



# El Dorado County Development Feasibility Study

December 7, 2010

**Economic & Planning Systems, Inc.**

*Public Finance • Real Estate Economics • Regional Economics • Land Use Policy*

*Presented by:  
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# Overview of Presentation

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- ▶ **Key findings**
- ▶ **Factors contributing to a slow recovery**
- ▶ **New home pricing**
- ▶ **Housing feasibility**
- ▶ **Next steps**



# Key Findings

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- ▶ **Magnitude of home price appreciation (2000-2005) was not sustainable in the long run. Future appreciation at the same scale is not likely to occur.**
- ▶ **Feasibility analysis should be based on historical relations between housing prices and income levels and traditional mortgage financing.**
- ▶ **For most entry-level and mid-range housing products, current infrastructure costs and fees exceed feasible ranges.**
- ▶ **Site improvement requirements and resulting costs also contribute to the infeasibility of new development.**



## **Key Findings (cont.)**

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- ▶ **The result is that new development for a large segment of potential homebuyers is infeasible.**
- ▶ **In most areas in the County, current cost structure makes single-family products below \$425,000-\$450,000 infeasible.**
- ▶ **Multifamily products below \$250,000 infeasible given current cost structure.**

# Required Reductions Range from \$20,000 to \$40,000 per Unit

## Example of Cost Reductions Required

| Item                                  | El Dorado Hills Prototype |                 | Minimum Reduction Required<br>[1] |
|---------------------------------------|---------------------------|-----------------|-----------------------------------|
|                                       | Existing Situation        | Reduced Costs   |                                   |
| Estimated Home Price                  | \$400,000                 | \$400,000       |                                   |
| <b>Current Infrastructure Burden</b>  |                           |                 |                                   |
| Amount                                | \$103,000                 | <b>\$80,000</b> | <b>(\$23,000)</b>                 |
| Percent of Home Price (Target 15-20%) | 26%                       | 20%             |                                   |
| <b>Residual Land Value</b>            |                           |                 |                                   |
| Amount                                | \$20,000                  | \$43,000        |                                   |
| Percent of Home Price (Target 10-15%) | 5%                        | 11%             |                                   |

[1] Minimum reduction required to fall within acceptable ranges.



# Potential Solutions

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## ▶ Immediate

- ▶ Reduce fees as an economic development incentive

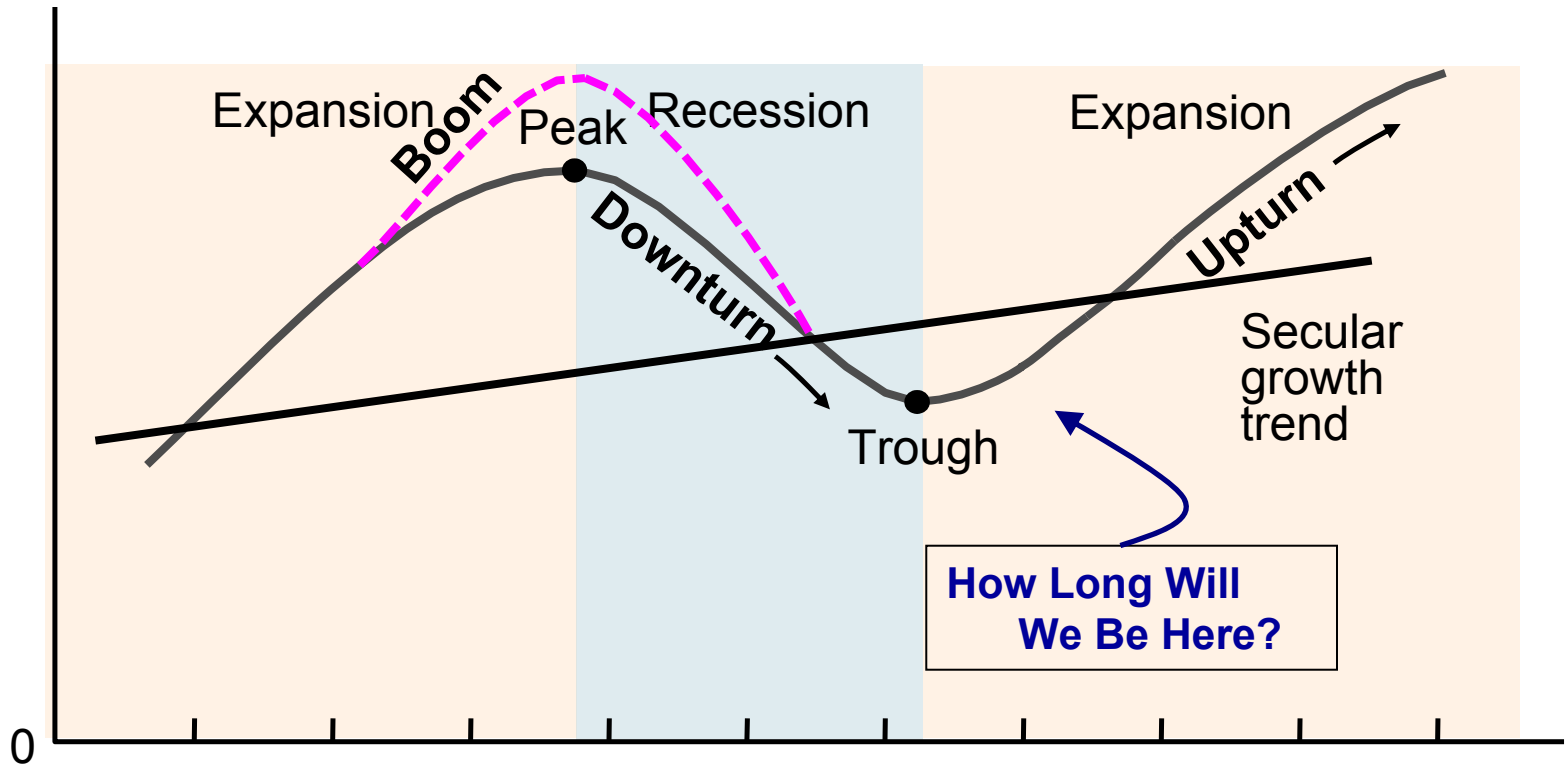
## ▶ Short to Mid-Term

- ▶ Update fee nexus studies to reflect cost reductions

## ▶ Long Term

- ▶ Revise General Plan or Specific Plan service level standards and facilities requirements

# Prolonged Economic Recovery



Source: McGraw-Hill/Irwin

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# Factors Contributing to a Slow Recovery

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- ▶ **Overall economic issues:**
  - ▶ Fewer jobs.
  - ▶ Slower income growth.
- ▶ **State and local government budget shortfalls limiting regional economic and employment-related growth.**
- ▶ **Issues specific to the real estate industry:**
  - ▶ Restructuring of home financing industry.
  - ▶ Overly restrictive credit standards.

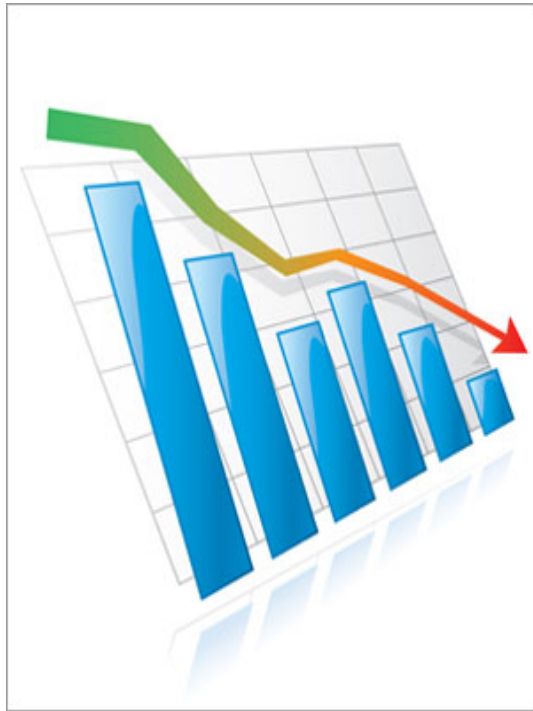


# Implications for Infrastructure Funding Capacity

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- ▶ **Developers will not be able to advance-fund infrastructure to the same extent as past years:**
  - ▶ **Slower absorption of residential units.**
  - ▶ **Increased regulation and lending requirements of the private debt and equity markets.**
  - ▶ **More highly regulated public debt market for land-secured financing.**

# New Home Pricing Trends





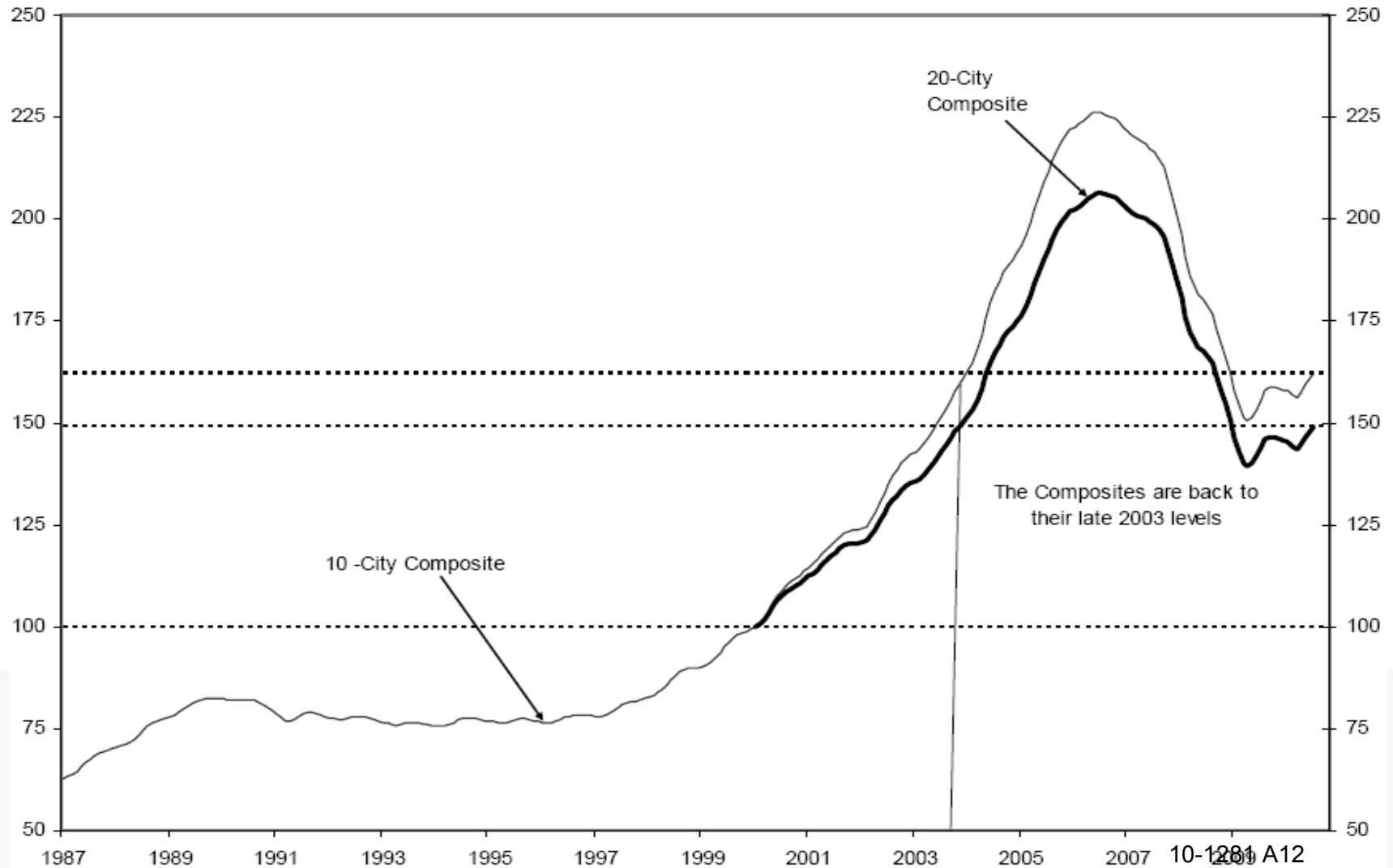
# New Home Pricing

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- ▶ **Past trends in new home prices were unsustainable for the long run.**
- ▶ **Household incomes could not support high price levels.**
- ▶ **Recent price reductions and steady income levels have resulted in more affordable housing.**
- ▶ **Future El Dorado County demand will lead to a more balanced housing market with diversity of housing product types.**

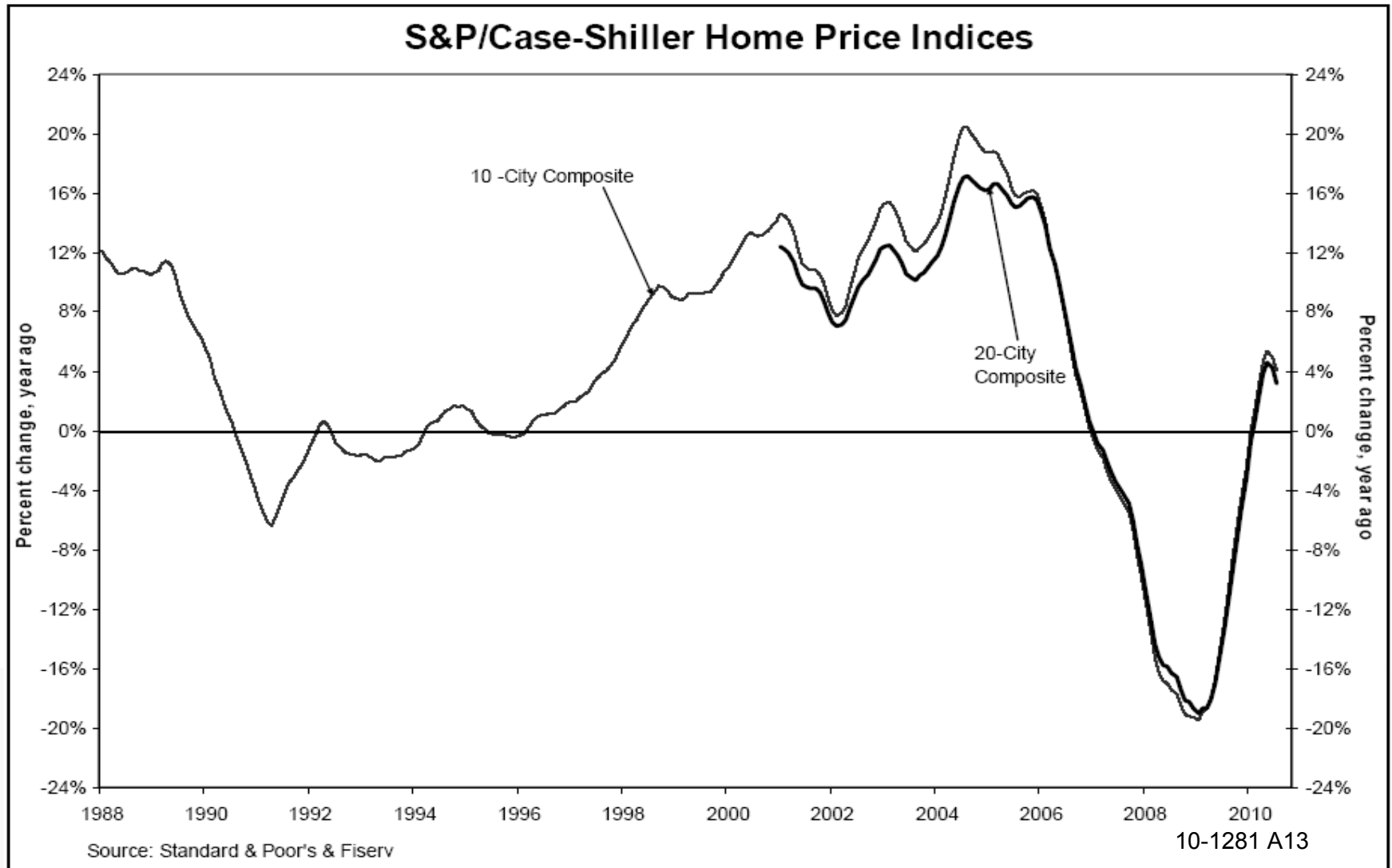


# Case-Shiller Housing Price Index (1987 to 2009)





# Case-Shiller Housing Price Index (1988 to 2010)



# Housing Price Appreciation Was Driven Primarily By Factors Other Than Income:

**“Housing prices have been driven by loose credit standards and misguided lender/borrower expectations that home prices would continue to rise”  
– Bank of America (January 2009)**

## **Aggressive Financing Practices:**

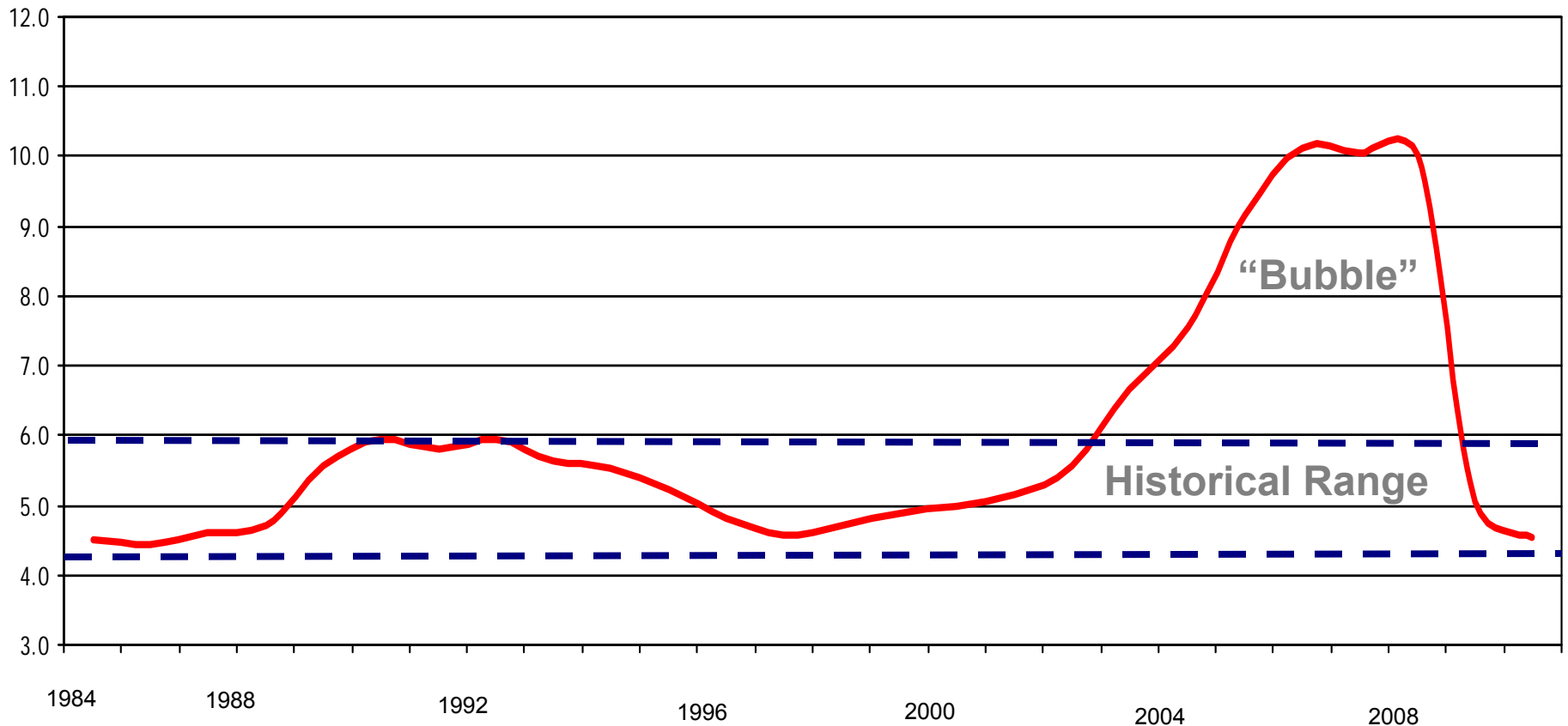
- Increased use of ARMs and Hybrid ARMs.
- Increased subprime lending.
- Lower underwriting standards.
- Zero down payment loans.

## **Increased Availability of Capital:**

- Securitization of mortgages.
- Institutional real estate investment.
- Foreign real estate investment.
- Private investment movement from stock to real estate capital markets.

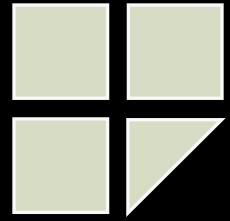
**These factors are not likely to reappear in the near future.**

# Ratio of Average New Home Price to Median Income: California

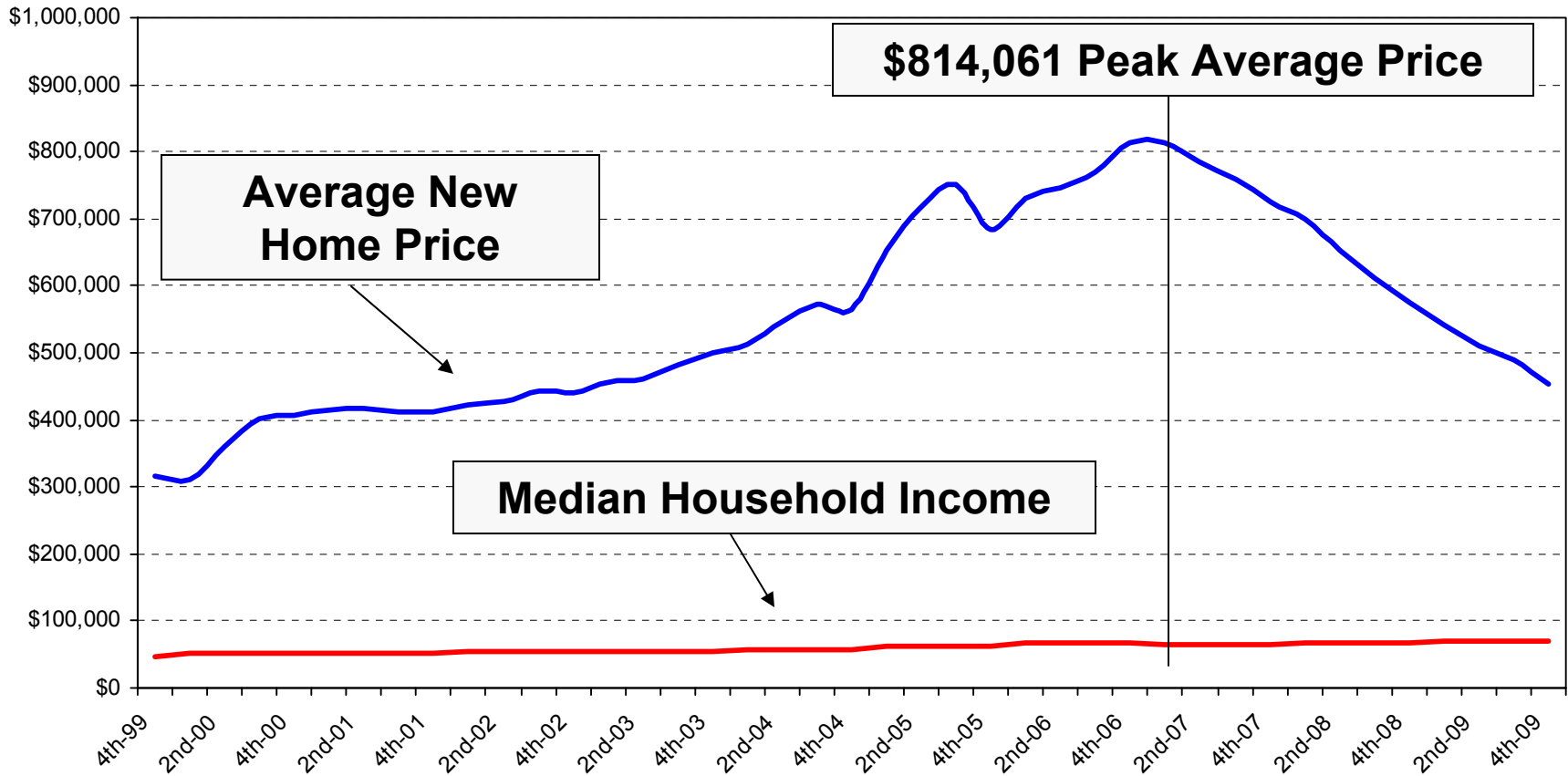


Source: The Gregory Group, EPS, US Census, Census 2000, American Community Survey, Estimates by The Gregory Group (Income 1999, 2001 and 2008).

# Relationship Between Estimated Average New Home Price and Median Household Income: El Dorado County



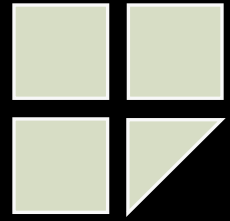
Note: Pricing after 4<sup>th</sup> Quarter 2007 reflects price estimated for projects to average 1.00 sales per week.



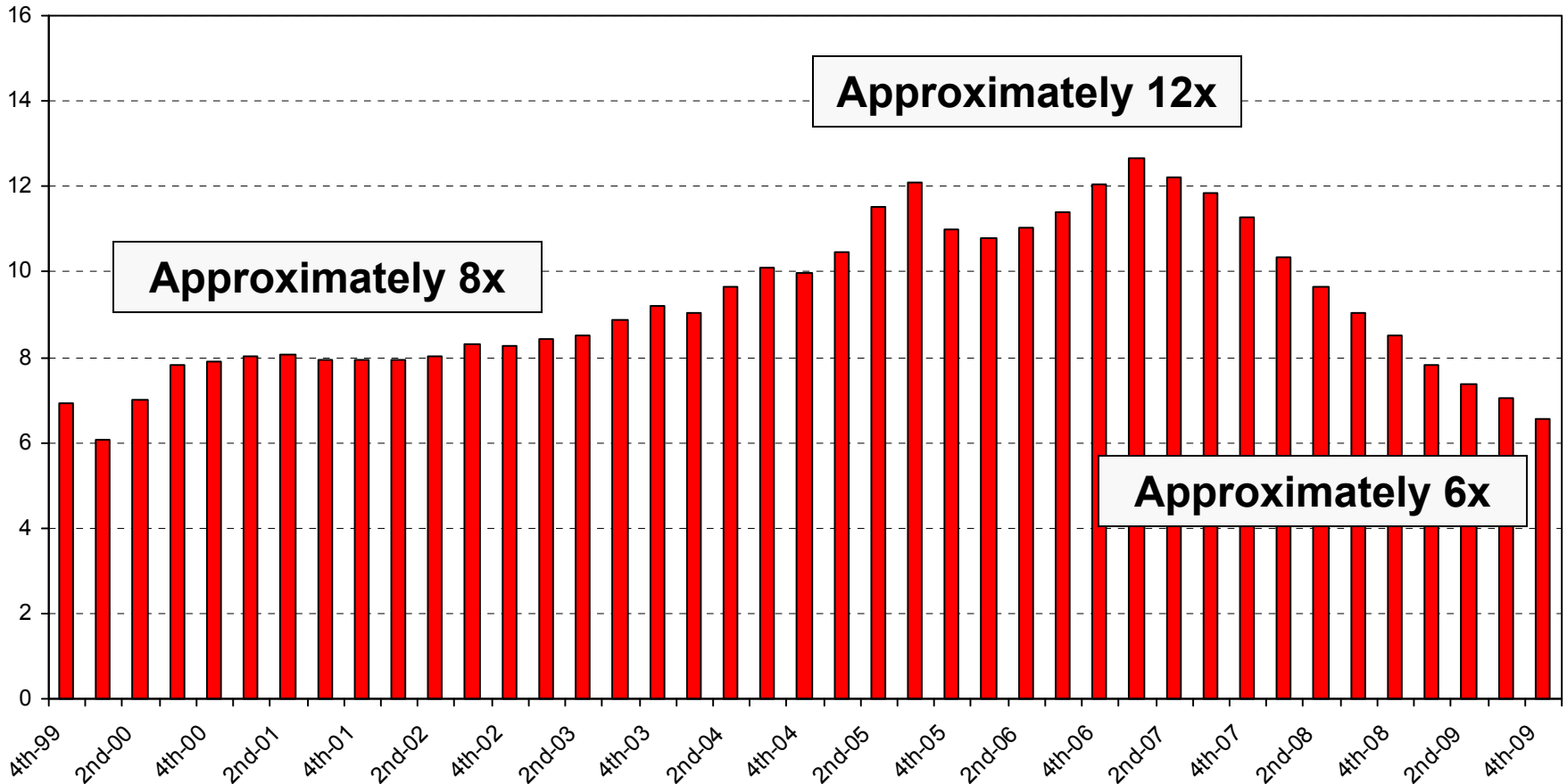
Source: The Gregory Group (Estimates 1999 and 2009), US Census, Census 2000, California Employment Development Department (2001 – 2007), American Community Survey (2008)



# Ratio of New Home Price to Median Income (El Dorado County)



Note: Pricing (and ratio) after 4<sup>th</sup> Quarter 2007 reflects price estimated for projects to average 1.00 sales per week.



# A New Paradigm – Back to Fundamentals



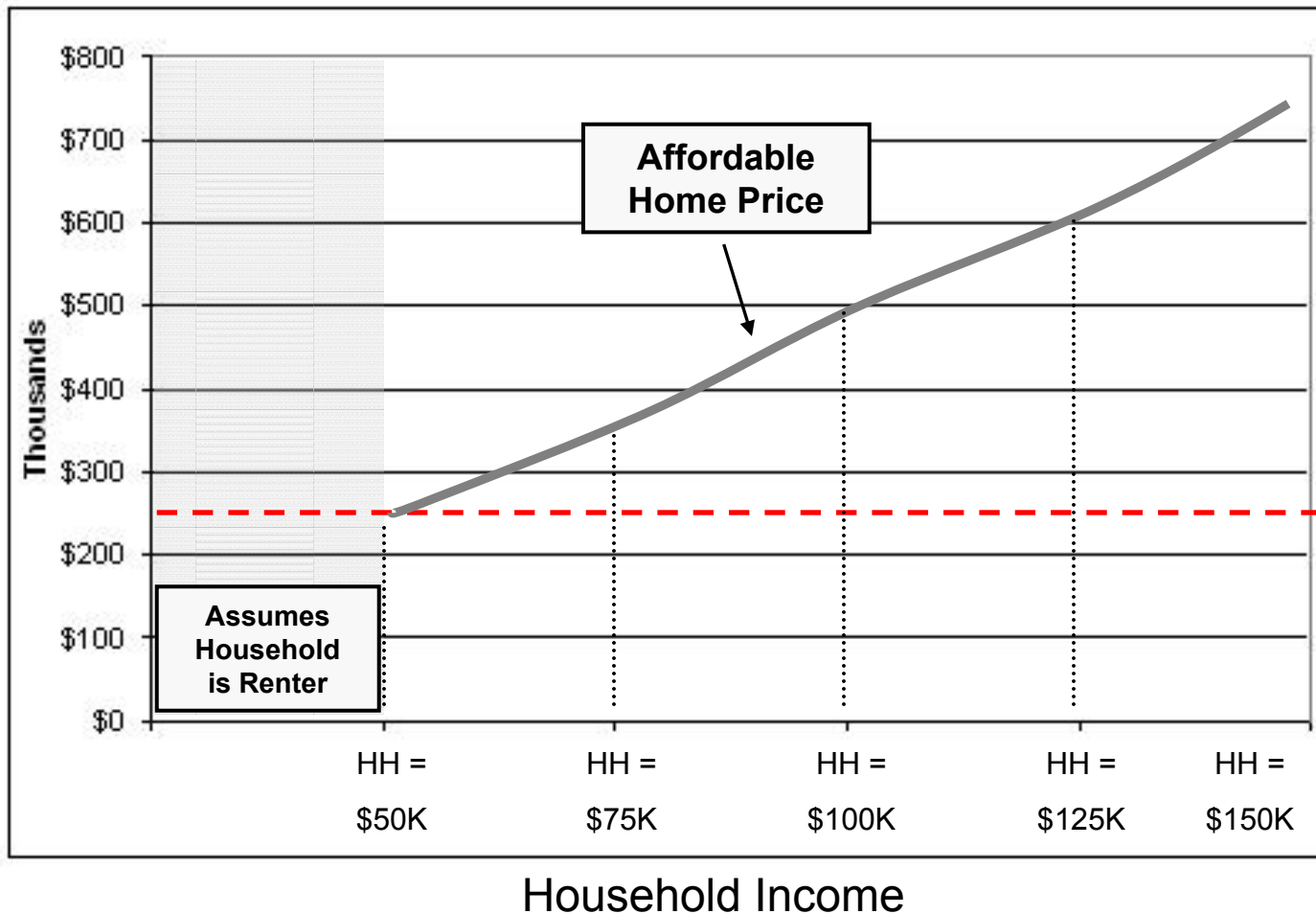


# Relationship of Housing Prices Relative to Income

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- ▶ **In a sustainable and stable market, home prices must be linked to household income levels.**

# Estimated Housing Prices and Affordability Based on Income



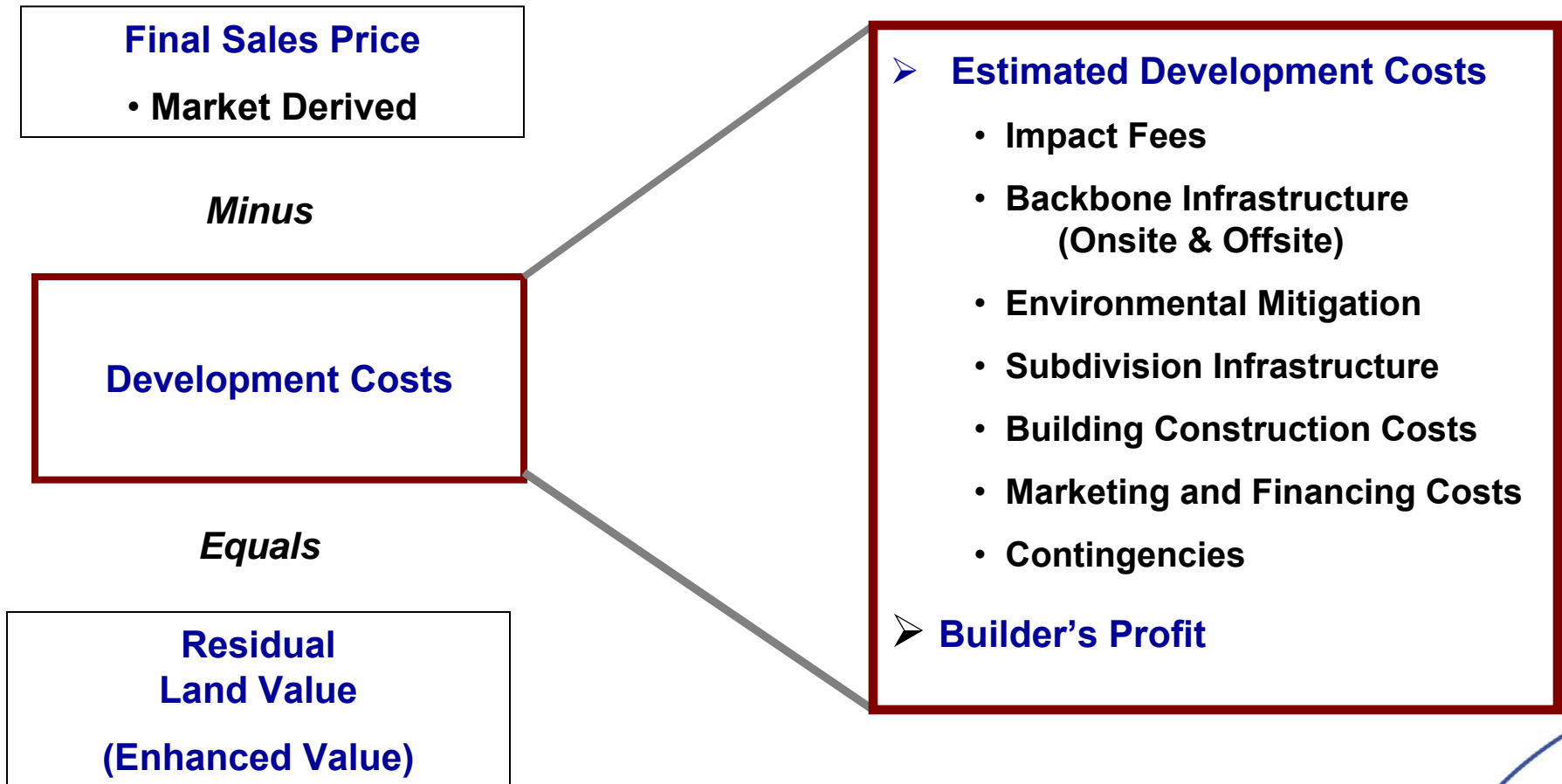
Median CA Home Sales  
= \$260 K  
(6/10)

# Measures of Development Feasibility

- ▶ **Residual Land Value.**
- ▶ **Infrastructure Cost Burden as a Percentage of Finished Home Sales Price.**



# Residual Land Value



# Land Development Cost



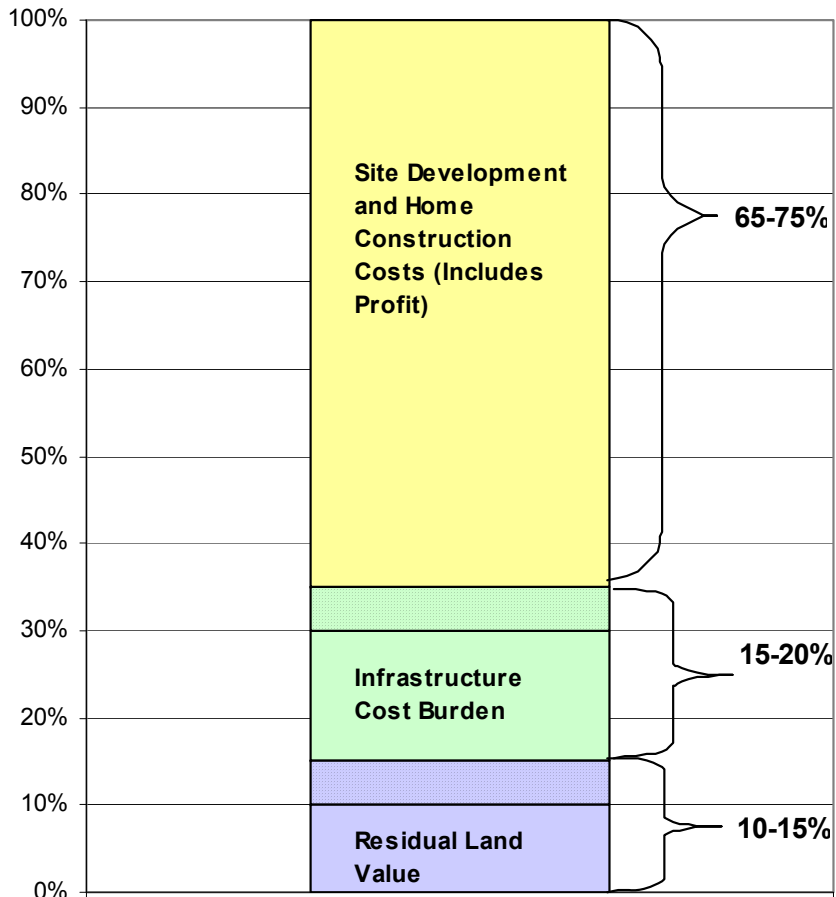
**Residual Land Value  
(Enhanced Value)**



- Land Acquisition
- Entitlement Costs
- Environmental Impact Report
- Planning Documents
- Infrastructure Master Plan
- Environmental Mitigation
- Developer Overhead
- Land Developer Profit

# Typical Components of New Single-Family Home Construction

Components of New Single Family Home Construction





# Residual Land Value Calculation – Single-Family Development

| Item   | Target %                   | Actual % of Selling Price - Single Family |                            |                            |                     |
|--|----------------------------|---|----------------------------|----------------------------|---------------------|
|  |                            | El Dorado Hills                           | Cameron Hills              | Oak Highlands              | Placerville Estates |
| Home Price   |                            | \$400,000                                 | \$340,000                  | \$300,000                  | \$354,000           |
| <b>Infrastructure Burden</b>                       | <b>No more than 15-20%</b> | <b>26%</b>                                | <b>29%</b>                 | <b>27%</b>                 | <b>19%</b>          |
| Unit Development                                   |                            | 69%                                       | 80%                        | 70%                        | 93%                 |
| Total Cost of Unit                                 |                            | 95%                                       | 109%                       | 97%                        | 112%                |
| <b>Residual Land Value</b>                         | <b>No less than 10-15%</b> | <b>5%</b>                                 | <b>-9%</b>                 | <b>3%</b>                  | <b>-12%</b>         |
| <b>Feasibility Test</b>                            |                            | <b>FAILS</b>                              | <b>FAILS</b>               | <b>FAILS</b>               | <b>FAILS</b>        |
| <b>Potential Range of Cost Reductions Required</b> |                            | <b>\$23,000 - \$43,000</b>                | <b>\$30,000 - \$47,000</b> | <b>\$22,000 - \$37,000</b> | <b>see note</b>     |

Note: Site improvement costs contribute to infeasibility of project.

# Residual Land Value Calculation – Single-Family Pro Forma Examples

| Item   | Feasibility Targets | Feasibility Range | Residual Land Value |                    |                  |                    |
|--|---------------------|-------------------|---------------------|--------------------|------------------|--------------------|
|  |                     |                   | El Dorado Hills     |                    | Oak Highlands    |                    |
|  |                     |                   | Total               | % of Selling Price | Total            | % of Selling Price |
| <b>Assumed Home Price</b>                      |                     |                   | \$400,000           | 100%               | \$300,000        | 100%               |
| <b>Infrastructure Burden</b>                   |                     |                   |                     |                    |                  |                    |
| City/County, Plan Area, & School Fees          |                     |                   | \$86,000            | 22%                | \$82,000         | 27%                |
| Other Backbone Infrastructure Costs            |                     |                   | \$17,347            | 4%                 | -                | 0%                 |
| <b>Subtotal Infrastructure Burden</b>          |                     | <b>15-20%</b>     | <b>\$103,347</b>    | <b>26%</b>         | <b>\$82,000</b>  | <b>27%</b>         |
| <b>Unit Development</b>                        |                     |                   |                     |                    |                  |                    |
| Cost of Unit Construction                      |                     |                   | \$136,875           | 34%                | \$113,150        | 38%                |
| In-tract Subdivision Infrastructure            |                     |                   | \$60,412            | 15%                | \$35,993         | 12%                |
| Soft Cost (20% of In-tract + Unit Const. Cost) |                     |                   | \$39,457            | 10%                | \$29,829         | 10%                |
| Builder Profit (10% of Sale Price)             |                     |                   | \$40,000            | 10%                | \$30,000         | 10%                |
| <b>Subtotal Unit Development Cost</b>          |                     |                   | <b>\$276,744</b>    | <b>69%</b>         | <b>\$208,972</b> | <b>70%</b>         |
| <b>TOTAL COST OF UNIT</b>                      |                     |                   | <b>\$380,091</b>    | <b>95%</b>         | <b>\$290,972</b> | <b>97%</b>         |
| <b>Residual Land Value (Paper Lot) [5]</b>     |                     | <b>10-15%</b>     | <b>\$19,909</b>     | <b>5%</b>          | <b>\$9,028</b>   | <b>3%</b>          |
| <b>Feasibility Tests</b>                       |                     |                   |                     |                    |                  |                    |
| Infrastructure Burden                          |                     |                   |                     | <b>FAIL</b>        |                  | <b>FAIL</b>        |
| Residual Land Value                            |                     |                   |                     | <b>FAIL</b>        |                  | <b>FAIL</b>        |

# Residual Land Value Calculation – Multifamily Development

| Item                         | Target %                   | Attached Multifamily - For-Sale |               | Multifamily - For-Rent |
|------------------------------|----------------------------|---------------------------------|---------------|------------------------|
|                              |                            | Cameron Park                    | Oak Highlands | El Dorado Hills        |
| Home Price                   |                            | \$240,000                       | \$210,000     | \$151,000              |
| <b>Infrastructure Burden</b> | <b>No more than 15-20%</b> | <b>30%</b>                      | <b>28%</b>    | <b>45%</b>             |
| Unit Development             |                            | 69%                             | 76%           | 106%                   |
| Total Cost of Unit           |                            | 99%                             | 104%          | 151%                   |
| <b>Residual Land Value</b>   | <b>No less than 10-15%</b> | <b>1%</b>                       | <b>-4%</b>    | <b>-51%</b>            |
| <b>Feasibility Test</b>      |                            | <b>FAILS</b>                    | <b>FAILS</b>  | <b>FAILS</b>           |

# Impact on Funding Infrastructure

- ▶ Industry standard assumptions:  $\leq$  15%-20% of home price.
- ▶ Example Peak and Current Market Conditions:

|                       | <u>Assumptions</u> | <u>Peak</u> | <u>Current</u> |
|-----------------------|--------------------|-------------|----------------|
| Average Home Price    |                    | \$600,000   | \$400,000      |
| Feasibility Range     | 15%                | \$90,000    | \$60,000       |
| For Backbone          | to                 | to          | to             |
| Infrastructure        | 20%                | \$120,000   | \$80,000       |
| and Public Facilities |                    |             |                |

*Decrease of approximately \$30,000-\$40,000 per unit.*

# Impact on Mello-Roos Financing

- ▶ Target:  $\leq 0.4\%$  of home price.
- ▶ Peak & current market price points:

|                                 | <u>Assumptions</u> | <u>Peak</u> | <u>Current</u> |
|---------------------------------|--------------------|-------------|----------------|
| Average Home Price              |                    | \$600,000   | \$400,000      |
| Tax Rate for Infrastructure     | 0.4% of Home Price | \$2,400     | \$1,600        |
| Total Bonds                     |                    | \$26,400    | \$17,600       |
| Estimated Construction Proceeds | 75% of Bonds       | \$19,800    | \$13,200       |

***Decrease of approximately \$6,600 per unit.***

# Potential Solutions

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# The Public/Private Partnership

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**A new paradigm for public finance is required.**

- ▶ **Builders and public agencies need to work together to reset expectations and responsibilities.**
- ▶ **Builders and public agencies need to recognize that home prices have fallen to a range that matches available income.**
- ▶ **Builders will need to adjust products and land plans.**
- ▶ **Public agencies will need to adjust expectations as to how much new housing can contribute to infrastructure.**



# Potential Solutions

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- ▶ **Immediate actions**
- ▶ **Short- to mid-term actions**
- ▶ **Long-term actions**





# Immediate Actions

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- ▶ **Authorize fee deferrals**
- ▶ **Permit fee financing**
  - ▶ **Participate in SCIP or other program(s).**
- ▶ **Interim reductions**
  - ▶ **Economic development incentives**
  - ▶ **This would allow fees to adjust with economic recovery**
- ▶ **Implement fee waivers**



# Short- to Mid-Term Actions

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- ▶ **Update nexus studies considering the following:**
  - ▶ Updated facility master plans.
  - ▶ Updated cost estimates.
  - ▶ Updated land use and cost allocation assumptions.
  - ▶ Fees scaled to unit size.
  - ▶ Total fee obligation based on percentage of valuation.
  - ▶ Apply available federal or State funding to high priority projects.
  
- ▶ **Establish alternative development-based financing methods to fund obligations.**



# Long-Term Actions

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- ▶ **Revise General Plan or specific plan service standards and facility requirements.**
- ▶ **Amend existing ordinances that impose costs on development.**
- ▶ **Develop broad-based funding sources for infrastructure priorities (e.g., local sales tax measure or real estate transfer tax).**
- ▶ **Identify economic development opportunities that strengthen the economic base and viability of local economy.**



# El Dorado County Development Feasibility Study

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## Questions and Comments