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MEMORANDUM

To: Joe La Mariana, Executive Director – South Bayside Waste Management Authority
From: Rick Simonson, Senior Vice President – HF&H Consultant
Date: June 7, 2023
Subject: Cost Analysis of Office Purchase versus Lease

Background

The South Bayside Waste Management Authority's (SBWMA's) administrative office is currently located in the City of San Carlos Library. The office has been located in this space for over 16 years. Under the terms of the current lease, SBWMA occupies 2,429 square feet at a monthly rent of \$5,618 or \$2.31/sf. The current lease term ends on June 30, 2024 and the City has indicated that the term will not be extended because the space is needed to accommodate San Carlos staff and will no longer be available to the SBWMA.

Since receiving this notice, Executive Director La Mariana has been working with a commercial real estate broker to identify potential alternative spaces. The goal has been to identify an affordable space that will accommodate the current staff and agency/public guests, provide proper space for Board and TAC meetings, have easy access to parking for Board and Technical Advisory Committee (TAC) members, be located near public transit, and be in close/immediate proximity to the Shoreway Facility. With these factors in mind, the Executive Director La Mariana has researched and toured many local properties that are currently available for rent and one property that is currently for sale.

Executive Director La Mariana has toured a property, currently for sale, at 1245 San Carlos Avenue, Suite E, in San Carlos. In addition, working with a commercial real estate broker, Executive Director La Mariana has identified a number of properties available to lease that meet the some, but not all, of criteria above. The current lease rates have been estimated to be between \$4.50-\$6.50 per square foot in the general San Carlos area.

The following analysis compares the projected costs, over a 30-year period, of purchasing the available property versus leasing a property of the same size; the specific property is unknown at this time. An Excel model was developed to calculate the projected costs over time with a number of assumptions. The model has been constructed to allow multiple scenarios regarding costs and funding terms. This memorandum summarizes one such cost scenario. The model will be available to run additional scenarios at any upcoming meetings.

Cost Analysis of 1245 San Carlos Avenue Property

Executive Director La Mariana's discussions with the real estate broker has identified a commercial suite located at 1245 San Carlos Avenue, Suite E, which is 2,841 square feet with 20-foot ceilings which can

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accommodate adding a second floor and increase the usable space to 3,977 square feet. The expanded space will accommodate existing SBWMA staff workspaces, ADA-compliant restrooms, a kitchen, storage, and a large fully-wired video conference room available to host Board and TAC meetings.

The estimated cost to purchase and make the necessary interior improvements is \$2.3 million - \$2.5 million. For this analysis we have assumed the high of \$2.5 million.

Figure 1 summarizes the cost assumptions used to evaluate the cost-per-square foot procuring, improving, and maintaining the San Carlos Avenue property. **Figure 2** summarizes the first-year total cost of the property and the projected cost per square foot (\$4.11 per square foot), with additional detail describing the assumptions following **Figure 2**. **Attachment 1** includes a 30-year analysis of projected costs, including the calculation of the present value of the total annual costs of occupying the property over the next 30-years.

Figure 1 – Office Purchase Key Assumptions

Size (at purchase)	2,841	square feet
Estimated Size (at buildout)	3,977	square feet
Property Purchase Price	\$1,700,000	(est. \$1.5 - \$1.7 million)
Plus: Tenant Improvements	\$800,000	
Total Project Cost	\$2,500,000	
Downpayment	30%	(\$750,000)
Total Loan Amount	\$1,750,000	
Loan Term for Pymt Calc	30	years
Amortization	25	years
Balloon Payment	\$551,295	due @ Year 25
Interest Rate	6.19%	
Payments per Year	12	
Bank Fee	0.50%	of loan amount
Broker Fee	1.00%	of purchase price
Association Fees	\$0.14	per sq. ft. per month @ size at purchase
Association/Utilities Fee escalator	5.00%	per year
Reserves Return-on-Investments	2.00%	per year

Figure 2 – Year 1 Cost Summary

		FY 2023-24
Office Purchase Financial Analysis		
Loan Repayment		\$128,482
Bank Fee		\$8,750
Broker Fee		\$17,000
Balloon Payment Reserve		\$16,874
Association Fees		\$4,773
Utilities (excl. refuse)		\$6,000
Opportunity Cost ¹		\$14,485
Total		\$196,364
Build-out Square Footage	3,977.00	
\$ per sq. ft. per month		\$4.11

¹Lost investment income from use of reserves for downpayment and upfront bank/broker fees

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Loan Repayment, Fees, and Balloon Payment Reserve. One-time loan and broker fees are included in Year 1 only. The estimated annual loan repayment (at the terms included in Figure 1) is repaid over 25 years with a “balloon” payment due in Year 25. For this analysis, we have assumed the SBWMA would reserve 1/25 of the balloon payment each year so the cash is available when due. The calculated annual reserve contribution assumes earned interest on the funds at 2.0% per year. The loan payment terms include a fixed 6.19% interest rate for the first 10 years and adjusted thereafter based on 10-year Treasury plus 2.5%. Our analysis assumes the 6.19% throughout the 25-year term. Actual interest rates may be higher or lower.

Association Fees. Association fees are paid monthly by all property owners (i.e., City of San Carlos, Commercial Owners, and Residential Owners through a Joint Use Agreement). The fees cover common area maintenance, insurance, window washing, natural gas, water, sewer, and refuse. In addition, a portion of the fees are set aside in reserves for future capital repairs and maintenance (e.g., building exterior repair and paint, roofs). In total, the five commercial suites are allocated 4.84% of Joint Maintenance Costs. The \$0.14 per square foot is based on recent budgeted expenses and reserve contributions. The analysis assumes a 5% annual increase, which may vary from the actual annual changes. Unexpected capital needs may arise which shall be assessed to all property owners in excess of the current \$0.14 per square foot fee.

Utilities. The Association fees cover common area utilities, and the refuse needs for the commercial suites. The current understanding is the SBWMA will be responsible for their water, sewer, and electricity needs for their suite. These have been estimated at \$500 per month with a 5% annual escalator for this analysis.

Opportunity Costs. To purchase a property instead of leasing, requires upfront cash outlay for the downpayment and one-time bank/loan fees (\$775,750 in total). The SBWMA has reserves available to make these upfront payments. This analysis includes a “cost” component for the purchase option to recognize the loss of investment income that would otherwise be earned if the cash was continued to be held in reserves. For this analysis, we have assumed the cost of purchasing the property includes the annual loss of investment income at 2.0% per year on the \$775,750 withdrawal from reserves, based on recent historical return-on-investments experienced by the SBWMA.

Cost Analysis of Leasing a Property

Executive Director La Mariana, with assistance from a real estate broker researched and toured dozens of rental properties. Currently, for properties that fit the needs of the SBWMA in this targeted geographic area, leases range from \$4.50 to \$6.50 per square foot per month. Typically, the lease amounts are inclusive of the Common Area Maintenance (CAM) expenses (e.g., water, sewer, refuse, electricity), though the charges are reviewed annually and reconciled for any incremental differences that are passed along (or refunded) to the tenant. For comparison purposes, and to be conservative, we have assumed all CAM-related costs are included in the per square foot lease charge throughout the 30-year period.

Attachment 1 includes a 30-year analysis of projected costs, including the calculation of the present value of the total annual costs of leasing a property over the next 30-years. The analysis assumes the low end

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of \$4.50 per square foot per month, escalated 2.0% per year, which is equivalent to approximately \$0.10 per square foot each year.

Limitations

The analysis has been prepared with readily available projections and information provided by SBWMA staff, Beale Street Lending, Barc Architecture, and discussions with the 1245 San Carlos property builder, KB Homes. The projections contained herein may change. Additional costs not contemplated in this financial analysis to acquire the San Carlos property may be incurred.

Recommendation

Figure 3 summarizes the comparison of total estimated costs, and average cost per square foot per month, of the two options: 1) purchasing the San Carlos Avenue property and 2) continue leasing available commercial properties, based on the assumptions and projections described in this memo. Based on this financial analysis, the net present value (based on a present value discount rate of 3.0% annually) of the cost to purchase the San Carlos Avenue property is considerably less (approximately 39% less) than leasing property at the low-end of current market rates. Assuming all costs of purchasing and maintaining the San Carlos Avenue property have been fairly represented, the purchase of the San Carlos Avenue property is recommended. Results may differ if the cost to purchase, finance the property, or other cost factors increase.

Figure 3 – Comparative Summary (detailed analysis provided in Attachment A)

	30-year Costs (in 2023\$)	Average Cost per Sq. Ft. per Month (in 2023\$)
Office Purchase	\$3,446,716	\$2.41
Office Lease	\$5,612,814	\$3.92

ATTACHMENT A

Key Assumptions - Office Purchase

Size (at purchase)	2,841	square feet
Estimated Size (at buildout)	3,977	square feet
Property Purchase Price	\$1,700,000	(est. \$1.5 - \$1.7 million)
Plus: Tenant Improvements	\$800,000	
Total Project Cost	\$2,500,000	
Downpayment	30%	(\$750,000)
Total Loan Amount		\$1,750,000
Loan Term for Pymt Calc	30	years
Amortization	25	years
Balloon Payment	\$551,295	due @ Year 25
Interest Rate	6.19%	
Payments per Year	12	
Bank Fee	0.50%	of loan amount
Broker Fee	1.00%	of purchase price
Association Fees	\$0.14	per sq. ft. per month @ size at purchase
Association/Utilities Fee escalator	5.00%	per year
Reserves Return-on-Investments	2.00%	per year

Key Assumptions - Lease

Size (square feet)	3,977	
Lease Amount	\$4.50	per sq. ft. per month (est. (\$4.50-\$6.50))
Annual Lease Amount	\$214,758	
Common Area Maint (CAM)	incl. in lease	water, sewer, electric, refuse, custodial, landscape, etc. (usually part of 1st yr lease amt (baseline), reconciled annually for incremental difference only)
Lease Inflation Rate	2.00%	

Key Assumptions - General

Present Value Discount Rate	3.0%
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Office Purchase Financial Analysis	FY 2023-24	FY 2024-25	FY 2025-26	FY 2026-27	FY 2027-28	FY 2028-29	FY 2029-30	FY 2030-31	FY 2031-32	FY 2032-33	FY 2033-34	FY 2034-35	FY 2035-36	FY 2036-37	FY 2037-38
Loan Repayment	\$128,482	\$128,482	\$128,482	\$128,482	\$128,482	\$128,482	\$128,482	\$128,482	\$128,482	\$128,482	\$128,482	\$128,482	\$128,482	\$128,482	\$128,482
Bank Fee	\$8,750														
Broker Fee	\$17,000														
Balloon Payment Reserve	\$16,874	\$16,874	\$16,874	\$16,874	\$16,874	\$16,874	\$16,874	\$16,874	\$16,874	\$16,874	\$16,874	\$16,874	\$16,874	\$16,874	\$16,874
Association Fees	\$4,773	\$5,012	\$5,262	\$5,525	\$5,801	\$6,092	\$6,396	\$6,716	\$7,052	\$7,404	\$7,775	\$8,163	\$8,571	\$9,000	\$9,450
Utilities (excl. refuse)	\$6,000	\$6,300	\$6,615	\$6,946	\$7,293	\$7,658	\$8,041	\$8,443	\$8,865	\$9,308	\$9,773	\$10,262	\$10,775	\$11,314	\$11,880
Opportunity Cost ¹	\$14,485	\$15,805	\$16,121	\$16,443	\$16,772	\$17,108	\$17,450	\$17,799	\$18,155	\$18,518	\$18,888	\$19,266	\$19,651	\$20,044	\$20,445
Total	\$196,364	\$172,473	\$173,354	\$174,271	\$175,223	\$176,213	\$177,243	\$178,314	\$179,428	\$180,586	\$181,792	\$183,048	\$184,354	\$185,714	\$187,131
Build-out Square Footage	3,977.00														
\$ per sq. ft. per month	\$4.11	\$3.61	\$3.63	\$3.65	\$3.67	\$3.69	\$3.71	\$3.74	\$3.76	\$3.78	\$3.81	\$3.84	\$3.86	\$3.89	\$3.92
Present Value Discount Factor	1.0000	1.0300	1.0609	1.0927	1.1255	1.1593	1.1941	1.2299	1.2668	1.3048	1.3439	1.3842	1.4258	1.4685	1.5126
Present Value of Future Cost	\$196,364	\$167,449	\$163,403	\$159,482	\$155,683	\$152,003	\$148,438	\$144,985	\$141,642	\$138,404	\$135,271	\$132,237	\$129,302	\$126,463	\$123,716
30-year Costs (2023S)	\$3,446,716														
Monthly NPV cost per square foot	\$2.41														

Office Purchase Financial Analysis	FY 2038-39	FY 2039-40	FY 2040-41	FY 2041-42	FY 2042-43	FY 2043-44	FY 2044-45	FY 2045-46	FY 2046-47	FY 2047-48	FY 2048-49	FY 2049-50	FY 2050-51	FY 2051-52	FY 2052-53	TOTAL
Loan Repayment	\$128,482	\$128,482	\$128,482	\$128,482	\$128,482	\$128,482	\$128,482	\$128,482	\$128,482	\$128,482						\$3,212,056
Bank Fee																\$8,750
Broker Fee																\$17,000
Balloon Payment Reserve	\$16,874	\$16,874	\$16,874	\$16,874	\$16,874	\$16,874	\$16,874	\$16,874	\$16,874	\$16,874						\$421,855
Association Fees	\$9,922	\$10,419	\$10,940	\$11,487	\$12,061	\$12,664	\$13,297	\$13,962	\$14,660	\$15,393	\$16,163	\$16,971	\$17,819	\$18,710	\$19,646	\$317,105
Utilities (excl. refuse)	\$12,474	\$13,097	\$13,752	\$14,440	\$15,162	\$15,920	\$16,716	\$17,552	\$18,429	\$19,351	\$20,318	\$21,334	\$22,401	\$23,521	\$24,697	\$398,633
Opportunity Cost ¹	\$20,854	\$20,854	\$20,854	\$20,854	\$20,854	\$20,854	\$20,854	\$20,854	\$20,854	\$20,854	\$20,854	\$20,854	\$20,854	\$20,854	\$20,854	\$579,758
Total	\$188,606	\$189,726	\$190,902	\$192,137	\$193,433	\$194,794	\$196,223	\$197,724	\$199,300	\$200,954	\$57,335	\$59,159	\$61,074	\$63,085	\$65,197	\$4,955,157
Build-out Square Footage																
\$ per sq. ft. per month	\$3.95	\$3.98	\$4.00	\$4.03	\$4.05	\$4.08	\$4.11	\$4.14	\$4.18	\$4.21	\$1.20	\$1.24	\$1.28	\$1.32	\$1.37	
Present Value Discount Factor	1.5580	1.6047	1.6528	1.7024	1.7535	1.8061	1.8603	1.9161	1.9736	2.0328	2.0938	2.1566	2.2213	2.2879	2.3566	
Present Value of Future Cost	\$121,059	\$118,231	\$115,499	\$112,860	\$110,312	\$107,853	\$105,480	\$103,191	\$100,983	\$98,856	\$27,383	\$27,432	\$27,495	\$27,573	\$27,666	

¹Lost investment income from use of reserves for downpayment and upfront bank/broker fees

¹Lost investment income from use of reserves for downpayment and upfront bank/broker fees

Office Lease Financial Analysis		FY 2023-24	FY 2024-25	FY 2025-26	FY 2026-27	FY 2027-28	FY 2028-29	FY 2029-30	FY 2030-31	FY 2031-32	FY 2032-33	FY 2033-34	FY 2034-35	FY 2035-36	FY 2036-37	FY 2037-38
Annual Lease		\$214,758	\$219,053	\$223,434	\$227,903	\$232,461	\$237,110	\$241,852	\$246,689	\$251,623	\$256,656	\$261,789	\$267,025	\$272,365	\$277,812	\$283,369
CAM Charges																
Other																
Total		\$214,758	\$219,053	\$223,434	\$227,903	\$232,461	\$237,110	\$241,852	\$246,689	\$251,623	\$256,656	\$261,789	\$267,025	\$272,365	\$277,812	\$283,369
\$ per sq. ft. per month		\$4.50	\$4.59	\$4.68	\$4.78	\$4.87	\$4.97	\$5.07	\$5.17	\$5.27	\$5.38	\$5.49	\$5.60	\$5.71	\$5.82	\$5.94
\$ change		\$0.09	\$0.09	\$0.09	\$0.09	\$0.10	\$0.10	\$0.10	\$0.10	\$0.10	\$0.11	\$0.11	\$0.11	\$0.11	\$0.11	\$0.12
Present Value Discount Factor		1.0000	1.0300	1.0609	1.0927	1.1255	1.1593	1.1941	1.2299	1.2668	1.3048	1.3439	1.3842	1.4258	1.4685	1.5126
Present Value of Future Cost		\$214,758	\$212,673	\$210,608	\$208,563	\$206,539	\$204,533	\$202,548	\$200,581	\$198,634	\$196,705	\$194,795	\$192,904	\$191,031	\$189,177	\$187,340
30-year Costs (2023\$)		\$5,612,814														
Monthly NPV cost per square foot		\$3.92														

Office Lease Financial Analysis		FY 2038-39	FY 2039-40	FY 2040-41	FY 2041-42	FY 2042-43	FY 2043-44	FY 2044-45	FY 2045-46	FY 2046-47	FY 2047-48	FY 2048-49	FY 2049-50	FY 2050-51	FY 2051-52	FY 2052-53	TOTAL
Annual Lease		\$289,036	\$294,817	\$300,713	\$306,727	\$312,862	\$319,119	\$325,501	\$332,012	\$338,652	\$345,425	\$352,333	\$359,380	\$366,568	\$373,899	\$381,377	\$8,712,320
CAM Charges																	\$0
Other																	\$0
Total		\$289,036	\$294,817	\$300,713	\$306,727	\$312,862	\$319,119	\$325,501	\$332,012	\$338,652	\$345,425	\$352,333	\$359,380	\$366,568	\$373,899	\$381,377	\$8,712,320
\$ per sq. ft. per month		\$6.06	\$6.18	\$6.30	\$6.43	\$6.56	\$6.69	\$6.82	\$6.96	\$7.10	\$7.24	\$7.38	\$7.53	\$7.68	\$7.83	\$7.99	
\$ change		\$0.12	\$0.12	\$0.12	\$0.13	\$0.13	\$0.13	\$0.13	\$0.14	\$0.14	\$0.14	\$0.14	\$0.15	\$0.15	\$0.15	\$0.16	
Present Value Discount Factor		1.5580	1.6047	1.6528	1.7024	1.7535	1.8061	1.8603	1.9161	1.9736	2.0328	2.0938	2.1566	2.2213	2.2879	2.3566	
Present Value of Future Cost		\$185,521	\$183,720	\$181,936	\$180,170	\$178,421	\$176,689	\$174,973	\$173,274	\$171,592	\$169,926	\$168,276	\$166,643	\$165,025	\$163,423	\$161,836	