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To: City of Salinas

From: Vernazza Wolfe Associates, Inc.

Re: Updated Financial Feasibility Analysis – For Sale Housing

Vernazza Wolfe Associates, Inc. was asked by the City of Salinas to update the financial feasibility analysis of for-sale housing, originally completed in Fall 2015 as part of the Housing Impact Fee Nexus Study prepared for the City of Salinas. This updated analysis is based on slightly higher costs and sales prices as described below. There are two cases presented. The first assumes that the City does not adopt a housing impact fee, and the second case assumes a housing impact fee of \$12 per square foot. This memo presents the results of the updated feasibility testing,

First, we recalculated financial feasibility using more recent prices and eliminated two developments with outdated sales prices (2008 and 2011). The names of the low density single family home developments and the small lot single family home development, unit sizes, and sales prices used in this updated analysis are presented in Table A-1. These prices are higher than the ones used to model feasibility in 2015. Two of the developments – Tuscan Sun and Bella Sera – were not used in the earlier analysis. Secondly, development costs are increased by 4.4%. The increase in cost is based on the increase in construction costs for California between 2015 and 2016, according to the California Construction Cost Index (CCCI). While this Index is based on construction costs only, we have increased all development costs, including land, by this same percentage. Builders that own land or have firm options to buy land would likely not experience this increased cost. Thus, the costs here may be slightly higher which would mean our calculations are more conservative.

Revenue and cost assumptions used in this updated analysis are presented in Table A-2.

Although development costs were increased, based on the revised sales prices, the base case for the large density and small lot single family prototypes show greater financial feasibility in comparison to the earlier analysis. The return on costs for the low density development is approximately 20%, and the return on the small lot prototype is higher at 39%. (See Table A-3.)

We then considered what would happen to financial feasibility if a \$12/SF housing impact fee were adopted, given updated sales prices and development costs. The return on costs is reduced to 12% for the low density housing prototype and to 30% for the small lot single family prototype. (See Table A-4.) While the financial feasibility of the small lot single family prototype is stronger than the low density prototype, both with and without a \$12/SF housing impact fee, the adoption of a housing impact fee of \$12/SF is likely not to deter development of low density single family homes based on the assumptions presumed in this analysis.¹

Table 1 presents the results of the updated feasibility analysis. Appendix tables provide the detailed information used to calculate these findings.

Table 1: Return on Costs With and Without a \$12/SF Housing Impact Fee ⁽¹⁾

	Low Density Single Family	Small Lot Single Family
Base Case Return	20%	39%
Base Case with \$12 Housing Impact Fee	12%	30%

¹ Determining a financially feasible return on costs for single family developments is different than assessing feasibility assessment for other residential investments, such as apartments. More capital is at risk in the multifamily situation, since units cannot be built incrementally. A developer does not need to build out all the units in the two single family prototype developments analyzed for the City of Salinas. Instead, a developer can build some of the units, see how the market demand is, and then build more. Phasing of development reduces risk.

Also, unlike return on multifamily units, there are no specific industry standards, and so it is necessary to survey developers directly to see what returns are needed. As part of this nexus study, developers in Salinas were sent a brief survey, but only one developer provided information. Thus, this nexus study used results from a survey of developers in comparable markets in Oakland. This survey, conducted in 2015, determined that for low-density, single family homes, the required return on costs was 6% to 8%, and the return for townhomes (representing small lot single family units) was 7% to 9%. Thus, the threshold feasibility return on costs used in the Salinas Study is defined as an average for each - 7% for single family low density, and 8% for the small lot development.

UPDATED FINANCIAL FEASIBILITY ANALYSIS OF FOR SALE HOUSING
APPENDIX

A-1: Updated Sales Prices of Single Family Homes Used in Salinas Feasibility Analysis

Prototype	Location	Unit Size	Sales Price	Price per SF	Average Price/SF
Single Family Homes, Low Density					
Monte Bella, Tesori	Salinas	2,260 SF	\$415,000 to \$510,000	\$184 - \$226/SF	\$205
Tuscan Sun	Hollister	2,399	\$514,600	\$215	\$215
East Garrison	Unincorporated Monterey Co.	1,575 - 2,877 SF	\$452,000 - \$655,000	\$228/SF to \$287/SF	\$258
Average					\$226
Small Lot Single Family					
Bella Sera (Averages)	Hollister	1,746	\$478,900	\$274	\$274

Source: Market Research conducted in 2015 – 2016.

Table A-2: Updated Cost and Revenue Assumptions Used in Feasibility Analysis of Single Family Homes

	Low Density Single Family (Square Foot Costs)	Small Lot Single Family (Square Foot Costs)
Average Unit Sizes Based on Original Prototypes	2,600 SF	1,750 SF
Average Sales Prices Per SF (Updated)	\$226	\$274
Sales Expenses (3.5%)	\$7.90	\$9.60
Net Revenues	\$218.10	\$264.40
Cost Assumptions (2015)		
Site Improvements Per SF ⁽¹⁾	\$18.62	\$18.62
Building Costs Per SF ⁽²⁾	\$85.00	\$93.00
Soft Costs Per SF ⁽³⁾	\$27.10	\$27.10
Additional Costs Per SF ⁽⁴⁾	\$9.00	\$9.00
Land	\$35.07 per SF of house	\$35.07 per SF of house
Land - based on DU/Acre	6 DU/Acre	9 - 15 DU/Acre
Total Costs per SF (2015)	\$174.79	\$182.79
Total Costs per SF (2017) ⁽⁵⁾	\$182.48	\$190.83
Unit Sizes	2,600	1,750
Market Expectation of Return on Costs ⁽⁶⁾	7%	8%

Table Notes

- (1) Site improvements include demolition, grading, sewer, storm drain, water, PG&E, curb, gutter, erosion control, bio swales, water, storage, signing, landscaping, fencing, paving, etc. Parking is also included.
- (2) Building improvements cover all costs from foundation to carpet.
- (3) Soft costs include construction financing, contingency, developer fee, city fees, consultants, engineering, architect, and insurance
- (4) These include temporary fencing, utilities, toilets, labor, debris disposal, administrative project manager, superintendent, construction labor, off-site administration
- (5) The total costs per SF from 2015 are increased by 4.4%.
- (6) The expectation of return on costs measure used here (7% for low density single family and 8% for small lot single family) is based on feasibility modeling included in a recent Oakland Fee Study examining new development in Oakland submarkets, such as East Oakland, that are similar to the Salinas market.

Table A-3: Updated Feasibility Analysis of Single Family Homes without Housing Impact Fee

	Low Density Single Family		Small Lot Single Family	
	Per SF	Per Unit	Per SF	Per Unit
Total Development Costs	\$182.48	\$474,450	\$190.83	\$333,957
Gross Revenue	\$226	\$587,600	\$274	\$479,500
Sales Expenses	\$7.90	\$20,566	\$9.60	\$16,800
Net Revenue	\$218.10	\$567,060	\$264.68	\$463,197
Net Value After Cost	\$35.62	\$92,612	\$73.85	\$129,240
Return on Costs ⁽¹⁾	20%	20%	39%	39%
Market Expectation of Return on Costs	7%	7%	8%	8%

(1) Return on costs is defined as net value divided by development costs.

Source: Table A-2.

Table A-4: Updated Feasibility Analysis of Single Family Homes with \$12/SF Housing Impact Fee

	Low Density Single Family		Small Lot Single Family	
	Per SF	Per Unit	Per SF	Per Unit
Total Development Costs	\$194.48	\$505,648	\$202.83	\$354,953
Gross Revenue	\$226	\$587,600	\$274	\$479,500
Sales Expenses	\$7.90	\$20,566	\$9.60	\$16,800
Net Revenue	\$218.10	\$567,060	\$264.68	\$463,197
Net Value After Cost	\$23.62	\$61,412	\$61.85	\$108,238
Return on Costs ⁽¹⁾	12%	12%	30%	30%
Market Expectation of Return on Costs	7%	7%	8%	8%

(1) Return on costs is defined as net value divided by development costs.

Source: Table A-2.