Appendix C: Financial Feasibility Study and Funding Sources

Keyser Marston Associates, Inc. (KMA) prepared an overview of market conditions and identification of development potential for land uses in the E+MLUMP. At the present time, new real estate development ventures are severely hampered by depressed market demand, market oversupply, impaired financing markets, and a gloomy outlook for the national economy. As these conditions are alleviated in the mid-term, KMA believes that the Study Area presents an excellent opportunity for new mixed-use development.

The Study Area is primarily an urban residential neighborhood, with commercial uses concentrated along the main corridors, Euclid Avenue and Market Street. The majority of the remaining developable vacant land is controlled by the Jacobs Center for Neighborhood Innovation (JCNI). The following summarizes key findings related to the KMA Economic and Market Analysis:

- The JCNI is the largest property owner in the Study Area and has developed a conceptual development program titled The Village at Market Creek. This conceptual plan may serve as a catalyst for future development.

- The Study Area (or 1-mile radius from the intersection of Euclid Avenue and Market Street) contains a younger population, with a median age of 28, while the City and San Diego County (County) population is about 35 years of age.

- The Study Area is a very diverse community. In the 1-mile trade area, 57 percent of population is of Hispanic decent. In terms of race, the population is largely comprised of Persons of Another Race (32 percent), African American (26 percent), and White (25 percent).

- Within a 1-mile radius of the Study Area, the median income is approximately $35,000 which is 40 percent lower than that of the City and County, ranging between $58,000 and $60,000. Approximately 20 percent of households within the 1-mile radius earn an annual income of less than $15,000.

- Large household sizes and the young population in the Study Area (or 1-mile radius) indicate that households are largely made up of families with children. The household size in 1-mile trade area is 3.7 persons per household, which is higher than the City and County (2.6 and 2.8, respectively).

- The following summarizes the demographics found in the 1-mile area as compared to the City:

Demographic Summary	Study Area (1-Mile)	City
Households:		
Number of Households	7,822	487,221
Average Household Size	3.69	2.62
Income:		
Median Household Income	$35,078	$58,173
Families Below Poverty	24.9%	9.8%
Families Below Poverty with Children	23.2%	7.7%
Population of Hispanic Ethnicity	57.4%	29.5%
Language Spoken at Home:		
English Only Spoken at Home	42.3%	60.6%
Other Spoken at Home	57.7%	39.4%
Educational Attainment:		
Less Than High School Graduate	38.0%	14.6%
High School Graduate (or GED)	25.6%	16.9%
Some College – No Degree	21.5%	20.9%
Completed Degree	14.9%	47.6%

- The largest employment sector in the 3-mile trade area is the retail trade industry with 24.3 percent, followed by professional and business services of 16.8 percent and educational services (16.2 percent).

- About 51 percent of the residential housing inventory is comprised of single-family homes, similar to that of the County.

- Median home prices have dropped dramatically in the Encanto neighborhood since 2005. For detached single-family homes, the median home price dropped 47 percent and for attached homes approximately 63 percent. In comparison, the Central San Diego neighborhood lost approximately 29 percent for single-family homes and 41 percent for attached homes.

- With the exception of the Joe and Vi Jacobs Center, the Study Area has limited traditional format office space. The majority of office space in the Study Area is one- to two-stories and single tenancy.

- Industrial development in the Study Area is concentrated along Market Street and primarily located east of Euclid Avenue.

- Retail space in the Study Area is generally located within three shopping centers and makes up about 75 percent of the Study Area's total retail inventory.

- The following summarizes the amount of commercial and industrial square footage and asking lease rates in the Study Area:

Land Use	Total Square Feet (SF)	Average Asking Lease Rate (1)
Office	156,000 SF	$2.02/SF (FSG)
Industrial	245,000 SF	$0.88/SF (NNN)
Retail/Restaurant	167,000 SF	$1.52/SF (NNN)

(1) Full-service gross (FSG) is defined as a type of rental rate in which the cost of taxes, insurance, and maintenance is included in the rent. Triple net (NNN) is defined as a type of rental rate in which the tenant assumes the cost for taxes, insurance, and maintenance in addition to the base rental rate.

Source: CoStar Group, Inc.

- Retail sales have decreased in nearly all retail categories within the Southeastern and Encanto Community Study Areas (CPAs), City, and County. The retail sales import/export (leakage) model for the Southeastern San Diego and Encanto CPAs combined indicate a leakage of approximately $130 million per year.

- The following presents a summary of KMA's space demand analysis for each land use:

Demand by Land Use	Low	High
Office	63,000 SF	105,000 SF
Retail/Restaurant	21,500 SF	44,000 SF
Residential	1,100 Units	2,200 Units

- Based on the demographics and market conditions found in CPAs and the Study Area, KMA assessed the market support for each land use in the near-, mid-, and long-term. These rankings are summarized as follows:

Market Support by Land Use	Retail/ Restaurant	Office	Residential	Industrial
Near Term (0 to 5 years)	Moderate	Weak	Weak	Moderate
Mid-Term (5 to 10 years)	Moderate	Weak	Moderate	Moderate
Long-Term (10 to 15 years+)	Moderate	Moderate	Moderate	Moderate

Chapter 4: Land Use
Section F. Land Uses Feasibility Analysis/ Development Concepts

KMA prepared financial feasibility analyses for potential development prototypes in accordance with the land use designations that are proposed as part of the E+MLUMP. The prototypes consist of a range of low, medium, and high densities with only residential, residential and commercial in a mixed-use format, and business park uses. The primary objectives of the KMA analysis are to determine which land uses are financially feasible considering current development costs and current market values, and to provide recommendations that would support long-term implementation of the proposed plan.

It should be noted that the land use designations proposed in the Study Area are to be considered over the long term and therefore, the KMA analysis is not indicative of changing economic and market conditions, should they improve or worsen in the future. New development in this area can benefit from the use of public-private partnership approaches utilizing the various sources of financing approaches to bridge and overcome the economic gap for most new development. Another approach would be to enter into transactions with non-profit type developers capable of accepting lower returns and/or funding all or major portions of the economic gap.

<u>Methodology</u>

The KMA financial feasibility analysis determines the estimated residual land value of each development prototype. Residual land value is defined as the maximum land payment that a private developer could afford to pay for a specified development opportunity based on a comparison of market value upon completion and total development costs, inclusive of an industry standard developer return requirement. KMA's estimate of market prices and rental rates are based on KMA's Market and Economic Analysis (August 2011), a review of current market pricing, and include a premium for new construction.

<u>Financial Feasibility Summary</u>

KMA evaluated a total of 7 development prototypes. Three (3) prototypes consisted of only residential uses, three (3) prototypes contained residential and commercial mixed-use development, and one (1) prototype assumes business park development. The following illustrates the estimated residual land value for each development prototype:

Prototype	Density	Description of Prototype	Residual Land Value	
			Total	Per SF Land
Low-Medium Residential	14 Units/Acre	2 to 3 Story Townhomes with Attached Garages	($57,000)	($3)
Medium Residential	29 Units/Acre	2 to 3 Story Stacked Flat Condominiums over Tuck-Under Parking	($977,000)	($45)
Medium-High Residential	44 Units/Acre	3 to 5 Story Stacked Flat Condominiums over Podium Parking	($1,551,000)	($71)
Neighborhood Commercial	29 Units/Acre	2 to 3 Story Stacked Flat Apartments over Tuck-Under Parking / Office with Ground-Floor Retail and Surface Parking	($1,580,000)	($73)
Community Commercial	44 Units/Acre	3 to 4 Story Stacked Flat Apartments with Wrapped Parking / Retail with Surface Parking	($1,683,000)	($39)
Community Village	74 Units/Acre	Up to 5 Stories Stacked Flat Apartments with Wrapped Parking / Commercial with Surface Parking	($6,804,000)	($156)
Business Park	0.25 Floor Area Ratio	2 to 3 Story Light Industrial/Flex Space with Surface Parking	($419,000)	($19)

As shown above, the residual land values are negative for all prototypes. Based on KMA's financial feasibility analysis, potential developers cannot afford to pay for land under these scenarios, and would in fact require an additional source of financial assistance to close the financing gap. These financing gaps range between $57,000 for the lowest density prototype (14 units per acre) to $6.8 million for the highest density prototype (74 units per acre). The principal reasons for these negative land values are as follows:

- Current residential market sales prices and rents are below the levels required to recuperate project costs thus making projects infeasible. This area generally experiences an economic gap even in robust economic periods, however today as a result of the national recession and local housing market downturn, the economic gap is greater.

For-sale residential housing values need to be a minimum of $200 per square foot (SF) for the lower density product to over $300 per SF for the higher-density product. In addition, apartment rents would need to exceed $1.75 per SF per month to generate a positive land value. The difficulty is that given the lower sales prices and rent levels, it is very challenging for a developer to make a proposed development financially feasible (comparison of development costs to economic value) because development costs are generally the same as in other parts of San Diego.

- Stacked-flat residential units yield higher development costs on a per-SF basis and therefore generate an even higher financial gap than non-stacked residential units (e.g., townhomes, rowhomes, or duplexes). In addition, a stacked-flat configuration assumes a minimum of 15% building inefficiency factor for circulation and common areas.

- Medium to high-density developments require some form of structured parking – whether in a tuck-under, "wrapped", or podium configuration – the cost of development is significantly more expensive than surface parking.

- Current market rents for commercial space in the Study Area and Southeastern San Diego community do not support the cost of new construction. In particular, office development burdens the feasibility of a development substantially more than the retail component.

Conclusions

The financial feasibility of the development prototypes is negatively impacted by current market conditions – which not only impacts Southeastern San Diego but other areas of San Diego County and the State. The housing market will need to rebound and experience a significant change in market pricing in order to produce healthy residual land values in the Southeastern San Diego community. Although the downturn in the housing market has slowed the pace of housing development and absorption, current market indicators find that a turnaround may be nearing. This improvement in market conditions may not be sufficient, however, to overcome the economic gap experienced in new development. The potential of new development occurring in the Study Area could be greatly enhanced if the public sector were to create public-private partnerships and utilize various financing approaches.

Chapter 7: Implementation discusses potential funding mechanisms and development recommendations and opportunities that may be used within the study area to improve financial feasibility.

Chapter 7: Implementation

Section B. Prioritized Implementation Strategies

It is important to note that the E+MLUMP is a long-term plan. New public investment in infrastructure, public facilities, and recreational amenities provides a strong catalyst for private development. Transit options, the addition of new retail shops and services, and place-making amenities such as outdoor public seating areas, enhanced landscaping, and pedestrian circulation will further generate demand for new housing and interest in the Study Area. Creating a “sense of place” and district identity will further guide development and new found interest in the Study Area.

There are strong fundamentals supporting attached housing and mixed-use development in in-fill locations throughout Central San Diego. Scarcity of land, rising housing costs, and the increase in non-family households will continue to generate demand for townhomes, condominiums, and apartments. In addition, increasing life expectancy and changing lifestyle patterns will generate demand for alternative development types among the baby boomers/empty nesters and Generations X and Y. The rental market is expected to continue to strengthen due principally to two current economic conditions: (1) households that have faced a short sale or foreclosure of a home; and (2) stricter mortgage lending standards that have caused young and/or newly formed households to postpone homeownership. This demand has caused a decrease in vacancy rates and increase in rents.

Another key factor to note is the involvement of the Jacobs Center for Neighborhood Innovation (JCNI). The JCNI is a non-profit organization that owns about 60 acres in the Study Area. The JCNI has set forth plans to redevelop a large area of Market Street from 47th Street to Euclid Avenue. Proposed projects currently underway or in the planning stages include a Wal-Mart, Walgreens pharmacy, and affordable residential units. The JCNI is well capitalized, plays an active role in the community, and is able to invest in many projects that private developers are not able to or willing to develop. In consideration of JCNI’s participation in the Study Area, the City should work with JCNI to coordinate planning efforts to ensure that the goals and objectives for new development in the Study Area come to fruition.

KMA has outlined several sources of financing approaches that can be used to develop and revitalize the Study Area. A combination of some or all of these financing approaches can be used by the City effectively. The following are the most likely approaches that the City can take with developer/property owners to offset the economic gap of proposed new development in the Study Area:

- Infrastructure Financing District can be created by the City and enter into an agreement with the County for participation in the use of all or a portion of the property tax received by the County from the new development.

- The Developer and City reach an agreement and sign a business transaction wherein the developer funds the infrastructure or economic gap and is paid back by the City from the increase in property and sales taxes. This is essentially structuring the developer funding of the gap as a loan to the City.

- Section 108 Loan Guarantee Program provides communities with a source of financing for economic development, housing rehabilitation, public facilities, and large-scale physical development projects.

- Community Facility Districts can be created by the City to fund all or a portion of the economic gap.

- Special Assessment Districts can be established by the City for funding infrastructure of the economic gap.

<u>Development Opportunities and Recommendations</u>
Based on the KMA estimate of market demand and current trends in mixed-use districts, KMA formulated a series of specific development opportunities and related recommendations for the City's consideration, as follows:

- Establish a branding and/or create a theme to guide development and implement landmark, signage, and wayfinding consistent with a district identity.

- Encourage developments with walkable environments and easy access to transit, retail, services, and amenities.

- Work with existing property owners and/or developers, such as the JCNI to rehabilitate and/or replace existing underutilized commercial developments with viable uses compatible with the Study Area goals and objectives.

- Work with the business and development community, the public, and other organizations to streamline business interaction with government, including the development review and approval process.

- Explore the potential for an IFD, CFD, or other Special Assessment District to fund initial infrastructure improvements.

- Once new development has begun in the Study Area, encourage and support the formation of a Property-based or Business Improvement District (PBID or BID) or other business support groups to manage and promote the Study Area.

Summary of Potential Funding Mechanisms

The Study Area was previously encompassed in the Central Imperial Redevelopment Project Area, which meant that developers could request and obtain tax increment funds and other forms of assistance from the San Diego Redevelopment Agency if a proposed project assisted in the removal of blight and/or provided low income housing. Without these redevelopment funds, residential and commercial projects would not have been constructed in the Study Area.

In February 2012, California redevelopment agencies were dissolved and their rights, powers, duties, and obligations were vested in the successor agencies. The City's successor agency, Civic San Diego is proposed to be the advocate for revitalization of San Diego's former project areas. It is also anticipated that new legislation will be established to continue to assist in removal of blight and development of affordable housing in San Diego neighborhoods. Since redevelopment agencies cannot collect and/or finance redevelopment activities in the traditional method, public-private partnerships need to creatively work together to identify different sources of financing.

In order to develop the uses proposed in the Study Area, a combination of public and private financing sources will be needed to fund public improvements and assist in development and redevelopment of private properties. The following identifies potential funding mechanisms, many of which are already being used in the City of San Diego and neighboring jurisdictions that may be potentially available to the City, developers, and/or business and property owners. These mechanisms include both public (local, State, and Federal) and private (property owners, developers, and users) funding sources.

A. Local Sources

- *Infrastructure Financing District (IFD)* – Similar in function to redevelopment tax increment, tax increment revenues within an IFD are used to finance construction of public works and facilities. However, in former redevelopment project areas, 80% of the 1% property tax could be captured by the local agency. IFDs can be created by cities, counties, and special districts but they can only capture the amount of tax increment generated by creating entity. If the county is not the creator of the district, it would have to agree to allow its tax increment to be captured in the IFD.

- *General Fund Revenue* – Fees collected in the City's General Fund, generated by property taxes, sales tax, transient occupancy tax, motor vehicle license fees, and other sources of revenue. An agreement with a land owner or developer can be transacted whereby the developer funds the infrastructure and/or economic gap, and the transaction is structured in the form of a loan from the developer to the City to be repaid over a term of years with the various tax revenues generated by the new development.

- *Reduction/Deferral of Permits and Fees* – Reduction or deferral of select permits and fees that result in upfront development cost reductions.

- *Affordable/In-Fill Housing and Sustainable Buildings Expedite Program* – Provides expedited permit processing for eligible affordable/in-fill housing and sustainable building developments.

- *Density Bonus Law* – A voluntary inclusionary housing ordinance providing incentives to developers providing affordable housing in their projects; State legislation requires cities and counties to grant both density bonuses and concessions.

- *Reduction in Development Standards* – Reduction in site development standards or modification of zoning code requirements or design requirements such as a reduction in setback and square footage requirements.

- *Reduction in Parking Standards* – Reduction in parking ratios can assist in creating a more efficient site plan and reducing the financial burden of potentially high structured parking costs.

B. State/Federal Sources

- *Community Development Block Grants (CDBG) / Section 108 Loans* – Annual grants for use towards economic development, public facilities, and housing rehabilitation; Section 108 loans provide front-end financing for large-scale community and economic development projects that cannot be financed from annual grants.

- *New Markets Tax Credits* (NMTCs) – Competitive program that permits taxpayers to receive a credit against Federal income taxes for making qualified equity investments in designated Community Development Entities (CDEs); provides investors and individuals with credits against federal income tax in return for new investments made in eligible businesses and commercial projects in low-income areas.

- *Low Income Housing Tax Credits* (LIHTCs) – Competitive program that allows developers to finance the development of affordable rental housing for low-income households.

- *Proposition 1C Funds* – The Housing and Emergency Trust Fund Act of 2006, was created to promote housing in in-fill and transit oriented projects, as follows:

    - In-fill – funds roads, parking structures, transit linkages, traffic mitigation, demolition and site preparation, and sidewalks and streetscapes.

  - Transit-Oriented Development (TOD) – funds property acquisition/relocation, construction work, engineering design/supervision, environmental studies/remediation/mitigation, and replacement parking require by a public agency.

- *Multi-Family Housing Program (MHP)* – Provides deferred payment loans to developers and assists in the construction, rehabilitation and preservation of permanent and transitional rental housing for lower income households.

- *Workforce Initiative Subsidy for Homeownership (WISH)* – State program designed to help people living in high cost areas to purchase homes near their place of work.

- *CalHome* – State program providing grants to local public agencies and non-profit developers to assist individual households through deferred payment loans.

- *Building Equity and Growth in Neighborhoods (BEGIN)* – State program providing down payment assistance loans to qualifying first-time low- and moderate-income homebuyers.

C. Developer/Property Owner/User Sources

- *Community Facilities District (CFD)* – A special property tax placed against property located within the established district to fund public facilities and services. Municipal bonds secured by revenues from the special tax rate are sold by the CFD to provide upfront funding to build improvements or fund services.

- *Special Assessment District* – Similar to a CFD but the funding of infrastructure is shifted from all taxpayers to only those who benefit specifically from the improvement; sets a fixed lien on every parcel within the assessment district.

- *Landscaping Districts/Parking Districts* – Assessment on properties located within a specific district that benefit from landscaping and/or parking; alternatively, collection of parking in-lieu fees on new development in lieu of on-site parking.

- *Property-Based or Business Improvement District (PBID or BID)* – Annual fees paid by business owners and/or property owners to fund activities and programs intended to enhance the business environment in a defined area.

- *Development Impact Fees* – Fees paid by developers to pay all or a portion of the costs of any public facility that benefits their development.

- *Property Owners/Developer Exactions* – Payment made by developers or property owners in addition to, or in lieu of, development impact fees – funds are used to install selected public improvements; alternatively, developers are required to construct and deliver specific improvements.

- *Developer Advances/Reimbursements* – Transaction structured as a loan to the City/public agency to from a developer to fund backbone infrastructure; alternatively, developers construct and deliver specific improvements.