ATTACHMENT A:
KEY FINANCIAL CONCEPTS, ASSUMPTIONS, AND VARIABLES

KEY FINANCIAL CONCEPTS

To better understand this technical memorandum, it is important first to understand the key financial concepts that underlie the PTMP financial model. These key financial concepts are briefly defined below:

- *Capital Costs (also called Capital Improvements)*. Initial monies spent to rehabilitate, upgrade, or newly construct the built and natural environments, including residential and non-residential buildings, interior improvements, roads, utility systems, water and sewer systems, electrical and telecommunications systems, forests, and open spaces, among other items. Capital costs do not include operating expenses. It is important to note that the model does not include any environmental remediation costs. These costs are being paid by the U.S. Army under pre-existing agreements governing environmental cleanup of the Presidio.

- *Capital Replacement Reserves (also called Capital Replacement Set-Asides)***.** Monies set aside into a reserve account to assure that funds are available in the future to repair and replace any and all capital improvements in Area B, such as components of buildings or entire buildings, and park infrastructure including roads, grounds, natural areas, utilities, etc. Capital reserves are funded only after capital projects are completed.

- *Financing Costs*. The Trust has the authority under the Trust Act to borrow $50 million from the U.S. Treasury. The costs associated with repayment of this loan (both principal and interest) are referred to as financing costs. For a full description of the terms of the U.S. Treasury loan, see the Presidio Trust Management Plan (PTMP) Financial Model Assumptions and Documentation Binder, available for review at the Presidio Trust's offices.

- *Operating Expenses*. Operating expenses include park-wide expenses incurred to manage the park on a day-to-day basis (e.g., facilities, maintenance, operations, legal, planning, public safety, finance, and insurance). In the PTMP financial model, operating expenses include program expenses (defined below) and financing costs.

- *Program Expenses*. On-going annual operating expenses associated with delivering public programs, such as interpretive programs, museums and institutes, exhibitions, events, arts and cultural programs, and community stewardship and resource education programs. Program expenses do not reflect subsidies for, or opportunity costs associated with, program-enhancing, mission-related tenants.

- *Revenues*. The total income produced or generated by a given source. At the Presidio, these revenue sources include non-residential and residential buildings (building leases and ground leases), government appropriations, Treasury borrowing, utilities and telecommunications income, parking fees, permit and salvage operations, special events, and other miscellaneous park-wide revenues.

KEY ASSUMPTIONS

This technical memorandum is not intended to explain every assumption that was incorporated into the PTMP financial model (See the PTMP Financial Model Assumptions and Documentation Binder for a full list and detailed description of all assumptions in the financial model)... Instead, it is intended to explain the methodology behind the model and the key assumptions that are common to all of the PTMP planning alternatives. Some of the key common assumptions are as follows:

Prioritizing the Completion of the Capital Improvements Program

After all operating expenses are paid, the remaining cash available each year is used to pay for scheduled building and infrastructure (including open space) capital improvements. Therefore, a consistent methodology for funding these capital improvements was developed and applied to all of the planning alternatives. Because of the Presidio Trust's need to generate revenues to meet financial self-sufficiency and sustainability requirements, projects with the highest revenue-generating potential are funded first. This assumption is made in order to ensure that each PTMP planning alternative is given the maximum opportunity to succeed.

The methodology also assumes that park-wide infrastructure improvements are completed early to enhance the revenue-generating potential of all uses at the Presidio. It is important to note that the actual selection and phasing of projects during implementation will depend on a variety of factors, including market conditions and Trust priorities. The methodology used to compare PTMP alternatives does not necessarily reflect a plan for future implementation.

Therefore, based on these assumptions, a prioritization (or ranking) of capital improvements was developed to determine which projects receive funding first. These are listed below, in order of priority:

1. Rehabilitation of residential buildings (both conversions and demolitions)
2. Rehabilitation of currently leased buildings (if needed)
3. Park-wide infrastructure improvements (i.e., roads, wet and dry utility systems, landscaping and hardscaping, communication networks, open spaces, and natural areas)
4. Demolition of non-residential buildings
5. Rehabilitation of buildings for non-residential uses, in the following order:
    a. Office space
    b. Retail space
    c. Lodging and conference space
    d. Industrial and warehouse space
    e. Cultural, educational and office space scheduled for use by mission-related, program-enhancing tenants
    f. Recreational space
    g. Non-revenue-generating space (i.e., facilities and administration buildings used by the Presidio Trust and the National Park Service (NPS))

Generally, when cash is available to fund capital improvements, the model allocates those monies to complete outstanding projects in the highest-priority category. Once these projects are completed, any available cash is allocated to the second-highest priority projects, and so on, until all the capital improvements have been completed.

Trust as Developer vs. Third-Party Developers

The financial model assumes that the Presidio Trust pays for all costs associated with any demolition, rehabilitation and conversion of existing residential and non-residential space at the Presidio, but does not pay for any new construction. It is assumed that third-party entities (e.g., developers, operators, or private investors) pay for all costs associated with new construction of residential and non-residential space. However, in response to public comments, the Presidio Trust did subsequently conduct a sensitivity analysis on third-party financing. This sensitivity analysis is discussed in greater detail in the Sensitivity Analyses section of this technical memorandum (see Section III.C.4), under third-party funding of non-residential rehabilitation.

Assuming the Presidio Trust pays for all capital costs associated with existing buildings is a reasonable middle-ground between assuming Trust financing of all capital development and assuming total reliance on third-party financiers. All of this new and rehabilitated space is phased in over time. Except for varying the timing assumption for Wherry Housing demolition, timing assumptions regarding the prioritization of demolition, rehabilitation, and new construction are common to all planning alternatives. These assumptions were made for the purposes of financial modeling, and should be interpreted only as a means to facilitate the comparison of PTMP planning alternatives.

In the Draft EIS financial analysis, two alternative financing scenarios were also examined: (1) Third parties perform and finance *all* the rehabilitation, conversion and new construction of residential and non-residential buildings at the Presidio (with the exception of Trust and NPS facilities and existing residential neighborhoods not planned for conversion), and (2) the Presidio Trust performs and finances *all* of the rehabilitation, conversion and new construction of residential and non-residential buildings at the Presidio. This analysis illustrates the inherent financial tradeoffs associated with choosing either of these two extremes, as is discussed below.

(1) *Third-Party Financing.* If the Trust were to rely on third-party developers to perform the rehabilitation of the majority of residential and non-residential space, the Trust would significantly reduce its capital costs but it would also reduce its revenues. Revenues would be lower because the Trust would not be assuming any of the risk associated with developing the building, and therefore would not be able to reap the revenues associated with assuming that risk (i.e., it would only be charging rent on the land, which is inherently less risky than the building and is a smaller component of the total investment). The significant reduction in revenues associated with ground rents potentially jeopardizes the financial self-sufficiency and sustainability of certain alternatives, particularly those with an emphasis on new residential construction.

(2) *Presidio Trust Financing.* Conversely, in the scenario where the Trust acts as the developer, the Trust would increase its long-term revenues but it would also substantially increase its capital costs. Long-term revenues would be higher because the Trust would be charging rent on Trust-owned buildings rather than land (i.e., ground rent revenue is assumed to be 20 percent of building rent revenue). In addition, the substantial increase in capital costs would extend the time required to complete the capital improvements program and fully fund the capital replacement reserves.

Capital Replacement Set-Asides (Reserves)

The PTMP financial analysis includes set-aside funds (referred to as capital replacement reserves or reserve set-asides) to pay for on-going capital costs, replacement of buildings and infrastructure at the end of their useful lives, and unexpected extraordinary costs, such as those associated with a catastrophe or natural disaster.

For purposes of financial modeling, the reserve set-aside is calculated based on the amount of rehabilitated building square footage and the estimated infrastructure reserve requirements. Using this formula, the model calculates the required reserve set-aside every year and accumulates this annual amount in a fund over time. Once all capital improvements have been made, the fund starts receiving cash and eventually becomes a healthy surplus.

This assumption is reasonable because substantial replacement reserves are unlikely to be needed during the capital-improvement phase since upgrades will have recently been completed on buildings and infrastructure. In the future, the Trust will be performing an on-going evaluation to determine the appropriate level of annual capital replacement reserves.

Capital Costs

The financial model incorporates the one-time capital costs required to rehabilitate, upgrade or newly construct the built and natural environments, including residential and non-residential buildings, interior improvements, roads, utility systems, water and sewer systems, electrical and telecommunications systems, forests, and open spaces, among other items[8]. Capital costs do not include operating expenses. Infrastructure improvement costs vary depending upon the capital program proposed in the PTMP alternative. The total infrastructure capital cost also includes those costs associated with additional open space and landscaping improvements (See the PTMP Financial Model Assumptions and Documentation Binder for a detailed description of these costs.).

Capital costs associated with residential building rehabilitation are based on Trust project experience with specific types of structures (e.g., concrete, masonry, wood-frame, and steel). Per-square-foot rehabilitation costs range from about $100 to $144. Unit rehabilitation costs for historic buildings converted to lodging (about $225 per square foot) and conference (about $150 per square foot) uses were based on Sedway Group's project experience with similar conversions at historic military bases. Capital costs associated with rehabilitation of existing residential units are based on the Presidio Trust's project experience. Capital costs associated with conversion of existing residential buildings vary by alternative (See the PTMP Financial Model Assumptions and Documentation Binder for a full description of costs.).

Operating Expenses

Operating expenses are assumed to be the same across all alternatives, despite differences in total building square footages for each alternative (However, in response to public comments, the Presidio Trust did subsequently conduct a sensitivity analysis for operating expenses. See the Sensitivity Analyses section of this technical memorandum – See Section III.C.3 – under variable operating expenses.) The operating expense assumptions are derived from the Trust's adopted FY 2001 budget and reflect operating costs based upon three years of the Trust's actual operational experience. Earlier operating cost estimates in the 1994 GMPA and the 1998 Financial Management Program (FMP) differ because these earlier costs were estimated without the benefit of direct operational experience.

The constant operating expense assumption was made because a reduction in building square footage does not necessarily mean a commensurate reduction in operating expenses at the Presidio. Even though a building is demolished and the Presidio Trust no longer incurs the operating expenses associated with maintaining that building, it still would need to maintain the open space that is created once the building has been removed (e.g., maintenance and other land support costs). In addition, operating expenses are held constant because a large portion of operating expenses at the Presidio are fixed, particularly costs associated with infrastructure systems. Overall, incorporating variable operating expenses into the financial model would not be material to the financial results, and would make it more difficult for public reviewers to compare one alternative to another.

Operating expenses include on-going personnel and non-personnel costs associated with facilities and infrastructure maintenance, open space and landscaped areas maintenance, planning, real estate leasing and management, legal, and administrative services. In the PTMP financial model, these costs are assumed to be at their highest between 2002 and 2006, when the Trust is in its early years and management needs – to get projects started and completed – are greatest.

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[8] The financial model does not include any environmental remediation costs, which are being paid by the U.S. Army under governing environmental cleanup agreements for the Presidio.

As the bulk of projects are completed, operating expenses associated with facilities, legal, planning, real estate and operations divisions are projected to decrease modestly in 2007, 2013 and 2020. Expenses associated with public safety, special events and finance and insurance are assumed to remain constant. In 2020, annual operating expenses are expected to stabilize. Thus, any potential variability in operating expenses is captured in the PTMP financial model by reducing operating expenses commensurate with overall leasing and construction activity.

KEY VARIABLES

A number of key variables drive the financial performance of the PTMP planning alternatives. These economic drivers include the land-use program (and associated capital costs), annual program expenses, the timing of Wherry Housing demolition, residential unit conversions, and the percentage of square footage devoted to program-enhancing, mission-related tenants. It is, in part, on the basis of these financial variables that the Trust will evaluate the performance and relative costs and benefits of the different planning alternatives. These variables are among the decision criteria to be considered when selecting the Plan Alternative. These criteria are each briefly discussed below:

- *The Land Use Program*. At the heart of each PTMP planning alternative is the conceptual land use program (see the body of the Final EIS document for a detailed description of the land use program for each planning alternative). Each alternative has a different mix of land uses. Obviously, some uses generate more revenue than other uses do, and those alternatives that have greater amounts of square footage devoted to high-revenue-generating uses tend to perform better financially. In general, high-revenue-generating uses include residential space (varies by residential neighborhood and ranges from $10 to $24 per square foot per year), office space (ranges from $20 to $30 per square foot per year), retail space ($18 per square foot per year), and lodging space (ranging from $0 to $26.75 per square foot per year). Similarly, lower-revenue generating uses include conference space ($0 per square foot per year), industrial/warehouse space ($12 per square foot per year), cultural/educational space ($9 per square foot per year), and recreational space ($5 per square foot per year). Residential rents for current unit configurations were provided to Sedway Group by the Presidio Trust, based on current actual leases. Non-residential rents were based on Sedway Group's market research and actual Presidio Trust leases. To be conservative, rental rates for office space are based on a seven-year trend of Class B and Class C office space (non-Central Business District) in San Francisco.

  Also, each of the planning alternatives, depending on its emphasis, incurs a unique mix of capital costs. To ensure a valid comparison, each alternative operates under a set of common, per-unit capital cost assumptions. However, the variation in each alternative's land use program generates a unique mix of costs for each alternative. As explained earlier in this technical memorandum, capital improvements are funded according to an assumed prioritization. Therefore, the level and type of capital costs associated with implementing each alternative affects its financial performance. For example, an alternative with high capital costs will take longer to implement than an alternative with low capital costs. In addition, per-unit rehabilitation costs vary by land use (e.g., the conversion of non-residential buildings into lodging uses is the most expensive rehabilitation effort). Therefore, the mix of land uses affects both the revenue-generating potential and total capital costs of each alternative, and, hence, has the potential to affect both financial self-sufficiency and sustainability.

- *Annual Program Expenses*. Similarly, each of the planning alternatives, depending on its emphasis, includes a different assumption about the desired level of annual program expenses. Depending on the alternative, these stabilized annual program expenses vary from $2 million to $10 million. In the PTMP financial model, the level of programming affects both financial self-sufficiency and financial sustainability. Program expenses affect financial self-sufficiency because they are part of total operating expenses, and, hence, influence the amount of money that is left over after total operating expenses are subtracted from total revenues in FY 2013. Program expenses also affect financial sustainability because they influence the cash flow available to fund capital improvements and capital replacement reserves over the long-term.

- *The Timing of Wherry Housing Demolition*. Wherry Housing is a significant revenue source for the Presidio, generating about $11.5 million a year. As Wherry Housing is removed, the Trust would lose this revenue source and incur a significant capital cost to demolish Wherry Housing. (The Trust estimates that it will cost about $22.8 million to demolish the entire residential complex.). Therefore, leaving Wherry Housing in service for leasing as long as possible has a significant positive effect on the financial performance of the PTMP planning alternatives. The longer the Presidio Trust collects revenues from Wherry Housing, the longer it can use these revenues to fund capital improvements.

  Public scoping comments indicated strong support for delaying the demolition of Wherry Housing so that its revenues could be used to fund other operating expenses and capital improvements. In response to these comments, the Trust modified its assumptions about the timing of Wherry Housing demolition. In the Final EIS financial analysis, the assumption used for the timing of the demolition of Wherry Housing for each PTMP planning alternative is as follows:

PTMP Alternative	Wherry Demolition Timing
Final Plan Alternative	1/3 in 2012, 1/3 in 2020, 1/3 in 2030
Final Plan Variant	1/3 in 2012, 1/3 in 2020, 1/3 in 2030
GMPA 2000 Alternative	All in 2012
Resource Consolidation	1/3 in 2012, 2/3 in 2020
Sustainable Community	1/3 in 2012, 2/3 in 2020
Cultural Destination	1/3 in 2012, 2/3 in 2020
Minimum Management	Permanently Retained

  A previous financial analysis of the GMPA 2000 Alternative demonstrated that demolishing Wherry Housing early (i.e., during the first four years of the analysis period) resulted in the alternative being financially infeasible in fiscal year 2013. The current timing assumption in the GMPA 2000 Alternative reflects a mid-point between early and late demolition and is consistent with the GMPA, which called for Wherry Housing to be removed at the end of the 1994 GMPA planning period.

- *Residential Unit Conversions*. Several residential buildings at the Presidio contain housing units that are not well-suited to meet the bulk of Presidio-based or regional residential demand. For example, the Presidio has a relatively large proportion of both very small, dorm-style residential barracks and very large, five- and six-bedroom houses. The Presidio currently does not have a large number of one- and two-bedroom units, which are generating the highest demand in today's market. To address this disparity, certain planning alternatives (i.e., the Final Plan Alternative, the Resource Consolidation Alternative, and the Sustainable Community Alternative) contemplate converting some of these hard-to-market properties into more marketable units (the Final Plan Variant sensitivity also incorporates substantial residential conversions). The cost to convert these units is relatively high ($200 per square foot), and the converted units are not expected to generate substantially higher revenues than the units do in their original configuration. Thus, while the converted units may meet the projected housing demand of Presidio-based residents, there is a minimal economic benefit to performing the conversion, based on the assumptions used in the PTMP financial model.