area. Given the site's location south of I-80, adjacent to limited retail offerings, and distance from the UC Davis campus and downtown, it is unlikely new office/R&D development could command this lease rate in the short term. Although the site historically was used for office space and is zoned to accommodate office space—among other commercial uses—the Project site is surrounded by existing residential and highway-oriented/neighborhood commercial uses. According to real estate brokers, contemporary office/R&D users are not interested in the site's location because of limited connectivity to commercial, service, and transportation options. One-time construction impacts and ongoing operational impacts associated with demolition of the existing structure and development of multiple new office buildings may have undesired impacts (e.g., traffic, noise) on surrounding residential uses.

- **Final Assessment.** Real estate professionals have not received any interest from office/R&D users related to the Project site. Further, the financial analysis provided in this memorandum results in a negative residual land value. Lease rates are too low to capitalize singular or multitenant speculative construction of new office/R&D space and too high for many start-ups to afford. Competitive cities in the region can offer built space below replacement cost, offering state-of-the-art structures for less than they could be built. In addition, competitive cities (e.g., Vacaville, Roseville, Folsom) have lower combined impact fee and Community Facility District (CFD) burdens than those in the City. These will continue to be factors limiting absorption in Davis among certain users inclined to consider regional location options for which university proximity is not paramount and are willing to trade location for cost. Finally, the site's location, as discussed for the adaptive reuse scenario, is not ideal for attracting office/R&D users; an existing or new innovation park/district would be better suited in attracting this type of land use (refer to **Appendix B** for a listing of factors supporting the successful development of office/R&D land uses).

New Construction: Retail

This scenario comprises community-serving retail uses of nearly 81,000 building square feet. The new space would comprise multiple retail buildings with associated parking, under the rules for lot size, building size, setbacks, and other conditions specified by City code:

- **Advantages.** A rezone is not required as the Project site currently permits or conditionally permits various retail uses, including automotive repair/supply, service commercial, automobile dealerships, service stations, restaurants, and community retail. New retail outlets would increase annual sales tax revenue to the City's General Fund.

- **Disadvantages.** Although development of retail does not require a rezone, this approach would remove the Project site from the inventory for office/R&D space, reducing the estimated land supply for office/R&D uses by 2 to 4 years (see **Table 2**). This reduction is not significant relative to total, vacant undeveloped land but has a greater impact to the shorter-term shovel-ready land supply for office/R&D space. The financial analysis included in this memorandum models the development of general neighborhood or community-serving retail uses. The pro forma estimates that development costs exceed the building's capitalized net value, resulting in a negative land residual value and an infeasible development scenario. Lease rates of approximately $2.70 per GLA (an increase of $.60 per square foot) would be required to match comparable land sale values. Additional retail in this location would create a larger retail district, extending existing highway- and neighborhood-serving retail uses to the east of the Project. However, new commercial retail space is not well-suited for the site's location because there is low demand for a 7.4-acre parcel that is not clustered with other community-serving retail uses. Retail tenants thrive in clusters of one or more large anchor tenants and multiple smaller in-line and retail pad tenants. The parcel size, location, and amount of existing, adjacent retail space are not a sufficient critical mass of space to attract many retail tenants. One-time construction impacts and ongoing operational impacts associated with demolition of the existing structure and development of new retail uses may have undesired impacts (e.g., traffic, noise) on surrounding residential uses.

- **Final Assessment.** The financial pro forma analysis does not support this development scenario. Specific highway-serving uses (e.g., gas station, hotel) may be viable but were not

analyzed based on adjacent uses' perceived incompatibility. Real estate brokerage professionals have noted some inquiries from automobile and recreational vehicle dealers seeking sites in the City, but interest has been limited as of recently. In addition, the Project site may not meet all site selection criteria required by dealerships, capital cost requirements for demolition and new construction may be too high, and a dealership on the Project site may create undesired lighting and traffic impacts on the adjacent residential neighborhood. Further market and feasibility analyses are warranted to determine if market support exists and if the demolition and site development costs inherent in redeveloping the Project site are less than these uses' capitalized net building value. Finally, the City must determine at a policy level if development of additional highway-serving uses or automobile/recreational vehicle dealerships meet City General Plan objectives.

New Construction: Proposed Multifamily Residential Project

This development scenario reflects the Client's proposed land use program: development of 130 market-rate rental apartments and 47 market-rate ownership townhomes. The project's location, offering of rental and ownership product, and proposed design and common area amenities, while not restrictive, are envisioned to target the preferences of non-students:

- **Advantages.** The pro forma financial analysis indicates the multifamily housing project, as proposed *and* under current market conditions, may be feasible. As shown in **Table 4**, the residual land value both is positive and exceeds comparable land sale values. Importantly, this Project directly would address the City's current severe multifamily rental and ownership housing shortage. As illuminated in a recent assessment of the City's apartment market, the City's rental market is extraordinarily tight, with vacancy rates near zero and rising rental rates. Vacancy is estimated to be zero for multifamily ownership units also. Local real estate professionals indicate receiving numerous inquiries seeking residential sites in the City. Only 5 percent of new apartment units developed in the City since 2005 have been market-rate. Only 2 resale listings and 1 multifamily ownership project with 30 remaining units exist in the City. The conditions indicate strong support for additional market-rate units in the City. Although demand exists for additional student and affordable multifamily housing units, the Project site's distance from the UC Davis campus and proximity to the Mace Boulevard interchange, Mace Park-and-Ride, Sacramento Regional Transit bus stop, and existing day care facility make it an attractive location for market-rate housing. New residents of the proposed Project will spend a portion of their income on retail goods and services in the City, thereby increasing the City's sales tax base.

- **Disadvantages.** The Project site requires rezoning from its current CMU designation to allow for residential uses on the site. As shown in **Table 2**, removal of the Project site from the inventory will reduce the estimated land supply for office/R&D uses by 2 to 4 years. This reduction is not significant relative to total, vacant undeveloped land but has a greater impact to the shorter-term shovel-ready land supply for office/R&D space. Regardless of whether the Project site is rezoned, however, the City should address ways to increase the supply of readily developable land. One-time construction impacts associated with demolition of the existing structure and development of new retail uses may have undesired impacts (e.g., traffic, noise) on surrounding residential uses. The ongoing impacts of new residential uses are unlikely to—but may—have an impact on surrounding residential uses. Residential development—in particular higher density, moderately valued residential development—often is a net fiscal burden on a city's operating budget. That is, the cost of

providing municipal services can exceed General Fund revenues (e.g., property tax revenue, sales tax revenue). However, cities desire residential land uses to accommodate a balance of land uses, provide workforce housing, and fulfill other policy objectives. Because the proposed units are envisioned to command market-rate values, and market-rate values are relatively strong in the City, revenues may fully cover the cost of providing municipal services to new development. Additional analyses would be required to estimate the fiscal impacts of the proposed Project on the City's General Fund.

- **Final Assessment.** The financial pro forma analysis supports development of the proposed Project. In addition to being the only development scenario that is financially feasible, there is high demand for and development interest in the construction of market-rate units in the City. This Project directly would address the City's need for additional market-rate multifamily units. The site's attributes make it an attractive site for market-rate units and, because of its distance from the UC Davis campus, a less attractive site for student housing. Development of market-rate units on the Project site would add local housing options to assist in attracting and retaining highly qualified young professionals for the City's expanding knowledge-based employment sector.

APPENDICES:

Appendix A: Comparable Land Sales

Appendix B: Summary of Key Factors and Effects on the Innovation Centers

APPENDIX A:

Comparable Land Sales

Table A-1 Comparable Land Sales

Table A-1
City of Davis Commercial Rezone Analysis
Comparable Land Sales

Property [1]	City	Sale Date	Sale Price	Acres	Sale Price Per Acre	Sale Price Per Sq., Ft.	Zoning/Proposed Use [2]
Commercial Property							
Covell Boulevard	Davis	7/15/2016	$3,009,998	6.02	$500,000	$11.48	Commercial/Other land
2270 Lake Washington Boulevard	West Sacramento	7/28/2016	$1,600,000	2.46	$650,407	$14.93	Commercial/Other land
1680/1700 Research Park Drive	Davis	10/28/2016	$4,194,600	6.20	$676,548	$15.53	Commercial/Other land
1401 Parkway Boulevard	West Sacramento	1/5/2017	$2,250,000	5.92	$380,068	$8.73	Commercial/Other land
Commercial Total/Average (Rounded)			**$11,054,598**	**20.60**	**$551,756**	**$12.67**	
Residential Property							
500-700 Drummond Avenue	Davis	8/21/2015	$3,400,000	3.44	$988,372	$22.69	Residential
Grande Avenue	Davis	7/2/2015	$5,500,000	8.79	$625,711	$14.36	Single-Family Residential
Natomas Park Drive	Sacramento	2/29/2016	$3,600,000	10.93	$329,369	$7.56	Multifamily Residential
East Commerce Way	Sacramento	8/30/2016	$3,970,000	6.40	$620,313	$14.24	Single-Family Residential
Residential Total/Average			**$16,470,000**	**29.56**	**$640,941**	**$14.71**	

land comp

Source: LoopNet; CoStar; ParcelQuest; EPS.

[1] Comparable land sale information obtained from LoopNet, CoStar, and ParcelQuest databases for properties between 2.5 and 11 acres sold between 2015 and 2017 in and surrounding Davis. Data accessed in January 2017.
[2] Land uses based on existing or proposed zoning designations.

APPENDIX B:

Summary of Key Factors and Effects on the Innovation Centers

SUMMARY OF KEY FACTORS AND EFFECTS ON THE INNOVATION CENTERS

As part of the September 2015 report on proposed Innovation Centers in Davis, EPS identified a group of factors associated with successful development of R&D/Flex space.[30] These success factors were distilled through stakeholder interviews and analysis of key concepts and trends of innovation districts and urban research parks.

University-Related Factors

***University Proximity*:** In addition to a university's presence as an anchor tenant in the park, close access to the larger university campus is important to facilitate collaborations and resource sharing.

***University-Tenant Match*:** The research strengths of the university should align with the types of businesses the park targets, in terms of the space and resources provided, as well as the outreach campaigns devised.

***University Investment/Commitment*:** Universities can serve as important catalysts of research parks that provide direction and leadership, as well as on-site services (incubators, accelerators) that otherwise would not be provided by the private market. The investment and commitment universities demonstrate in the planning stages of a research park help determine the future role and presence they will have.

Regional Economy Factors

Regional Economic Health: Key regional dynamics include continued rent growth and draw down of surplus real estate in adjacent markets.

***Regional Clusters-Innovation Match*:** Innovation Centers should provide space and resources for, as well as market to, businesses in innovative clusters that are strong points for the regional economy because there is substantial crossover between regional and UC Davis strengths. Growth prospects likely are to be a blend of companies focused on Davis with ties to the university or other tenants, as well as regional companies attracted by the perceived and real upside of being located in Davis because of the university presence and other positive attributes. Demand likely is to stem from a subset of five regional clusters:

1. Clean Energy Technology
2. Agriculture & Food Production
3. Life Sciences & Health Services

[30] "Economic and Fiscal Impact Analysis of Proposed Innovation Centers in Davis" report prepared by EPS, September 8, 2015.

4. Information & Communications Technology
5. Advanced Manufacturing & Materials

The clusters use the following services: Scientific R&D Services; Management, Scientific, and Technical Consulting Services; Architectural, Engineering, and Related Services; and Specialized Design Services.

***Regional Entrepreneurial Support/Tech Transfer*:** While certain start-up supports should be offered within park boundaries, the availability of area resources that foster collaboration and assist in the commercialization of research will be attractive to many prospective tenants.

***Regional Access to Capital*:** The growth of many innovative companies in their early stages depends on their ability to obtain sources of capital.

Local Market Factors

University as a Tenant (anchor or otherwise): UC Davis is a strong historic source of real estate demand in the City. Overall, the relatively high property values associated with innovative companies and research activities in innovation centers partly are based on university proximity and interactions that are absent in more generic settings.

Ability to Accommodate Tech Companies and Gazelles: These fast-growing and innovative companies are a key focus area in terms of tracking near-term demand for buildings and land.

Ability to Accommodate Start-Ups: The composition of start-ups favors medical technology, agricultural technology, clean tech, and software applications. Space needs for these companies likely are to include both flex/lab and basic multitenant spec office. Both are tenuous propositions in today's market.

Real Estate Feasibility: A mix of small and large firms is an important driver of innovation and must meet feasibility requirements to proceed.

Public-Private Approach to Improving Feasibility: Cities and private entities should work together to negotiate ways to improve feasibility, as necessary.

Project Implementation Factors

***Diversity of Space/Tenants*:** Innovation centers should have spaces that support a mix of large and small companies, as well as a mix of industries.

***Neighborhood Amenities*:** Successful innovation centers need a mix of services that activate public areas, encourage social interaction, and attract the knowledge professionals that work in cutting-edge industries. It is important to make the value proposition as powerful as possible through the provision of meaningful amenities and high-quality public spaces.

***Connectivity*:** Innovation centers must be designed to link institutions and people together both within park boundaries and to the rest of the metropolitan area. The following connection types are critical in Davis: vehicular connections, bike/pedestrian/transit connections, broadband/data and other utilities, labor force, and local and regional housing options.

On-Site Start-Up Support Infrastructure: While substantial technology transfer and entrepreneurial resources may be available in the City, the availability of an incubator and other supports for start-ups within park boundaries serves as a key differentiator between a typical research park and an innovation center.

***Supportive Policy Environment—Entitlement and Public Finance*:** The combination of market forces, impact fees, and local regulations, both park-specific and areawide, will determine whether the business community will embrace the opportunities presented by the innovation centers or turn to more attractive options elsewhere. Because the user base can be cost-sensitive, it is important to understand how the City compares to regional competition.

Project Development and Management Expertise: Experienced property developers and managers are highly motivated to accommodate the broadest swath of users feasible.

Local Leadership: Strong leadership is necessary, preferably from a variety of vital, local institutions, to provide direction and ensure the park's activities match the goals outlined for the project.