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Memorandum

To: Dan Vanderpriem and Oakland Harbor Partners, LLC (OHP)

From: Joe Litten and Robert Gamble

Re: Review of Oak to 9th proposed development

Public Financial Management, Inc. (PFM), has reviewed the following documents with respect to the proposed Oak to 9th development:

1. The affordable housing provisions of the proposed Developer Agreement.
2. The impact analysis performed by EPS in July 2005.
3. The EPS analysis of the proposed uses for the Ninth Avenue Terminal.
4. Sources and uses and cash flow analyses provided by Oakland Harbor Partners, LLC.

Our preliminary findings are as follows:

Impact Analysis

The general approach used by EPS estimates the impacts on the City of Oakland. It makes no attempt to measure impacts on other public entities, such as schools, special districts, etc. There is nothing inherently correct or incorrect in this methodology, so long as the information is not taken to have a broader meaning.

In general, we are in agreement with the EPS methodology with a single, but significant, exception. In estimating the incremental cost of public services created by the Oak to 9th project, EPS estimates ratios of the cost of services per capita. For some services, EPS uses only variable costs rather than full costs. In our opinion, the long term impact of such developments, especially of this magnitude, is best measured as average *total* costs. Over the long term, capital facilities and other fixed cost elements must be expanded to accommodate population growth. While we were not asked to revise such estimates, it would appear based on our review that the marginal impact of these differences would not be large.

Rate of Return/Affordable Housing Contributions

Based upon the financial estimates provided to PFM, we have estimated the rate of return on equity (ROE) for OHP. In reviewing the estimates we find the financial assumptions to be reasonable given the long term nature of the project and current financial conditions.

We have determined that before OHP's Affordable Housing Contribution of $4,000,000, the estimated ROE would be in the lowest quartile of the range of returns on equity for similar projects. The Affordable Housing Contribution brings the rate of return to a level at at the bottom of the lowest quartile. This lower rate of return is offset somewhat by the City's acquisition of parcels early in the development of the project, thereby mitigating some of the developer's risk. The project remains a relatively high risk development because of the size, complexity and location of the project, which will require development and absorption over a number of years.

Terminal

Our opinion is based upon a review of the EPS Analysis of the 9th Avenue Terminal dated February 27, 2006. Our review was limited to the financial impact of the redevelopment of the Terminal on the project without regard other considerations.

The EPS report provides four alternatives for development:

1. **The "Proposed Project Alternative".** This is a 15,000 square foot Visitors' Center with historical and cultural exhibits.
2. **The "1927 Reuse Alternative".** This is a 90,000 square foot facility comprised of the original 1927 structure with more substantial retail development.
3. **The "Fort Mason Center Model".** This is 180,000 square foot facility comprised of the entire existing structure, contemplating mixed uses such as the Fort Mason facility in San Francisco.
4. **The "Conference Facility".** This would be the same size as the Fort Mason Center Model, but with the structure remodeled to serve as a conference facility.

Table 7 of the EPS report summarizes the costs and revenues associated with each of the alternatives. However, the alternatives include substantial costs, such as retrofitting the pier and landscaping the open area, which would be incurred without redevelopment of the Terminal. The table below adjusts the project cost estimates to remove costs that would be incurred with each of the alternatives even without redevelopment of the pier.

Estimated Incremental Cost of Terminal Redevelopment		Proposed Project Alternative	1927 Reuse Alternative	Ft. Mason Center Model	Conference Facility
Total Project Cost from EPS Report Table 4		$ 18,400,124	$ 32,309,302	$45,754,723	$47,455,723
Less:	Ninth Avenue Pier Retrofit	(10,576,000)	(10,576,000)	(10,576,000)	(10,576,000)
	Open Space Landscaping and Irrigation	(1,320,000)	(808,000)	-	-
	Finance Charges and Profit	(3,796,851)	(3,796,851)	(3,796,851)	(3,796,851)
Incremental Cost of Terminal Development		$ 2,707,273	$ 17,128,451	$31,381,872	$33,082,872
Debt Service on Incremental Cost of Terminal Development		$ (255,547)	$ (1,616,805)	$ (2,962,227)	$ (3,122,789)
Net Operating Income		171,000	923,400	994,500	1,020,000
Net Cash Flow		$ (84,547)	$ (693,405)	$ (1,967,727)	$ (2,102,789)

None of the alternatives shows a positive cash flow, and the amount of the annual losses increases with the size and complexity of the alternative facilities. Although one might view the costs associated with these alternatives solely as noting differences in the magnitude of losses created by the alternative scenarios, we believe that, in addition, the risks associated with the larger developments are greater than those associated with the Proposed Project Alternative.

Each of the alternatives defined in the original analysis generate revenue streams based on the proposed usages and their relative square footages. These revenue streams range from $171,000 per year for the 15,000 square foot alternative up to $1,020,000 for the conference facility alternative. All of these revenue streams are premised on development scenarios which appear to be challenging based on the location of the facility and general economic conditions. EPS has attempted to account for this increased risk by assuming higher vacancy risks for each of the alternatives ranging from 10% to 15%. Although these rates may turn out to be reasonable over a longer period of time, there should be concern that these rates could be higher, especially in the early years of the project. There is also a risk that some of these alternatives would turn out not to be economically viable, and would need to be reconfigured. While these risks cannot be quantified, it is important that the City be aware of and concerned about them. It should be noted that these risks increase as the size of the developed area. It should also be noted that the net cash flow could be brought to zero with additional capital investment to eliminate loan debt service. However this additional contribution, together with the affordable housing contribution, would reduce the project to infeasible levels of return.

Conclusion

Our conclusion is that all of the suggested plans for saving a larger portion of the 9th Avenue Terminal than presently proposed would place the Oak to 9th Project at further financial risk. Based on the financial information we reviewed, a significantly larger Terminal than presently proposed would reduce to rates of return to infeasible levels for the overall project.