Today’s Panelists

Dan Baker  
Senior Vice President  
NorthMarq Capital

David Garcia  
Policy Director  
UC Berkeley  
Terner Center

Jonathan Fern  
Senior Director,  
Development  
Greystar
The mission of the Terner Center for Housing Innovation is to formulate bold strategies to house families from all walks of life in vibrant, sustainable and affordable homes and communities.
Origins of Terner Center’s work on the math behind housing development

Terner Center presented original “development math” to CASA committee in fall of 2017
There are many costs associated with building housing in California

Nearly all the costs that go into building a home have risen in recent years. For example:

- Construction **material costs** increased by 4.4 percent in 2017.
- Cost of **lumber** has increased 30 percent since 2017.
- From 2000 to 2016, **land pricing** in the United States climbed by 76 percent—almost twice the rate of inflation.
- Labor and subcontractor **shortage**, little competition on bids.
- **Insurance premiums** for wood frame construction have increased due to recent Bay Area building fires.
- **Steel** prices in June hit highest point in a decade
- **Interest rates** gradually increasing.
- **Development fees** increasing in California, other high cost areas.
Despite numerous drivers of housing costs, “developer greed” is routinely singled out

**UCLA:** “Opposition to new development increases by 20 percentage points when respondents see the argument that a developer is likely to earn a large profit from the building. This magnitude is double the increase in opposition associated with concerns about traffic congestion.”

**Mercury News:** 57% of survey respondents agree that “developers who are trying to maximize profits rather than build what people need” are a *major* reason for the housing crisis.
There is often a lack of understanding about the cost to build new housing.
The Realities of Housing Development Math

“Terner Terrace” characteristics

• Market rate building
• “Premier” location – 1 acre
• 160 units:
  • (59) studios
  • (64) 1 bdrm apartments
  • (37) 2 bdrm apartments
• 160 parking spaces
• 2,000 square feet of retail
• 5 over 1 construction (stick over podium)

Photograph courtesy of BRIDGE Housing
The Realities of Housing Development Math

Development assumptions:

- $8 million land price
- No EIR*
- No demolition*
- No environmental remediation*
- No offsite infrastructure improvements*
- No exactions*
- Standard approval times
- Standard wages
- $40,000/unit in fees
- Q2-2018 Construction Costs

* It is rare that infill projects avoid these costs. Any combination of these costs plus current inflation could add as much as $100,000/unit.
The Realities of Housing Development Math

Total Cost to Build Prototype: $79,092,001

- Tax, Title, Insurance: $759,257
- Consultants: $2,923,230
- Financing: $6,765,615
- Fees: $6,400,000
- Hard Cost: $54,188,900
- Land: $8,055,000
The Realities of Housing Development Math

Total Cost to Build Prototype: $494,325 per unit

- Tax, Title, Insurance: $4,745
- Consultants: $18,270
- Financing: $42,285
- Fees: $40,000
- Hard Cost: $338,681
- Land: $50,344

68% of the total cost is Hard Cost, 22% is Consultants, and 10% is Land.
What are the financing requirements to make this project feasible?
How much debt can I raise?

Debt Service Coverage Ratio (DSCR) is the Debt to Net Operating Income (NOI) required by our bank.
Terner Terrace Financing Requirements

How much debt can I raise?

Financing breakdown for a 62% “Loan to Cost”:

- $51,985,347 in debt (at 5% interest rate)
- $27,106,654 in equity needed
Terner Terrace Financing Requirements

Equity Requirements:
Return on Cost (NOI/Total Project Cost) threshold for any investor: 5.50%

Terner Terrace:
• ROC: 5.50%
• Internal Rate of Return: 15.7%
Who could invest in Terner Terrace?

*Housing competes for a global pool of capital. Investors might be:*

**Private Equity Companies**
e.g. Blackstone, Oaktree Capital, Colony Capital, Brookfield.

**Pension Funds**
e.g. CalPers, Cal STRS, AFL_CIO Investment Trust

**Sovereign Funds**
e.g. Norway Oil Fund, Qatar Investment Authority

*These groups need a certain return to mitigate the risk involved in the volatile real estate market, otherwise they will not invest and their money will go elsewhere (bonds, stocks). Moreover, many funds have unique objectives/stakeholders (e.g. retirees, public expenditure requirements, etc).*
The Result: High Rents

To meet debt, operating expense, and investor requirements, Terner Terrace *monthly* rents must be:

- Studio: $2,406, $5.23/sf
- 1 bedroom: $2,819, $4.51/sf
- 2 bedroom: $3,832, $4.12/sf
What’s the market demand for Terner Terrace?

To afford a 2 bedroom unit ($3,832/month) a renter household would need to earn $153,280 annually.

Income of Renter Occupied Households, Santa Clara County - 2016
Terner Terrace
Financing Requirements

To reach minimum development thresholds, project must be exceptional

- “Premier” location (e.g. North San Jose)
- Rents are at very top end of South Bay market
- Less than 1:1 parking rare, $100/month per parking space even more rare
Cumulative Policy Impacts on Terner Terrace

The layering of many common city policies can result in either higher rents or stopping projects altogether.
Cumulative Policy Impacts on Terner Terrace

On site Affordable
+ Reduced fees ($15k total)
+ Reduced Parking
+ Replace ground floor retail/parking with units

On the other hand, combining incentives/offsets can lead to the achievement of policy goals without stopping housing
Please visit www.ternercenter.berkeley.edu for more information on our Cost of Building Housing Research Series and our other work.

Thank you!
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Please join us for our next Luncheon Forum:
Do the Math- The Feasibility of Retail and When it Should be Required

November 15th, 12:30-1:30pm
@SPUR, San Jose