



MEMORANDUM

To: Brian Halvorson, City of Lompoc Planning Manager

From: Ken K. Hira, President, Kosmont Companies
Thomas Jirovsky, Senior Advisor, Kosmont Companies

Date: April 4, 2023

Subject: **Lompoc New Housing Feasibility Analysis**

Kosmont & Associates, Inc. doing business as Kosmont Companies (“Kosmont”) is pleased to present this preliminary Analysis (“Analysis”) in connection with the production of infill housing to meet RHNA standards outlined in the City of Lompoc, California (“City”) Housing Element.

Kosmont, a certified Small Business Enterprise (“SBE”), is a real estate and economic development services firm with over 36 years of experience offering a full range of market and financial feasibility, fiscal and economic impact analyses, project finance, transaction structuring, negotiation assistance, special district analyses for California public and private sectors. See Appendix A for summary of Kosmont qualifications and public sector client list.

BACKGROUND AND OBJECTIVE

City requested assistance from Kosmont to provide a high-level housing market feasibility analysis, as to the current state of the residential market conditions in the City of Lompoc and their ability to meet State RHNA housing production primarily through new infill development. Kosmont also examined potential constraints that may impede the delivery of new housing development and the possibility of achieving RHNA compliance by the City.

We understand that the City seeks LAFCO approval of an Ad Hoc Subcommittee to work with City to address concerns over the City’s Sphere of Influence Adjustment Application (“Application”) submitted to the Santa Barbara County LAFCO and addressed in the February 2, 2023 meeting.

RESEARCH

Kosmont reviewed the City's draft Housing Element and met with the Lompoc Planning and Community Development managers to review the Housing Element. Kosmont toured the City and the identified areas zoned for residential development in the Housing Element. Data sources included draft Housing Element, Costar, interviews with local builders and Kosmont's experience with multi-family pro forma analysis.

Demographic Data

Kosmont prepared an Demographic and Economic Profile, illustrating social and economic characteristics, including population, household incomes, housing preferences and other metrics, such as amount of vacant and underutilized land parcels.

City population of 42,500 has had virtually zero growth in past 11 years, due to a 4% decline that began in 2017. Median Household Income is approximately \$55,000 – 35% less than County levels of \$83,200 for 2021.

According to the draft Housing Element, there are 13,657 housing units in the City, of which only 35% (5,000) are multi-family apartments, with 91% of the units more than 25 years old, and with 40% more than 50 years old.

Multi-Family Market Analysis

Kosmont analyzed the current and historic market conditions for single family and multi-family residential development within the City, including an analysis of existing inventory, vacancy, absorption rates, general price and/or rent levels and other factors that impact the feasibility of development in the City.

Median market rents for apartment units advertised on Zillow is approximately \$2,200 per month. However, these are typically Class A unit rents. Median rent for all market rate apartments according to CoStar is approximately \$1,700 per month.

Development Standards

The City has several zoning categories that accommodate multi-family development:

- R-2 requires 6.2 to 14.5 units per acre on lots no less than 6,000 SF
- R-3 requires 14.5 to 22 units per acre on lots no less than 7,000 SF
- Old Town Commercial (OTC) requires 20 to 44 units per acre on lots of 7,000 SF or larger
- MU allows all residential (including multi-family) at 14.5-44 units per acre on lots no less than 7,000 SF

Parking requirements are 1 space for each studio or 1 bedroom unit, and 2 spaces per unit for units with 2 or more bedrooms, which is a typical standard in suburban locations.

Developable Land Inventory

The City has 889 housing units planned and approved, but have yet to be built. During the Fifth Housing Element Cycle that just ended, the City adopted the H Street Corridor Infill

Area and H Street Overlay Zone that converted commercial zoning to mixed-use residential (multi-family) and commercial. The latest Draft Housing Element identifies 83 vacant or underutilized sites that are physically feasible to accommodate 1,421 new units to help meet the 2,500 unit RHNA goal. But based on our analysis, below, none of the high density is likely to be financially feasible due to high construction costs and an insufficient return on cost.

The definition of underutilized sites in the Draft Housing Element includes sites where the assessed value of improvements is less than the assessed value of the land, or where the improvements are less than half of allowable FAR density, or are over 50 years old.

It is important to note that only 32 sites are actually vacant and can accommodate 30% of the RHNA target units (~450). Of the vacant sites, only six are greater than one acre in size, with 19 parcels under 0.5 acres making multi-story construction problematic.

Estimated Land Cost

A Costar survey of recent vacant land sales in Lompoc indicate a value of \$500,000 to \$1 million per acre. Since 70% of the identified sites have physical improvements that most likely have economic value, the cost of acquiring those properties will be higher due to the existing improvements, which will have to be demolished to allow housing.

FINANCIAL FEASIBILITY ANALYSIS

It is important to recognize that increased density envisioned by the City's R-3 and OTC/MU zoning requires substantially higher construction costs estimated at \$25,000 to \$50,000 per unit, just to meet the onsite residential parking needs and requirements.

Capital investment in real estate development is a high-risk venture. In order to obtain financing commitments, developers must be able to demonstrate sufficient returns to offset the risks related to construction cost overruns and changes in the local economy during the multi-year entitlement and construction period that could affect market rents and occupancy following construction.

In our experience with development feasibility studies, the approach most widely accepted to determine financial feasibility is the return on cost, which is measured as the stabilized net operating income ("NOI") divided by gross development costs, and measured against a minimum acceptable annual return on cost threshold or profit margin.

Pro Forma Analysis

While there are many factors that impact developer interest in building new housing, pro forma analysis is a major tool used to determine if the proposed project will likely yield a substantial investment value at completion to repay the debt and equity capital required for land acquisition, entitlements and construction.

A key metric that developers, lenders and investors can use to assess the feasibility of new development is Residual Land Value (“RLV”). Using pro forma models, we can calculate the market value of a completed project (based on its estimated NOI), net of development costs and the developer’s profit.

RLV’s demonstrate the price that a developer can afford to pay for a site, by subtracting total hard and soft construction costs and an allowance for developer profit/overhead from the estimated value at stabilized occupancy. The remaining RLV must allow for a market rate return on cost to attract lenders and investors.

Kosmont has prepared a simple pro forma to illustrate the residual land value for the R-3 and OTC/MU zones with densities of 22 and 44 units per acre respectively, consistent with the City’s applicable upper density ranges for multi-family development for these zones, under a range of market rent assumptions starting at \$2,200 per month. Construction and operating cost estimates were based on Kosmont’s experience with similar apartment projects.

The Analysis also showed a 10-20% increase in rents above the current market rates to demonstrate the affect on profitability. This Analysis can then be compared to the estimated \$500,000 to \$1 million per acre cost of acquiring sites for development to identify a financing gap.

- Exhibit 1 illustrates development of 22 units on a 1-acre R-3 zoned site yields a **negative** land value approaching \$1 million per acre (=\$50,000 per unit).
- Exhibit 2 illustrates development of 44 units on a 1-acre OTC/MU zoned site yields a **negative** land value approaching \$3 million per acre (=\$75,000 per unit).

CONCLUSION

This Analysis shows that, with information available at this preliminary level, multi-family development meeting applicable zoning is generally not economically feasible. As a result, the City will likely not be able to meet RHNA’s Above Moderate production goals utilizing vacant/underutilized infill land within the next 8-year cycle, unless financial incentives of at least \$50,000 to \$75,000 per unit can be made available for market rate units.

Exhibit 1
R-3 Density 22/acre
Feasibility - Rent Sensitivity

			Scenario 1	Scenario 2	Scenario 3
			Current Rent	10% Higher	20% Higher
Residential Units	22	850 sf (net)			
Stabilized Income:					
Market Gross income	20	\$2,200 /mth	\$528,000	\$580,800	\$633,600
Low income Rent	2	\$1,200 /mth	\$28,800	\$31,680	\$34,560
Less: Vacancy Factor		5.0% of rent	<u>(\$26,400)</u>	<u>(\$29,040)</u>	<u>(\$31,680)</u>
Effective Gross Income (EGI)			\$530,400	\$583,440	\$636,480
Maint., Taxes & Insurance		35.0% of EGI	<u>(\$185,640)</u>	<u>(\$204,204)</u>	<u>(\$222,768)</u>
Net Operating Income			\$344,760	\$379,236	\$413,712
Development Costs					
Onsite Improvements	\$12.00	43,000 SF	\$516,000	\$516,000	\$516,000
Arch & Engineering	5.0%		\$247,500	\$247,500	\$247,500
Permits & Fees	\$ 15.00	psf	330,000	\$330,000	\$330,000
Resid. Construction	\$200	psf	\$4,400,000	\$4,400,000	\$4,400,000
Construction - Parking	\$25,000	per unit	\$550,000	\$550,000	\$550,000
Financing	5.8%	18 mths	\$320,595	\$320,595	\$320,595
Taxes & insurance	1.5%		\$82,913	\$82,913	\$82,913
Developer Overhead	3.0%	of costs	\$193,410	\$193,410	\$193,410
Contingency	5.0%	of costs	<u>\$322,350</u>	<u>\$322,350</u>	<u>\$322,350</u>
A. Total Costs			\$6,962,768	\$6,962,768	\$6,962,768
B. Threshold Return	6.00%		\$5,746,000	\$6,320,600	\$6,895,200
Residual Land Value (B - A)			<u>(\$1,220,000)</u>	<u>(\$640,000)</u>	<u>(\$70,000)</u>

Disclaimer:

The analyses, projections, assumptions presented herein are for illustrative purposes and are not a guarantee of future results. Actual results may differ from those expressed in this analysis as results are difficult to predict as a function of market conditions, natural disasters, pandemics, pandemics, significant economic impacts, legislation and administrative actions.

Exhibit 2
OTC High Density 44/acre
Feasibility - Rent Sensitivity

			Scenario 1 Current Rent	Scenario 2 10% Higher	Scenario 3 20% Higher
Residential Units	44	850 sf (net)			
Stabilized Income:					
Market Gross income	40	\$2,200 /mth	\$1,056,000	\$1,161,600	\$1,267,200
Low income Rent	4	\$1,200 /mth	\$57,600	\$63,360	\$69,120
Less: Vacancy Factor		5.0% of rent	<u>(\$55,680)</u>	<u>(\$61,248)</u>	<u>(\$66,816)</u>
Effective Gross Income (EGI)			\$1,057,920	\$1,163,712	\$1,269,504
Maint., Taxes & Insurance		35.0% of EGI	<u>(\$370,272)</u>	<u>(\$407,299)</u>	<u>(\$444,326)</u>
Net Operating Income			\$687,648	\$756,413	\$825,178
Development Costs					
Onsite Improvements	\$12.00	43,000 SF	\$516,000	\$516,000	\$516,000
Arch & Engineering	5.0%		\$550,000	\$550,000	\$550,000
Permits & Fees	\$ 15.00	psf	\$660,000	\$660,000	\$660,000
Resid. Construction	\$200	psf	\$8,800,000	\$8,800,000	\$8,800,000
Construction - Parking	\$50,000	per unit	\$2,200,000	\$2,200,000	\$2,200,000
Financing	6.0%	24 mths	\$732,600	\$732,600	\$732,600
Taxes & insurance	1.5%		\$183,150	\$183,150	\$183,150
Developer Overhead	3.0%	of costs	\$409,253	\$409,253	\$409,253
Contingency	5.0%	of costs	<u>\$682,088</u>	<u>\$682,088</u>	<u>\$682,088</u>
A. Total Costs			\$14,733,090	\$14,733,090	\$14,733,090
B. Threshold Return	6.00%		\$11,460,800	\$12,606,880	\$13,752,960
Residual Land Value (B - A)			<u>(\$3,270,000)</u>	<u>(\$2,130,000)</u>	<u>(\$980,000)</u>

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ATTACHMENT A

Kosmont Companies, a Small Business Enterprise (“SBE”), is a real estate and economic advisory firm offering a full range of market analysis, financial feasibility studies, fiscal impact analyses, project financing, transaction structuring, negotiation assistance and special district analyses for both the public and private sectors.

What sets Kosmont apart is our understanding of how economics relates to future project implementation, as well as our understanding and extensive experience working with both hundreds of municipalities and developers throughout California. We have extensive experience in Santa Barbara County, having done market and economic studies for major development projects in Santa Barbara, Goleta, Carpinteria, Buellton and King City.

We integrate our established ability, strengths, seasoned experience, and hands-on knowledge to deliver the requested consulting services. A brief highlight of our services can be found below:

Economic Development Consulting Services

- Economic Development Strategies (EDSP)
- Special Districts (e.g., Enhanced Infrastructure Financing Districts)
- Downtown Revitalization
- Asset Management Plans
- Tax/Fee Analysis
- Developer Selection RFQ/RFP & ENA/DDA

Land Use/Zoning and Community Planning Services

- Development Opportunity Reserve (D.O.R.[®])
- Sales Tax Assessment Revenue (STAR*[®])
- Other Zoning & Implementation Strategies for Economic Development

Planning and Development Services

- Project Market Evaluation
- Project Financials & Pro-Forma Assessment
- Property Acquisition/Leasing
- Land Use/Entitlements
- Due Diligence Reports

Real Estate Economics & Financial Advisory Services

- Fiscal & Economic Impacts
- Project Economics, Highest & Best Use (HBU) & Market Studies
- Public & Private Financing Structures
- Affordable Housing (Pro Forma, Housing Element, Negotiation Assistance, Feasibility)

Kosmont staff includes economic consultants, real estate brokers and public finance professionals along with former real estate developers and city community development officials that provide an in-depth understanding of the California economy, its local real estate markets to more effectively respond to our Clients advisory needs.

Kosmont is a full-service firm which also provides various other services through Kosmont Realty (“KR”) and Kosmont Financial Services (“KFS”). KR is a full service and licensed real estate brokerage firm and KFS is a public finance firm registered with the SEC.

In the aggregate, Kosmont Companies have extensive experience working with local and State government on real estate transactions between public agencies and private parties and structured project financing involving public and private funding sources. Collectively, Kosmont provides public agencies broad access to real estate consultants and brokers, public sector deal structure experts, and public-private financial advisors. Our diverse roles and experience in the real estate and financial industries have made us highly adaptable and skilled for this type of assignment.

Kosmont has been the recipient of numerous awards for its advisory services:

- California City Management Foundation (CCMF)
Kosmont Companies is the proud recipient of the
“2022 CCMF Corporate Sponsor of the Year Award”
- Southern California Association of Governments (SCAG)
Sustainability Award “5/2019 – City of Placentia”
- Mr. Larry J. Kosmont, CRE® is the honored recipient of the

“2016 California Business Properties Association (CBPA) Champion of the Industry Award” (
for his service in real estate and economic development)

- California Association for Local Economic Development (CALED)

“2014 Award of Excellence in Economic Development Partnerships

[South Gate azalea Project](#)”

- California Association for Local Economic Development (CALED) Awards of Excellence P

“2017 Award of Excellence for Economic Development Partnerships

– Redondo Beach Marine Ave Hotels Project ”

Client List

On the following page we have listed a select sampling of the hundreds of public agency clients Kosmont has assisted in California.

Select Public Sector Client List

Agoura Hills, City of:	Indio, City of:	Rialto, City of:
Alhambra, City of:	Irvine, City of:	Riverside, City of:
Aliso Viejo:, City of:	La Mirada, City of:	Salinas, City of:
Anaheim, City of:	La Puente, City of:	San Dimas, City of
Arroyo Grande, City of:	La Verne, City of:	San Fernando, City of:
Azusa, City of:	Laguna Hills, City of:	San Gabriel, City of:
Bakersfield, City of:	Lancaster, City of:	San Juan Capistrano, City of:
Baldwin Park, City of:	Lomita, City of:	San Luis Obispo, City of:
Buellton, City of:	Long Beach, City of:	Santa Ana, City of:
Camarillo, City of:	Los Angeles County	Santa Barbara, City of:
Carson, City of:	Manhattan Beach, City of:	Santa Clarita, City of:
Carpinteria, City of:	Mission Viejo, City of:	Santa Fe Springs, City of:
Chula Vista, City of:	Modesto, City of:	Santa Paula DLA
City of Glendora:	Montebello, City of:	Sausalito, City of:
Commerce, City of:	Moreno Valley, City of:	Seal Beach, City of:
Culver City, City of:	Murrieta, City of:	Simi Valley, City of:
Cypress, City of:	Newport Beach, City of	Solvang, City of:
Daly City, City of:	Norwalk, City of:	South Gate, City of:
Diamond Bar, City of:	Ontario, City of:	South Pasadena, City of:
Duarte, City of:	Oxnard, City of:	St. Helena, City of:
Eastvale, City of:	Palmdale, City of:	Temple City, City of:
El Monte, City of:	Paramount, City of:	Thousand Oaks, City of:
El Segundo, City of	Pasadena, City of:	Upland, City of:
Escondido, City of	Perris, City of:	Vernon, City of:
Fresno, City of:	Pico Rivera, City of:	Victorville, City of:
Fullerton, City of:	Pismo Beach DLA	Walnut, City of
Gardena, City of:	Placentia, City of:	West Covina, City of:
Goleta, City of	Poway, City of:	Whittier, City of:
Hawthorne, City of:	Rancho Cucamonga, City of:	Yorba Linda, City of:
Hermosa Beach, City of:	Rancho Mirage, City of:	Yucaipa, City of:
Huntington Park, City of:	Rancho Palos Verdes, City of	
Indian Wells, City of:	Redlands, City of:	
	Redondo Beach, City of:	