

**ECONOMIC ANALYSIS OF  
METRO RAIL BENEFIT ASSESSMENT  
IN DOWNTOWN LOS ANGELES**

**FEBRUARY, 1985**

**Prepared By  
THE CITY OF LOS ANGELES COMMUNITY REDEVELOPMENT AGENCY**

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## EXECUTIVE SUMMARY

This report outlines the findings of studies completed on the benefit assessment district proposed as a partial funding mechanism for the first 4.4 mile segment of the Metro Rail project. The findings deal with two aspects of benefit assessment: 1) the real estate impact of the assessment rates; and 2) concepts for exemption or appeals mechanisms for specific uses that may be sensitive to the proposed rates. The Community Redevelopment Agency of the City of Los Angeles (CRA) has undertaken this study effort to augment the studies of the Southern California Rapid Transit District, the Agency responsible for establishing and administering the benefit assessment district.

An economic analysis was prepared in order that the impact of benefit assessment on redevelopment activities could be assessed. It involved determining the economic impact of the proposed prototypical downtown buildings to the rate structure proposed.

The overall finding was that the dollar impact on new and renovated office space, the dominant downtown land use, would be generally very minor and would not materially affect the economics of modern office buildings. There are, however, several other land uses for which the proposed assessments could materially affect the economics of property ownership and operation.

A number of land uses would be "sensitive" to the proposed rates if they cannot pass the expense on to tenants. In some cases, this pass-through is not possible because the space is unoccupied. Vacancy may occur due to barriers to full economic use, such as inefficient floor plans, safety limitations on use, or economic barriers to use. An example of buildings that fall under this category are the historic Broadway retail uses. In other cases, uses such as industrial/warehouse activities have a rent structure that renders them much more sensitive to a given assessment rate than are typical office uses.

A series of appeals mechanisms are suggested, addressing concerns relating to sensitive uses. In each instance, the criteria by which an appeal would be considered are identified, and the revenue-loss implications to assessment district are estimated. It has been established that the overall revenue impact of the appeals mechanisms suggested can be offset by an overall rate adjustment of between two and four cents per square foot.

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## 1.0 INTRODUCTION

### Purpose

This report summarizes technical findings and recommendations regarding the use of benefit assessment as a funding mechanism for the Southern California Rapid Transit District (SCRTD) Metro Rail project. The report was prepared by The Community Redevelopment Agency of the City of Los Angeles (CRA), with the assistance of Kotin, Regan & Mouchly, Inc. (KRM), who provided real estate and economic analysis.

The purpose of the report is to provide a parallel analysis of certain benefit assessment issues, particularly in the area of the economic and real estate impact of the proposed assessment, that could be shared with SCRTD and others during their study process. The report has two major components: 1) an analysis of the impact of the proposed rate structure on the economics of various land uses in downtown Los Angeles; and 2) suggestions regarding appropriate exemption and appeals mechanisms to deal with uses that may not receive a level of benefit similar to the majority of downtown uses.

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### CRA Role in Benefit Assessment

CRA has participated extensively in the study process established by SCRTD for the development of benefit assessment. Input has been provided through interagency technical and management committees over the past six months. This study effort was undertaken so the CRA could contribute an analysis of a number of issues particularly relevant to the Redevelopment Agency. CRA will continue to work cooperatively with SCRTD and other Agencies as the proposal is further refined.

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## 1.0 INTRODUCTION

### **Metro Rail and Benefit Assessment in Context**

Metro Rail is a key element in the realization of downtown Los Angeles as a "world-class" city. It will provide a fast and convenient transportation service to the most densely populated area in the region, and will help downtown to continue its pattern of growth and improvement. Metro Rail will be an 18 mile subway line connecting Union Station, Downtown Los Angeles, the Wilshire corridor, Hollywood and the San Fernando Valley. It will be built in phases, the first being a 4.4 mile segment from Union Station to Alvarado (termed MOS-1).

The use of benefit assessment to fund a portion of Metro Rail is based on the concept that substantial benefits are accrued to those located near transit stops and that a portion of those benefits can be recaptured to fund the construction of the system. These benefits can include improved access to employees, shoppers and tourists, decreased costs of providing for automobile access, and enhanced land values and development potential. An accompanying CRA report, entitled Real Estate Development Potential in the Metro Rail Corridor, indicates the expected real estate impact of Metro Rail.

CRA has taken an active role in the benefit assessment issue for two reasons: 1) support for the establishment of the benefit assessment mechanism and Metro Rail; and 2) interest in the potential impact of benefit assessment on redevelopment activities and market conditions in the CBD.

Benefit assessment is one of a number of areas of Agency involvement in the Metro Rail Project. Other activities include preparation of Station Area Master Plans that guide development around Metro Rail stations, cooperative activities regarding joint development on parcels next to stations, and efforts to enhance designs for station entrances.

**2.0 SCRTD BENEFIT ASSESSMENT PROPOSAL**

**Metro Rail Funding**

Benefit assessment is a key element of the funding package for Metro Rail. The Federal Urban Mass Transportation Administration (UMTA) requires that communities demonstrate local financial commitment to a project as a condition of Federal funding. The funding package for the first 4.4 mile segment of Metro Rail requires that SCRTD raise \$130 million in capital funds from the private sector. Benefit assessment has been proposed as the most equitable method of raising the funds.

**Current Proposal**

The SCRTD passed a Resolution of Intent to establish a benefit assessment district December 13, 1984. The proposal contained in that resolution is summarized below:

Stations: Union Station, Civic Center, Hill Street, Seventh Street, Alvarado

Proposed Initial Rates (per year):

The rate structure indicated is SCRTD's latest proposal. Use of a blended rate (assessment on improvements only and vacant land) would not substantially alter the findings of this study.

	28¢ a square foot on the building (max. 40¢)	14¢ a square foot on the land parcels containing assessable improvements (max. 20¢)	28¢ a square foot on the land parcels not containing assessable improvements (max. 40¢)
Offices	x	x	--
Retail, Commercial	x	x	--
Hotel/Motel	x	x	--
Industrial/Warehouse	--	--	x
Parking Lot	--	--	x
Publicly Owned & Used	-----E X E M P T-----		
Non-Profit Owned & Used	-----E X E M P T-----		
Residential	-----E X E M P T-----		



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## 2.0 SCRTD BENEFIT ASSESSMENT PROPOSAL

Rate Changes: Rates may be adjusted to generate the necessary annual revenues to raise \$130.3 million, plus sums to pay interest on bonds or loans and associated debt issue and administrative costs. Rates cannot exceed maximums indicated in the rate chart.

Use of Funds: Capital costs for Metro Rail stations.

Timing: Benefit assessment scheduled to commence in 1985, and will run for approximately 20 years.

Appeals: Appeals mechanism to be provided; not yet outlined in detail by SCRTD.

Figure 1 shows the boundaries proposed for the downtown assessment district. They are based on a one-half mile walking distance from the center of each station. The shaded areas represent areas recently added to the district due to an SCRTD revision in boundary definitions. This additional area was not included in the analysis described in this report. However, it is not expected that the overall findings will be affected by the additions.

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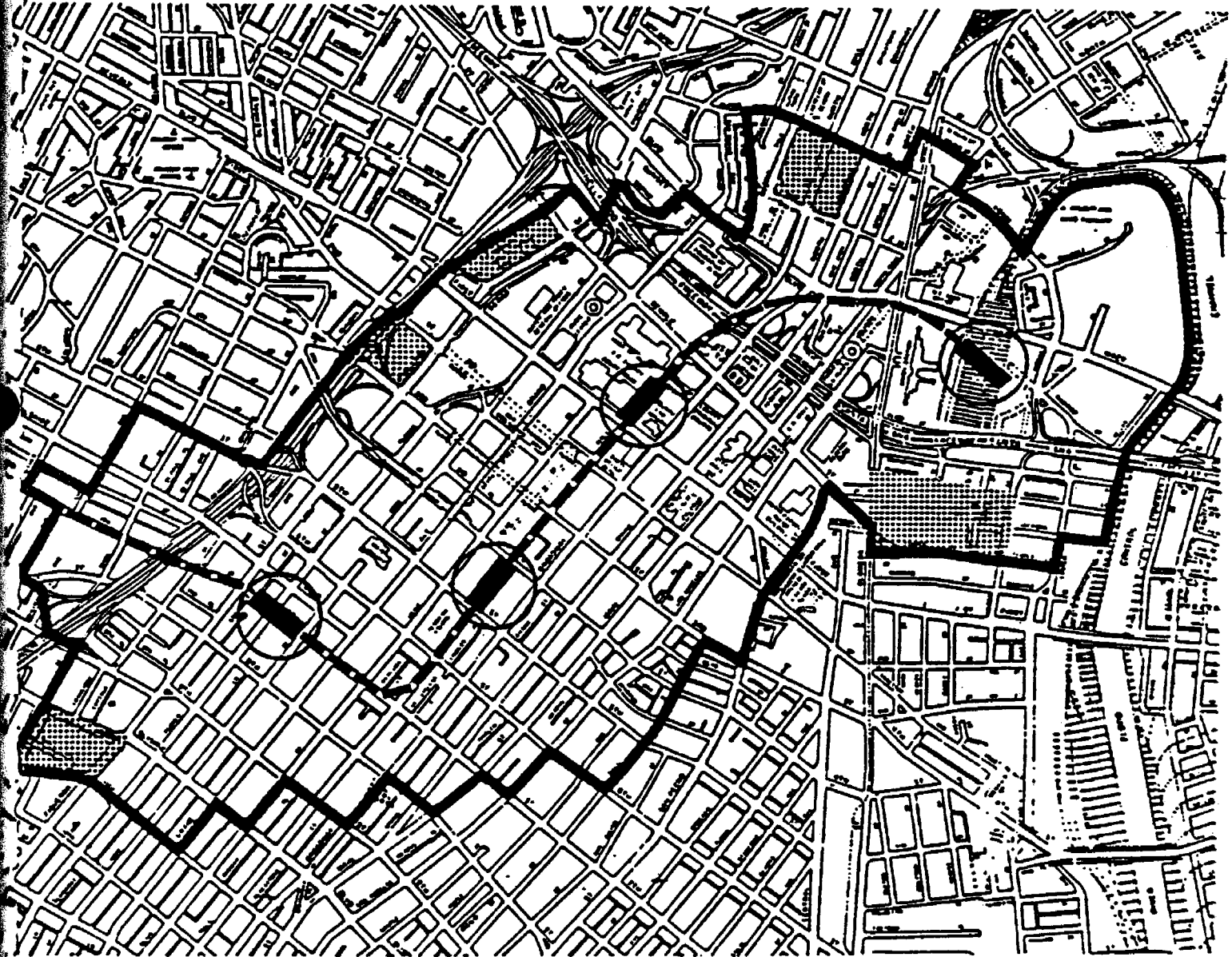
### Unresolved Issues

The SCRTD Resolution of Intent provided for assessment exemptions for certain uses and for the creation of a structured appeals mechanism. However, it did not specify the details of these processes. Development of these programs is the subject of ongoing SCRTD work efforts, and this document provides ideas on how those mechanisms could be structured.

A second issue is that the benefit assessment structure for areas outside of the initial 4.4 mile Metro Rail segment has not yet been determined. An additional study process, with separate public hearings, will take place when construction begins. The findings in this report pertain to the CBD, and may not be fully relevant to other redevelopment areas along the Metro Rail corridor.

Proposed  
Benefit  
Assessment  
District  
Boundary

Benefit Assessment District No. A1 of the  
Southern California Rapid Transit District  
(CBD District)



Map Source: SCRTD

- Metro Rail Alignment
- Benefit Assessment District Boundary

- Metro Rail Stations
- ▨ Areas Affected by SCRTD Boundary Revision

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### 3.0 ANALYSIS OF RATE STRUCTURE

#### General Approach

The general approach taken has been to focus on the full impact of assessment on the property owner and operator. The problems of quantifying benefit to the tenants and, from that, inferring benefits to the property owners is a complex and highly judgmental process. While techniques exist for such research, it was deemed more appropriate to determine first which land uses would be materially affected by assessments on gross building area. Accordingly, a simple computer model was prepared by the consultant (KRM) on which 18 prototypical properties were run, representing alternative land uses, rent structures and ages.

In the computer model, two related measures of sensitivity were used. One is the proportional increase in rents required to offset the impact of an assessment. The second measure is the number of years required for inflation, at a 4% annual rate, to compensate for the additional assessment. In KRM's judgment, any fee structure that took more than 1.5 years of inflationary rent increase to recover could represent a significant hardship for that property type, if the property owner is not able to recover the rate from tenants.

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#### Rationale for Approach

The approach selected is deliberately intended as a screening approach in which potential sensitive uses will be defined. It is not intended to be definitive or to draw conclusions with respect to the issue of benefits. There are several reasons for this, perhaps the most important of which is that the SCRTD consultant team has already conducted a very extensive analysis of potential benefits. A second reason concerns the issue of comparability between transit benefits that have been observed in other cities to the potential benefits that may occur in Los Angeles. Rather than pursue the benefit issue, a methodology has been chosen which focuses on the relatively small number of land uses which emerge as sensitive to the potential assessment.

### 3.0 ANALYSIS OF RATE STRUCTURE

#### Summary Findings

As shown in Table 1, new or recently renovated office buildings whose rents exceed \$20 per square foot are not materially affected at either the initial or the maximum assessment rates. Older, more inefficient buildings and industrial uses are moderately affected. The only significantly impacted use appears to be older retail establishments located in vacant office or hotel buildings. Retail buildings that are fully utilized are similar in economics to office space. However, many retail uses exist in ground floor areas of old structures whose upper levels are not suitable for other uses. If the assessment fee is applied to the entire building, these properties become significantly affected.

Figure 2 illustrates potential revenue losses for different building types in a bar graph format.

Exercising the model over 18 comparative properties indicated the following general patterns:

1. The impact of assessment rates at any level is inversely proportional to the net rent achieved. The higher the net rent, the less sensitive the land use is to assessment.
2. The implication of the assessment rate to gross building area creates significant problems in older buildings that are, by modern standards, considerably less efficient. Key examples of this are the Bradbury Building and the Arcade Building.
3. Retail uses occupying lower levels of multi-story office buildings in which the higher floors are largely vacant or underutilized are also penalized significantly by an assessment on gross building area.
4. Industrial land uses are, as expected, somewhat more sensitive since the net rent for these uses are only a small proportion of the net rent for office buildings. This has been offset by the SCRTD proposal to assess only the land area of these uses.

Appendix A describes the model and the impact of the assessment fees on the specific properties in greater detail.

### 3.0 ANALYSIS OF RATE STRUCTURE

TABLE I

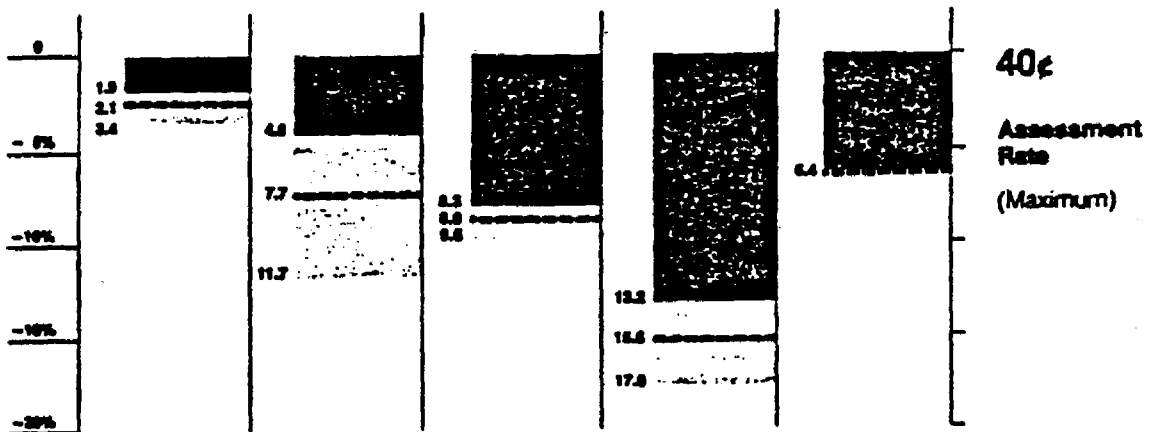
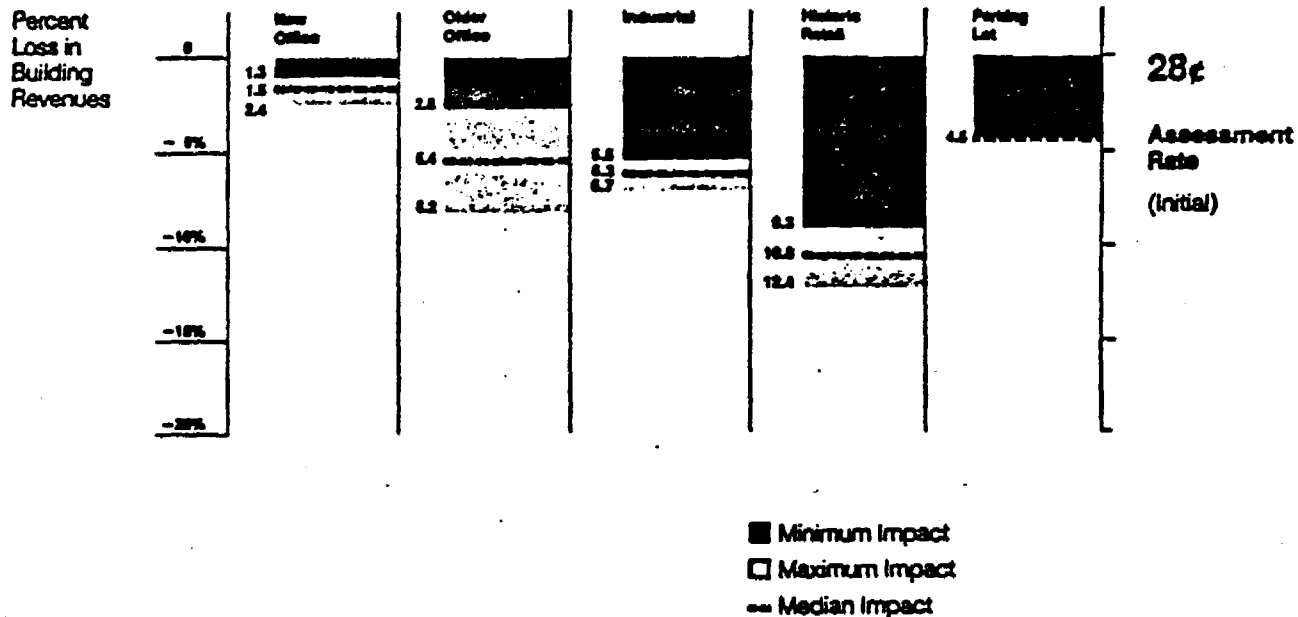
#### SUMMARY COMPARISON OF REVENUE/VALUE IMPACTS

Land Use	Code	Initial	Maximum
		Land/Building Rates For Uniform Area*	Land/Building Rates For Uniform Area*
		\$0.14-\$0.28/Sq.Ft.	\$0.20-\$0.40/Sq.Ft.
New or Renovated High-rise Office Buildings	Sensitivity	Not material	Not material
	Loss in Annual Income	1.3%-2.4%	1.9%-3.4%
	Inflationary Recovery Period	0.3-0.4 years	0.4-0.6 years
Older Office Buildings	Sensitivity	Moderate	Moderate
	Loss in Annual Income	2.8%-8.2	4.0%-11.7%
	Inflationary Recovery Period	0.5-1.3 years	0.7-1.9 years
Industrial/Warehouse Buildings	Sensitivity	Moderate	Significant
	Loss in Annual Income	5.8%-6.7%	8.3%-9.5%
	Inflationary Recovery Period	1.4-1.7 years	2.1-2.4 years
Historic Retail Buildings	Sensitivity	Significant	Significant
	Loss in Annual Income	9.3%-12.4%	13.2%-17.8%
	Inflationary Recovery Period	2.1-3.1 years	2.9-4.4 years
Parking Lots	Sensitivity	Not material	Not material
	Loss in Annual Income	4.5%	6.4%
	Inflationary Recovery Period	0.3 years	0.4 years

\*Rates of \$0.14 per square foot of land area and \$0.28 per square foot of gross building are with assessable uses and \$0.28 per square foot of land area without assessable uses.

Source: Kotin, Regan & Mouchly, Inc.

Potential  
Building  
Area  
Revenue Loss  
Attributable  
To Assessment  
By Building Type



### 3.0 ANALYSIS OF RATE STRUCTURE

#### Inventory of Affected Land Use

Without an itemized building survey it is difficult to accurately measure the extent of affected land use. Utilizing existing surveys of the downtown area, a breakdown by office, retail, and industrial use was approximated.

From Peat, Marwick, & Mitchell's 1981 "Inventory & Projection of Land Use in Los Angeles C.B.D.", the total square footage of various uses within the primary and secondary assessment areas was determined. From Economics Research Associates' 1984 "Summary Report on Real Estate Development Potential Within the Metro Rail Corridor", the amount of office space, whose rent levels are low enough to be at least moderately affected at the proposed assessment fees have been estimated, as shown in Table 2:

TABLE 2

#### BUILDING SQUARE FOOTAGE BY LAND USE

	<u>Office</u>	<u>Retail</u>	<u>Industrial</u>
Total Downtown Area	42,000,000	10,000,000	12,700,000
Within Assessment Area	36,000,000	8,000,000	2,600,000
% of Total Downtown	85%	77%	20%
Building Area at least "Moderately Affected"	8,500,000	N/A (1)	2,600,000(2)

- (1) No estimate since there has been no breakdown of retail uses completed.
- (2) By virtue of the low rent levels in all areas, all industrial/manufacturing space should be at least moderately affected.

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### 3.0 ANALYSIS OF RATE STRUCTURE

#### Implications

The measured impact of various assessment fees was found to be proportional to the net operating income of each property. Additionally, those properties with high net income levels per square foot of building area are relatively unaffected. As a result of assessing based on gross footage, the assessment fee penalizes the more "architecturally interesting" projects that have large public areas, e.g., the Bradbury Building.

Age of the building can be a relevant negative factor, since older buildings tend to have less efficient layouts and may be in unattractive rental areas that warrant substantial rehabilitation efforts. To the extent an old building exists in a prime area, economic prospects for rehabilitation reduces the eventual negative impact of the various assessment fees.

Application to net leasable area rather than gross should be used so as not to penalize inefficient buildings which might otherwise be highly desirable as part of the downtown cityscape. This could be accomplished in an appeals process, requiring the property owner to prove the useable area of the building.

Specific exemptions for publicly desirable land uses, e.g., education, etc., and for specifically sensitive uses such as historic buildings, can address the potential impact of the assessment rates on these uses.

Absent major redevelopment of Broadway, possibly with a loss of its current character and market, most of the buildings with unoccupied upper levels cannot afford to sustain the assessments currently proposed. This consideration can be addressed in the appeals process.



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## 4.0 COMMENTS ON SELECTED ASPECTS OF THE BENEFIT ASSESSMENT PROPOSAL

### Separate Assessments for Land and Buildings

The use of a separate assessment for land and buildings is a desirable mechanism in two important respects. First of all, assessing land independent of its improvements is consistent with an attempt to discourage speculation and encourage orderly development. This could be accomplished by simply having a vacant land tax but not a tax on the land portion of improved property. Such an approach, which has been considered, has some disadvantages, the major one being that it would in a sense subsidize under-improved property. A second desirable effect of separating assessment of land and building is the isolation of physical and market restrictions on building use which limit the owner's opportunity to benefit from Metro Rail but which do not reduce the underlying land value.

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### The Need for Exemptions and Appeals

The use of a low and uniform rate for a large district area goes a long way towards minimizing the potential disruption of orderly development. There do, however, remain definite areas of sensitivity and potential inequity. As noted in the discussion of the impact in Section 3.0, several types of land uses will suffer potentially adverse effects even at the minimum proposed assessment rates.

These specifically include economically inefficient buildings and Broadway retailing in largely vacant office buildings. For these and other uses, the appeals process is a more appropriate mechanism of adjustment than a broader set of generalized exemptions. In the following section, the areas of particular importance and sensitivity are noted and discussed. This mechanism is crucial to remove inequities that are not addressed in general land use categorizations and to balance the needs of SCRTD with critical public policy and land use planning considerations.

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## 4.0 COMMENTS ON SELECTED ASPECTS OF THE BENEFIT ASSESSMENT PROPOSAL

### District Boundaries

The boundaries and procedures currently proposed for the SCRTD Benefit Assessment District are reasonable and defensible and are generally consistent with CRA's objectives in the CBD. This is in part the result of an extensive analysis by the SCRTD, its consultant and task force, and participating Agencies. There are, however, several areas which warrant specific comment and elaboration.

The selection of a basic half-mile boundary and the resulting CBD Benefit Assessment District limits as shown in Figure 1 (found in Section 2.0) are generally consistent with the orbit of potential impact from Metro Rail. By choosing a large area, rather than a smaller one, the SCRTD has minimized the overall rate.

It is recognized that the boundaries are not absolutely fixed even now. The shaded areas in Figure 1 represent areas recently added to the district to rationalize its boundaries. As noted previously, these recently added areas are not part of the quantitative analysis that the CRA and its consultant KRM have undertaken.

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### The Merits of a Low and Uniform Rate

One conclusion that emerges clearly from the analysis is that a low rate will leave unaffected the majority of high value land use in the Downtown Los Angeles area, i.e., recently constructed office buildings. Furthermore, a uniform rate will minimize inequities that would result from tiered rate structures and tiered rates. The use of tiered rates would complicate administration and would create anomalies and discontinuities at boundaries. Even now, the edges of the Assessment District itself can potentially create a boundary anomaly in which development is significantly encouraged outside the District and discouraged inside the District. The boundaries are sufficiently consistent with the general boundaries of the CBD to largely minimize that affect.

The uniformity of the rate across various land uses further contributes to its fading into the background of real estate operation as part of the general "noise level" or the tendency for building owners to expect and accept on-going continuous increases in fees. Singling out individual land uses for higher or lower rates would significantly complicate administration and raise questions of inequities.

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#### 4.0 COMMENTS ON SELECTED ASPECTS OF THE BENEFIT ASSESSMENT PROPOSAL

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## 5.0 SUGGESTED EXEMPTION AND APPEALS PROGRAM

### Basis

The key finding of the economic analysis is that the dominant economic use, new or renovated office buildings, is not sensitive to the benefit assessment rate proposed. However, a number of other land uses may be sensitive because they may realize reduced or delayed benefits. Certain categories, such as industrial/warehouse uses, may receive less than proportional benefits as compared to other activities. Other examples include buildings with inefficient floor plans, those with safety limitations on use, certified historic buildings or Broadway retail uses in office buildings with high historic office vacancy rates. These instances can be categorized into special subgroups. They suggest the need for an exemption program for uses that receive reduced benefits and an appeals process for uses having specific characteristics that reduce benefit received.

The uses described in this section as being appropriate for an exemption or appeals program represent the minority of building floor space in the downtown, but are nonetheless important elements that contribute to its viability. An assessment mechanism not sensitive to these uses would impair the ability of the CRA to fulfill redevelopment objectives, particularly in the area of historic preservation or maintenance of Broadway's retail viability.

SCRTD's approach to benefit assessment incorporates both generalized exemptions and a specific appeals process. The appeals process should offer an opportunity for partial exemption, full exemption or at least deferral of assessment rates for those uses which meet two tests. The first test is that the imposition of the assessment rates would represent some significant impact on the economics of the real estate operation. The second test is that the sensitive land uses be uses which from a public policy point of view are desirable to be maintained in the Central Business District.

Recognizing that assessments should track benefits to the land uses, there are certain vulnerable land uses for which benefits may occur only at a later date after certain changes have been made in their physical structure. Any system which imposes uniformly an assessment based on gross building area will inevitably create certain inequities.

## 5.0 SUGGESTED EXEMPTION AND APPEALS PROGRAM

### Areas of Concern With Respect to the Appeals Process

Issues of particular concern include the following:

1. Buildings with low economic building efficiency, i.e., low ratios of net rentable area to gross building area.
2. Buildings subject to safety limitations on use.
3. Certified historical buildings
4. Broadway commercial uses with low economic (rental) efficiency.
5. Non-profit uses, to the extent that they are not already covered by the generalized exemption for property owned and operated by the same non-profit organization.

With respect to each of these five categories, the CRA together with its consultant KRM, has examined the impact of an appeals process in terms of four items:

- o The issues of concern and the rationale for exemption or deferral.
- o Recommended procedure for exemption or deferral.
- o Recommended formula for exemption or deferral.
- o A very general range estimate of the potential revenue impact of exemption or deferral.

In the following sections, each of the five areas of concern with respect to the appeals process is discussed in terms of these four major sections.

Before proceeding to a discussion of individual areas of concern for appeal, there are certain general comments which apply to the appeals process.

Three major principles should govern the creation of exemption appeals:

1. The burden of proof should be clearly on the appellant.
2. There should be a minimization of processing requirements and judgmental input from the SCRTD appeals review function.

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## 5.0 SUGGESTED EXEMPTION AND APPEALS PROGRAM

3. There should be extensive use of third-party certification of key representations so as to minimize the need for independent research or validation by the SCRTD.

Other elements which could be profitably introduced into the appeals process are deferral and automatic expiration. Some of the conditions warranting exemption are transitory and any exemption based thereon should provide for an automatic expiration of that exemption without renewal by the appellant.

In certain cases, most notably Broadway retailing and certain buildings in need of rehabilitation or redevelopment, a strong argument can be made that the benefits of Metro Rail will not accrue until it is in operation and arguably not until the route has been extended past the initial four-mile segment. To the extent that this is valid, arrangements should be considered for deferral of the assessment with recovery at a specified future date measured either in terms of elapsed time or in terms of completion of the Metro Rail system or a part thereof.

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### Appeals Related to Property Size and/or Efficiency

#### Appeals Issues Suitable For Coordinated Treatment

Three logically related issues have been identified as appropriate for coordinated treatment.

1. Improper estimate of parcel size.
2. Improper estimate of gross building area.
3. Special considerations for "low efficiency" buildings.

Insofar as all three of these deal with physical measurement, the need for third-party certification, and are matters of fact which presumably will operate on a permanent basis and not be subject to revision, a generally common appeals procedure can be applied to all of them.

## 5.0 SUGGESTED EXEMPTION AND APPEALS PROGRAM

### Recommended Procedure

There are three major elements recommended with respect to a procedure:

1. A required survey (for land area) and required certified building plans for the other issues.
2. Clearly defined standards for the measurement of rentable and gross building area.
3. Specified levels of the third-party certification.

With respect to survey and building plans, land surveys, often with formal legal descriptions provided by title companies, are readily available and should uniquely identify the parcel size. There is, however, a related issue of easements that have been granted for public use and may restrict the available parcel size. While this is a technical issue, the SCRTD should work with a title company and perhaps an appraiser to establish a uniform set of standards for the types of easements that are excluded from parcel area.

The standards for gross and rentable building area should not be too difficult to implement. Gross building area has a fairly standard definition as extending from exterior wall to exterior wall. In the case of rentable area the problem is somewhat greater. The first and basic standard should probably be that implemented by the Building Owners and Managers Association (BOMA). This standard may be too rigid for certain old buildings, however. The reason for this is that BOMA exempts from "rentable area" only those elements in the building which represent vertical penetrations, i.e., elevator shafts, stairwells and equipment channels. This may be too rigid for many older buildings which have large hallway and foyer areas for which they cannot, like some of the newer buildings, recover on a proration basis.

Accordingly, it is recommended that there be a specific modification of the BOMA standard for hallways determined to be unrentable by a licensed third-party. The determinations of unrentability should be physical in nature in that the building and fire codes prevent such areas from being enclosed for rental use by an office tenant.

Third-party certifications for key factual items can be provided by surveyors and/or title companies for parcel size. For gross

## 5.0 SUGGESTED EXEMPTION AND APPEALS PROGRAM

and rentable building area, California licensed architects can be utilized.

### Recommended Formula

It is recommended that an 80% building efficiency (net rentable area divided by gross building area) should be the threshold. Buildings demonstrating a lower efficiency should be entitled to exempt the entire amount of their non rentable area. The 80% figure was recommended by KRM because it is already lower than almost all modern office buildings. Efficiency below 80% typically denotes a materially different layout and character of the building in which the opportunities for full floor tenancy and other offsetting devices are largely absent. Accordingly, it is recommended that a building with 75% efficiency be entitled to a 25% exemption; a building with 50% efficiency should be entitled to a 50% exemption.

There are three reasons for exempting all of the unrentable area in "low efficiency" buildings rather than simply the amount of unrentable space in excess of the "normal" loss of efficiency. The first and most important reason is that buildings with efficiencies below 80% tend to be qualitatively and systematically different from conventionally efficient buildings. The 80% threshold is set sufficiently low so as to avoid minor changes at the margin of "modern" buildings. In addition, buildings with low economic efficiency tend to have proportionally higher operating costs. Many operating costs, notably including utilities, are a function of gross enclosed area rather than rentable area and as a consequence rise sharply per rentable square foot in a low efficiency building. Finally, by exempting the entire amount of unrentable space, the issue of what constitutes "normal" efficiency is removed.

### Estimated Revenue Impact

The full impact of the proposed exemption or exception is difficult to estimate. It would require a detailed survey of downtown office buildings well beyond the scope of this or any other initial study. Based on some rather general and deliberately conservative assumptions, KRM estimated a possible range of impacts of this type of exemption.



## 5.0 SUGGESTED EXEMPTION AND APPEALS PROGRAM

The key assumptions underlying this estimate are:

1. There are approximately 20-30 buildings characterized by low efficiency.
2. The average building efficiency in these buildings is 75%.
3. The average size of inefficient buildings is 75,000 square feet.

Based on these assumptions the volume of exempt footage would range from 375,000 square feet to 500,000 square feet. Applying the initial building area assessment rate of \$.28, together with the formula proposed above, would yield a revenue loss of \$105,000 to \$140,000 per year.

Using the higher maximum rate of \$.40 per square foot per year of gross building area, the revenue loss would be \$150,000 to \$200,000 per year.

A detailed summary of computations for this and other potential revenue impacts is provided in Appendix B to this report. Figure 3 shows the incremental and cumulative dollar impact of each of the forms of recommended exemption or deferral discussed in this section.

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### Appeals Related to Safety Limitations on Building Use

#### Issues and Approach

There are several limitations on current or future use of many of the older buildings in the CBD. These relate primarily to fire code violations that require some degree of rehabilitation and failure to comply with the recently adopted seismic ordinance. In many cases, compliance with the seismic code may require significant structural rehabilitation.

In some cases, these limitations apply currently to the entire building. More often, fire code limitations apply only to upper floors because of inadequate fire exits or only to the future use of all or part of the building in the case of failure to meet seismic requirements.

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## 5.0 SUGGESTED EXEMPTION AND APPEALS PROGRAM

### Recommended Procedure

The three major elements in the recommended procedure are:

1. Certification by the relevant public agency of a safety problem.
2. Detailed specification of the building area affected by the problem.
3. Computation and certification by a third-party professional of the square feet of area and the percentage of total net rentable area affected.

In all cases, the elements of safety certification should be subject to automatic annual expiration with requirements for recertification.

### Recommended Formula

It is recommended that the SCRTD establish a category of non-useable building area based on safety problems. A generous definition of this area would include any area in a building for which regular occupancy is either currently prohibited or is scheduled to expire within the next three years as a function of fire and safety code regulations, modifications thereof, or the seismic ordinances adopted by the City of Los Angeles.

The use of a future concept rather than a present limitation is critical. Buildings requiring extensive and costly physical modification within the next three to five years to comply with future deadlines and existing seismic and fire ordinances will not be able to benefit from Metro Rail until and unless such modifications are undertaken. The economic and regulatory issues involved and the owners decision for such modification are potentially much larger than any short- or medium-term benefits from Metro Rail.

A 100% exemption for such "non-useable" areas is recommended.

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## 5.0 SUGGESTED EXEMPTION AND APPEALS PROGRAM

### Revenue Impact

A preliminary estimate of building space classified as non-complying safety hazards falls somewhere within the range of 1.5 to 1.9 million square feet. Approximately one-half of the unsafe space is located in inefficient buildings and approximately one-half of the inefficient buildings contain unsafe space. In calculating the revenue impact of the unsafe space, KRM assumed that property owners with inefficient and partially unsafe buildings will opt to claim 100% unsafe area exemption instead of a partial building inefficiency exemption. Using the \$.28 initial assessment rate, the probable revenue reduction of the safety exemption would be somewhere between \$420,000 and \$532,000. Using the \$.40 maximum assessment rate, the probable revenue reduction would be between \$600,000 to \$760,000.

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### Appeals Related to Historical Status

### General Issues and Approach

There are several classes of historical buildings. These represent different appeal problems and have different indirect remedies for relieving the burden of assessment costs.

1. Historical buildings with low efficiency will probably be covered by the appeals related to building efficiency described above, at least to some degree.
2. Many historical buildings have safety problems associated with either fire codes or seismic ordinances and these would be eligible for exemption if the suggested safety-based exemption is implemented.
3. There remain still some sound and safe historical buildings of considerable interest for which there may be little or no relief due to low efficiency.

## 5.0 SUGGESTED EXEMPTION AND APPEALS PROGRAM

### Recommended Procedure

Three major elements in the recommended procedure are:

1. Certification of historical status.
2. Use of a specifically expiring exemption, e.g., a "sunset" provision.
3. A consideration of deferral if not exemption for those buildings with historical significance but no alternative source of assessment relief.

This is the one instance in which a value determination might be a useful secondary test. If, in the opinion of a designated board of appraisers, the market value of the building on a per square foot basis was less than some specified threshold, e.g., 75% of other buildings within a specified radius, e.g., 500 feet, constructed within the last 30 years, full exemption/deferral would be allowed. The only reason for a secondary test is that some historical buildings have been adequately renovated so that they now compete in the office space market on an equal footing with more recently constructed buildings.

### Recommended Formula

With respect to historical buildings without any accompanying safety problems or efficiency laws, it is suggested that a 3-5 year deferral be granted to certified historical structures. This will provide adequate time for the building owner to rehabilitate the structure, sell it or otherwise preserve it.

To the extent that a value test is imposed it should be updated at regular intervals either annually or bi-annually.

### Estimated Revenue Impact

At the present time there are approximately 10 buildings officially certified on the historical register. CRA records indicate that approximately 220 total buildings are eligible or potentially eligible for such registration. In preparing an estimate of revenue impacts, a range of impacts were identified in which the lower end of the range would assume only those buildings currently designated by name on the historical register.

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## 5.0 SUGGESTED EXEMPTION AND APPEALS PROGRAM

For a higher estimate, a multiple of the present number of buildings would be used. In this case, the multiplication factor was 3, yielding an upper estimate of 30 buildings.

Based on the limited data available and certain major assumptions which are documented in Appendix B, KRM estimated the total square footage area to be affected to be between 1.0 million square feet and 3.0 million square feet.

Based on these and other assumptions set forth in Appendix B, KRM estimates the range impact to be as follows:

<u>Rate Assumption</u>	<u>Total Impact</u>	<u>Incremental Impact</u>
Initial Rate at \$.28/Sq.Ft.	\$280,000 - \$840,000	\$140,000-\$280,000
Maximum Impact at \$.40/Sq.Ft.	\$400,000-\$1,200,000	\$200,000-\$400,000

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### Appeals Related to Broadway Retailing

#### General Issues and Approach

Safety issues may provide a basis for significant exemptions for Broadway retailing under the "non-useable" standards recommended in this section.

There still may remain numerous technically safe buildings that are economically unrentable. In this case, the primary basis for relief would be a deferral of assessments on the grounds that time and the completion of Metro Rail will either cause occupancy and rents to increase or result in redevelopment of the property.

An argument could be made that the failure to occupy upper-floor offices in Broadway retailing buildings is attributable to management or maintenance problems. However, there are some much more important reasons that relate to market barriers outside of the control of the building owner or operator.

## 5.0 SUGGESTED EXEMPTION AND APPEALS PROGRAM

These market barriers are the result of convergence of two trends in Downtown development. First of all, the desirable locations for primary office space have tended to move west, away from the traditional office corridors of Spring and Broadway. What this means is that older areas benefit only from spill-over demand in which the prospective tenant must compromise on location in order to obtain lower rent outside the prime office sub-area.

Unfortunately, the second factor, which is the street character of Broadway provides an environment that is specifically inhospitable and otherwise unsuitable for office tenants. Office tenants seeking spill-over space want the same kind of unobstructed and attractive entry treatment and street level access that buildings in the primary office market enjoy. This is clearly not available in the Broadway retailing area since the streetscape and street activity is very different from that of the traditional office area. Accordingly, Broadway, and to a similar extent, Spring Street cannot perform the traditional role of absorbing lower cost tenants on the fringe of a relocated primary office market. The very vitality and activity that creates the strongly ethnically defined retailing tend to provide a difficult environment for conventional office rentals. These factors may represent a stronger barrier to occupancy than the benefits of Metro Rail, because their root does not lie in a transportation problem, but rather the particular characteristics and use of the structures.

### Recommended Procedures

The first and most critical element for any exemption or deferral other than on a safety basis should be a demonstration of historical vacancy. This would, in turn, require both a certification of the rentable area on a physical basis as set forth in the discussion of appeals related to building efficiency and certification and demonstration of a specified level of vacancy for a specified time period.

A suggested threshold is that vacancies in excess of 50% (excluding ground floor retail) be demonstrated for at least three years.

This should be confirmed by third-party certification of which the most obvious form is an audited operating statement for the building accompanied by a tax return revenue or that portion of a tax return describing the building's revenue.

## 5.0 SUGGESTED EXEMPTION AND APPEALS PROGRAM

Each year a new set of audited statements and/or tax returns should be solicited to confirm the vacancy status.

### Recommended Formula

Any such deferral or exemption granted on this basis should be for the total amount of demonstrated vacant space. Such deferral should be explicitly expiring and should have a calendar expiration of three to five years with some built-in extension for failure to complete Metro Rail within that time period.

### Estimated Revenue Impact

Based on a very rough estimate, it has been assumed that approximately two-thirds of the total floor space in the Broadway retail district is vacant. Based on LUPAM data there are 4.6 million square feet of space in the district.

There would therefore be a resulting exemption of approximately 2.7-3.3 million square feet. Accordingly, the revenue loss or deferral associated with the initial assessment rates would range from \$756,000 to \$924,000 per year. At the maximum assessment rate, the range of revenue loss or deferral would be between \$1.08 and \$1.32 million. The incremental impact would be approximately 30% less insofar as it is estimated that roughly 30% of these buildings would qualify for exemptions as unsafe an/or inefficient.

## 5.0 SUGGESTED EXEMPTION AND APPEALS PROGRAM

### Appeals Related to Non-Profit Uses

#### General Issues and Approach

While there seems to be general consensus with respect to the exemption of non-profit land uses from the assessment, the criteria for determining whether or not a building qualifies warrant some further discussion.

It is proposed that only buildings used exclusively or primarily for non-profit purposes be exempted. There are a variety of reasons why non-profit organizations may opt to occupy moderate amounts of space in nominally expensive multi-tenant buildings. Given the wide choice of available locations, such decisions suggest that the benefits of high-rent locations outweigh the costs and do not cause a significant hardship on the organization.

Only those buildings in which non-profit entities occupy all or almost all the space should be exempted. The administrative burden of isolating specific tenants in large multi-tenant buildings does not seem justified.

#### Recommended Procedures

An owner or operator of a building would have to document that the building is at least 95% occupied by non-profit organizations with executed leases or other evidence of occupancy if the building were non-profit owned and occupied. The use of a 95% threshold provides some tolerance for coffee shops, smoke shops and other minor profit-oriented service uses.

Exemptions should automatically expire annually and require recertification for renewal. In this instance, as in other annually-expiring exemptions, the recertification process can be considerably less detailed than the initial exemption application.

#### Recommended Formula

Non-profit buildings, as defined, should be 100% exempt so long as they qualify.



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## 5.0 SUGGESTED EXEMPTION AND APPEALS PROGRAM

### Estimated Revenue Impact

No formal estimates of non-profit occupancy has been made, nor can such an estimate be generated without considerable primary research. In the opinion of KRM, the revenue impact of the recommended proposed exemption would be quite small in absolute terms.

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### Summary of Appeals Issues

Table 3 provides an overall summary of the appeals issues discussed in this Section. It is intended to provide a brief overview of the rationale, procedure, formula and revenue impact of each of the five areas in which the appeals process appears to be particularly important. The revenue impacts shown at the far right are the individual impacts associated with each of the five conditions. No revenue impacts were estimated for non-profit exemptions.

For the remaining four conditions, the impacts shown in Table 3 are not truly additive. In many instances, some buildings which are inefficient or unsafe are also historical buildings. The conditions on which appeals can be based are not mutually exclusive. Viewed individually, the dollar impacts range from a minimum of \$105,000 (initial rate for inefficient buildings) to \$1.3 million (maximum rate for Broadway retail).

**TABLE 3  
SUMMARY OF RECOMMENDED APPEALS PROGRAM**

	RATIONALE	PROCEDURE	FORMULA		REVENUE IMPACT
			EXEMPTION/DEFERRAL	TERM	
INEFFICIENT BUILDINGS	<ul style="list-style-type: none"> <li>- ARCHITECTURALLY INTERESTING</li> <li>- NON PRODUCTIVE SPACE SHOULD NOT BE TAXED</li> <li>- FEE WOULD CREATE ECONOMIC HARDSHIP</li> </ul>	<ul style="list-style-type: none"> <li>- CERTIFIED BUILDING PLANS</li> <li>- STANDARDS FOR RENTABLE AREA</li> <li>- THIRD PARTY CERTIFICATION</li> <li>- EFFICIENCY MUST BE LESS THAN 80%</li> </ul>	ALL NON-RENTABLE AREA	INDEFINITE	INITIAL RATE \$105,000-\$140,000  MAXIMUM RATE \$150,000-\$200,000
UNINHABITABLE - SAFETY CODE	<ul style="list-style-type: none"> <li>- NO BENEFITS TO UNUSABLE SPACE</li> <li>- FEE WOULD CREATE ECONOMIC HARDSHIP UNTIL REHABILITATION OCCURS</li> </ul>	<ul style="list-style-type: none"> <li>- CERTIFIED BY PUBLIC AGENCY</li> <li>- SPECIFIED BUILDING AREA AFFECTED</li> <li>- CURRENT &amp; FUTURE RESTRICTIONS</li> <li>- THIRD PARTY CERTIFICATION</li> </ul>	ALL NON-USEABLE AREA	INDEFINITE	INITIAL RATE \$420,000-\$532,000  MAXIMUM RATE \$600,000-\$760,000
HISTORIC BUILDINGS	<ul style="list-style-type: none"> <li>- DESIRE TO RETAIN ARCHITECTURAL STYLE</li> <li>- FEE WOULD CREATE ECONOMIC HARDSHIP UNTIL REHABILITATION OCCURS</li> </ul>	<ul style="list-style-type: none"> <li>- CERTIFIED HISTORICAL STATUS</li> <li>- TEMPORARY EXEMPTION OR DEFERRAL</li> <li>- NO EXEMPTION IF RECENTLY REMODELED</li> </ul>	ENTIRE BUILDING	3-5 YEARS	INITIAL RATE \$280,000-\$840,000  MAXIMUM RATE \$400,000-\$1,200,000
BROADWAY RETAIL	<ul style="list-style-type: none"> <li>- DESIRE TO RETAIN VIABLE RETAIL USES</li> <li>- VACANT UPPER FLOORS ARE UNUSED</li> <li>- FEE WOULD CREATE ECONOMIC HARDSHIP UNTIL REHABILITATION OCCURS</li> <li>- MARKET BARRIERS TO OCCUPANCY</li> </ul>	<ul style="list-style-type: none"> <li>- CERTIFIED BUILDING PLANS</li> <li>- STANDARDS FOR RENTABLE AREA</li> <li>- THIRD PARTY CERTIFICATION</li> <li>- ANNUAL REVIEW OF AUDITED STATEMENT</li> <li>- DEFERRAL OR EXEMPTION</li> </ul>	ALL NON-RENTED ABOVE 2ND FLOOR	3-5 YEARS	INITIAL RATE \$756,000-\$924,000  MAXIMUM RATE \$1,080,000-\$1,320,000
NON-PROFIT	<ul style="list-style-type: none"> <li>- GENERAL PRINCIPLE OF NON-TAXATION OF NON-PROFIT ENTITIES</li> </ul>	<ul style="list-style-type: none"> <li>- 95% OCCUPANCY BY NON-PROFIT USERS</li> <li>- ANNUAL RENEWAL PROCESS</li> </ul>	ENTIRE BUILDING	ANNUAL REVIEW	NO ESTIMATE

**5.0 SUGGESTED EXEMPTION AND APPEALS PROGRAM**

**NOTE:** Cumulative revenue impact of all programs is less than the sum of each incremental impact (See Table B-1)

## 5.0 SUGGESTED EXEMPTION AND APPEALS PROGRAM

### Revenue Implications of Appeals Program

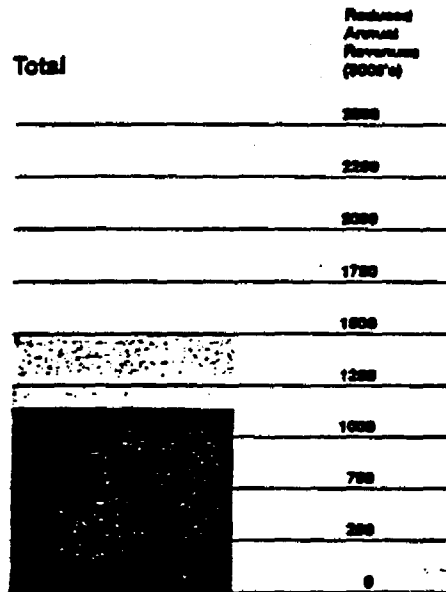
The revenue losses associated with individual appeals elements have been discussed and summarized in Table 3. The cumulative potential impact of all revenue losses has been tentatively estimated to be approximately \$1.5 million at the initial rate of \$.28 a square foot and \$2.2 million at the maximum rate of \$.40 a square foot. The amount and composition of this cumulative impact is shown in Figure 3.

Appendix B provides a detailed analysis of the derivation of revenue losses used for making the estimates. It is important to stress that these are purely order of magnitude estimates designed to show the difference between \$100,000 impacts and million dollar impacts. Any precise impact estimation would require a much more detailed inventory of the various "appeals eligible" uses in the affected areas.

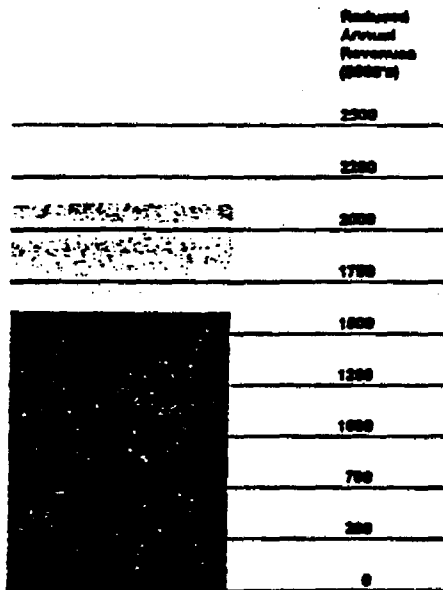
In interpreting the impact as potential revenue loss, it should be stressed that for the most part it is brief and temporary. As indicated in the preceding Table 3, the proposed appeals bases which have an "indefinite term" are "inefficient buildings" and are "uninhabitable due to safety" code problems. Presumably, the uninhabitable safety code buildings will be repaired or redeveloped in the next few years. Inefficient buildings have by far the smallest potential impact and represent only about \$100,000 - \$200,000 over the full range of rates. The safety code buildings will expire within a period of several years. The remaining two bases for specialized appeals are historic buildings and Broadway retail. These are explicit self-terminating exemptions or deferrals. In the case of Broadway retail, only a deferral may be required rather than a full-scale waiver or a temporary exemption.

If the full revenue impact of \$1.5 million in the early years poses a problem, an increase of perhaps \$.02 - \$.04 in the overall assessment rate would be adequate to compensate for this loss. Such an increase could be imposed at the initial review date two years after creation of the District and would not materially change the sensitivity of remaining land uses. It would solve any revenue problems created by this appeals process if the full volume of projected appeals were to occur.

Cumulative  
Impact of  
Exemption  
Categories  
On Assessment  
Revenues

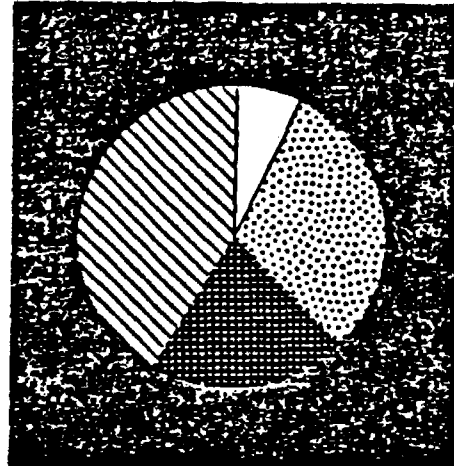


**\$.28 Building Assessment Rate**

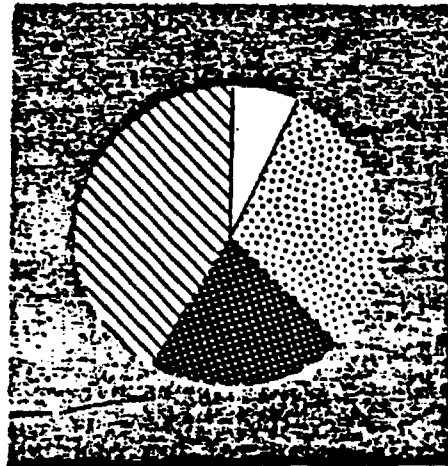


**\$.40 Building Assessment Rate**

By Category



Breakdown of Exemption Elements (Average)



Breakdown of Exemption Elements (Average)

- Low Range Estimate
- High Range Estimate

- Inefficient
- Safety
- Historic
- Broadway

Note: Cumulative total less than sum of individual categories due to overlap (see text)  
Source: KRM

## 6.0 SUMMARY FINDINGS

The following conclusions have been reached in the course of this analysis:

- 1) The dominant economic use in the CBD, new or rehabilitated office space, is not sensitive to the assessment rate structure proposed by SCRTD. Neither the initial or the maximum rates will have a material impact on the economics of the buildings, regardless of their ability to recapture benefits.
- 2) Older office buildings, historic retail buildings, and industrial/warehouse buildings will be sensitive to the proposed rates if they cannot recapture the assessments from their tenants. In these instances the ability to take advantage of the benefits of Metro Rail may be delayed or reduced due to other economic barriers, the rent structure of the use, or other factors influencing the ability of the building owner to alter the leasing arrangements of the building. The tenants in these buildings although not a focus of this study, may have difficulty in absorbing any lease increases passed on to them.
- 3) Exemption and appeals programs can be created to address particular uses that may not be able to take full advantage of the benefits provided by Metro Rail. The programs can take the form of permanent or temporary relief from some or all of the assessment or deferral of assessment to a later date.
- 4) The following exemptions and appeals can be strongly justified: 1) permanent exemption on the building area assessment for industrial/warehouse buildings; 2) partial exemption (through appeal) of buildings with large amounts of space that cannot be leased (e.g., atriums); 3) an expiring exemption (through appeal) of space currently or scheduled to be prohibited from use by fire, safety or seismic regulations; 4) an expiring exemption (through appeal) for certified historic buildings; 5) an expiring exemption or deferral (through appeal) for Broadway retail space with historically vacant upper floors; and 6) an exemption (through appeal) for buildings that lease primarily to non-profit uses.
- 5) Potential revenue losses associated with an appeals mechanism can be offset by a rate adjustment after SCRTD's bi-annual review of rates. It has been estimated that a rate adjustment of between 2¢ and 4¢ could recover the cost of an appeals program outlined in this report.

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## APPENDIX A: SENSITIVITY MODEL

### Model Description

KRM developed a simple computer model to analyze the impact of alternative assessment rates on different buildings. During the course of this analysis, the model was used to study several different types of rate structures proposed by the SCRTD and their impact on various land uses.

Before reviewing the results of the model it is important to stress that it is a "worst case" model in that it assumes that the owners and operators of income property have no ability to recover the increased costs from the tenants and must absorb the full impact in the form of reduced operating income. The model further assumes that this reduction in operating income, through the mechanism of a capitalization rate, is translated directly into a reduction in property value. Finally, the model assumes that since neither rents nor construction costs change as a function of crossing the assessment district boundary, the reduction in property value for the improved property is directly translatable into a dollar-for-dollar reduction in land value.

These stringent assumptions were made in order that the model could be used to "screen" for sensitive uses. Those uses found not to be sensitive required no further analysis as to their ability to recapture rates from their tenants. Those uses found to be sensitive would have to recapture the rates from tenants in order to avoid an adverse economic impact.

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### Example Run

#### Inputs

Table A-1 provides an example of the operation of the model using the initial assessment rates of \$.14 per square foot of land area and \$.28 per square foot of building area, a 4% inflation rate, and a capitalization rate of 9.5%. To a significant degree all three of these assumptions are relatively conservative since 4% is likely to be minimum long-term inflation rate. The capitalization rate of 9.5% gives the maximum value to the property in the current market and hence will show the maximum negative impact from a reduction in operating income.

APPENDIX A: SENSITIVITY MODEL

TABLE A-1

SCRPTD BENEFIT ASSESSMENT IMPACT VALUATION  
PROTOTYPICAL NEW OFFICE BUILDING

	<u>INPUT VALUE</u>	<u>CURRENT PRO FORMA</u>	<u>ADJUSTED PRO FORMA</u>
LAND VALUE	67,000,000		
LAND AREA (SQ. FT.)	312,000		
GROSS BUILDING AREA (SQ. FT.)	3,500,000		
NET RENTABLE AREA (SQ. FT.)	2,972,000		
CAPITALIZATION RATE	8.5%		
INFLATION RATE	4.0%		
ASSESSMENT FEE-LAND AREA (\$ PER SF)	0.14		
ASSESSMENT FEE-BLDG. AREA (\$ PER SF)	0.28		
<u>AFFECT ON EXISTING BUILDINGS</u>			
GROSS RENTAL INCOME	30.00	89,160,000	89,160,000
TOTAL OPERATING EXPENSES	6.50	19,318,000	19,318,000
ASSESSMENT FEE-BLD.			980,000
ASSESSMENT FEE-LAND			43,680
NET OPERATING INCOME		69,842,000	68,818,300
PROJECT VALUE		<u>735,179,000</u>	<u>724,403,000</u>
PROJECT VALUE REDUCTION			<u>10,775,600</u>
% REDUCTION IN VALUE-BLDG. FEE ONLY	1.4%		
% REDUCTION IN VALUE-TOTAL	1.5%		
<u>AFFECT ON FUTURE DEVELOPMENT LAND VALUES</u>			
ORIGINAL LAND VALUE		<u>67,000,000</u>	67,000,000
PROJECT VALUE REDUCTION			<u>-10,775,600</u>
REDUCED LAND VALUE			<u>56,224,500</u>
REDUCTION PER SQUARE FOOT			<u>35</u>
% REDUCTION IN LAND VALUE-LAND FEE ONLY	0.7%		
% REDUCTION IN LAND VALUE-TOTAL FEE	16.1%		
<u>RECOVERY OF ASSESSMENT</u>			
OFFSETTING REVENUE INCREASE (%)	1.1%		
YEARS TO PRIOR CASH FLOW LEVEL	0.29		

## APPENDIX A: SENSITIVITY MODEL

### Format and Basic Calculations

As shown in Table A-1, there are a series of inputs listed in the first column under "input value". Some of these inputs describe the size and value of the land while others deal with the gross building area and the net rentable area. Capitalization rates, inflation rates rental income per square foot per year, and operating expenses per square foot per year are also given. The next two columns of the model show the current pro forma income and value of the property according to the assumptions stated in the input values section. In this column, the row labeled "assessment fee" is empty. In the third and final column of the model, the assumed assessment fee is applied and net operating income is recalculated. From this recalculation in net operating income a recalculated project value is established based on the input capitalization rate.

These two calculations, the current pro forma and the adjusted pro forma, form the basis for a "project value reduction" calculation which is also expressed in percentage terms.

### Land Value

Operating on the assumption that construction cost and/or improvement values do not change, the entire property value change is then expressed in terms of land value to compute the reduced per square foot land value and the corresponding percentage reduction.

### Indices of Sensitivity

Presented at the bottom of Table A-1 are two critical indices to measure how severe this reduction is in terms of the operation of the building. The first one is "offsetting revenue increase (%)". This number which, in Table A-1 is 1.1% means that it would require a 1.1% increase in the gross revenue of the building to compensate for the increased operating cost reflected by the assessment fee.

The second element at the bottom of the output is labeled as "years to prior cash flow levels". This is the amount of time (in years) that it would take for the building to recover from normal inflation (as expressed as an input value at the top of the page) to its original revenue levels. Any fee structure that took more than 1.5 years of inflationary rent increase to recover .



## APPENDIX A: SENSITIVITY MODEL

represented a significant hardship for that property type under the "worst case" assumptions previously outlined.

### Output

Table A-1, which is based on a prototypical new office project, shows that the impacts are for the most part rather minor. While in dollar terms there is a \$10.8 million reduction in property value, this represents only a 1.5% reduction since this is an extremely high value project. Attributing the entire \$10.8 million reduction to land value produces a reduction in per square foot values of \$35 per square foot which represents a 16.1% reduction in original land value.

This latter finding is of some interest in that it says more about future buildings than it does about the example project. It suggests that under this "worst case scenario", land values would be significantly reduced for the next building of a similar size and rent level.

This apparently negative result is to some degree offset by the very limited increase in revenue required to reestablish the original level. Only a 1.1% increase or \$.33 per square foot per year or \$.03 per square foot per month is necessary to compensate for this. It seems likely that either through "pass through clauses" in leases, or through the natural play of the marketplace, the developer/operator of the building could recover all or most of this increase rather quickly.

Even without a deliberate attempt to recover it, normal inflation would compensate for it in less than one-half a year as shown by the 0.29 years to prior cash flow level.

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## APPENDIX A: SENSITIVITY MODEL

### Summary Results

As shown in Table A-2 and Table A-3, new or recently renovated office buildings whose rents exceed \$20 per square foot are not materially affected at either the initial or the maximum assessment rates. Older, more inefficient buildings and industrial uses are moderately affected. The only significantly impacted use appears to be older retail establishments in vacant office or hotel buildings. Retail buildings that are fully utilized, are similar in economics to office space. However, many retail uses exist in ground floor areas of old structures not suitable for other uses. If the assessment fee is applied to the entire building, these properties become significantly affected.

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### Implications of Results

KRM found the measured impact of various assessment fees is proportional to the net operating income of each property. Additionally, those properties with high net income levels per square foot of building area are relatively unaffected. As a result of assessing based on gross footage, the assessment fee penalizes the more "architecturally interesting" projects that have large public areas, i.e. the Bradbury Building.

Future inflation rates will have a significant impact on the affect of various fees on the properties. At an 8% inflation rate or higher almost all of the buildings studies would not be significantly affected by the initial or maximum assessment fees.

Age of the building can be a relevant negative factor, since older buildings tend to have less efficient layouts and may be in unattractive rental areas that make substantial rehabilitation efforts difficult. To the extent an old building exists in a prime area, economic prospects for rehabilitation reduces the eventual negative impact of the various assessment fees.

**TABLE A-2**  
**INCOME/VALUE IMPACTS OF PROPOSED RTD ASSESSMENT FOR 18 PROTOTYPICAL PROPERTIES**

PROPOSED INITIAL RATE = \$0.28 PER SQ. FT. OF ASSESSABLE BUILDING AREA  
 \$0.14 PER SQ. FT. OF LAND AREA

<u>TYPE</u>	<u>AGE</u>	<u>FAR</u>	<u>NET RENT</u>	<u>CAP RATE</u>	<u>PERCENT REDUCTION VALUE/RENT</u>	<u>DOLLAR REDUCTION LAND VALUE</u>	<u>ORIGINAL LAND VALUE PER SF/LAND</u>	<u>ORIGINAL LAND VALUE PER SF/BLDG</u>	<u>PERCENT REDUCTION LAND VALUE</u>	<u>OFFSETTING REVENUE INCREASE</u>	<u>YEARS TO PRIOR C.F.LEVEL</u>
<u>NEW HIGH RISE OFFICE</u>											
HIGH RISE OFFICE	NEW	9.5	\$23.50	0.095	1.5%	\$ 35	\$215	\$ 22.50	16.1%	1.1%	0.3
HIGH RISE OFFICE	NEW	8.1	25.75	0.095	1.3%	29	179	22.12	16.2%	1.0%	0.3
HIGH RISE OFFICE	NEW	8.3	23.50	0.095	1.5%	30	275	33.00	11.0%	1.2%	0.3
HIGH RISE OFFICE	NEW	4.5	23.50	0.095	1.5%	17	225	49.50	7.5%	1.2%	0.3
HIGH RISE OFFICE	NEW	6.8	23.50	0.095	1.5%	24	275	40.00	8.9%	1.1%	0.3
HIGH RISE OFFICE	NEW	12.0	23.00	0.095	1.4%	42	275	22.92	15.3%	1.1%	0.3
HIGH RISE OFFICE	NEW	8.1	20.50	0.090	1.7%	31	350	43.08	8.8%	1.3%	0.3
HIGH RISE OFFICE	NEW	9.5	26.00	0.090	1.3%	36	500	53.07	7.2%	1.0%	0.3
HIGH RISE OFFICE	OLD	9.5	15.00	0.095	2.3%	33	250	26.60	13.6%	1.6%	0.4
HIGH RISE OFFICE	OLD	10.0	15.00	0.090	2.4%	38	400	40.00	9.7%	1.7%	0.4
<u>OLD OFFICE BLDGS.</u>											
HIGH RISE OFFICE	OLD	11.0	12.00	0.100	2.8%	38	250	22.90	15.3%	1.9%	0.5
OFFICE	OLD	8.8	8.00	0.095	5.4%	37	100	11.40	40.0%	3.6%	0.9
OFFICE/RETAIL	OLD	1.9	9.40	0.090	8.2%	16	115	60.00	14.3%	5.4%	1.3
<u>INDUSTRIAL/MANUFACTURING</u>											
INDUSTRIAL	OLD	1.0	4.80	0.080	5.8%	11	150	150.00	7.4%	5.8%	1.4
INDUSTRIAL	OLD	0.8	4.20	0.100	6.6%	3	40	50.00	7.0%	6.7%	1.7
<u>OLD RETAIL</u>											
RETAIL/HOTEL	OLD	9.0	40.00	0.095	9.3%	27	100	100.00	27.5%	8.2%	2.1
RETAIL/OFFICE	OLD	6.0	18.00	0.090	12.4%	19	85	110.00	22.6%	12.4%	2.9
<u>PARKING LOT</u>											
PARKING	OLD	0.0	6.25	0.050	4.5%						

TABLE A-3

TABLE A-3

INCOME/VALUE IMPACTS OF PROPOSED RTD ASSESSMENT FOR 18 PROTOTYPICAL PROPERTIES

PROPOSED MAXIMUM RATE = \$0.40 PER SQ. FT. OF ASSESSABLE BUILDING AREA  
\$0.20 PER SQ. FT. OF LAND AREA

TYPE	AGE	FAR	NET RENT	CAP RATE	PERCENT REDUCTION VALUE/RENT	DOLLAR REDUCTION LAND VALUE	ORIGINAL LAND VALUE PER SP/LAND	ORIGINAL LAND VALUE PER SF/BLDG	PERCENT REDUCTION LAND VALUE	OFFSETTING REVENUE INCREASE	YEARS TO PRIOR C.F. LEVEL
<u>NEW HIGH RISE OFFICE</u>											
HIGH RISE OFFICE	NEW	9.5	\$23.50	0.095	2.18	\$ 49	\$215	\$ 22.50	23.08	1.68	0.4
HIGH RISE OFFICE	NEW	8.1	25.75	0.095	1.98	41	179	22.12	23.18	1.58	0.4
HIGH RISE OFFICE	NEW	8.3	23.50	0.095	2.18	43	275	33.00	15.78	1.68	0.4
HIGH RISE OFFICE	NEW	4.5	23.50	0.095	2.28	24	225	49.50	10.88	1.78	0.4
HIGH RISE OFFICE	NEW	6.8	23.50	0.095	2.18	35	275	40.00	12.78	1.68	0.4
HIGH RISE OFFICE	NEW	12.0	23.00	0.095	2.18	60	275	22.92	21.88	1.68	0.4
HIGH RISE OFFICE	NEW	8.1	20.50	0.090	2.48	44	350	43.08	12.58	1.88	0.5
HIGH RISE OFFICE	NEW	9.5	26.00	0.090	19.38	51	500	53.07	10.38	1.58	0.4
HIGH RISE OFFICE	OLD	9.5	15.00	0.095	33.38	47	250	26.60	19.48	2.38	0.6
HIGH RISE OFFICE	OLD	10.0	15.00	0.090	3.48	55	400	40.00	13.98	2.48	0.6
<u>OLD OFFICE BLDGS.</u>											
HIGH RISE OFFICE	OLD	11.0	12.00	0.100	4.08	52	250	22.90	20.88	2.78	0.7
OFFICE	OLD	8.8	8.00	0.095	7.78	53	100	11.40	57.08	5.18	1.3
OFFICE/RETAIL	OLD	1.9	9.40	0.090	11.88	23	115	60.00	20.58	7.78	1.9
<u>INDUSTRIAL/MANUFACTURING</u>											
INDUSTRIAL	OLD	1.0	4.80	0.080	8.38	16	150	150.00	10.78	8.38	2.1
INDUSTRIAL	OLD	0.8	4.20	0.100	9.58	4	40	50.00	10.08	9.58	2.4
<u>OLD RETAIL</u>											
RETAIL/HOTEL	OLD	9.0	40.00	0.095	13.28	38	100	100.00	39.38	11.88	2.9
RETAIL/OFFICE	OLD	6.0	18.00	0.090	17.88	27	85	110.00	32.38	17.88	4.4
<u>PARKING LOT</u>											
PARKING	OLD	0.0	6.25	0.050	6.48	8	125	0.00	6.48	6.48	0.4

APPENDIX A: SENSITIVITY MODEL

## APPENDIX B: SENSITIVE USES

### Assumptions Used for the Analysis of the Revenue Impacts of Exemptions

Five exemption categories have been proposed to allow for appeal for a deferral or exemption of the benefit assessment placed upon the building area. The revenue impacts of these exemptions are difficult to estimate because of a lack of an inventory by types of building area eligible for exemptions. Based on the CRA's preliminary estimates, an illustrative range of revenue impacts is hereby provided for four of the five exemptions. (See Appendix Table B-1.) The estimated range is at best an educated guess as to the magnitude of assessment revenue reduction as a result of exemptions, and should not be considered as a conclusive finding. The following discussion documents the assumptions used to arrive at a revenue impact range estimate.

### Inefficient Buildings

Based on Land Use Planning Area Map (LUPAM) data, there are approximately 44 million square feet of office and retail building area subject to benefit assessment in the downtown Assessment District. Approximately 4.6 million square feet of that space are estimated to be located within the Broadway Retail District. It has been estimated that about 20% of the Broadway Retail District building area is housed in buildings considered inefficient. Inefficiency is defined as a circumstance where less than 80% of the gross building area is rentable. It was also estimated that an equivalent amount of inefficient building area is located in the rest of the Assessment District.

These rough estimates suggest that the total volume of affected square footage is 1.5 to 2.0 million. With an average building efficiency of 75%, the exempted square footage based on inefficiency is approximately 375,000 to 500,000 square feet.

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## APPENDIX B: SENSITIVE USES

### Uninhabitable Space Due To Safety Violations

It has been estimated that about 20% of the Broadway Retail District building area is uninhabitable due to safety violations, with an additional equivalent amount located in the rest of the Assessment District. The estimated building area in this exemption category is calculated to be approximately 1.5 to 1.9 million square feet. There are some buildings which can be classified as both inefficient and containing uninhabitable space. Approximately 50% of the uninhabitable space was estimated to be located in inefficient buildings, bringing the incremental square footage of this exemption to 700,000 to 900,000 square feet.

In calculating the revenue impacts, property owners of buildings with both the unsafe and inefficient attributes are assumed to apply for exemption under the safety code category, which exempts 100% of the uninhabitable space and is judged to create a larger savings in most buildings.

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### Historic Buildings

There are approximately 10 registered historic buildings in the Assessment District, with an average gross building area of 100,000 square feet, and approximately 220 buildings which are eligible or potentially eligible to apply for the historic building designation. The consultant used the existing registered buildings as the low-end estimate of approximately one million square feet eligible for exemption under the historic category and a potential addition of 20-30 buildings (with average building area of 75,000 square feet) or 3 million square feet as the high-end estimate.

Since old buildings are generally less efficient and more likely to require structural upgrade to meet fire and seismic standards, the consultant also assumed that 50% of the existing historic buildings were either unsafe or inefficient, and 75% of the potential historic buildings as unsafe and inefficient. The incremental impact of the historic exemption is then calculated to be within the range of 500,000 to 1 million square feet, all of which is entitled to a 100% exemption.

## APPENDIX B: SENSITIVE USES

### Broadway Retail District Vacant Space

It has been estimated that two-thirds of the total building area in the Broadway Retail District is vacant. Based on LUPAM data, there are 4.6 million square feet of space in the district, which would result in a potential exemption of 2.7 to 3.3 million square feet. Since 20% of the Broadway space is estimated to be located in inefficient buildings, 20% of the space is judged to be unsafe (both building attributes are not mutually exclusive), and historic buildings are located in the district, the consultant has estimated that approximately 30% of the Broadway Retail District building area is either inefficient, unsafe, or in historic buildings. The incremental impact of this exemption is therefore estimated in the range of 1.9 to 2.3 million square feet.

TABLE B-1

IMPACT OF RECOMMENDED EXEMPTION CATEGORIES

	<u>INEFFICIENT BUILDINGS</u>	<u>UNINHABITABLE SAFETY CODE</u>	<u>HISTORIC BUILDINGS</u>	<u>BROADWAY RETAIL</u>
<b>A: GROSS SQUARE FOOTAGE AFFECTED (000s)</b>				
Affected Area by Category	1,500 - 2,000	1,500 - 1,900	1,000 - 3,000	2,700 - 3,300
Incremental Affected Area	1,500 - 2,000	700 - 900	500 - 1,000	1,900 - 2,300
Cumulative Affected Area <sup>1</sup>	1,500 - 2,000	→ 2,200 - 2,900	→ 2,700 - 3,900	→ <b>4,600 - 6,200</b>
Exemption Percentage	25%	100%	100%	100%

← Total area that could be exempted

**B: ANNUAL REVENUE REDUCTION (000s)**

<b>1. At Initial \$.28 Rate</b>				
By Category Area	\$105 - \$140	\$420 - \$532	\$280 - \$840	\$756 - \$924
Cumulative Affect <sup>1</sup>	\$105 - \$140	→ \$472 - \$602	→ \$612 - \$882	→ <b>\$1,144 - \$1,526</b>
				← <u>Revenue loss at 28¢ rate</u>
<b>2. At Maximum \$.40 Rate</b>				
By Category Area	\$150 - \$200	\$600 - \$760	\$400 - \$1,200	\$1,080 - \$1,320
Cumulative Affect <sup>1</sup>	\$150 - \$200	→ \$675 - \$860	→ \$875 - \$1,260	→ <b>\$1,635 - \$2,180</b>
				← <u>Revenue loss at 40¢ rate</u>

NOTES:

(1) - Cumulative values are less than the sum of the individual values since many buildings fall into several of the exemption categories.