

**Beltramo's Inc. &
Beltramo's Investment Co., Inc.**
1540 El Camino Real
Menlo Park CA 94025-4199
650-326-3230 ▪ Fax: 650-326-1109

April 6, 2010

City of Menlo Park
Housing and Redevelopment Department
Attention: Douglas W. Frederick, Ph.D., Housing Manager
701 Laurel Street
Menlo Park, CA 94025

Re: 1460 El Camino Real Project – Additional Information Related to Proposed
BMR Housing Agreement Revision

Dear Dr. Frederick:

We are writing to provide additional information related to our application for revisions to the BMR Housing Agreement for the North Menlo Mixed Use Development, also known as the 1460 El Camino Real Project (Project). As you know, this BMR Agreement was approved as part of the Planned Development Permit (Permit) for the Project in August 2006. The Permit currently expires on August 1, 2010. We have applied for a two-year extension of the Permit, concurrently with our request for revisions to the BMR Agreement.

As noted in the cover letter submitted with our application, we no longer believe that it is economically feasible (if it ever was) to provide three BMR units on site, as currently required by the agreement. There are a multitude of facts and circumstances that have led us to this conclusion, as explained below.

Project Development History

First, it is necessary to understand something of the history of the Project. The planning for this Project began nearly 14 years ago, when we had our architect prepare plans for a solely commercial building with all ground level parking on the Project site. Our original plan was to build the Project, and manage and rent it ourselves to provide ongoing income for our families. We had a study meeting with the City's Planning Commission, and the City expressed a strong desire for housing to be added to the Project. Finally, we agreed to incorporate residential uses into the Project, which resulted in a redesign that includes a podium structure with underground parking, *which greatly added to the cost of construction for the Project.*

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Negotiations with the City on the BMR units began with a request by a Housing Commissioner for six on site units; however, an agreement was reached for three out of the 16 approved townhouses to be offered as BMR units on site. We made that agreement assuming that such units would remain under the family's ownership and control, and would be rented for residential users, but it eventually became clear that the podium necessitated by the residential component and the economics of renting units would require the residential units to be sold to make the Project at all feasible. Unfortunately, all of this transpired over a much longer period of time than should have been the case because the City spent several years attempting to down zone the El Camino Real C-4 zoning before we could proceed with a formal project review.

In 2006, while decommissioning dry wells on the site, we learned that there was soil contamination in one portion of the site. While minor in nature, we were required to undertake extensive testing and evaluation, first in conjunction with the San Mateo County Public Health and Environmental Protection Divisions and then with the State Department of Toxic Substances Control. This has required approximately \$360,000 in expenses for consultants and governmental fees, in addition to several years of further delays to construction of the Project. The soil contamination issue is not yet completely resolved, although we hope this will happen by the end of this year. Remediation costs could be in the neighborhood of \$250,000.

Because of the delay and added expense caused by the environmental clean-up and the significant downturn in the real estate market generally over the past two years, we have had to closely examine the amount of investment we have made in the Project and reconsider its overall feasibility, particularly in light of the residential component.

Project Cost Analysis¹

As detailed on the enclosed spreadsheet, we have calculated the Project's estimated economics under two scenarios. To compute the construction costs, we solicited estimates from four local contractors based on the Project's conceptual drawings. The analysis includes a scenario based on the lowest construction cost (Lowest Construction Cost), and because the Lowest Construction Cost may be unrealistic given the number of variables, the analysis also includes what we consider a more reasonable "average" of the four cost estimates received (Average Construction Cost). Additional costs taken into consideration in the analysis include off site hard costs, utility fees and costs, governmental fees,

¹ Please note that all figures on the attached spreadsheet are our best estimates based on information available to us at this point in time, and are subject to change based on market conditions, additional bids, information that may be discovered or developed depending on final designs, clean-up requirements, etc.

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architectural and other professional fees, insurance and bonding costs, development costs and financing costs. Detailed information concerning the construction cost calculation by general categories can be made available to the City upon request.

The estimated sales price for the market rate units and rental income for the commercial component are based on our personal experience as commercial property owners, discussions with knowledgeable real estate brokers, and review of recent sales and rental rates for comparable properties in the area. Enclosed is one letter from an experienced area real estate agent regarding the likely sale price for the market rate residential units.

We used a land value of \$82.64/square foot, which is the same land value used by the City to establish the Project's recreation fee. However, we note that other similarly situated properties in the vicinity of the Project have sold for land values closer to \$120/square foot or more in the past several years. Therefore, the analysis already includes a potentially substantial loss in land value to us as the landowner.

As shown in the enclosed analysis, the ability of the Project to "pencil out" and show any possibility of profit will depend largely on the ultimate cost of the construction, in addition to the potential sales prices and rental rates that might be achieved. Because of the high cost of constructing the podium for underground parking, which was required to fit the residential component on this small site, the construction cost is fairly high.

In the Average Construction Cost scenario, the Project simply does not pencil out. Regardless of whether the BMR units are constructed on site or payment of in the lieu fee is applied, the Project shows a loss and hence would not justify moving forward with construction of the Project. However, the loss is less substantial (approaching break even) if the in lieu fee is applied instead of building on site BMR units.

Under the Lowest Construction Cost scenario, if an in lieu fee is applied rather than requiring construction of the BMR units on site, the Project shows a marginal pro forma return of 15.24% (\$4,617,698 divided by total net proceeds of \$30,292,051). The general standard in the industry for anticipated pro forma return to consider a project potentially feasible is a low of 20% where a project is considered ordinary risk. (See enclosed letter from Kirk Trammell of Marcus & Millichap brokers.) Where more risk is involved, such as in uncertain market conditions like we are currently experiencing, it is not uncommon to see pro forma returns required to be more in the 30% range.

If the BMR units must be built on site, the possible pro forma return for the Project is reduced to 12.54%. Such a scenario is not reasonable under the industry standard, particularly given the uncertainty associated with the cost of Project construction and the overall economic climate that could significantly impact assumed potential sales/rental

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prices. The 2.7% differential between building the BMR units on site and paying the in lieu fee is substantial for this Project and the Project cannot be considered feasible if the BMR units must be built on site.

BMR Impact Differential

Another way of viewing the impact of the on site BMR requirement for the Project is to consider the difference just in the cost associated with building the BMR units versus paying the in lieu fee within the residential component of the Project. In the current market, we estimate that the market-rate townhomes at the Project could sell for about \$850,000. We are informed by the City that the BMR units could sell for about \$230,000-\$270,000 depending on economic conditions; we used an average of \$250,000 for the proforma. Based on these assumptions, if the Project is allowed to pay an in lieu fee instead of building the units on site, the in lieu payment would be approximately \$615,348 (3% of \$13,600,000 for the residential component, plus \$14.01 per sq. ft. x 14,800 sq.ft. [26,800 - 12,000 existing] for the commercial component). Thus, the economic impact to the Project of building the BMR units on site rather than paying an in lieu fee is a **loss of more than \$1 million** in revenues, assuming the BMR units were sold at the average price of \$250,000 per unit (\$850,000 x 3 less closing expenses of 6.3% or \$53,550, and less BMR in lieu fees of \$408,000 and \$207,348 = \$1,024,002). If the BMR units sold closer to the lower end (\$230,000) or the market rate units sold for less than assumed, the adverse economic impact would be even more severe.

Part of the reason for this large and, in our opinion, inequitable differential is the fact that the BMR Guidelines require that the BMR units built on site be of the same square footage and character as the market rate units, and fail to take into consideration the provision of high-end amenities at the Project, the amount of parking, the land value and the overall density, not to mention whether the units are townhouse, apartment or free standing residences. Thus the cost of constructing the BMR units is the same as the cost of constructing the market rate units even though the ability to recover that cost is severely limited. Indeed, many developers are challenging the constitutionality of BMR programs similar to the City's for this and other reasons. (For example, in *BIA v. City of Patterson*, 171 Cal.App.4th 886, decided in March 2009, the court held that there was no nexus between the new housing and the City's increased BMR fees. Locally, two lawsuits have been initiated in the City of Palo Alto and one in San Jose challenging various aspects of BMR zoning.)

Conclusion

We are attempting with our Project to meet the City's strong desire for reasonably priced residential units close to transit, as well as our desire to develop a commercial project.

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However, in the current market, given our nearly 14 years and approximately \$1.4 million investment in the Project, as well as the additional time and expense for environmental clean up, and not even taking into consideration the land value or assigning a dollar value to the many years of time and effort put into development of this Project, we have concluded that it is simply not feasible for the Project to absorb a \$1+ million loss by building the BMR units on site when the overall potential profit margin for the Project is so low and construction costs and market conditions so uncertain.

The City's BMR Guidelines specifically provide that although there is a strong preference for having development projects include the required BMR units on site, payment of an in lieu fee is permissible where it is not feasible to provide the units on site. (Menlo Muni. Code § 16.96.030; BMR Guidelines 3.1.1 and 4.3.1.) The City has approved use of the in lieu fee in the past not just for commercial projects but also for residential projects with site constraints and/or a small number of residential units.

We are not unmindful of the need for the City to provide housing to lower income citizens, and we are willing to do our fair share as part of the Project. We cannot, however, feasibly build the Project if it must absorb a loss of more than \$1 million caused by building the BMR units on site. Thus, we respectfully request that the Housing Commission approve a revision to our BMR Housing agreement to allow instead the payment of in-lieu fees.

We understand that our application will be considered by the Housing Commission at its May 5th meeting. Please let us know if you have any questions or there is any additional information you need. Thank you.

Sincerely,



John R. Beltramo
President of Beltramo's Investment Co.



Daniel A. Beltramo
President of Beltramo's Inc.

Enclosures

cc: Amy G. Nefouse, Esq. (w/encl.)
Pat McGaraghan, Esq. (w/encl.)



COMPARISON OF BUILDING & SELLING BMR VS. PAYING IN LIEU FEE BASED ON TOTAL PROJECT VALUATION METHOD

	Using Lowest Contractor Cost				Using Average Contractor Cost				Differential
	Building & Selling BMR Units	Paying In Lieu Fee	Differential		Building & Selling BMR Units	Paying In Lieu Fee	Differential		
FMV/SALE OF COMMERCIAL BUILDING									
GROSS MONTHLY NNN RENT FOR 28,500 SQ. FT.	\$4.50	\$ 120,600							
GROSS NNN RENT ANNUALLY		\$ 1,447,200							
LESS VACANCY & COLLECTION	5.00%	\$ (72,360)							
EFFECTIVE GROSS INCOME		\$ 1,374,840							
LESS LEASING COMMISSIONS (% IS 10 YR AVERAGE)	3.65%	\$ (50,182)			Same as columns to left				
LESS MANAGEMENT FEE	5.00%	\$ (68,742)							
LESS REPLACEMENT RESERVE	2.00%	\$ (27,497)							
NET OPERATING INCOME		\$ 1,228,420							
CAPITALIZED AT % INDICATED = FMV/SALES PRICE	7.00%	\$ 17,548,851							
SALES COMMISSION - Not used in direct capitalization									
NET FUNDS FROM SALE OF COMMERCIAL BUILDING		\$ 17,548,851			\$ 17,548,851				\$ 17,548,851
SALE OF RESIDENTIAL UNITS									
SALE OF (No. Indicated) UNITS AT \$850,000/unit	13	\$ 11,050,000			13	\$ 11,050,000			16
LESS COMMISSIONS, ADVERTISING & CLOSING EXP. (5% + 1% + .3%)	6.30%	\$ (696,150)			6.30%	\$ (856,800)			6.30%
PLUS SALE OF 3 BMR UNITS @ average \$ indicated	\$ 250,000	\$ 750,000			\$ 250,000	\$ 750,000			n/a
TOTAL NET PROCEEDS FROM SALE OF COMMERCIAL BUILDING & TOWNHOMES		\$ 28,652,701				\$ 28,652,701			\$ 30,292,051
LESS HARD & SOFT COSTS FOR BUILDING PROJECT WITHOUT: LAND COST, PROFIT OR IN LIEU FEES		\$ (19,480,805)				\$ (19,480,805)			\$ (24,439,330)
LESS BMR Fee 3% OF GROSS SALES PRICE						\$ (408,000)			\$ (408,000)
COMMERCIAL PAYS IN LIEU FEE ON NET NEW SQ. FT. (26,800-12,000=14,800) x \$14.01 =						\$ (207,348)			\$ (207,348)
PROCEEDS AVAILABLE TO PAY FOR LAND & PROFIT		\$ 9,171,896				\$ 10,195,898	\$ 1,024,002		\$ 5,237,373
LESS LAND VALUE AT A CONSTANT OF \$82.64/Sq. Ft. X 67,500 Sq.Ft.	67,500	\$ (5,578,200)				\$ (5,578,200)			\$ (5,578,200)
DEVELOPER'S PROFIT		\$ 3,593,696				\$ 4,617,698	\$ 1,024,002		\$ (340,827)
PROFIT AS A PERCENTAGE OF NET SALES PROCEEDS FROM COMMERCIAL BUILDING AND TOWNHOMES		12.54%			Loss:	-4.76%			Loss
						15.24%	2.70%		-1.13%
									3.64%

Please note that all figures above are our best estimates at this point in time based on conceptual drawings, and are subject to change based on market conditions, additional bids, information that may be discovered or developed depending on final designs, clean-up requirements, etc. Owners & their agents do not make any warranty, either express or implied, that actual cost or other figures will not vary from the amounts indicated and they assume no liability for such variances.

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March 27, 2010

Dear Dan and John,

I have reviewed the drawings of your North Menlo Mixed Use Development at 1460 El Camino Real, Menlo Park.

I believe the average sales price of the sixteen units, of approximately 1,450 square feet each, facing San Antonia Avenue, would sell for an average of \$850,000 each at this time.

I am quite familiar with the street and our office handled the sale of the five similar units but somewhat larger five units on the same street two years ago.

If I can be of any further help please do not hesitate to call.

Regards,



Mary Gebhardt

Vice President-Manager

Marcus & Millichap

Real Estate Investment Services

2626 Hanover Street
Palo Alto, CA 94304
Tel: (650) 494-8900
Fax: (650) 494-0213
www.MarcusMillichap.com

March 26, 2010

Dan Beltramo
1540 El Camino Real
Menlo Park, CA 94025

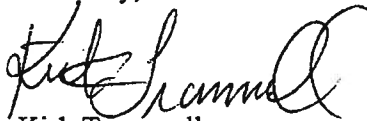
Dear Dan

You asked for my opinion of what the "standard in the industry" is for a pro forma return (profit) necessary to make a mixed-use (residential and commercial) Bay Area project potentially feasible. As you know, I have been in the Bay Area commercial real estate business for 20 year with Marcus & Millichap Real Estate Investment Brokerage. Additional information related to by background and experience is enclosed.

In my experience, the low end of what would be considered an acceptable pro forma return is around 20%, assuming generally acceptable risk conditions. In the current difficult economic climate, it would not be uncommon for a potential buyer of a project to want to see a pro forma return closer to the 30% range.

Of course, every project is different and subject to a multitude of circumstances that could affect risk, cost, and return. However, these are general figures that I believe would be considered "industry standard" for a project such as what you are proposing at your 1460 El Camino Real site. Please let me know if you have any questions.

Sincerely,



Kirk Trammell
Senior Vice President
Marcus and Millichap



Kirk L. Trammell
Senior Vice President Investments
Senior Director - National Multi Housing Group
Senior Director - National Retail Group

Kirk Trammell has been involved in Real Estate Brokerage and/or ownership for the past 20 years. Kirk joined Marcus and Millichap in 1989 in the Palo Alto office, and since has consistently been a top performer in the Northern California market. He is experienced in the sales of warehouse, retail, land, office and apartments properties. Over the past 20 years Kirk has participated in the transactions for over \$900 million in investment real estate. The experience that he brings to the table includes critical analysis skills to achieve superior underwriting, pricing and marketing to help sellers maximize the value of their real estate.

The "National Achievement Award" is given to Marcus and Millichap agents achieving the highest degree of excellence in the company. Out of 1300 agents in the company, Kirk is one of only 12 agents that have received for 13 years. Over the past 20 years Kirk has been a "Top 5 Producer" in the Palo Alto office on 9 separate occasions. He has also received "Recognition Achievement Awards" for the past 16 years.

The following are Developers and Clients that Kirk has represented throughout his career**:

- Donahue Schriber Realty Corp.
- Evergreen Properties
- Bixby Land Co.
- Village Properties
- Sobrato Development Company
- Warehouse Properties
- Regents of the University of California
- Barry Swenson Builder
- Tenoesketter and Breeding
- Cortese Brothers
- Chamberlin Associates
- Thomas Properties
- Comerica Bank
- Michalke Trust
- Frankel Trust
- Hawkins Companies
- Hunter Storm Development

**Contact information for references available upon request

