

## **EXHIBIT F.4:**

# **Summary of Feasibility Results for Community Benefit Requirements on Adaptive Reuse Projects**

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### **Downtown Community Plan**

CF 22-0617; CPC-2017-432-CPU; CPC-2014-1582-CA; ENV-2017-433-EIR

Recommended by the City Planning Commission on September 23, 2021

September 2022

## MEMORANDUM

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To: Craig Weber & Brittany Arceneaux, Los Angeles Department of City Planning  
From: HR&A Advisors, Inc.  
Date: August 12, 2022  
Re: Summary of Feasibility Results for Community Benefit Requirements in Adaptive Reuse Projects in Downtown Los Angeles

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HR&A Advisors, Inc. (“HR&A”) prepared this memorandum on behalf of the Los Angeles Department of City Planning (“LADCP”) to evaluate the financial feasibility of applying community benefit requirements to adaptive reuse projects<sup>1</sup> in the Downtown area of the City of Los Angeles (the “City”). The evaluation of adaptive reuse projects includes analysis of whether it is financially feasible to also include affordable units under a mandatory inclusionary housing program. The memorandum concludes with a set of observations that could inform the City decision-making process as the Downtown Community Plan update (“DTLA 2040”) approaches adoption.

### DTLA 2040 Context

#### Plan Overview

DTLA 2040 presents a long-term vision for the future of Downtown, focusing on the implementation of land use, urban design, mobility, and open space strategies to support significant anticipated growth.<sup>2</sup> The strategies articulated in DTLA 2040 also inform a comprehensive zoning code update in Downtown, which is currently under development. The structure of the updated zoning code will be organized under five key pillars – Form, Frontage, Development Standards, Use, and Density – that together will govern various aspects of development.

As part of this new regulatory framework, LADCP has developed a “Community Benefits Program” that seeks to encourage private development to deliver a range of community benefits, including affordable housing, publicly accessible open space, community facilities, and various other public improvements, resources, and services, through appropriate incentives and regulations that consider financial feasibility. The Community Benefits Program as presented to the Los Angeles City Planning Commission (“CPC”) was elective in nature, meaning that community benefits were only required of development projects seeking

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<sup>1</sup> This memorandum defines “adaptive reuse” as the rehabilitation and conversion of an existing non-residential building to a residential use.

<sup>2</sup> See a separate HR&A memorandum dated September 15, 2022 on mandatory inclusionary housing for more information on DTLA 2040 goals, policies, and benefits to developers.

additional (“bonus”) floor area. This “Base-Bonus” system may be replaced by a “graduated” mandatory inclusionary housing system, under which all newly constructed multi-family residential projects – including those built at or below a base Floor Area Ratio (“FAR”) – would be required to provide on-site affordable housing or pay a fee in-lieu thereof. Projects would be eligible for additional FAR first under the State Density Bonus Law in consideration of the inclusionary units provided they meet statutory Density Bonus requirements. Projects could then access additional FAR under the Base-Bonus system by providing additional on-site affordable housing, or provide a fee in-lieu thereof, in accordance with the stated program parameters. In a separate memorandum, HR&A analyzed the financial feasibility of imposing mandatory inclusionary housing requirements on Downtown multi-family residential projects at different density levels.

Since adaptive reuse projects generally utilize an existing building shell with limited new construction, they were not initially considered as part of the Base-Bonus framework. Mandatory inclusionary housing requirements could, however, apply to adaptive reuse projects wherein commercial buildings are converted to multi-family residential use. This memorandum summarizes our analysis of the financial feasibility of requiring mandatory inclusionary housing for adaptive reuse projects.

## **Adaptive Reuse Overview**

### **Overview**

“Adaptive reuse” is the process by which an obsolete or underutilized building is rehabilitated and converted to a new, more valuable use. This technique can apply to a broad range of building typologies and land uses. Small-scale warehouses in urban settings are sometimes converted to hospitality, entertainment, or retail uses, while multi-story commercial buildings are increasingly being converted for apartment or condominium uses in cities across the U.S.

Adaptive reuse already has a long and successful track record in Downtown Los Angeles. In an effort to catalyze Downtown revitalization, the City adopted the Adaptive Reuse Ordinance (“ARO”) in 1999,<sup>3</sup> which authorized the conversion of non-residential buildings to residential, hotel, or live/work uses in the Downtown area. The ARO specifically applies to buildings that fall under one of three categories:

- Commercial buildings in specified Zones<sup>4</sup> built in conformance with building and code requirements in effect prior to July 1, 1974;
- Historic buildings included in a federal or local historic resources register and/or located in a Historic Preservation Overlay Zone (“HPOZ”); or
- Commercial or industrial buildings built in conformance with building and code requirements in effect prior to July 1, 1974, if:
  - Five years have elapsed since issuance of the final Certificates of Occupancy, and

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<sup>3</sup> City of Los Angeles Ordinance No. 175588, effective 12/01/2003

<sup>4</sup> Eligible Zones include CR, C1, C1.5, C2, C4, C5, CM, and R5.

- A Zoning Administrator deems the building no longer “economically viable as an exclusively commercial or industrial building”.

Additional restrictions apply to industrial properties. The ARO authorizes the conversion of buildings in M Zones if:

- Surrounding uses are not detrimental to the safety and welfare of prospective residents, and
- The project will not displace viable industrial uses.

The ARO also contains several incentives designed to encourage building reuse. First, use conversions on eligible properties are allowed, subject to a Zoning Administrator Determination, but are not subject to the City’s lengthy site plan review processes. Second, the ARO does not require projects to provide any additional parking beyond what already exists on-site, which is a factor that significantly reduces the cost of development in comparison to new projects.<sup>5</sup> Third, projects are allowed to provide a one-story rooftop addition, which has served in some buildings as a resident amenity. Together, these incentives have facilitated significant residential growth in Downtown. Between 1999 and 2019, more than 12,000 housing units – nearly one-third of all units constructed in Downtown – were produced via adaptive reuse.<sup>6</sup>

More recently, adaptive reuse has been recognized as a strategy to help alleviate California’s housing shortage. In addition to new construction, adaptive reuse provides another means by which local governments can increase housing supply. Increasing office vacancies owing to changes in space utilization and employee preferences for remote work, which greatly accelerated during the COVID-19 pandemic, have prompted renewed discussion about the conversion of underutilized office buildings to housing. In a May 2021 report, the RAND Corporation estimated that the conversion of underutilized commercial real estate in Los Angeles County could deliver between 9 percent and 14 percent of the units needed by the year 2029.<sup>7</sup>

Development economics for adaptive reuse projects differ in important ways from ground-up new construction. With some exceptions specified in the ARO in Los Angeles, adaptively reused buildings must be extensively retrofitted to conform with current building code requirements based on the use to which they have been converted. This process often involves upgrading water supply lines, electrical systems, fire sprinklers and alarms, adding or replacing mechanical systems, and in Los Angeles, performing seismic safety retrofits. Stakeholders interviewed while preparing this memorandum cited seismic improvements as one of the costliest expenses associated with adaptive reuse projects, which is made more difficult by periodic changes to seismic code requirements. While this general suite of upgrades applies to many

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<sup>5</sup> DTLA 2040 does not require parking in new-construction buildings.

<sup>6</sup> Central City Association, “Adaptive Reuse: Reimagining Our City’s Buildings to Address Our Housing, Economic and Climate Crises”, (2021).

<sup>7</sup> RAND Corporation, “Can Adaptive Reuse of Commercial Real Estate Address the Housing Crisis in Los Angeles?” (2021).



adaptive reuse projects, it is important to note that conversion costs vary considerably due to the unique nature of each building, including its age, physical condition, prior use, intended use, and scale.

As part of the DTLA 2040 adoption and associated rezoning, LADCP is considering expanding the scope of the ARO to facilitate additional housing development. As currently proposed, DTLA 2040 will modify the ARO to include the following additional incentives, subject to a Zoning Administrator Determination:

- Allow adaptive reuse in all parts of the Downtown Community Plan Area;
- Replace the 1974 qualifying criteria with a rolling date of 25 years to allow for the conversion of buildings constructed after 1974 (buildings older than 10 years but less than 25 years old are allowed with a Class 1 Conditional Use Permit);
- Allow for the conversion of parking structures that are at least 10 years old;
- Allow for conversion to any viable use (in addition to residential) permitted by underlying zoning;
- Offer FAR exemptions for interstitial floors and mezzanines; and
- Remove dwelling unit minimum size requirements.<sup>8</sup>

Though beneficial to achieving the City's housing production goals, such changes could cause displacement of viable industrial uses that provide employment opportunities to Los Angeles residents. A separate HR&A memorandum dated August 12, 2022, discusses strategies to limit displacement risk from conversion of buildings that contain garment-related uses in the Fashion District.

## **Financial Feasibility Approach and Methodology**

### **Residual Land Value Analysis**

HR&A utilized a detailed Residual Land Value ("RLV") Model for three adaptive reuse prototypes (defined in the next section) to test the feasibility of converting existing office and industrial buildings to multi-family residential use. A RLV Model, which was also used for other HR&A analysis for DTLA 2040, accounts for total development costs, net operating income and capitalized sale value, among other factors, to solve for the amount a well-informed, capable developer could afford to pay for (in the case of adaptive reuse) existing buildings and earn a market-responsive return on investment. For this analysis, HR&A updated the RLV Model with current market-rate rents, construction costs and land values, as well as affordable rents, reflecting the Los Angeles Housing Department's ("LAHD") Schedule VI 2022 Income and Rent Limits. In contrast with our other analyses, this analysis evaluates the feasibility of acquisition and redevelopment of an existing building on building value, not new development on underutilized land. As such, this analysis benchmarks Residual Land Value ("RLV") per square foot of building area, to mirror how a developer would evaluate the purchase of an existing building (i.e., would pay more for a larger building of similar quality). This RLV Model enables dynamic testing of new development prototypes at six different rent levels (i.e., Acutely Low Income, Extremely Low Income, Very Low Income, Low Income, Moderate

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<sup>8</sup> Department of City Planning Recommendation Report – City Planning Commission, June 17, 2021.

Income, and market rate), and with two additional development regulation flexibilities (e.g., Affordable Housing Linkage fee payment exclusion and parking reduction).

HR&A's RLV financial model considers affordable units as a percentage of total units in a project, rather than a percentage of the "base" units allowed. This assumption aligns the modeling with the affordable housing calculation approach in the City's Transit Oriented Communities Incentive Program ("TOC"), which applies along the City's transit corridors outside of Downtown.

Because ARO projects tend to represent building stock of different ages and building types, the need for – and cost of – seismic retrofits often vary between buildings. These upgrades can significantly increase the cost of adaptive reuse, adding anywhere from 20 to 30 percent<sup>9,10</sup> on top of base hard costs. As such, HR&A considered the feasibility of the three prototypes with and without seismic retrofit to offer insights into a greater range of likely ARO scenarios in Downtown.

Development feasibility is based on the degree to which each tested prototype supports a residual building value comparable to recent building sales within each prototype's respective submarket. HR&A also applied a Return on Cost ("ROC") threshold as a companion measure of developer return. Under this approach, a prototype must generate an investment return (measures as net operating income divided by total development cost) that is at least a 100 basis points (i.e., one percentage point) more than the weighted average income capitalization rate for the prototype. In all cases, RLV was the lagging indicator of feasibility, and therefore the primary measure of financial feasibility used in this memorandum.<sup>11</sup>

### Development Prototypes

As previously noted, selection of representative adaptive reuse prototypes is difficult since such projects vary significantly. To arrive at a reasonable selection of illustrative prototypes in Downtown, HR&A performed research and stakeholder outreach to ascertain the remaining underutilized types of buildings in Downtown that are the most likely candidates for conversion. Through this process, two building typologies surfaced: (1) 1920s-era Industrial-Manufacturing buildings, some of which were not previously eligible under the ARO; and (2) outdated 1960s, 1970s, and 1980s office buildings, some of which were also not previously eligible. Having identified these typologies, HR&A then selected three Downtown submarkets whose building stocks most closely resemble one or both of these two typologies. The submarkets selected include:

- Fashion District (1920s Industrial-Manufacturing);
- Arts District (1920s Industrial-Manufacturing), and
- Financial District (60s-80s Office)

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<sup>9</sup> RAND Corporation, "Can Adaptive Reuse of Commercial Real Estate Address the Housing Crisis in Los Angeles?" (2021).

<sup>10</sup> Interview with Karen Liljegren and Roberto Vasquez.

<sup>11</sup> For simplicity, the feasibility analyses presented in this memorandum only display results of the RLV analysis. Full analytic results, which include ROC metrics and their associated benchmarks, are included as Appendices.

HR&A chose one candidate building in each submarket whose features formed the basis of three adaptive reuse prototypes. The parameters of these prototypes are defined below in Figure 1.

**FIGURE 1: ADAPTIVE REUSE PROTOTYPE – FASHION DISTRICT (1200 S. MAPLE AVE.)**

	Fashion District	Arts District	Financial District
<b>Acreage</b>	0.5	0.6	0.6
<b>Max. Stories</b>	11	9	5
<b>FAR</b>	7.80	3.10	2.60
<b>GBA</b>	172,500	82,500	65,000
<b>Construction Type</b>	Type II	Type II	Type II
<b>Address</b>	1200 S. Maple Ave.	1033 E. 4 <sup>th</sup> Pl.	533 S. Fremont Ave.
<b>Adaptive Reuse Typology</b>	1920s Industrial-Manufacturing	1920s Industrial-Manufacturing	1960s Office

### Data Sources and Inputs

HR&A utilized a variety of data sources to update real estate market assumptions and relevant regulatory parameters, including:

- Commercial Real Estate databases, such as CoStar, Engineering News Record, Marshall & Swift, CBRE, Redfin;
- Expert opinion, based on interviews with developers, architects, and related professionals; and
- DTLA 2040 and Updated Zoning Requirements, including updated development standards related to parking, building height, and density, among others.

### Financial Feasibility Analysis Results

Even with market-rate units only, none of the adaptive reuse prototypes are feasible under current market conditions and construction costs. Development remains infeasible for each prototype even if seismic retrofit costs are not included. More specifically, the after-conversion, per-building square foot residual values are all well below the benchmark sale prices of other existing buildings in their submarkets. These results are summarized in Figure 2. Notably, while these findings are for buildings that we have deemed to be most prototypical, the actual feasibility of converting any given building is likely to vary widely based on existing building conditions, the quality and cost of necessary upgrades, new finishes and amenities, and the market positioning of the finished product. Furthermore, construction costs for conversions and cost of acquisition of commercial buildings are subject to fluctuation as the real estate market shifts unpredictably during the recovery from the COVID-19 pandemic.

**FIGURE 2: FEASIBILITY ANALYSIS – ADAPTIVE REUSE PROJECTS**

	Construction Type	RLV per Bldg. SF	RLV Benchmark	Feasible?
1200 S. Maple Ave.				
With Seismic Retrofit	Type II	(\$3)	\$230	No
Without Seismic Retrofit	Type II	\$104		No
1033 E. 4 <sup>th</sup> Pl.				
With Seismic Retrofit	Type II	\$32	\$420	No
Without Seismic Retrofit	Type II	\$139		No
533 S. Fremont Ave.				
With Seismic Retrofit	Type II	\$53	\$350	No
Without Seismic Retrofit	Type II	\$160		No

Because all three adaptive reuse prototypes assuming 100 percent market-rate units proved financially infeasible, no additional testing was performed to analyze mandatory inclusionary housing requirements, because the lower rents for those units would further reduce net operating income, and hence worsen feasibility results.<sup>12</sup>

## Summary of Results & Other Observations

As noted in a separate HR&A memorandum, mandatory inclusionary housing may burden an already-challenged real estate market. Even when assuming only market-rate units, all adaptive reuse prototypes tested were infeasible both with and without seismic retrofitting costs. The imposition of mandatory inclusionary housing requirements on adaptive reuse projects could therefore result in further delays to housing production until market conditions strengthen.

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<sup>12</sup> Given the fixed form of adaptive reuse prototypes, it is unlikely (though possible) that such projects might take advantage of the State Density Bonus and its associated off-setting benefits.

## APPENDIX A: FEASIBILITY TESTING DETAILED RESULTS

### Overview

The subsequent tables provide detailed results from the feasibility tests performed for the adaptive reuse prototypes defined in this memorandum. These tests include baseline feasibility analysis for market-rate development.

## Adaptive Reuse Testing

### MARKET-RATE WITHOUT SEISMIC RETROFITTING

	1200 S Maple Ave	10033 E 4TH PI	533 S Fremont Ave
	Base Scenario	Base Scenario	Base Scenario
<b>Development Program</b>			
Acreage	0.5	0.6	0.6
Height	114 ft.	54 ft.	94 ft.
Stories	11 stories	5 stories	9 stories
Residential Units	175	65	90
Market Rate	175	65	90
Affordable	0	0	0
Average Unit Size	825 SF	825 SF	825 SF
Construction Type			
Residential - Rental	Type II	Type II	Type II
Retail	Type II	Type II	Type II
Average Floorplate	15785 ft.	13048 ft.	9209 ft.
FAR	7.80	2.60	3.10
GBA	172,500 SF	65,000 SF	82,500 SF
<b>Development Cost and Value</b>			
Seismic Costs? (Y/N)	No	No	No
Total Development Costs per GBA	\$430	\$430	\$434
Capitalized Value per GBA	\$628	\$670	\$699
Corporate HQ Premium (15%)	No	No	No
<b>Development Cost per Unit</b>	\$425,494	\$433,875	\$396,899
<b>Incentives</b>			
Parking Ratio	.00 spaces/key	.00 spaces/key	.00 spaces/key
<b>Community Benefits</b>			
Affordable Housing Linkage Fee	Yes	Yes	Yes
<b>Financial Returns</b>			
RLV over Base Scenario			
Residual Land Value	\$17,955,676	\$9,096,483	\$13,166,873
RLV Per Acre	\$4,513,663	\$6,042,626	\$6,962,915
<b>Residual Land Value per SF of GBA</b>	\$104	\$139	\$160
<b>Land sale comps benchmarks (average)</b>	\$230	\$230	\$350
Return on Cost	6.02%	6.44%	6.45%
Weighted CAP	4.10%	4.11%	4.00%
<b>Findings</b>			



Feasible by 100 bps ROC Spread Over Weighted Avg. Cap Rate	Yes	Yes	Yes
Feasible by RLV?	No	No	No

#### MARKET-RATE WITH SEISMIC RETROFITTING

	1200 S Maple Ave	10033 E 4TH PI	533 S Fremont Ave
	Base Scenario	Base Scenario	Base Scenario
<b>Development Program</b>			
Acreage	0.5	0.6	0.6
Height	114 ft.	54 ft.	94 ft.
Stories	11 stories	5 stories	9 stories
Residential Units	175	65	90
Market Rate	175	65	90
Affordable	0	0	0
Average Unit Size	825 SF	825 SF	825 SF
Construction Type			
Residential - Rental	Type II	Type II	Type II
Retail	Type II	Type II	Type II
Average Floorplate	15785 ft.	13048 ft.	9209 ft.
FAR	7.80	2.60	3.10
GBA	172,500 SF	65,000 SF	82,500 SF
<b>Development Cost and Value</b>			
Seismic Costs? (Y/N)	Yes	Yes	Yes
Total Development Costs per GBA	\$537	\$537	\$540
Capitalized Value per GBA	\$628	\$670	\$699
Corporate HQ Premium (15%)	No	No	No
<b>Development Cost per Unit</b>	\$531,258	\$541,630	\$494,657
<b>Incentives</b>			
Parking Ratio	.00 spaces/key	.00 spaces/key	.00 spaces/key
<b>Community Benefits</b>			
Affordable Housing Linkage Fee	Yes	Yes	Yes
<b>Financial Returns</b>			
<b>RLV over Base Scenario</b>			
Residual Land Value	(\$552,986)	\$2,092,418	\$4,368,671
RLV Per Acre	(\$139,009)	\$1,389,954	\$2,310,244
<b>Residual Land Value per SF of GBA</b>	(\$3)	\$32	\$53
<b>Land sale comps benchmarks (average)</b>	\$230	\$230	\$350
Return on Cost	4.82%	5.16%	5.18%
Weighted CAP	4.10%	4.11%	4.00%

<b>Findings</b>			
Feasible by 100 bps ROC Spread Over Weighted Avg. Cap Rate	No	Yes	Yes
Feasible by RLV?	No	No	No