KEYSER MARSTON ASSOCIATES

# INCLUSIONARY AFFORDABLE HOUSING
# REAL ESTATE FINANCIAL FEASIBILITY ANALYSIS

*Prepared for:*
**City of Encinitas**

*Prepared by:*
**Keyser Marston Associates, Inc.**

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# INTRODUCTION AND SUMMARY OF FINDINGS

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**INCLUSIONARY AFFORDABLE HOUSING**
**REAL ESTATE FINANCIAL FEASIBILITY ANALYSIS**

## 1.0 OVERVIEW

### 1.1 Objective

This report presents the real estate financial feasibility analysis prepared by Keyser Marston Associates, Inc. (KMA) for the City of Encinitas (City) to analyze the impacts that potential inclusionary requirements may have on the financial feasibility of new residential development.

For an inclusionary housing program to be an effective tool for creating housing, it must not burden new development to such a degree that it renders new development financially infeasible. To that end, the KMA financial feasibility analysis has been prepared to determine the viability of potential affordable housing requirements on a range of residential product types likely to be developed in the City. In addition, KMA also analyzed the likelihood of incentivizing affordable housing development on specific sites in the City through an upzone that was implemented as part of the City's Housing Element Update adopted in March 2019.

In undertaking this analysis, KMA performed the following technical analyses:

1. *Real Estate Financial Feasibility Analysis – Citywide* – KMA evaluated the impact of updated inclusionary housing requirements on the feasibility of market-rate residential development projects occurring throughout the City.

2. *Real Estate Financial Feasibility Analysis – Housing Element Update "R-30" Sites* - KMA evaluated the impact of inclusionary housing requirements on the "R-30" Overlay Zone sites identified in the City's Housing Element Update.

3. *Affordability Gap Analysis* – KMA estimated the inclusionary housing in-lieu fee levels that would be needed in order to achieve targeted inclusionary production levels in an off-site location.

4. *Nexus Study* – KMA prepared a nexus study for consideration in setting an inclusionary in-lieu fee. The KMA nexus study is provided under separate cover.

### 1.2 Organization of Report

This report is organized into the following key sections:

- *Section 1.0, Overview* provides an introduction to the KMA financial feasibility analysis and reviews the City's existing inclusionary housing requirements.

- *Section 2.0, Methodology* identifies the key work tasks performed by KMA and describes the development scenarios evaluated as part of this financial feasibility analysis.

- *Section 3.0, Key Findings* summarizes the residential development prototypes analyzed by KMA and the findings of the KMA feasibility analyses.

- *Section 4.0, Build On-Site – Financial Feasibility Analysis of Citywide Inclusionary* presents the findings and methodology used to analyze the feasibility of developing on-site inclusionary units.

- *Section 5.0, Build On-Site – Financial Feasibility Analysis of Housing Element Update "R-30" Sites* presents the analysis and findings related to incentivizing the development of inclusionary units on the "R-30" Overlay Zone sites.

- *Section 6.0, Build On-Site – Financial Feasibility of Alternative Scenarios* presents the findings of a series of alternative scenarios, specifically: (1) assuming the City's pre-August 2018 inclusionary requirements as the base case assumption; and (2) assuming the "R-30" Overlay Zone sites will be developed as for-sale multi-family residential, rather than rental.

- *Section 7.0, Build Off-Site – Estimate of Affordability Gap* presents the findings and methodology used to estimate fee levels needed to achieve inclusionary production in an off-site location ("off-site compliance").

- *Section 8.0* presents limiting conditions pertaining to this report.

Provided under separate cover, the KMA nexus study provides the economic justification for the maximum supportable inclusionary in-lieu fee from a legal perspective.

### 1.3 City of Encinitas Existing Inclusionary Affordable Housing Ordinance

Prior to August 2018, the City's inclusionary housing program required that subdivisions of at least 10 units set aside, or pay an in-lieu fee equivalent to, one unit at Very Low for every 10 units. On August 8, 2018, the City Council adopted Ordinance No. 2018-03 which:

1. Increased the City's inclusionary requirement to 10% for Very Low-Income households or 15% for Low-Income households for both rental and for-sale units;

2. Authorized the use of accessory dwelling units to meet the inclusionary requirement (up to five units); and

3. Established the affordability time limit for affordability restrictions as perpetuity.

The City is currently considering increasing the percentage of affordable units above the 2018 adopted standards. As such, the City retained the services of KMA to conduct a real estate financial feasibility analysis to determine the impact of increasing the City's affordable housing inclusionary requirements.

## 2.0 METHODOLOGY

### 2.1 Work Tasks

The purpose of this real estate financial feasibility analysis is to evaluate the feasibility of imposing additional inclusionary housing requirements on residential development in the City. Economic feasibility for residential developments is achieved when the projected return for a specific development (or investment) proposal equals or exceeds the required return of the developer (or investor). Financial pro formas are a standard tool utilized by developers and investors to analyze the feasibility of a new project. The pro forma estimates the development costs to build a project, the operating income or sales revenue that can be achieved upon completion, and the anticipated development profit supported. It is important to keep in mind that financial pro formas for proposed projects represent a series of estimates of probable outcomes. For the purposes of this financial feasibility analysis, KMA identified and analyzed a range of development prototypes. These prototypes are illustrative of the types of development projects occurring, and anticipated to occur, throughout the City. While this level of feasibility analysis is useful for conceptual planning purposes, the actual circumstances for individual projects – physical, planning, market, financial, and other factors – will likely vary from the KMA findings presented in this report.

In completing this analysis, KMA performed the following key work tasks:

- Reviewed background documentation and historical data relevant to the City's Inclusionary Housing Ordinance.

- Reviewed market trends data, land values, development cost estimates, and industry return requirements for both rental and for-sale residential development.

- Worked with City staff to formulate the residential development prototypes.

- Prepared base case financial models to estimate the residual land value generated by each residential prototype, assuming the City's existing inclusionary requirement of 10% at Very Low or 15% at Low. (The concept of residual land value is discussed in detail in Section III below.)

- Prepared financial models testing a range of inclusionary set-asides and targeted household income levels to determine the impact of inclusionary requirements on residual land value.

- Prepared base case financial models for each "R-30" site, estimating the residual land value if developed based on the sites' base zoning.

- Prepared financial models for each "R-30" site, estimating the residual land value if developed within using the "R-30" Overlay Zone. The "R-30" Overlay Zone scenarios were then used to test a range of inclusionary set-asides and targeted household income levels to determine the impact of inclusionary requirements on residual land value.

- Prepared financial models, estimating the affordability gap resulting from developing Very Low- and Low-Income housing in an off-site location ("off-site compliance").

## 2.2 Development Scenarios

The KMA feasibility analysis involved the preparation of base case financial pro forma models, as well as a series of sensitivity tests, to evaluate the impacts of a range inclusionary set-asides (percent of affordable units) and targeted household income levels (percent of Area Median Income) to determine the impact of inclusionary requirements against residual land value.

Overall, KMA evaluated a total of six inclusionary scenarios as part of the feasibility analysis. These scenarios are summarized in Table 2-1.

| Table 2-1: Development Scenarios | | |
|---|---|---|
| **CITYWIDE INCLUSIONARY** | **HOUSING ELEMENT UPDATE "R-30" SITES** | |
| **Scenario 1** | **Scenario 2** | **Scenario 3** |
| **Base Case: Existing Conditions** | **Base Case: Existing Conditions** | **Base Case: Existing Conditions** |
| 10% Very Low – no Density Bonus<br>15% Low – no Density Bonus<br><br>10% Very Low – w/Density Bonus<br>15% Low – w/Density Bonus | 10% Very Low – no Density Bonus<br>15% Low – no Density Bonus<br><br>10% Very Low – w/Density Bonus<br>15% Low – w/Density Bonus | 10% Very Low – no Density Bonus<br>15% Low – no Density Bonus<br><br>10% Very Low – w/Density Bonus<br>15% Low – w/Density Bonus |
| **Inclusionary Scenarios** | **"R-30" Overlay Zone Scenarios - Rental** | **"R-30" Overlay Zone Scenarios – For-Sale** |
| 15%, 20%, 25% @ Very Low w/Density Bonus<br><br>20%, 25%, 30% @ Low w/Density Bonus<br><br>Test: High Capitalization Rate<br>Low Capitalization Rate | 10%, 15%, 20%, 25% @ Very Low w/Density Bonus<br><br>15%, 20%, 25%, 30% @ Low w/Density Bonus<br><br>Test: High Capitalization Rate<br>Low Capitalization Rate | 10%, 15%, 20%, 25% @ Very Low w/Density Bonus<br><br>15%, 20%, 25%, 30% @ Low w/Density Bonus |

| Table 2-1: Development Scenarios | | |
|---|---|---|
| **CITYWIDE INCLUSIONARY** | **HOUSING ELEMENT UPDATE "R-30" SITES** | |
| **Scenario 1A** | **Scenario 2A** | **Scenario 3A** |
| **Base Case: Pre-August 2018** | **Base Case: Pre-August 2018** | **Base Case: Pre-August 2018** |
| 1 unit @ Very Low for every 10 units<br>No Density Bonus (For-Sale Only) | 1 unit @ Very Low for every 10 units<br>No Density Bonus (For-Sale Only) | 1 unit @ Very Low for every 10 units<br>No Density Bonus (For-Sale Only) |
| 1 unit @ Very Low for every 10 units<br>w/ Density Bonus (For-Sale Only) | 1 unit @ Very Low for every 10 units<br>w/ Density Bonus (For-Sale Only) | 1 unit @ Very Low for every 10 units<br>w/ Density Bonus (For-Sale Only) |
| **Inclusionary Scenarios** | **"R-30" Overlay Zone Scenarios - Rental** | **"R-30" Overlay Zone Scenarios – For-Sale** |
| 15%, 20%, 25% @ Very Low w/Density Bonus<br>20%, 25%, 30% @ Low w/Density Bonus<br>Test: High Capitalization Rate<br>Low Capitalization Rate | 10%, 15%, 20%, 25% @ Very Low w/Density Bonus<br>15%, 20%, 25%, 30% @ Low w/Density Bonus<br>Test: High Capitalization Rate<br>Low Capitalization Rate | 10%, 15%, 20%, 25% @ Very Low w/Density Bonus<br>15%, 20%, 25%, 30% @ Low w/Density Bonus |

For the purposes of this report, key findings from Scenarios #1 and #2 are presented below in Sections 3.0, 4.0, and 5.0. The corresponding detailed technical analyses are provided in Appendices 1 and 2. Key findings from the remaining four scenarios are addressed in Section 6.0, with the detailed technical analyses contained in Appendices 3 through 6.

## 3.0 KEY FINDINGS

The purpose of the KMA financial pro forma analyses is to analyze financial parameters for each development prototype such as: (1) estimated development costs, (2) revenue potential, and (3) a reasonable developer return/profit commensurate with the cost of funds (interest expense) and development risk. This approach produces a residual land value that a developer of each prototype can afford to pay to acquire a site. Residual land value is defined as the maximum land value supported by a proposed development. It is calculated by estimating the total value upon completion and subtracting the estimated total development costs (other than land acquisition costs) required to develop the project.

Specifically, the residual land value for each residential development prototype is derived from the calculation shown in Table 3-1.

**Table 3-1: Residual Land Value Calculation**

| | | | | |
|---|---|---|---|---|
| **Total Value at Completion** | - | **Estimated Development Costs (excluding land)** | = | **Residual Land Value** |

If the residual land value exceeds the cost to acquire a site for development, the prototype is generally determined to be feasible. If the residual value is less than the cost to acquire the site, feasibility will be more challenging and some improvement in the economics of the development will likely be necessary for it to move forward. In preparing the base case financial pro forma models, KMA collected market and industry data to determine appropriate inputs and assumptions that resulted in feasible financial pro formas. These balanced base case pro formas yield appropriate, market-based returns/profits for developers and residual land values for property owners.

### 3.1 Financial Feasibility of Citywide Inclusionary

*<u>Residential Development Prototypes</u>*

Scenario #1 of the KMA feasibility analyses identified a range of residential development prototypes currently planned, under development, or recently completed in the City. The development prototypes are described in Table 3-2 below.

| Table 3-2: Citywide Inclusionary Residential Development Prototypes | | | | | | |
|---|---|---|---|---|---|---|
| **For-Sale Residential Prototypes** | | **Zoning** | **No Density Bonus** | | **With Density Bonus** | |
| | | | **Units/Acre** | **Units** | **Units/Acre** | **Units** |
| A | Single-Family Detached – Large Lot | R-3 | 3.0 | 12 | 4.3 | 17 |
| B | Single-Family Detached – Medium Lot | R-5 | 5.0 | 20 | 6.5-6.8 | 26-27 |
| C | Single-Family Detached – Small Lot | R-8 | 8.0 | 12 | 10.7-11.3 | 16-17 |
| D | Single-Family Detached – Small Lot | RS-11/R-11 | 11.0 | 33 | 14.3-15.0 | 43-45 |
| E | Mixed-Use Development | --- | 10.0 | 5 | 14.0 | 7 |
| F | Townhomes | R-15 | 15.0 | 45 | 19.3-20.3 | 58-61 |
| **Rental Residential Prototypes** | | **Zoning** | **No Density Bonus** | | **With Density Bonus** | |
| | | | **Units/Acre** | **Units** | **Units/Acre** | **Units** |
| G | Garden Apartments | R-20 | 20.0 | 40 | 25.5-27.0 | 51-54 |

For each prototype noted above, KMA prepared base case financial pro forma models, with and without an affordable housing density bonus, as well as a series of sensitivity tests. The purpose of this exercise was to evaluate the impacts of a broad range of inclusionary set-asides and targeted household income levels on the economic feasibility of each prototype, measured specifically in terms of residual land value.

*Citywide Inclusionary - Key Findings*

In the KMA analyses, the impact of alternative inclusionary requirements is measured as the difference between residual land value generated by the base case scenario and the residual land value when additional inclusionary requirements are imposed. Summaries of the KMA key findings from Scenario #1 regarding the feasibility measures for the seven development prototypes are presented in Tables 3-3 and 3-4. The two tables correlate to inclusionary requirements at Very Low-Income (Table 3-3) and Low-Income (Table 3-4), respectively. For ease of understanding the potential impacts of numerous inclusionary scenarios on the various development prototypes, KMA has summarized the findings by level of economic impact, using the feasibility benchmarks outlined below.

**Low Impact:** less than 15% decrease in Residual Land Value from Base Case; likely to have nominal impact on project feasibility

**Medium Impact**: 15%-25% decrease in Residual Land Value from Base Case; may raise concerns for project feasibility

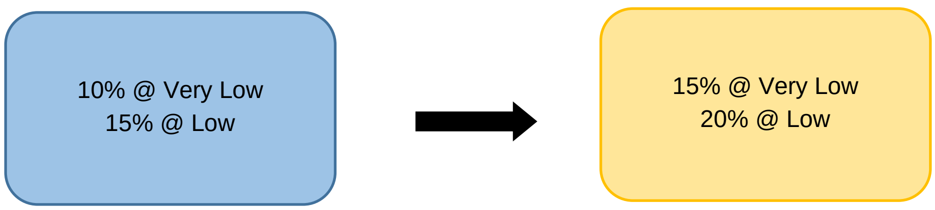
**High Impact:** greater than 25% decrease in Residual Land Value from Base Case; may result in financially infeasible project

| Table 3-3: Scenario #1 - Estimated Impact of Citywide Inclusionary Requirements – Very Low-Income | | | | | |
|---|---|---|---|---|---|
| | | | With Density Bonus | | |
| | | *Base Case 10% @ Very Low* | 15% @ Very Low | 20% @ Very Low | 25% @ Very Low |
| A | Single-Family Detached – Large Lot (R-3) | *$37/SF* | $37/SF | $30/SF | $30/SF |
| B | Single-Family Detached – Medium Lot (R-5) | *$60/SF* | $52/SF | $45/SF | $37/SF |
| C | Single-Family Detached – Small Lot (RS-8) | *$40/SF* | $45/SF | $34/SF | $34/SF |
| D | Single-Family Detached – Small Lot (RS-11/R-11) | *$45/SF* | $41/SF | $32/SF | $23/SF |
| E | Mixed-Use Development | *$102/SF* | $102/SF | $102/SF | $62/SF |
| F | Townhomes (R-15) | *$69/SF* | $61/SF | $53/SF | $40/SF |
| G | Garden Apartments (R-20) | | | | |
| | High Capitalization Rate (4.75%) | *$92/SF* | $86/SF | $78/SF | $70/SF |
| | Low Capitalization Rate (4.25%) | *$121/SF* | $115/SF | $106/SF | $96/SF |

| Table 3-4: Scenario #1 - Estimated Impact of Citywide Inclusionary Requirements – Low-Income | | | | | |
|---|---|---|---|---|---|
| | | | With Density Bonus | | |
| | | *Base Case 15% @ Low* | 20% @ Low | 25% @ Low | 30% @ Low |
| A | Single-Family Detached – Large Lot (R-3) | *$38/SF* | $31/SF | $31/SF | $24/SF |
| B | Single-Family Detached – Medium Lot (R-5) | *$49/SF* | $46/SF | $39/SF | $32/SF |
| C | Single-Family Detached – Small Lot (RS-8) | *$42/SF* | $37/SF | $37/SF | $27/SF |
| D | Single-Family Detached – Small Lot (RS-11/R-11) | *$39/SF* | $36/SF | $28/SF | $24/SF |
| E | Mixed-Use Development | *$105/SF* | $105/SF | $68/SF | $68/SF |
| F | Townhomes (R-15) | *$59/SF* | $57/SF | $46/SF | $38/SF |
| G | Garden Apartments (R-20) | | | | |
| | High Capitalization Rate (4.75%) | *$82/SF* | $81/SF | $73/SF | $66/SF |
| | Low Capitalization Rate (4.25%) | *$109/SF* | $109/SF | $101/SF | $92/SF |

The above summary tables demonstrate that a 5% increase in the Citywide inclusionary set-aside requirement has a relatively minor impact on residual land value. With one exception, the outcome is a reduction in residual land value of less than 15%. It is the KMA judgement that an impact of this magnitude is relatively minor and will have nominal impact on project feasibility. For any new or increased inclusionary housing requirement, a period of adjustment may be needed for the development marketplace to adjust to the new requirements. Specifically, developers and landowners will need to consider how to incorporate the new requirements and evaluate alternative means of compliance, such as payment of an in-lieu fee, if available.

Based on the findings from the feasibility analyses, it is the KMA conclusion that a 5% increase in the Citywide inclusionary set-aside requirement appears feasible, as illustrated below.




*Citywide Existing Inclusionary Requirement*

*Citywide Potential Increased Inclusionary Requirement*

**3.2 Financial Feasibility of Housing Element Update "R-30" Sites**

*Residential Development Prototypes*

Scenario #2 of the KMA feasibility analyses evaluated the impact of updated inclusionary housing requirements on specific sites identified in the City's Housing Element Update adopted in March 2019 as "R-30" sites. For each site, KMA prepared a pro forma with development prototypes based on the site's base zoning and existing Citywide inclusionary requirements. Additionally, KMA formulated a development prototype based on the sites' location within an "R-30" Overlay Zone allowing for 30 units per acre.

The financial pro formas prepared by KMA for each "R-30" site reflect KMA estimates of development costs, market sales prices/rents, and developer return requirements. The pro formas do not reflect actual financial pro formas prepared by the sites' property owners or developers.

The development prototypes are described in Section 5.0 and summarized below in Tables 3-5 and 3-6, respectively.

| Table 3-5: Housing Element Update "R-30" Sites – Existing Conditions Development Prototypes | | | | | | |
|---|---|---|---|---|---|---|
| **Site** | | **Land Use** | **Tenure** | **Base Zoning** | **Development** (1) | **Average Unit Size** |
| 08a/08b | Rancho Santa Fe Parcels | Single-Family | For-Sale | RR-2 | 12 Units | 5,020 SF |
| AD1 | Sage Canyon (2) | Single-Family | For-Sale | R-3 | 10 Units | 3,250 SF |
| AD2 | Baldwin & Sons Properties (3) | Single-Family | For-Sale | R-3/R-5 | 52 Units | 2,998 SF |
| 07 | Jackel Property | Visitor Serving Commercial | ---- | N-LVSC | 90 Rooms<br>5,000 SF | ---- |
| 12 | Sunshine Garden | Office | ---- | OP | 89,000 SF | ---- |
| AD11 | Manchester Avenue West | Single-Family | For-Sale | R-11 | 18 Units | 2,506 SF |

(1) Project descriptions reflect base density before any affordable housing density bonus, except as noted below.
(2) Development prototype for Sage Canyon based on site's current entitlements for a 10-lot subdivision.
(3) Development prototype for Baldwin & Sons Properties based on proposed entitlements for the site currently under review by the City.

| Table 3-6: Housing Element Update "R-30" Sites – "R-30" Overlay Zone Development Prototypes | | | | | | |
|---|---|---|---|---|---|---|
| **Site** | | **Land Use** | **Tenure** | **Zoning** | **Development** (1) | **Average Unit Size** |
| 08a/08b | Rancho Santa Fe Parcels | Stacked Flats | Rental | R-30 | 180 Units | 1,000 SF |
| AD1 | Sage Canyon | Stacked Flats | Rental | R-30 | 99 Units | 1,000 SF |
| AD2 | Baldwin & Sons Properties | Stacked Flats | Rental | R-30 | 273 Units | 1,000 SF |
| 07 | Jackel Property | Stacked Flats<br>Hotel<br>Commercial | Rental | R-30 | 39 Units<br>30 Rooms (2)<br>5,000 SF | 1,000 SF |
| 12 | Sunshine Gardens | Stacked Flats | Rental | R-30 | 101 Units | 1,000 SF |
| AD11 | Manchester Avenue West | Stacked Flats | Rental | R-30 | 50 Units | 1,000 SF |

(1) Project descriptions reflect base density pursuant to an "R-30" Overlay Zone before any affordable housing density bonus.
(2) California Coastal Commission requires that the Jackel Property site include at least 30 hotel rooms and a commercial component.

### *Housing Element Update "R-30" Sites - Key Findings*

The impact of inclusionary requirements on the "R-30" sites is measured as the difference between residual land value generated by the sites' base zoning (base case scenario) and the residual land value reflecting the sites' location within the "R-30" Overlay Zone.

Summaries of the KMA key findings from Scenario #2 regarding the feasibility measures for the six "R-30" sites are presented in Tables 3-7 and 3-8, below. The two tables correlate to inclusionary requirements at Very Low-Income (Table 3-7) and Low-Income (Table 3-8), respectively. The findings presented below also reflect development of the "R-30" sites with an affordable housing density bonus, thereby increasing the capacity of each site up to 40 units per acre.

The KMA findings are summarized by level of economic impact, using the feasibility benchmarks outlined below for ease of understanding the numerous development sites/inclusionary scenarios.

| | |
|---|---|
| (green) | **High Impact:** greater than 25% increase in Residual Land Value from Existing Conditions (without "R-30" Overlay Zone); likely to provide an incentive to develop site using "R-30" Overlay Zone |
| (yellow) | **Medium Impact**: 15%-25% increase in Residual Land Value from Existing Conditions (without "R-30" Overlay Zone); may not provide incentive to develop site using "R-30" Overlay Zone |
| (red) | **Low Impact:** less than 15% increase in Residual Land Value from Existing Conditions (without "R-30" Overlay Zone); least likely to provide incentive to use "R-30" Overlay Zone |

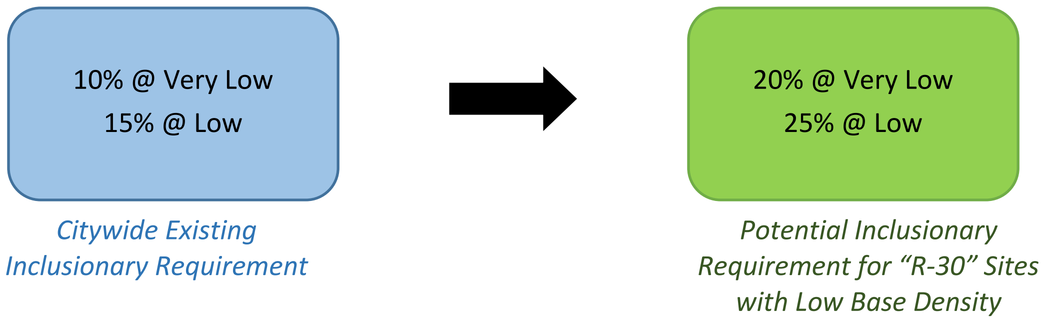
**Table 3-7: Scenario #2 - Estimated Impact of Inclusionary Requirements on "R-30" Sites – Very Low-Income**

| | | | With Density Bonus | | | |
|---|---|---|---|---|---|---|
| | | ***Existing Conditions*** | **10% @ Very Low** | **15% @ Very Low** | **20% @ Very Low** | **25% @ Very Low** |
| 08 | Rancho Santa Fe Parcels | *$33/SF* | | | | |
| | High Capitalization Rate (4.75%) | | $71/SF | $60/SF | $47/SF | $34/SF |
| | Low Capitalization Rate (4.25%) | | $118/SF | $106/SF | $91/SF | $77/SF |
| AD1 | Sage Canyon | *$24/SF* | | | | |
| | High Capitalization Rate (4.75%) | | $74/SF | $61/SF | $48/SF | $34/SF |
| | Low Capitalization Rate (4.25%) | | $121/SF | $107/SF | $92/SF | $77/SF |
| AD2 | Baldwin & Sons Properties | *$34/SF* | | | | |
| | High Capitalization Rate (4.75%) | | $73/SF | $61/SF | $48/SF | $34/SF |
| | Low Capitalization Rate (4.25%) | | $121/SF | $107/SF | $92/SF | $77/SF |
| 07 | Jackel Property | *$75/SF* | | | | |
| | High Capitalization Rate (4.75%) | | $72/SF | $65/SF | $59/SF | $53/SF |
| | Low Capitalization Rate (4.25%) | | $51/SF | $45/SF | $40/SF | $31/SF |
| 12 | Sunshine Gardens | *$56/SF* | | | | |
| | High Capitalization Rate (4.75%) | | $71/SF | $58/SF | $46/SF | $33/SF |
| | Low Capitalization Rate (4.25%) | | $118/SF | $104/SF | $90/SF | $75/SF |
| AD11 | Manchester Avenue West | *$49/SF* | | | | |
| | High Capitalization Rate (4.75%) | | $68/SF | $59/SF | $48/SF | $33/SF |
| | Low Capitalization Rate (4.25%) | | $115/SF | $105/SF | $93/SF | $76/SF |

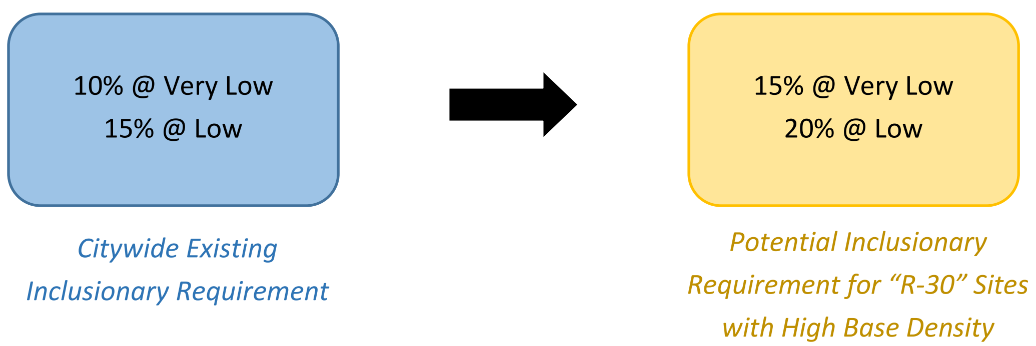
| Table 3-8: Scenario #2 - Estimated Impact of Inclusionary Requirements on "R-30" Sites – Low-Income | | | | | | |
|---|---|---|---|---|---|---|
| | | | With Density Bonus | | | |
| | | ***Existing Conditions*** | **15% @ Low** | **20% @ Low** | **25% @ Low** | **30% @ Low** |
| 08 | Rancho Santa Fe Parcels | *$30/SF* | | | | |
| | High Capitalization Rate (4.75%) | | $54/SF | $51/SF | $39/SF | $28/SF |
| | Low Capitalization Rate (4.25%) | | $97/SF | $96/SF | $83/SF | $69/SF |
| AD1 | Sage Canyon | *$24/SF* | | | | |
| | High Capitalization Rate (4.75%) | | $53/SF | $52/SF | $40/SF | $28/SF |
| | Low Capitalization Rate (4.25%) | | $97/SF | $97/SF | $83/SF | $70/SF |
| AD2 | Baldwin & Sons Properties | *$34/SF* | | | | |
| | High Capitalization Rate (4.75%) | | $54/SF | $52/SF | $40/SF | $28/SF |
| | Low Capitalization Rate (4.25%) | | $97/SF | $97/SF | $83/SF | $70/SF |
| 07 | Jackel Property | *$75/SF* | | | | |
| | High Capitalization Rate (4.75%) | | $63/SF | 61/SF | $55/SF | $49/SF |
| | Low Capitalization Rate (4.25%) | | $44/SF | $41/SF | $36/SF | $31/SF |
| 12 | Sunshine Gardens | *$56/SF* | | | | |
| | High Capitalization Rate (4.75%) | | $52/SF | $50/SF | $38/SF | $27/SF |
| | Low Capitalization Rate (4.25%) | | $95/SF | $95/SF | $82/SF | $68/SF |
| AD11 | Manchester Avenue West | *$40/SF* | | | | |
| | High Capitalization Rate (4.75%) | | $58/SF | $53/SF | $38/SF | $29/SF |
| | Low Capitalization Rate (4.25%) | | $102/SF | $98/SF | $82/SF | $71/SF |

The above summary tables demonstrate mixed results regarding the feasibility of increased inclusionary requirements on the "R-30" sites. Of the six "R-30" sites evaluated by KMA, three sites are currently zoned for relatively low-density housing: 08a/08b Rancho Santa Fe Parcels (RR-2), AD1 Sage Canyon (R-3), and AD2 Baldwin & Sons Properties (R-3/R-5). The other three sites are zoned for non-residential use or higher-density housing: 07 Jackel Property (N-LVSC), 12 Sunshine Gardens (OP), and AD11 Manchester Avenue West (R-11). Findings for these two categories of sites are discussed separately below.

- *Existing Low Base Density Residential Zoning (08a/08b Rancho Santa Fe Parcels, AD1 Sage Canyon, and AD2 Baldwin & Sons Properties)* – For these three sites, KMA generally finds that it will be feasible for developers to use the "R-30" Overlay Zone while providing a 10% increase above the existing Citywide inclusionary set-aside requirement. In almost all cases, KMA found that developers using the "R-30" density (plus density bonus) could provide either 20% Very Low- units or 25% Low-Income units. In making this determination, KMA used a relatively high threshold measured as a minimum 25% increase in residual land value. Based on this finding, it is the KMA conclusion that these three "R-30" sites could support a 10% increase over the existing Citywide inclusionary set-aside requirement, as illustrated below.




- *Existing Non-Residential or High Base Density Residential Zoning (07 Jackel Property, 12 Sunshine Gardens, and AD11 Manchester Avenue West)* – KMA generally finds that it will be feasible to increase the City's existing inclusionary requirement, from the current 10% Very Low-Income or 15% Low-Income, to 15% Very Low-Income or 20% Low-Income for developers of the 12 Sunshine Gardens and AD11 Manchester Avenue West properties. For the 07 Jackel Property, KMA finds that due to the potential for visitor-serving development under the base zoning, the "R-30" Overlay Zone is not sufficient to offset any potential increase in the Citywide inclusionary requirement. Based on this finding, it is the KMA conclusion that these "R-30" sites could support at most a 5% increase over the existing Citywide inclusionary set-aside requirement, as illustrated below.




As with the analysis of the Citywide inclusionary prototypes, development returns and feasibility of the "R-30" sites should be viewed as a continuum of outcomes, as opposed to hard and fast thresholds. This is particularly true when analyzing the economic feasibility of conceptual development prototypes, as opposed to specific development proposals. Moreover, it should be noted that KMA did not interview individual property owners or developers of the "R-30" sites regarding their specific development plans for their sites.

### 3.3 Fee Levels for Consideration

The City requested that KMA analyze potential inclusionary in-lieu fee levels on projects with one (1) to six (6) units, as well as fractional units. In order to provide the City with a framework for setting possible fee levels, KMA considered three approaches: (1) the maximum in-lieu fee amounts supported by a residential nexus analysis; (2) the funding level required for the City to implement targeted inclusionary housing production in an off-site location; and (3) the economic impact of incorporating affordable housing on-site.

*Approach 1: Nexus-Supported Fee Amounts*

The first approach to setting fee levels, the nexus-supported fee, is detailed under separate cover in the KMA residential nexus analysis. The KMA residential nexus analysis was prepared to establish the maximum supportable fee level from a legal nexus perspective. The underlying nexus concept is that newly constructed market-rate units represent new households in the City. These households represent new income in Encinitas that will consume goods and services, either through purchases of goods and services or by "consuming" governmental services. New consumption translates to new jobs, of which a portion of the jobs are at lower compensation levels; low compensation jobs translate to lower income households that cannot afford these market-rate units in Encinitas and therefore need affordable housing.

Based on current case law, a nexus study is not required to implement an inclusionary requirement or to establish in-lieu fees that are alternatives to including affordable units on-site. However, since some projects may not have a practical ability to include affordable units on-site, especially small projects and single-unit developments, making the fee the primary compliance option available, the nexus study was prepared as a secondary "backup" legal support measure for in-lieu fees. As shown in Table 3-9, the nexus study determined maximum affordable housing fees for residential development and residential care facilities that may be applied consistent with the Mitigation Fee Act (California Government Code § 66000 et seq.) as follows:

- The maximum supported affordable housing fee for market-rate residential ranges from $32 to $66 per square foot (SF) of living area.

- If the City adopted one single, per-SF fee for all market-rate housing, the study supports a maximum fee of $32 per SF.

**Table 3-9: Maximum Nexus-Supported Fee Amounts**

| | Prototype A | Prototype B | Prototype C | Prototype D | Prototype E | Prototype F | Prototype G |
|---|---|---|---|---|---|---|---|
| | Single-Family Large Lot | Single-Family Medium Lot | Single-Family Small Lot | Single-Family Small Lot | Mixed-Use Development | Townhomes | Garden Apartments |
| Per Unit | $128,000 | $110,900 | $84,800 | $76,300 | $87,000 | $63,700 | $54,600 |
| Per SF | $32.00 | $34.00 | $38.30 | $38.20 | $58.00 | $42.30 | $66.10 |

*Approach 2: Funding Level Required for City to Create Affordable Housing Off-Site*

The second approach to setting fees is based on the affordability gap associated with developing affordable housing in an off-site location. This approach, as detailed in Section 7.0 and Appendix 7, estimates the funds that the City would need to receive from the developer of a market-rate residential project in order to create affordable rental housing in a separate off-site location. Table 3-10 shows that each Very Low-Income rental unit has an estimated financing gap of $271,000, and each Low-Income rental unit has an estimated financing gap of $242,000. In other words, for the City to facilitate creation of Very Low-Income units, it would need to collect $271,000 per affordable rental unit required. Likewise, for the City to facilitate creation of Low-Income units, it would need to collect $242,000 per affordable rental unit required.

**Table 3-10: Estimate of Funding Gap by Income Level** (1)

| | Very Low-Income 50% AMI | Low-Income 60% AMI |
|---|---|---|
| **Affordability Gap per Affordable Unit** | $271,000 | $242,000 |
| **Per Market-Rate Unit** | | |
| @ 10% Inclusionary | $27,100 | --- |
| @ 15% Inclusionary | $40,650 | $36,300 |
| @ 20% Inclusionary | --- | $48,400 |

(1) Estimate of affordability gap assumes the development of an affordable housing rental development subject to prevailing wages and financed with 4% Low Income Housing Tax Credits.

As shown above, under the City's existing inclusionary requirement, this gap figure for Very Low-Income units equates to $27,100 per market-rate rental unit developed (10% times $271,000), or $36,300 per market-rate unit (15% times $242,000) for Low-Income units. If the City adopts fees below these levels, it would not be able to keep pace with providing 10% Very Low- units or 15% Low-Income units in a separate off-site location.

As shown in Table 3-11, to fund the creation of 10% Very Low-Income units in an off-site location, the City would need to receive a fee of between $6.78 to $32.85 per SF, depending on the size of the market-rate unit, or an average of $23.50 per SF. To fund the creation of 15% Low-Income units in an off-site location, the City would need to receive between $9.08 to $44.00 per SF, depending on the size of the market-rate unit, or an average of $28.00 per SF.

| Table 3-11: Funding Level Required for City to Create Affordable Housing Off-Site – Existing Citywide Inclusionary Requirement | | | | | | | |
|---|---|---|---|---|---|---|---|
| | **Prototype A** | **Prototype B** | **Prototype C** | **Prototype D** | **Prototype E** | **Prototype F** | **Prototype G** |
| | **Single-Family Large Lot** | **Single-Family Medium Lot** | **Single-Family Small Lot** | **Single-Family Small Lot** | **Mixed-Use Development** | **Townhomes** | **Garden Apartments** |
| 10% @ Very Low | | | | | | | |
| Per Unit | $27,100 | $27,100 | $27,100 | $27,100 | $27,100 | $27,100 | $27,100 |
| Per SF | $6.78 | $8.34 | $12.22 | $13.55 | $18.07 | $17.95 | $32.85 |
| 15% @ Low | | | | | | | |
| Per Unit | $36,300 | $36,300 | $36,300 | $36,300 | $36,300 | $36,300 | $36,300 |
| Per SF | $9.08 | $11.17 | $16.37 | $18.15 | $24.20 | $24.04 | $44.00 |

Additionally, the City may consider increasing its Citywide inclusionary requirement by 5%. In that event, the affordability gap per market-rate unit would increase to $40,650 (15% times $271,000) for Very Low-Income units or $48,800 (20% times $242,000) for Low-Income units. If the City adopts fees below these levels, it would not be able to keep pace with providing 15% Very Low-Income units or 20% Low-Income units in a separate off-site location. As shown in Table 3-12, this funding level translates to a range from $10.16 to $49.27, or an average of $23.50 per SF, assuming a 15% Very Low-Income affordability inclusionary requirement and a range of $12.10 to $58.67, or an average of $28.00 per SF, assuming a 20% Low-Income affordability requirement.

| Table 3-12: Funding Level Required for City to Create Affordable Housing Off-Site – 5% Increase to Citywide Inclusionary Requirement | | | | | | | |
|---|---|---|---|---|---|---|---|
| | **Prototype A** | **Prototype B** | **Prototype C** | **Prototype D** | **Prototype E** | **Prototype F** | **Prototype G** |
| | **Single-Family Large Lot** | **Single-Family Medium Lot** | **Single-Family Small Lot** | **Single-Family Small Lot** | **Mixed-Use Development** | **Townhomes** | **Garden Apartments** |
| 15% @ Very Low | | | | | | | |
| Per Unit | $40,650 | $40,650 | $40,650 | $40,650 | $40,650 | $40,650 | $40,650 |
| Per SF | $10.16 | $12.51 | $18.34 | $20.33 | $27.10 | $26.92 | $49.27 |
| 20% @ Low | | | | | | | |
| Per Unit | $48,400 | $48,400 | $48,400 | $48,400 | $48,400 | $48,400 | $48,400 |
| Per SF | $12.10 | $14.89 | $21.83 | $24.20 | $32.27 | $32.05 | $58.67 |

*Approach 3:  Economic Impact of Incorporating Affordable Housing On-Site*

The economic impact to market-rate developments resulting from incorporation of the City's existing inclusionary requirement on-site can be measured using each of the financial pro formas for the seven (7) prototypes evaluated in this study.  Findings consider the cost of setting aside the affordable units, as well as the offsetting density bonus benefit to the project.  As shown in Table 3-13, the KMA findings indicate the following:

- The economic impact of including 10% Very Low-Income units on-site is estimated to range from $0 to $26.16 per SF, or an average of $15.09 per SF living area of market-rate development.  (Some prototypes are estimated to have zero economic impact from providing affordable units on-site due to the fact that the density bonus benefits are found to outweigh the costs of providing the affordable units.  The two development prototypes found to have zero economic impact of including affordable units on-site are excluded in calculating the $15.09 per SF average, as these projects would not be expected to utilize a fee option.)

- Including 15% Low-Income units on-site results in an economic impact to market-rate developers ranging from $0 to $33.94 per SF, or an average of $25.72 per SF of living area. (The $25.70 per SF average excludes two prototypes estimated to have zero economic impact from including units on-site because these project types are assumed to be unlikely to utilize an in-lieu fee option.)

**Table 3-13:  Economic Impact of Incorporating Affordable Housing On-Site – Existing Citywide Inclusionary Requirement**

| | Prototype A | Prototype B | Prototype C | Prototype D | Prototype E | Prototype F | Prototype G |
|---|---|---|---|---|---|---|---|
| | Single-Family Large Lot | Single-Family Medium Lot | Single-Family Small Lot | Single-Family Small Lot | Mixed-Use Development | Townhomes | Garden Apartments |
| 10% @ Very Low | | | | | | | |
| Per Unit | $55,000 | $0 | $58,000 | $51,000 | $0 | $6,000 | $5,000 |
| Per SF | $13.75 | $0.00 | $26.16 | $25.50 | $0.00 | $3.97 | $6.06 |
| 15% @ Low | | | | | | | |
| Per Unit | $43,000 | $0 | $46,000 | $76,000 | $0 | $38,000 | $28,000 |
| Per SF | $10.75 | $0.00 | $20.75 | $38.00 | $0.00 | $25.17 | $33.94 |

Similarly, KMA evaluated the economic impact to market-rate developments resulting from incorporation of a potential 5% increase in the Citywide on-site inclusionary requirement.  As shown in Table 3-14, the KMA findings indicate the following:

- The economic impact to market-rate developments resulting from including 15% Very Low-Income units on-site (5% increase over existing requirements) is estimated to range from $0 to $34.50 per SF, or an average of $20.18 per SF living area of market-rate development.  (The two development prototypes found to have zero economic impact of including affordable units on-site are excluded in calculating the $20.18 per SF average, as these projects would not be expected to utilize a fee option.)

- Including 20% Low-Income units on-site (5% increase over existing requirement) results in an economic impact to market-rate developers ranging from $0 to $45 per SF, or an average of $30.54 per SF of living area. (The $30.54 per SF average excludes one prototype estimated to have zero economic from including units on-site because this project type is assumed to be unlikely to utilize an in-lieu fee option.)

**Table 3-14: Economic Impact of Incorporating Affordable Housing On-Site – 5% Increase to Citywide Inclusionary Requirement**

| | Prototype A | Prototype B | Prototype C | Prototype D | Prototype E | Prototype F | Prototype G |
|---|---|---|---|---|---|---|---|
| | Single-Family Large Lot | Single-Family Medium Lot | Single-Family Small Lot | Single-Family Small Lot | Mixed-Use Development | Townhomes | Garden Apartments |
| 10% @ Very Low | | | | | | | |
| Per Unit | $55,000 | $0 | $27,000 | $69,000 | $0 | $30,000 | $17,000 |
| Per SF | $13.75 | $0.00 | $12.18 | $34.50 | $0.00 | $19.87 | $20.61 |
| 15% @ Low | | | | | | | |
| Per Unit | $146,000 | $24,000 | $71,000 | $90,000 | $0 | $43,000 | $28,000 |
| Per SF | $36.50 | $7.38 | $32.03 | $45.00 | $0.00 | $28.48 | $33.94 |

*KMA Fee Level Recommendation*

In view of the above approaches, and assuming the City proceeds with the 5% increase to existing inclusionary requirements found to be supportable, the City may wish to consider an in-lieu fee of approximately $20 per SF of living area for market-rate residential development and a consistent fee of $20 per SF of floor area for residential care facilities, based on the following key findings:

- The nexus study supports a *maximum* fee of $32 to $66 per SF for residential and $48.70 for residential care facilities.

- The funding level required for the City to create affordable housing off-site averages approximately $23.50 per SF across all of the prototypes analyzed, or $19 per SF for for-sale prototypes, excluding higher off-site costs for apartment projects from the average. (Due to the smaller average unit sizes of apartments compared to for-sale projects, funding levels required to create affordable units off-site translate into a higher per-SF cost measured against the market-rate apartments, although costs are the same on a per-unit basis.)

- The economic impact of incorporating affordable housing on-site averages to about $20 per SF with the 15% Very Low inclusionary requirement.

- A fee less than the maximum nexus-supported level allows the City to collect the required amount to build off-site affordable units, while maintaining fees at a feasible level that is roughly in balance with the cost of including units on-site.

- If the City would like to maintain a focus on on-site affordable units, the City may wish to continue to require a discretionary approval to utilize the in-lieu fee option for projects of seven or more units.

The City may also wish to consider allowing for a sliding scale of the $20 per SF fee for projects with six or less units in order to enhance project feasibility.

In order to mitigate affordable housing impacts -- and fund affordable housing -- over a long term and respond to economic cycles, the City should consider a potential annual escalator that could be used to adjust fee levels over time, such as the Construction Cost Index (CCI).

# METHODOLOGY AND ASSUMPTIONS

**CITY OF ENCINITAS**
**INCLUSIONARY AFFORDABLE HOUSING**
**REAL ESTATE FINANCIAL FEASIBILITY ANALYSIS**

## 4.0 BUILD ON-SITE: FINANCIAL FEASIBILITY ANALYSIS OF CITYWIDE INCLUSIONARY

### 4.1 The Development Prototypes

Six new construction for-sale residential prototypes and one new construction rental prototype were identified based on extensive discussion with City staff. The prototypes reflect current and anticipated residential development in the City. Table 4-1 provides a description of the seven prototypes analyzed by KMA as representative of new market-rate development likely to be developed in the City.

**Table 4-1: Citywide Inclusionary - Development Prototypes**

| | Prototype A | Prototype B | Prototype C | Prototype D | Prototype E | Prototype F | Prototype G |
|---|---|---|---|---|---|---|---|
| | **Single-Family Large Lot** | **Single-Family Medium Lot** | **Single-Family Small Lot** | **Single-Family Small Lot** | **Mixed-Use Development** | **Townhomes** | **Garden Apartments** |
| Description | Type V with attached garage | Type V with attached garage | Type V with attached garage | Type V with attached garage | Type V with subterranean parking | Type V with attached garage | Type V with surface parking |
| Tenure | For-Sale | For-Sale | For-Sale | For-Sale | For-Sale | For-Sale | Rental |
| Zoning | R-3 | R-5 | R-8 | RS-11/R-11 | --- | R-15 | R-20 |
| Site Area | 4.0 acres | 4.0 acres | 1.5 acres | 3.0 acres | 0.5 acres | 3.0 acres | 2.0 acres |
| Density (units/acre) | 3.0 | 5.0 | 8.0 | 11.0 | 10.0 | 15.0 | 20.0 |
| Number of Units (1) | 12 units | 20 units | 12 units | 33 units | 5 units | 45 units | 40 units |
| Unit Mix | 4 and 5 bedrooms | 3 and 4 bedrooms | 3 and 4 bedrooms | 3 and 4 bedrooms | 2 bedrooms | 2 and 3 bedrooms | 1 and 2 bedrooms |
| Stories | 2 stories | 2 stories | 2 stories | 2 stories | 2 stories | 2 stories | 2-3 stories |
| Average Unit Size | 4,000 SF | 3,250 SF | 2,217 SF | 2,000 SF | 1,500 SF | 1,510 SF | 825 SF |

(1) Reflects base density before any affordable housing density bonus.

### 4.2 Projected Market Sales Prices and Rents

KMA surveyed new for-sale and rental developments throughout the City. The purpose of the survey was to derive estimates of the currently achievable market prices and rental rates for the types of developments likely to be constructed in the City. The base case market-rate sales prices and monthly rent estimates that are used in the financial feasibility analyses are presented in Table 4-2.

| Table 4-2: Citywide Inclusionary - Projected Market Prices/Rents | | | | | | | |
|---|---|---|---|---|---|---|---|
| | **Prototype A** | **Prototype B** | **Prototype C** | **Prototype D** | **Prototype E** | **Prototype F** | **Prototype G** |
| | **Single-Family Large Lot** | **Single-Family Medium Lot** | **Single-Family Small Lot** | **Single-Family Small Lot** | **Mixed-Use Development** | **Townhomes** | **Garden Apartments** |
| $/SF | $475 | $500 | $475 | $475 | $750 | $500 | $3.60/ month |
| Average Unit Size | 4,000 SF | 3,250 SF | 2,217 SF | 2,000 SF | 1,500 SF | 1,510 SF | 825 SF |
| Market Price/Rent | $1,900,000 | $1,625,000 | $1,053,000 | $950,000 | $1,125,000 | $755,000 | $2,970/mo. |

### 4.3 Affordable Price and Rent Calculations

For the purposes of this financial feasibility analysis, the maximum affordable prices and rents for the income-restricted units were calculated based on the standards imposed by California Health and Safety Code Section 50052.5 (H&SC 50052.5) for ownership and Section 50053 for rental. The calculations are presented in Appendix 9, and the assumptions and results are summarized below.

*Affordable Sales Price*

- The price restrictions were calculated for three different for-sale residential prototypes (single-family, mixed-use stacked flats, and townhomes).

- The household income information used in the calculations is based on 2019 income statistics for San Diego County as a whole. The household incomes are published annually by the U.S. Department of Housing and Urban Development (HUD).

- The household size appropriate for the unit is based on the H&SC Section 50052.5 standard of the number of bedrooms in the home plus one. It should be noted that this is a benchmark, not an occupancy cap.

- The household incomes at 50% of AMI represent the income level for Very Low-Income households. The household incomes at 70% of AMI represent the income level for Low-Income households.

- Thirty percent (30%) of defined household income is allocated to housing-related expenses.

- Housing-related costs reflect the specifics of the residential prototype. KMA has assumed the following housing-related costs based on current lending industry underwriting criteria:

  - Utilities based on the July 1, 2019 Encinitas utility allowance schedule and the assumption that the homeowner's utility costs are comprised of gas cooking and water heating, gas heating, other basic electric services, water and sewer, and trash.

  - Homeowner Association (HOA) dues, reflecting an allowance for structure insurance, maintenance, and reserves.

  - Property taxes, assuming a typical City tax rate of 1.09% of assessed value.

  - Supportable mortgage, assuming a 30-year loan, 4.5% interest, and a 5.0% down payment.

The resulting affordable sales prices are presented in Table 4-3.

**Table 4-3: Citywide Inclusionary - Affordable Sales Prices**

| | Two Bedroom | | Three Bedroom | | Four Bedroom | | Five Bedroom | |
|---|---|---|---|---|---|---|---|---|
| | Very Low 50% AMI | Low 70% AMI | Very Low 50% AMI | Low 70% AMI | Very Low 50% AMI | Low 70% AMI | Very Low 50% AMI | Low 70% AMI |
| Single-Family | --- | --- | $96,000 | $171,000 | $94,000 | $175,000 | $93,000 | $181,000 |
| Mixed-Use / Stacked Flats | $96,000 | $164,000 | --- | --- | --- | --- | --- | --- |
| Townhomes | $105,000 | $173,000 | $109,000 | $184,000 | --- | --- | --- | --- |

*<u>Affordable Rent</u>*

- The household income information used in the calculations of affordable rent is based on 2019 income statistics for San Diego County as a whole. The household incomes are published annually by HUD.

- The household size appropriate for the unit is based on the H&SC Section 50053 standard of the number of bedrooms in the home plus one. This is a benchmark, not an occupancy cap.

- The household income at 50% of AMI represents the income level for Very Low-Income households.

- The household income at 60% of AMI represents the income level for Low-Income households.

- Thirty percent (30%) of defined household income is allocated to housing-related expenses.

The KMA calculations are based on the assumption that the tenants will be required to pay for gas cooking and water heating, gas heating, other basic electric services, and trash. The July 1, 2019 Encinitas utility allowances were applied to this analysis. The resulting affordable rents are presented in Table 4-4.

| 4-4: Citywide Inclusionary - Affordable Rent Calculations | | | | |
|---|---|---|---|---|
| | One Bedroom | | Two Bedroom | |
| | Very Low 50% AMI | Low 60% AMI | Very Low 50% AMI | Low 60% AMI |
| Maximum Monthly Cost | $863 | $1,036 | $971 | $1,165 |
| (Less) Monthly Utility Allowance | ($79) | ($79) | ($100) | ($100) |
| Affordable Rent | $784 | $957 | $871 | $1,065 |

## 4.4 Financial Pro Forma Analyses

To estimate the impact of alternative inclusionary housing requirements on market-rate residential development economics, KMA prepared base case financial pro forma models and conducted a series of sensitivity tests to evaluate the impacts of a broad range of inclusionary set-asides and targeted household income levels.

The financial pro forma models present comparative impacts of the potential inclusionary requirements on residual land value, as compared to the City's current inclusionary housing requirements. A pro forma analysis is used to validate that a requirement of this magnitude is supported by the project economics. Appendix 1 provides the supporting pro forma analyses prepared by KMA for each residential prototype. Each attachment within Appendix 1 is organized as follows:

| | |
|---|---|
| Table 1 | Estimate of Sales Proceeds or Annual Revenue |
| Table 2 | Estimate of Development Costs |
| Table 3 | Estimate of Residual Land Value |

Each attachment displays a pro forma estimating the residual land value for: (1) a base case consisting of a market-rate development that complies with the City's existing inclusionary requirement, i.e., with either 10% of the units at Very Low or 15% at Low, and (2) a pro forma estimating the residual land value for a development with a range of inclusionary set-asides.

The base case residual land value outcome can then be measured against the residual land value that is generated when higher affordability requirements are imposed. For each prototype, KMA also ran an alternative scenario factoring in an affordable housing density bonus. In addition, for garden apartments (Prototype G), KMA tested the impact on residual land value assuming both low and high capitalization rates of 4.25% and 4.75%, respectively.

The results of these feasibility analyses -- in terms of residual land value impacts for each prototype -- are summarized in Table 4-5 for inclusionary requirements at Very Low-Income and Table 4-6 for inclusionary requirements at Low-Income.

**Table 4-5: Citywide Inclusionary - Residual Land Value – Very Low-Income**

| | | | With Density Bonus | | |
|---|---|---|---|---|---|
| | | ***Base Case 10% @ Very Low*** | **15% @ Very Low** | **20% @ Very Low** | **25% @ Very Low** |
| A | Single-Family Detached – Large Lot (R-3) | *$37/SF* | $37/SF | $30/SF | $30/SF |
| B | Single-Family Detached – Medium Lot (R-5) | *$60/SF* | $52/SF | $45/SF | $37/SF |
| C | Single-Family Detached – Small Lot (RS-8) | *$40/SF* | $45/SF | $34/SF | $34/SF |
| D | Single-Family Detached – Small Lot (RS-11/R-11) | *$45/SF* | $41/SF | $32/SF | $23/SF |
| E | Mixed-Use Development | *$102/SF* | $102/SF | $102/SF | $62/SF |
| F | Townhomes (R-15) | *$69/SF* | $61/SF | $53/SF | $40/SF |
| G | Garden Apartments (R-20) | | | | |
| | High Capitalization Rate (4.75%) | *$92/SF* | $86/SF | $78/SF | $70/SF |
| | Low Capitalization Rate (4.25%) | *$121/SF* | $115/SF | $106/SF | $96/SF |

**Table 4-6: Citywide Inclusionary - Residual Land Value – Low-Income**

| | | | With Density Bonus | | |
|---|---|---|---|---|---|
| | | ***Base Case 15% @ Low*** | **20% @ Low** | **25% @ Low** | **30% @ Low** |
| A | Single-Family Detached – Large Lot (R-3) | *$38/SF* | $31/SF | $31/SF | $24/SF |
| B | Single-Family Detached – Medium Lot (R-5) | *$49/SF* | $46/SF | $39/SF | $32/SF |
| C | Single-Family Detached – Small Lot (RS-8) | *$42/SF* | $37/SF | $37/SF | $27/SF |
| D | Single-Family Detached – Small Lot (RS-11/R-11) | *$39/SF* | $36/SF | $28/SF | $24/SF |

| Table 4-6: Citywide Inclusionary - Residual Land Value – Low-Income | | | | | |
|---|---|---|---|---|---|
| | | | With Density Bonus | | |
| | | ***Base Case 15% @ Low*** | **20% @ Low** | **25% @ Low** | **30% @ Low** |
| E | Mixed-Use Development | *$105/SF* | $105/SF | $68/SF | $68/SF |
| F | Townhomes (R-15) | *$59/SF* | $57/SF | $46/SF | $38/SF |
| G | Garden Apartments (R-20)<br>High Capitalization Rate (4.75%) | *$82/SF* | $81/SF | $73/SF | $66/SF |
| | Low Capitalization Rate (4.25%) | *$109/SF* | $109/SF | $101/SF | $92/SF |

# 5.0 BUILD ON-SITE: FINANCIAL FEASIBILITY OF HOUSING ELEMENT UPDATE "R-30" SITES

## 5.1 Housing Element Update "R-30" Sites - Existing Conditions (Base Case)

*Development Prototypes*

As part of the City's Housing Element Update, the City identified 19 sites for Very Low- and Low-Income units. KMA evaluated the impact of updated inclusionary housing requirements on six (6) of these sites, which represent various geographic locations and land use zones throughout the City. Table 5-1 provides a description of the six sites analyzed by KMA and the development prototypes assumed for each site. For the AD 1 Sage Canyon site, KMA analyzed development of a 10-lot subdivision, representative of the site's existing entitlements. For the AD 2 Baldwin & Sons Properties site, KMA analyzed the development of a 52-unit single-family subdivision based on proposed entitlements currently under review by the City. Development prototypes for the remaining four "R-30" sites were based on existing base zoning, including the Jackel and Sunshine Gardens sites, both of which are currently zoned for non-residential uses.

**Table 5-1: Housing Element Update "R-30" Sites - Existing Conditions (Base Case) - Development Prototypes**

| | Site 08 | Site AD 1 | Site AD2 | Site 07 | Site 12 | Site AD11 |
|---|---|---|---|---|---|---|
| | **Rancho Santa Fe Parcels** | **Sage Canyon** (1) | **Baldwin & Sons Properties** (2) | **Jackel Property** | **Sunshine Gardens** | **Manchester Avenue West** |
| Description | Single-Family Large Lot | Single-Family Large Lot | Single-Family Medium Lot | Limited Visitor Serving | Professional Office | Single-Family Small Lot |
| Tenure | For-Sale | For-Sale | For-Sale | --- | ---- | For-Sale |
| Base Zoning | RR-2 | R-3 | R-8 | N-LVSC | OP | R-11 |
| Net Site Area | 6.0 acres | 3.3 acres | 9.1 acres | 3.0 acres | 3.4 acres | 1.7 acres |
| Density (units/acre) | 2.0 | 3.0 | 5.7 | 3.0 | --- | 11.0 |
| Development (3) | 12 units | 10 units | 52 units | 90 rooms | 82,000 SF | 18 units |
| Unit Mix | 4 and 5 bedrooms | 4 and 5 bedrooms | 4 and 5 bedrooms | --- | --- | 3 and 4 bedrooms |
| Stories | 2 stories | 2 stories | 2 stories | 2 stories | 2 stories | 2 stories |
| Average Unit/Room Size | 5,020 SF | 3,250 SF | 2,998 SF | 575 SF | ---- | 2,506 SF |

(1) Development prototype for Sage Canyon site based on site's current entitlements for a 10-lot subdivision.
(2) Development prototype for Baldwin & Sons Properties site based on proposed entitlements currently under review by the City.
(3) Project descriptions reflect base density before any affordable housing density bonus, except as noted above.

## 5.2 Projected Market Prices

For each prototype development, KMA estimated the achievable market prices based on surveys of recent new for-sale residential developments in the City and surrounding communities. The market prices assumed in the financial feasibility analysis are presented in Table 5-2.

Estimated rents for non-residential uses on the Jackel and Sunshine Gardens sites are also presented below. These include rental rates for retail and office uses and occupancy and Average Daily Rate (ADR) for hotel use.

**Table 5-2: Housing Element Update "R-30" Sites – Existing Conditions (Base Case) - Market Factors**

| | Site 08 | Site AD 1 | Site AD2 | Site 07 | Site 12 | Site AD11 |
|---|---|---|---|---|---|---|
| | **Rancho Santa Fe Parcels** | **Sage Canyon** | **Baldwin & Sons Properties** | **Jackel Property** | **Sunshine Gardens** | **Manchester Avenue West** |
| Description | Single-Family Large Lot | Single-Family Large Lot | Single-Family Medium Lot | Limited Visitor Serving | Professional Office | Single-Family Small Lot |
| $/SF | $475/SF | $475/SF | $500/SF | --- | --- | $475/SF |
| Average Unit Size | 5,020 SF | 3,250 SF | 2,998 SF | --- | --- | 2,506 SF |
| Residential Market Price | $2,385,000 | $1,544,000 | $1,499,000 | --- | | $1,190,000 |
| Hotel ADR/ Occupancy | --- | --- | --- | $200<br>82% | --- | --- |
| Commercial Rent | --- | --- | --- | $4.00/SF per month | $3.75/SF per month | --- |

*<u>Financial Pro Forma Analyses</u>*

For each "R-30" site, KMA prepared base case financial pro forma models estimating residual land value for the sites under their existing zoning. For those sites with existing residential zoning, the base case pro forma assumed a market-rate residential development with 10% of the units at Very Low-Income or 15% at Low-Income.

For the AD 1 Sage Canyon site, KMA assumed payment of an affordable housing in-lieu fee, as approved by the City. For the AD 2 Baldwin & Sons Properties site, KMA assumed the development of six (6) Very Low-Income units and one (1) Low-Income unit, as currently proposed by the developer.

Affordable sales prices and rents for the affordable units were estimated using the affordable sales price methodology and assumptions discussed in Section 4.0. The base case financial pro forma analyses for the Jackel and the Sunshine Gardens sites reflect development of non-residential uses and therefore do not have an affordable housing inclusionary requirement.

Appendix 2 provides the supporting pro forma analyses prepared by KMA for each “R-30” site. Each attachment within Appendix 2 is organized as follows:

| | |
|---|---|
| Table 1 | Estimate of Sales Proceeds or Annual Revenue |
| Table 2 | Estimate of Development Costs |
| Table 3 | Estimate of Residual Land Value |

*Residual Land Value*

The results of these feasibility analyses -- in terms of base case residual land value for each “R-30” site prototype -- are summarized in Table 5-3.

<table>
<tr><th colspan="7">Table 5-3: Housing Element Update “R-30” Sites - Existing Conditions (Base Case) – Residual Land Value</th></tr>
<tr><th rowspan="2"></th><th>Site 08</th><th>Site AD 1</th><th>Site AD2</th><th>Site 07</th><th>Site 12</th><th>Site AD11</th></tr>
<tr><th>Rancho Santa Fe Parcels</th><th>Sage Canyon</th><th>Baldwin & Sons Properties</th><th>Jackel Property</th><th>Sunshine Gardens</th><th>Manchester Avenue West</th></tr>
<tr><td>Description</td><td>Single-Family Large Lot</td><td>Single-Family Large Lot</td><td>Single-Family Medium Lot</td><td>Limited Visitor Serving</td><td>Professional Office</td><td>Single-Family Small Lot</td></tr>
<tr><td>Residual Land Value – 10% Very Low w/ Density Bonus</td><td>$33/SF</td><td rowspan="2">$24/SF</td><td rowspan="2">$34/SF</td><td rowspan="2">$75/SF</td><td rowspan="2">$56/SF</td><td>$49/SF</td></tr>
<tr><td>Residual Land Value – 15% Low w/ Density Bonus</td><td>$30/SF</td><td>$40/SF</td></tr>
</table>

## 5.3 “R-30” Overlay Zone

*Development Prototypes*

For each ”R-30” site, KMA also prepared development prototypes reflecting its location within the “R-30” Overlay Zone. The “R-30” zoning designation allows for the development of residential uses at a density of up to 30 units per acre.

Table 5-4 provides a description of the development prototypes analyzed by KMA assuming the “R-30” zoning designation. Each “R-30” site was assumed to be developed with a stacked-flat rental development with podium/tuck-under parking. Development of the “R-30” sites with a stacked-flat for-sale development is addressed in Section 6.0.

| Table 5-4: Housing Element Update "R-30" Sites – "R-30" Overlay Zone - Development Prototypes (1) | | | | | | |
|---|---|---|---|---|---|---|
| | **Site 08** | **Site AD 1** | **Site AD2** | **Site 07** | **Site 12** | **Site AD11** |
| | **Rancho Santa Fe Parcels** | **Sage Canyon** | **Baldwin & Sons Properties** | **Jackel Property** (2) | **Sunshine Gardens** | **Manchester Avenue West** |
| Description | Stacked Flats | Stacked Flats | Stacked Flats | Stacked Flats, Hotel, Retail | Stacked Flats | Stacked Flats |
| Parking | Podium/ Tuck-under | Podium/ Tuck-under | Podium/ Tuck-under | Podium/ Tuck-under/ Surface | Podium/ Tuck-under | Podium/ Tuck-under |
| Tenure | Rental | Rental | Rental | Rental | Rental | Rental |
| Zoning | R-30 | R-30 | R-30 | R-30 | R-30 | R-30 |
| Net Site Area | 6.0 Acres | 3.3 Acres | 9.1 Acres | 3.0 Acres | 3.4 Acres | 1.7 Acres |
| Density (units/acre) | 30 | 30 | 30 | 30 | 30 | 30 |
| Development | 180 Units | 99 Units | 273 Units | 39 Units<br>30 Hotel Rooms<br>5,000 SF Retail | 101 Units | 50 Units |
| Unit Mix | 1 and 2 bedrooms | 1 and 2 bedrooms | 1 and 2 bedrooms | 1 and 2 bedrooms | 1 and 2 bedrooms | 1 and 2 bedrooms |
| Stories | 3 stories | 3 stories | 3 stories | 3 stories | 3 stories | 3 stories |
| Average Unit Size | 800 SF | 800 SF | 800 SF | 800 SF | 800 SF | 800 SF |

(1) Project descriptions reflect base density pursuant to the "R-30" Overlay Zone before any affordable housing density bonus.
(2) California Coastal Commission requires the Jackel Property site include at least 30 hotel rooms and a commercial component.

*Financial Pro Forma Analyses*

For each "R-30" site, KMA prepared financial pro forma models estimating residual land value. Each pro forma assumed tested a range of inclusionary set-asides (percent of affordable units) and targeted household income levels (percent of AMI) to determine the impact of inclusionary requirements against residual land value. Affordable rents for the affordable units were estimated using the affordable rent methodology and assumptions discussed in Section 4.0.

Appendix 2 provides the supporting pro forma analyses prepared by KMA for each "R-30" site. Each attachment within Appendix 2 is organized as follows:

| | |
|---|---|
| Table 1 | Estimate of Annual Revenue |
| Table 2 | Estimate of Development Costs |
| Table 3 | Estimate of Residual Land Value |

*Residual Land Value*

The results of the feasibility analyses -- in terms of residual land value for each "R-30" site – are summarized in Tables 5-5 (for Very Low-Income inclusionary requirements) and 5-6 (for Low-Income inclusionary requirements).

As shown, for each "R-30" site, KMA tested both low and high capitalization rates of 4.25% and 4.75%, respectively. The findings presented below also reflect development of the "R-30" sites with an affordable housing density bonus, thereby increasing the capacity of each site up to 40 units per acre.

**Table 5-5: Housing Element Update "R-30" Sites – "R-30" Overlay Zone – Residual Land Value – Very Low-Income - Rental**

| | | With Density Bonus | | | |
|---|---|---|---|---|---|
| | | **10% @ Very Low** | **15% @ Very Low** | **20% @ Very Low** | **25% @ Very Low** |
| 08 | Rancho Santa Fe Parcels<br>High Capitalization Rate (4.75%) | $71/SF | $60/SF | $47/SF | $34/SF |
| | Low Capitalization Rate (4.25%) | $118/SF | $106/SF | $91/SF | $77/SF |
| AD1 | Sage Canyon<br>High Capitalization Rate (4.75%) | $74/SF | $61/SF | $48/SF | $34/SF |
| | Low Capitalization Rate (4.25%) | $121/SF | $107/SF | $92/SF | $77/SF |
| AD2 | Baldwin & Sons Properties<br>High Capitalization Rate (4.75%) | $73/SF | $61/SF | $48/SF | $34/SF |
| | Low Capitalization Rate (4.25%) | $121/SF | $107/SF | $92/SF | $77/SF |
| 07 | Jackel Property<br>High Capitalization Rate (4.75%) | $72/SF | $65/SF | $59/SF | $53/SF |
| | Low Capitalization Rate (4.25%) | $51/SF | $45/SF | $40/SF | $34/SF |
| 12 | Sunshine Gardens<br>High Capitalization Rate (4.75%) | $71/SF | $58/SF | $46/SF | $33/SF |
| | Low Capitalization Rate (4.25%) | $118/SF | $104/SF | $90/SF | $75/SF |
| AD11 | Manchester Avenue West<br>High Capitalization Rate (4.75%) | $68/SF | $59/SF | $48/SF | $33/SF |
| | Low Capitalization Rate (4.25%) | $115/SF | $105/SF | $93/SF | $76/SF |

**Table 5-6: Housing Element Update "R-30" Sites – "R-30" Overlay Zone – Residual Land Value - Low-Income - Rental**

| | | With Density Bonus | | | |
|---|---|---|---|---|---|
| | | 15% @ Low | 20% @ Low | 25% @ Low | 30% @ Low |
| 08 | Rancho Santa Fe Parcels | | | | |
| | High Capitalization Rate (4.75%) | $54/SF | $51/SF | $39/SF | $28/SF |
| | Low Capitalization Rate (4.25%) | $97/SF | $96/SF | $83/SF | $69/SF |
| AD1 | Sage Canyon | | | | |
| | High Capitalization Rate (4.75%) | $53/SF | $52/SF | $40/SF | $28/SF |
| | Low Capitalization Rate (4.25%) | $97/SF | $97/SF | $83/SF | $70/SF |
| AD2 | Baldwin & Sons Properties | | | | |
| | High Capitalization Rate (4.75%) | $54/SF | $52/SF | $40/SF | $28/SF |
| | Low Capitalization Rate (4.25%) | $97/SF | $97/SF | $83/SF | $70/SF |
| 07 | Jackel Property | | | | |
| | High Capitalization Rate (4.75%) | $63/SF | $61/SF | $55/SF | $49/SF |
| | Low Capitalization Rate (4.25%) | $44/SF | $41/SF | $36/SF | $32/SF |
| 12 | Sunshine Gardens | | | | |
| | High Capitalization Rate (4.75%) | $52/SF | $50/SF | $38/SF | $27/SF |
| | Low Capitalization Rate (4.25%) | $95/SF | $95/SF | $82/SF | $68/SF |
| AD11 | Manchester Avenue West | | | | |
| | High Capitalization Rate (4.75%) | $58/SF | $53/SF | $38/SF | $29/SF |
| | Low Capitalization Rate (4.25%) | $102/SF | $98/SF | $82/SF | $71/SF |

## 6.0 BUILD ON-SITE: FINANCIAL FEASIBILITY ANALYSIS OF ALTERNATIVE SCENARIOS

The City also requested that KMA conduct financial feasibility analyses on variations of the above-described inclusionary scenarios. These alternative scenarios included the following:

(1) The assumption that the Housing Element Update "R-30" sites will be developed as for-sale, rather than rental, residential developments (Scenario #3).

(2) Comparative analysis of the Citywide inclusionary feasibility tests against a base case comprised of the City's pre-August 2018 inclusionary requirement of one (1) Very Low-Income unit for every 10 units (Scenario #1A).

(3) Comparative feasibility analyses of the potential inclusionary requirements for the Housing Element Update "R-30" sites against a base case comprised of the City's pre-August 2018 inclusionary requirement of one (1) Very Low-Income unit for every 10 units. KMA assumed development of the "R-30" sites with rental development in Scenario #2A and as for-sale residential development in Scenario #3A.

The results of these alternative scenarios -- in terms of residual land value impacts for each scenario and prototype -- are presented in Appendices 3 through 6 and summarized below.

### 6.1 Housing Element Update "R-30" Sites – "R-30" Overlay Zone Scenario: For-Sale

Scenario #3 assumes the "R-30" sites will be developed as for-sale, rather than rental, residential developments as previously assumed in Scenario #2.

The KMA key findings from Scenario #3 regarding the feasibility measures for the six "R-30" sites developed as for-sale developments are summarized in Tables 6-1 and 6-2, below. The two tables correlate to inclusionary requirements at Very Low-Income (Table 6-1) and Low-Income (Table 6-2), respectively.

The KMA findings are summarized by level of economic impact, using the feasibility benchmarks outlined below for ease of understanding the numerous development sites/inclusionary scenarios.

| | |
|---|---|
| | **High Impact:** greater than 25% increase in Residual Land Value from Existing Conditions (without "R-30" Overlay Zone); likely to provide an incentive to develop site using the "R-30" Overlay Zone |
| | **Medium Impact**: 15%-25% increase in Residual Land Value from Existing Conditions (without "R-30" Overlay Zone); may not provide incentive to develop site using "R-30" Overlay Zone |
| | **Low Impact:** less than 15% increase in Residual Land Value from Existing Conditions (without "R-30" Overlay Zone); least likely to provide incentive to use "R-30" Overlay Zone |

**Table 6-1: Scenario #3: Housing Element Update "R-30" Sites – Impact of Inclusionary Requirements - Very Low-Income - For-Sale Development**

| | | | With Density Bonus | | | |
|---|---|---|---|---|---|---|
| | | ***Existing Conditions*** | **10% @ Very Low** | **15% @ Very Low** | **20% @ Very Low** | **25% @ Very Low** |
| 08 | Rancho Santa Fe Parcels | *$33/SF* | $76/SF | $61/SF | $45/SF | $29/SF |
| AD1 | Sage Canyon | *$24/SF* | $77/SF | $61/SF | $44/SF | $28/SF |
| AD2 | Baldwin & Sons Properties | *$33/SF* | $77/SF | $62/SF | $45/SF | $28/SF |
| 07 | Jackel Property | *$75/SF* | $54/SF | $47/SF | $39/SF | $32/SF |
| 12 | Sunshine Gardens | *$56/SF* | $75/SF | $59/SF | $43/SF | $27/SF |
| AD11 | Manchester Avenue West | *$49/SF* | $71/SF | $59/SF | $46/SF | $26/SF |

**Table 6-2: Scenario #3: Housing Element Update "R-30" Sites – Impact of Inclusionary Requirements – Low-Income - For-Sale Development**

| | | | With Density Bonus | | | |
|---|---|---|---|---|---|---|
| | | ***Existing Conditions*** | **15% @ Low** | **20% @ Low** | **25% @ Low** | **30% @ Low** |
| 08 | Rancho Santa Fe Parcels | *$30/SF* | $56/SF | $53/SF | $39/SF | $24/SF |
| AD1 | Sage Canyon | *$24/SF* | $57/SF | $52/SF | $38/SF | $23/SF |
| AD2 | Baldwin & Sons Properties | *$33/SF* | $56/SF | $53/SF | $38/SF | $25/SF |
| 07 | Jackel Property | *$75/SF* | $45/SF | $43/SF | $37/SF | $30/SF |
| 12 | Sunshine Gardens | *$56/SF* | $53/SF | $51/SF | $37/SF | $23/SF |
| AD11 | Manchester Avenue West | *$40/SF* | $61/SF | $54/SF | $37/SF | $25/SF |

The above summary tables present findings that are generally consistent with Scenario #2, where all six "R-30" sites were assumed to be developed as rental housing under the "R-30" Overlay Zone scenario. The three sites with low base density residential zoning -- 08a/08b Rancho Santa Fe Parcels, AD1 Sage Canyon, and AD2 Baldwin & Sons Properties – can support a 10% increase above the existing Citywide inclusionary set-aside requirement. In these cases, KMA found that developers using the "R-30" Overlay Zone density (plus density bonus) could provide either 20% Very Low-Income units or 25% Low-Income units. In making this determination, KMA used a relatively high threshold measured as a minimum 25% increase in residual land value. based on this finding, it is the KMA conclusion that these three low base density "R-30" sites could support a 10% increase over the existing Citywide inclusionary set-aside requirement. For the three sites with existing non-residential or high base density zoning -- 07 Jackel Property, 12 Sunshine Gardens, and AD11 Manchester Avenue West – it appears that 12 Sunshine Gardens and AD11 Manchester Avenue West, if developed as for-sale housing pursuant to the "R-30" Overlay Zone, can support a 5% increase above the existing Citywide inclusionary housing requirement.

As with the analysis of the Citywide inclusionary prototypes, development returns and feasibility of the Housing Element Update "R-30" sites should be viewed as a continuum of outcomes, as opposed to hard and fast thresholds. This is particularly true when analyzing the economic feasibility of conceptual development prototypes, as opposed to specific development proposals. Moreover, it should be noted that KMA did not interview individual property owners or developers of the "R-30" sites regarding their specific development plans for their sites.

## 6.2 Citywide Inclusionary – Base Case: Pre-August 2018

Scenario #1 of the KMA feasibility analyses estimated the impact of alternative inclusionary requirements for a range of residential development prototypes currently planned, under development, or recently completed in the City. The Scenario #1 analysis assumed a base case scenario reflecting the City's existing inclusionary requirement of 10% for Very Low-Income households or 15% for Low-Income households. Scenario #1A estimates the impact of inclusionary requirements on the same development prototype analyzed in Scenario #1, but assuming a base case scenario reflecting the City's previous inclusionary requirement of one (1) Very Low unit for every 10 market-rate units.

The KMA key findings from Scenario #1A are summarized in Tables 6-3 and 6-4, below. The two tables correlate to inclusionary requirements at Very Low-Income (Table 6-3) and Low-Income (Table 6-4), respectively. The KMA findings are summarized by level of economic impact, using the feasibility benchmarks outlined below for ease of understanding the numerous development sites/inclusionary scenarios.

**Low Impact:** less than 15% decrease in Residual Land Value from Base Case; likely to have nominal impact on project feasibility

**Medium Impact**: 15%-25% decrease in Residual Land Value from Base Case; may raise concerns for project feasibility

**High Impact:** greater than 25% decrease in Residual Land Value from Base Case; may result in financially infeasible project

| **Table 6-3: Scenario #1A: Citywide Inclusionary – Impact of Inclusionary Requirements – Very Low-Income<br>Base Case: Pre-August 2018 Inclusionary Requirements** | | | | | |
|---|---|---|---|---|---|
| | | | **With Density Bonus** | | |
| | | ***Pre-August 2018: 1 Unit @ Very Low for every 10 Units*** | **15% @ Very Low** | **20% @ Very Low** | **25% @ Very Low** |
| A | Single-Family Detached – Large Lot (R-3) | *$41/SF* | $37/SF | $30/SF | $30/SF |
| B | Single-Family Detached – Medium Lot (R-5) | *$60/SF* | $52/SF | $45/SF | $37/SF |
| C | Single-Family Detached – Small Lot (RS-8) | *$51/SF* | $45/SF | $34/SF | $34/SF |
| D | Single-Family Detached – Small Lot (RS-11/R-11) | *$45/SF* | $41/SF | $32/SF | $23/SF |
| E | Mixed-Use Development | *$105/SF* | $102/SF | $102/SF | $62/SF |
| F | Townhomes (R-15) | *$68/SF* | $61/SF | $53/SF | $40/SF |
| G | Garden Apartments (R-20) | | | | |
| | High Capitalization Rate (4.75%) | *$107/SF* | $86/SF | $78/SF | $70/SF |
| | Low Capitalization Rate (4.25%) | *$136/SF* | $115/SF | $106/SF | $96/SF |

| **Table 6-4: Scenario #1A: Citywide Inclusionary – Impact of Inclusionary Requirements – Low-Income<br>Base Case: Pre-August 2018 Inclusionary Requirements** | | | | | |
|---|---|---|---|---|---|
| | | | **With Density Bonus** | | |
| | | ***Pre-August 2018: 1 Unit @ Very Low for every 10 Units*** | **20% @ Low** | **25% @ Low** | **30% @ Low** |
| A | Single-Family Detached – Large Lot (R-3) | *$41/SF* | $31/SF | $31/SF | $24/SF |
| B | Single-Family Detached – Medium Lot (R-5) | *$60/SF* | $46/SF | $39/SF | $32/SF |
| C | Single-Family Detached – Small Lot (RS-8) | *$51/SF* | $37/SF | $37/SF | $27/SF |
| D | Single-Family Detached – Small Lot (RS-11/R-11) | *$45/SF* | $36/SF | $28/SF | $24/SF |
| E | Mixed-Use Development | *$105/SF* | $105/SF | $68/SF | $68/SF |
| F | Townhomes (R-15) | *$68/SF* | $57/SF | $46/SF | $38/SF |

| Table 6-4: Scenario #1A: Citywide Inclusionary – Impact of Inclusionary Requirements – Low-Income<br>Base Case: Pre-August 2018 Inclusionary Requirements | | | | | |
|---|---|---|---|---|---|
| | | With Density Bonus | | | |
| | | *Pre-August 2018: 1 Unit @ Very Low for every 10 Units* | 20% @ Low | 25% @ Low | 30% @ Low |
| G | Garden Apartments (R-20)<br>High Capitalization Rate (4.75%) | *$107/SF* | $81/SF | $73/SF | $66/SF |
| | Low Capitalization Rate (4.25%) | *$136/SF* | $109/SF | $101/SF | $92/SF |

The above summary tables present the following key findings:

- Measured against the pre-August 2018 inclusionary requirement, the impact of a 15% Very Low-Income requirement is relatively minor, i.e., not greater than a 15% reduction in residual land value. The impact of a 20% Very Low-Income requirement is more significant, i.e., exceeding a 15% reduction in residual land value, which may raise concerns for project feasibility.

- Measured against the pre-August 2018 inclusionary requirement, the impact of a 20% Low-Income requirement is significant, i.e., generally resulting in a 15% to 25% reduction in residual land value, which may raise concerns for project feasibility. The impact of a 25% Low-Income requirement is more significant, i.e., exceeding a 25% reduction in residual land value; this may result in a financially infeasible project.

- For both the Very Low-Income and Low-Income inclusionary tests, the Garden Apartments prototype experienced a higher negative impact than the other development prototypes.

## 6.3 Housing Element Update "R-30" Sites – Base Case: Pre-August 2018

Scenarios #2 and #3 of the KMA feasibility analyses estimated the impact of alternative inclusionary requirements on specific sites identified in the City's Housing Element Update as "R-30" sites for Very Low- and Low-Income units.

The impact of inclusionary requirements on the "R-30" sites is measured as the difference between residual value land value generated by the sites' base zoning (base case scenario) and the residual land value assuming the sites' location within a R-30 Overlay Zone, which allows 30 units per acre. For those sites currently zoned for residential development, the base case scenario reflected the City's existing inclusionary requirement of 10% for Very Low-Income households or 15% at for Low-Income households. Scenarios #2A and #3A estimate the impact of alternative inclusionary requirements for the same "R-30" sites, but assume a base case scenario reflective of the City's previous inclusionary requirement of one (1) Very Low unit for every 10 market-rate units.

The KMA key findings from Scenario #2A, assuming development of the "R-30" sites with residential rental development with an affordable housing density bonus, are summarized in Tables 6-5 (Very Low-Income) and 6-6 (Low-Income), below.

The KMA key findings from Scenario #3A, assuming development of the "R-30" sites with for-sale residential development with an affordable housing density bonus, are presented in Tables 6-7 (Very Low-Income) and 6-8 (Low-Income), below.

The KMA findings are summarized by level of economic impact, using the feasibility benchmarks outlined below for ease of understanding the numerous development sites/inclusionary scenarios.

| | |
|---|---|
| (green) | **High Impact:** greater than 25% increase in Residual Land Value from Existing Conditions (without "R-30" Overlay Zone); likely to provide an incentive to develop site using "R-30" Overlay Zone |
| (yellow) | **Medium Impact**: 15%-25% increase in Residual Land Value from Existing Conditions (without "R-30" Overlay Zone); may not provide incentive to develop site using "R-30" Overlay Zone |
| (red) | **Low Impact:** less than 15% increase in Residual Land Value from Existing Conditions (without "R-30" Overlay Zone); least likely to provide incentive to use "R-30" Overlay Zone |

**Table 6-5: Scenario #2A – Housing Element Update "R-30" Sites – Impact of Inclusionary Requirements – Base Case: Pre-August 2018 Inclusionary Requirements "R-30" Overlay Zone Scenario: Very Low-Income - Rental**

| | | | With Density Bonus | | | |
|---|---|---|---|---|---|---|
| | | ***Pre-August 2018: 1 Unit @ Very Low for every 10 Units*** | **10% @ Very Low** | **15% @ Very Low** | **20% @ Very Low** | **25% @ Very Low** |
| 08 | Rancho Santa Fe Parcels | *$43/SF* | | | | |
| | High Capitalization Rate (4.75%) | | $71/SF | $60/SF | $47/SF | $34/SF |
| | Low Capitalization Rate (4.25%) | | $118/SF | $106/SF | $91/SF | $77/SF |
| AD1 | Sage Canyon | *$69/SF* | | | | |
| | High Capitalization Rate (4.75%) | | $74/SF | $61/SF | $48/SF | $34/SF |
| | Low Capitalization Rate (4.25%) | | $121/SF | $107/SF | $92/SF | $77/SF |

**Table 6-5: Scenario #2A – Housing Element Update "R-30" Sites – Impact of Inclusionary Requirements – Base Case: Pre-August 2018 Inclusionary Requirements "R-30" Overlay Zone Scenario: Very Low-Income - Rental**

| | | | With Density Bonus | | | |
|---|---|---|---|---|---|---|
| | | *Pre-August 2018: 1 Unit @ Very Low for every 10 Units* | **10% @ Very Low** | **15% @ Very Low** | **20% @ Very Low** | **25% @ Very Low** |
| AD2 | Baldwin & Sons Properties | *$65/SF* | | | | |
| | High Capitalization Rate (4.75%) | | $73/SF | $61/SF | $48/SF | $34/SF |
| | Low Capitalization Rate (4.25%) | | $121/SF | $107/SF | $92/SF | $77/SF |
| 07 | Jackel Property | *$75/SF* | | | | |
| | High Capitalization Rate (4.75%) | | $72/SF | $66/SF | $59/SF | $53/SF |
| | Low Capitalization Rate (4.25%) | | $51/SF | $45/SF | $40/SF | $34/SF |
| 12 | Sunshine Gardens | *$56/SF* | | | | |
| | High Capitalization Rate (4.75%) | | $71/SF | $58/SF | $46/SF | $33/SF |
| | Low Capitalization Rate (4.25%) | | $118/SF | $104/SF | $90/SF | $75/SF |
| AD11 | Manchester Avenue West | *$85/SF* | | | | |
| | High Capitalization Rate (4.75%) | | $68/SF | $59/SF | $48/SF | $33/SF |
| | Low Capitalization Rate (4.25%) | | $115/SF | $105/SF | $93/SF | $76/SF |

**Table 6-6: Scenario #2A – Housing Element Update "R-30" Sites – Impact of Inclusionary Requirements – Base Case: Pre-August 2018 Inclusionary Requirements "R-30" Overlay Zone Scenario: Low-Income - Rental**

| | | | With Density Bonus | | | |
|---|---|---|---|---|---|---|
| | | *Pre-August 2018: 1 Unit @ Very Low for every 10 Units* | **15% @ Low** | **20% @ Low** | **25% @ Low** | **30% @ Low** |
| 08 | Rancho Santa Fe Parcels | *$43/SF* | | | | |
| | High Capitalization Rate (4.75%) | | $54/SF | $51/SF | $39/SF | $28/SF |
| | Low Capitalization Rate (4.25%) | | $97/SF | $96/SF | $83/SF | $69/SF |
| AD1 | Sage Canyon | *$69/SF* | | | | |
| | High Capitalization Rate (4.75%) | | $53/SF | $52/SF | $40/SF | $28/SF |
| | Low Capitalization Rate (4.25%) | | $97/SF | $97/SF | $83/SF | $70/SF |
| AD2 | Baldwin & Sons Properties | *$65/SF* | | | | |
| | High Capitalization Rate (4.75%) | | $54/SF | $52/SF | $40/SF | $28/SF |
| | Low Capitalization Rate (4.25%) | | $97/SF | $97/SF | $83/SF | $70/SF |

| Table 6-6: Scenario #2A – Housing Element Update "R-30" Sites – Impact of Inclusionary Requirements – Base Case: Pre-August 2018 Inclusionary Requirements "R-30" Overlay Zone Scenario: Low-Income - Rental | | | | | | |
|---|---|---|---|---|---|---|
| | | With Density Bonus | | | | |
| | | *Pre-August 2018: 1 Unit @ Very Low for every 10 Units* | 15% @ Low | 20% @ Low | 25% @ Low | 30% @ Low |
| 07 | Jackel Property | *$75/SF* | | | | |
| | High Capitalization Rate (4.75%) | | $63/SF | $61/SF | $55/SF | $49/SF |
| | Low Capitalization Rate (4.25%) | | $44/SF | $41/SF | $36/SF | $31/SF |
| 12 | Sunshine Gardens | *$56/SF* | | | | |
| | High Capitalization Rate (4.75%) | | $52/SF | $50/SF | $38/SF | $27/SF |
| | Low Capitalization Rate (4.25%) | | $95/SF | $95/SF | $82/SF | $68/SF |
| AD1 1 | Manchester Avenue West | *$85/SF* | | | | |
| | High Capitalization Rate (4.75%) | | $58/SF | $53/SF | $38/SF | $29/SF |
| | Low Capitalization Rate (4.25%) | | $102/SF | $98/SF | $82/SF | $71/SF |

| Table 6-7: Scenario #3A – Housing Element Update "R-30" Sites – Impact of Inclusionary Requirements – Base Case: Pre-August 2018 Inclusionary Requirements "R-30" Overlay Zone Scenario: Very Low-Income – For-Sale | | | | | | |
|---|---|---|---|---|---|---|
| | | With Density Bonus | | | | |
| | | *Pre-August 2018: 1 Unit @ Very Low for every 10 Units* | 10% @ Very Low | 15% @ Very Low | 20% @ Very Low | 25% @ Very Low |
| 08 | Rancho Santa Fe Parcels | *$43/SF* | $76/SF | $61/SF | $45/SF | $29/SF |
| AD1 | Sage Canyon | *$69/SF* | $77/SF | $61/SF | $44/SF | $28/SF |
| AD2 | Baldwin & Sons Properties | *$67/SF* | $77/SF | $62/SF | $45/SF | $28/SF |
| 07 | Jackel Property | *$75/SF* | $54/SF | $47/SF | $39/SF | $32/SF |
| 12 | Sunshine Gardens | *$56/SF* | $75/SF | $59/SF | $43/SF | $27/SF |
| AD11 | Manchester Avenue West | *$85/SF* | $71/SF | $59/SF | $46/SF | $26/SF |

| Table 6-8: Scenario #3A – Housing Element Update "R-30" Sites – Impact of Inclusionary Requirements – Base Case: Pre-August 2018 Inclusionary Requirements "R-30" Overlay Zone Scenario: Low-Income – For-Sale | | | | | | |
|---|---|---|---|---|---|---|
| | | | With Density Bonus | | | |
| | | *Pre-August 2018: 1 Unit @ Very Low for every 10 Units* | **15% @ Low** | **20% @ Low** | **25% @ Low** | **30% @ Low** |
| 08 | Rancho Santa Fe Parcels | *$43/SF* | $56/SF | $53/SF | $39/SF | $24/SF |
| AD1 | Sage Canyon | *$69/SF* | $57/SF | $52/SF | $38/SF | $23/SF |
| AD2 | Baldwin & Sons Properties | *$67/SF* | $56/SF | $53/SF | $38/SF | $25/SF |
| 07 | Jackel Property | *$75/SF* | $45/SF | $43/SF | $37/SF | $30/SF |
| 12 | Sunshine Gardens | *$56/SF* | $53/SF | $51/SF | $37/SF | $23/SF |
| AD11 | Manchester Avenue West | *$85/SF* | $61/SF | $54/SF | $37/SF | $25/SF |

The above summary tables present the following key findings:

- *"R-30" Sites with "R-30" Overlay Zone Projects as Rental Housing* -- Measured against the pre-August 2018 inclusionary requirement, KMA generally finds that five of the six "R-30" sites can support an increase to 15% Very Low-Income or 20% Low-Income. One of the sites – 08 Rancho Santa Fe – shows the strongest feasibility for a 15% Very Low-Income requirement. AD1 Sage Canyon, AD2 Baldwin & Sons Properties, 12 Sunshine Gardens, and AD11 Manchester Avenue West present mixed results. At an optimistically low capitalization rate (4.25%), they can support significantly higher inclusionary requirements, ranging from 15% to 25% Very Low-Income or 20% to 30% Low-Income. However, if a conservatively high capitalization rate is assumed (4.75%), then only the 08 Rancho Santa Fe Parcels demonstrate feasibility for a higher inclusionary requirement. Testing various inclusionary requirements on 07 Jackel Property resulted in reductions in residual land value. This finding of infeasibility relates to the shift in the use of the property from primarily hotel rooms (base case) to apartments ("R-30" Overlay Zone project), resulting in a lower return to the developer.

- *"R-30" Sites with "R-30" Overlay Zone Projects as For-Sale Housing* -- Measured against the pre-August 2018 inclusionary requirement, KMA generally finds that all six "R-30" sites developed as for-sale housing at 30 units per acre do not support an increased inclusionary requirement.

As with the analysis of the Citywide inclusionary prototypes, development returns and feasibility of the "R-30" sites should be viewed as a continuum of outcomes, as opposed to hard and fast thresholds. This is particularly true when analyzing the economic feasibility of conceptual development prototypes, as opposed to specific development proposals. Moreover, it should be noted that KMA did not interview individual property owners or developers of the “R-30” sites regarding their specific development plans for their sites.

## 7.0 BUILD OFF-SITE: ESTIMATE OF AFFORDABILITY GAPS

KMA prepared estimates of the affordability gaps associated with developing affordable housing in an off-site location. The purpose of this financial analysis was to estimate the funds that the City would need to receive from a market-rate residential developer in order for the City to create the targeted inclusionary housing production in a separate off-site location.

As detailed in Appendix 7, the analysis assumed the affordable housing project to be developed would reflect a garden apartments development consisting of 35 units on a 2.0-acre site. KMA estimated the development costs, operating budget, and anticipated funding sources for the affordable housing development.

The KMA analysis is presented in a side-by-side comparison format assuming development of the affordable housing with and without Low Income Housing Tax Credits (Tax Credits), as well as with and without prevailing wages.

KMA analyzed a range of affordable housing income levels ranging from 30% AMI to 120% AMI. For the purposes of this report, key assumptions and findings presented below are based on the affordability gap associated with a rental development at Very Low- (50% AMI) and Low-Income (60% AMI), financed with Tax Credits, and subject to prevailing wages. Key assumptions used in the affordability gap analysis are as follows:

- Development costs are estimated at $411,000 per unit, including acquisition costs estimated at $50 per SF of site area.

- Monthly rents and the resulting stabilized annual net operating income generated by the affordable units are shown in Table 7-1.

| Table 7-1: Affordable Units – Net Operating Income per Unit per Year | | |
|---|---|---|
| | **Very Low-Income 50% AMI** | **Low-Income 60% AMI** |
| Monthly Rent, 2019 | $871 | $1,065 |
| Effective Gross Income | $10,243 | $12,471 |
| (Less) Operating Expenses (1) | ($5,950) | ($5,950) |
| Net Operating Income | $4,293 | $6,521 |
| (1) Assumes property tax exemption. | | |

- Funding sources available for the affordable units would include a combination of first mortgage debt and Tax Credit equity investment. These potential funding sources are itemized in Table 7-2.

| Table 7-2: Affordable Units -- Sources of Funds per Unit | | |
|---|---|---|
| | **Very Low-Income 50% AMI** | **Low-Income 60% AMI** |
| Supportable Permanent Loan | $55,000 | $83,000 |
| Low Income Housing Tax Credit Equity | $125,000 | $125,000 |
| Total Sources of Funds | $180,000 | $208,000 |

- As shown in Table 7-3, the affordability gaps for the affordable units are estimated at $271,000 per Very Low-Income unit and $242,000 per Low-Income unit. These figures are calculated as the difference between total development costs and total funding sources.

| Table 7-3: Affordable Units -- Affordability Gaps per Unit by Income Level | | |
|---|---|---|
| | **Very Low-Income 50% AMI** | **Low-Income 60% AMI** |
| Sources of Funds | $180,000 | $208,000 |
| (Less) Total Development Costs | ($450,000) | ($450,000) |
| Affordability Gap Per Affordable Unit | ($271,000) | ($242,000) |

## 8.0 LIMITING CONDITIONS

1. The analysis contained in this document is based, in part, on data from secondary sources such as state and local government, planning agencies, real estate brokers, and other third parties. While KMA believes that these sources are reliable, we cannot guarantee their accuracy.

2. The analysis assumes that neither the local nor national economy will experience a major recession. If an unforeseen change occurs in the economy, the conclusions contained herein may no longer be valid.

3. The findings are based on economic rather than political considerations. Therefore, they should be construed neither as a representation nor opinion that government approvals for development can be secured.

4. Development opportunities are assumed to be achievable during the specified time frame. A change in development schedule requires that the conclusions contained herein be reviewed for validity.

5. The analysis, opinions, recommendations and conclusions of this document are KMA's informed judgment based on market and economic conditions as of the date of this report. Due to the volatility of market conditions and complex dynamics influencing the economic conditions of the building and development industry, conclusions and recommended actions contained herein should not be relied upon as sole input for final business decisions regarding current and future development and planning.

6. Any estimates of development costs, capitalization rates, income and/or expense projections are based on the best available project-specific data as well as the experiences of similar projects. They are not intended to be projections of the future for the specific project. No warranty or representation is made that any of the estimates or projections will actually materialize.

7. KMA is not advising or recommending any action be taken by City of Encinitas with respect to any prospective, new or existing municipal financial products or issuance of municipal securities (including with respect to the structure, timing, terms and other similar matters concerning such financial products or issues).

8. KMA is not acting as a Municipal Advisor to the City of Encinitas and does not assume any fiduciary duty hereunder, including, without limitation, a fiduciary duty to the City of Encinitas pursuant to Section 15B of the Exchange Act with respect to the services provided hereunder and any information and material contained in KMA’s work product.

9. The City of Encinitas shall discuss any such information and material contained in KMA's work product with any and all internal and/or external advisors and experts, including its own municipal advisors, that it deems appropriate before acting on the information and material.