13.B.14 FINANCIAL FEASIBILITY EVALUATION – HOUSE NATIONAL CITY

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MEMORANDUM

To: Carlos Aguirre, Director of Housing Authority
City of National City

From: KEYSER MARSTON ASSOCIATES, INC.

Date: September 15, 2022

Subject: Financial Feasibility Evaluation – House National City

I. INTRODUCTION

Background

The City of National City (City) is currently in the process of a Focused General Plan Update (FGPU) with assistance from WSP USA (WSP) and Gates Planning Strategies (GPS) (collectively, Consultant Team). As part of the FGPU effort, the City and Consultant Team engaged Keyser Marston Associates, Inc. (KMA) to conduct financial feasibility analyses related to the proposed opt-in House National City Program (Program). The goal of the proposed Program is to increase the supply of affordable housing, incentivize housing within Transit Priority Areas (TPAs), increase transit ridership, and provide additional community benefits. The draft Program currently under review includes certain requirements such as affordable housing set-asides and a unit mix that incorporates larger family units. In exchange, eligible projects would receive incentives such as Floor Area Ratio (FAR)-based density, reduced parking ratios, fee waivers, and waiver of base zone regulations. The Program's requirements and incentives as of the date of this report are summarized below.

Summary of Proposed House National City Program	
Requirements	• Within Program-designated FAR Tier 1 or FAR Tier 2 zones • Set-aside of 10% of total post-bonus units @ 50% Area Median Income (AMI)
Incentives	• FAR-based density • Development Impact Fee (DIF) waiver • Reduced parking to allow for 1.0 parking space for units above 800 SF and 0.50 parking space for units under 800 SF • Further reduced parking ratio of 0.50 parking spaces for all units

KMA Methodology

To assess the financial feasibility of the proposed Program, KMA performed the following tasks:

- Reviewed potential development concepts prepared by WSP for six (6) test sites (Test Sites) within the Program's qualified FAR Tier zones. These Test Sites were selected because they represent a variety of characteristics in the National City real estate market, including site location, zoning, density, lot size/coverage, design standards, and setback requirements.

- Collaborated with WSP to formulate two (2) multi-family rental development prototype scenarios for each Test Site: (a) a Base Case Scenario, reflecting maximum development yield under existing zoning, and (b) a Bonus Scenario, reflecting potential development yield achievable based on the requirements and incentives contained in the proposed Program.

- Conducted market research for the National City and South Bay multi-family residential market, including market rents, comparable land sales, and project values.

- Prepared financial pro forma models for each pair of Base Case/Bonus Scenarios for each Test Site to measure the impact of the Program on development economics. In some cases, KMA determined that some Base Case Scenarios were not feasible under current market conditions. As a result, KMA also determined the required increase in market rent ("break-even rent") for the Base Case Scenario to become economically feasible.

- Prepared a series of alternative financial pro forma models reflecting additional developer incentives (Additional Incentives) such as:

(a) Reduced required parking ratio to 0.50 parking spaces for all units

(b) Less restrictive affordability, i.e., providing a minimum of 10% three-bedroom units in exchange for less restrictive affordability (10% @ 80% AMI post-bonus)

(c) Waiver of base zone regulations such as setback, lot coverage, and street frontage requirement

January 2023 Addendum

It is important to note that after the date this memorandum report was originally published, California Governor Gavin Newsom approved Assembly Bill No. 2097 (AB 2097) on September 22, 2022. AB 2097 prohibits a public agency from imposing any minimum parking requirement on any residential, commercial, or other development project that is located within one-half mile of public transit. AB 2097 has only been in effect since January 1, 2023; therefore, there is little concrete evidence available regarding how it will impact development economics for individual multi-family development proposals. However, it is the KMA view that developers are unlikely to propose multi-family projects in National City with extremely limited or no parking in the near-term. As demonstrated in this report, the KMA financial analyses conclude that reduced parking ratios, where accepted by the marketplace, positively impact project feasibility.

Report Organization

This executive summary memorandum report is organized as follows:

- Following this Introduction, Section II presents the KMA key findings.
- Section III presents the financial pro forma methodology.
- Section IV reviews key factors for Program viability and development feasibility.
- Finally, Section V presents Limiting Conditions governing the KMA feasibility evaluation.

II. KEY FINDINGS

The KMA key findings from the financial feasibility evaluation are summarized in the table below.

Overall Financial Feasibility Conclusions

- **The proposed Program is viable under certain site, planning, and market conditions.** A key feasibility factor is whether developers are able to utilize the proposed Program bonus to achieve a substantial increase in total units without advancing to a significantly more costly construction type and/or parking configuration.

- **The proposed Program is formulated to strike the balance between capturing the value enhancement for community benefits** – rather than creating a windfall in increased land value to property owners.

- **It will be important to monitor Program results in terms of the mix, type, size, location, and other key features of development projects proposed and implemented under the Program.** This will enable the City, in coordination with property owners, developers, and other key stakeholders, to determine if the Program is delivering the desired community benefits while also enabling project feasibility.

- **The Baseline Program's waiver of Development Impact Fees (DIFs) contributes to higher project feasibility.** The waiver of DIFs for all covenant-restricted affordable units and units larger than 800 SF reduces the estimated development costs of the project, thereby enhancing financial feasibility.

- **The Baseline Program is more feasible when parking ratio is reduced to 0.50 parking spaces per unit**. Parking ratio is a large factor that impacts a project's feasibility. KMA tested a range of parking ratios ranging from zero to 1.00 per unit in the Bonus Scenarios, finding that projects with a lower parking ratio experienced greater financial feasibility. KMA believes that the proposed minimum parking ratio of 0.50 allows an option for projects to enhance feasibility in exchange for providing affordable and/or family units. However, to date there is limited experience outside of dense urban areas with multi-family housing development with fewer than 1.00 parking space per unit. Therefore, the market may react slowly to this incentive, i.e., gradually introduce projects with lower parking ratios over time.

- **The Program's Additional Incentive of 10% @ 80% AMI post-bonus units in exchange for a minimum of 10% three (3)-bedroom units is moderately feasible.** The requirement of three-bedroom units is likely to negatively impact the feasibility of a project due to the lower achievable rents per SF and higher operating expenses. Therefore, KMA believes that allowing less restrictive affordability will help offset the financial impact of requiring three-bedroom family units.

Overall Financial Feasibility Conclusions
• **The Program's Additional Incentive of waiver of base zone regulations contributes to higher feasibility.** Potential waivers of base zone regulations – such as maximum lot area, street frontage requirements, minimum lot coverage, and front/side setbacks – allow for more market-rate and affordable units to be developed on a site. While the higher project density associated with the additional units may increase project construction costs on a per-SF basis, the additional rental income and greater economies of scale will help improve project feasibility.

It is important to note that density bonuses do not always result in improved economics for multi-family development projects. In many cases, developers are already maximizing the achievable building height and density within the most feasible construction type (e.g., wood, steel, or concrete) and parking configuration (e.g., surface, tuck-under, wrap, podium, or subterranean). Additional height or density may trigger a change in construction type, causing the project to be more expensive to build. Depending on the site location and surrounding market, a taller, denser building may or may not be able to achieve higher market rents to offset the higher construction costs. The KMA feasibility analyses assume that the Bonus Scenarios will result in projects with smaller average unit sizes and more amenities than their corresponding Base Case Scenarios. Where these factors support higher market rents in the Bonus Scenario, the Program's density bonus is likely to improve the economic feasibility of a multi-family development.

III. FINANCIAL PRO FORMA METHODOLOGY

This section provides an overview of the KMA financial pro forma methodology used to conduct the comparative evaluation of the Base Case vs. Bonus Scenarios.

1. KMA participated in discussions with WSP, GPS, and City staff that resulted in the identification of potential development concepts for six (6) Test Sites within the Program's FAR Tiers. FAR Tier 1 refers to sites where any portion of the premises is located outside the Downtown Specific Plan. FAR Tier 2 encompasses any premises located on Plaza Bonita Road, within the Hospital District, and along Sweetwater Road/East 30th, as well as the area along 4th Avenue that is south of State Route 54 (SR54) that is zoned MXC-2.

2. WSP formulated two (2) multi-family rental development prototype scenarios for each Test Site:

   (a) A Base Case Scenario, reflecting maximum development yield under either (1) existing zoning or, when applicable, (2) the new proposed zoning as part of the FGPU. The Base Case Scenarios ranged in density from 21 to 75 units per acre. These range from Type V (wood) townhomes with tuck-under parking to Type V (wood) apartments with podium parking.

(b) A Bonus Scenario, reflecting potential development yield achievable based on the requirements and incentives contained in the proposed Program. The Bonus Scenarios ranged in density from 56 to 176 units per acre.

3. KMA prepared financial pro forma models for each pair of Base Case/Bonus Scenarios, for each Test Site, in order to measure the impact of the Program requirements and incentives on development economics. Financial feasibility was measured in terms of residual land value. Residual land value is defined as the maximum land value supported by a proposed development. It is calculated by estimating total project value upon completion and subtracting the estimated total development costs (other than land acquisition costs) required to develop the project. All development concepts were tested as rental housing, reflective of recent multi-family development trends in the National City and South Bay markets. All Base Case pro formas were modeled as economically feasible projects in order to provide an appropriate starting point for comparison with the Bonus Scenario pro forma under the proposed Program. As stated previously, some Base Case Scenarios were not feasible under current market conditions. KMA determined that in order for the Base Case Scenarios to achieve financial feasibility, current market rents must increase between 4% and 28% over prevailing market rents in the current market.

(a) Bonus Scenarios assumed the following:

- Waiver of existing units/acre density limit and a new FAR density limit based on whether the development is located in FAR Tier 1 or FAR Tier 2.

- Waiver of parking requirements to allow one (1) parking space for units larger than 800 SF and 0.50 parking spaces for units less than 800 SF.

- Waiver of DIFs for all covenant-restricted affordable dwelling units and all dwelling units that exceed 800 SF.

(b) KMA analyzed Additional Incentives on select Sites such as: (1) waiver of parking requirements to allow for 0.50 parking spaces per unit for all units; (2) provision of a minimum of 10% three-bedroom family units in exchange for 10% @ 80% AMI post-bonus units; and (3) waiver of base zone regulations, including street frontage requirements, lot coverage, and setback requirements.

(c) KMA compared the residual land value outcomes of the Base Case Scenarios versus the corresponding Bonus Scenarios. Based on an analysis of current market data, KMA determined that comparable land values for multi-family development in the City are approximately $60 per SF land area (order-of-magnitude estimate). In order for the proposed Program to be feasible for a development project, the Bonus Scenario would need to generate a higher residual land value than the Base Case Scenario. In cases where the Bonus Scenario generated a higher residual land value than the Base Case Scenario, KMA concluded that it would be feasible for a developer to opt into the proposed Program.

(d) Conclusions for the Baseline Program and Additional Incentives as measured against the six (6) Test Sites are presented below. As shown, the modifications to the Baseline Program, such as reduced parking ratio or waiver of base zone regulations, contributed to greater feasibility.

Overall Feasibility Conclusion				
	Baseline Program		**Additional Incentives**	
	Baseline	**Baseline + Reduced Parking Ratio**	**Baseline + 3-Bedroom Requirement**	**Baseline + Waiver of Base Zone Regulations**
I. Public Benefit	• Affordable units	• Affordable units	• Affordable units • Minimum 10% 3-bedroom units	• More affordable units
II. Developer Incentives	• Far density • DIF waiver • Reduced parking	• FAR density • DIF waiver • Further reduced parking (0.50 spaces/unit)	• FAR density • DIF waiver • Reduced parking • Less restrictive affordability	• FAR density • DIF waiver • Additional waivers (e.g., setbacks, open space, lot coverage)
III. Proposed Level of Affordability	• 10% @ 50% AMI (Post-bonus)	• 10% @ 50% AMI (Post-bonus)	• 10% @ 80% AMI (Post-bonus)	• 10% @ 50% AMI (Post-bonus)
IV. Overall Feasibility Conclusion	**Moderately Feasible**	**Feasible**	**Moderately Feasible**	**Feasible**

IV. KEY FACTORS CONTRIBUTING TO PROGRAM VIABILITY

The following section presents the KMA conclusions regarding certain project characteristics and Program features that will encourage developers to opt into the proposed Program.

Developers will be more likely to opt into the proposed Program when:

- There is sufficient market acceptance and support for projects with lower parking ratios.

- Higher market rents on a per-SF basis can be achieved for smaller units in multi-family or mixed-use buildings by offering a variety of project amenities.

- The project is able to utilize greater density under the Program to provide additional units without advancing to a more costly construction type and/or parking configuration.

Based on the feasibility analyses, KMA concludes that the following proposed Program features demonstrate a positive impact on overall project feasibility:

- DIFs are waived for all covenant-restricted affordable units and units larger than 800 SF.

- The number of affordable units does not exceed 10% of post-bonus unit total.

- Parking ratio is reduced to a minimum of 0.50 parking spaces per unit.

- Waivers of base zone regulations are available in order to increase the number of units developed on the site.

V. LIMITING CONDITIONS

1. KMA has made extensive efforts to confirm the accuracy and timeliness of the information contained in this document. Although KMA believes all information in this document is correct, it does not guarantee the accuracy of such and assumes no responsibility for inaccuracies in the information provided by third parties.

2. 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. No guarantee is made as to the possible effect on development of current or future Federal, State, or local legislation including environmental or ecological matters.

3. 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.

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. If an unforeseen change occurs in the local or national economy, the analysis and conclusions contained herein may no longer be valid.

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

6. It has been assumed that the value of the property will not be impacted by the presence of any soils, toxic, or hazardous conditions that require remediation to allow development. Additionally, it is assumed that perceived toxic conditions (if any) on surrounding properties will not affect the value of the property.

7. KMA is not advising or recommending any action be taken by the City 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 and does not assume any fiduciary duty hereunder, including, without limitation, a fiduciary duty to the City 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 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.