



**KEYSER MARSTON ASSOCIATES™**  
ADVISORS IN PUBLIC/PRIVATE REAL ESTATE DEVELOPMENT

## MEMORANDUM

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**To:** Judson Brown, Housing Division Manager  
City of Santa Ana

**From:** Tim Bretz

**Date:** October 27, 2022

**Subject:** Habitat Washington Avenue – Preliminary Financial Gap Analysis

At your request, Keyser Marston Associates, Inc. (KMA) prepared a preliminary financial gap analysis for the project proposed to be developed at 1921 West Washington Avenue (Site) by Habitat for Humanity of Orange County (Habitat). The Site is currently owned by Habitat. Habitat proposes to demolish the existing vacant structures on the Site, and construct six for-sale units to be sold to low income households (Project). Habitat is requesting \$2.20 million in financial assistance from the City of Santa Ana (City). The purpose of the KMA analysis is to evaluate Habitat's financial assistance request.

### EXECUTIVE SUMMARY

The results of the KMA financial gap analysis are compared to Habitat's financial proposal in the following table:

	KMA	Habitat	Difference
Total Development Costs	\$4,290,000	\$4,311,000	(\$21,000)
(Less) Total Available Revenue	(2,054,000)	(2,111,000)	\$57,000
Estimated Financial Gap	\$2,236,000	\$2,200,000	\$36,000

As shown in the preceding table, KMA estimates the Project's financial gap at \$2.24 million. Comparatively, Habitat is requesting \$2.20 million in financial assistance from the City. This equates to a \$36,000, or less than 2% differential. As such, it can be concluded that the proposed City financial assistance will not provide a windfall profit to Habitat.

## PROJECT DESCRIPTION

The proposed scope of development can be described as follows:

1. The Site area totals approximately 16,000 square feet, or approximately 0.37-acres of land area.
2. The Project's unit mix can be summarized as follows:
  - a. The Project will include six for-sale units developed in three duplex buildings, which equates to a density of 16 units per acre.
  - b. Each of the units will include three bedrooms and two bathrooms.
  - c. Four units will be approximately 1,430 square feet of gross building area (GBA) and two units will be approximately 1,165 square feet of GBA, which results in an average unit size of 1,340 square feet of GBA; and
  - d. The Project's total GBA is estimated at 8,050 square feet.
3. Each unit incorporates an attached garage consisting of two parking spaces. An additional surface parking space will be provided for a van stall. This results in a total of 13 parking spaces for the Project.
4. All six units will be restricted to low income households per the definitions set forth in California Health and Safety Code (H&SC).

## FINANCIAL GAP ANALYSIS

KMA prepared a pro forma analysis to estimate the Project's financial gap. The analysis is located at the end of this memorandum, and is organized as follows:

Table 1:	Estimated Development Costs
Table 2:	Estimated Available Revenue
Table 3:	Estimated Financial Gap
Table 4:	Silent Second Mortgage Revenue Calculation
Table 5:	Affordable Sales Price Calculation

### Estimated Development Costs (Table 1)

KMA reviewed Habitat's October 2022 pro forma, and then independently prepared a pro forma analysis of the Project. The resulting construction costs are estimated as follows:

#### PROPERTY ACQUISITION COSTS

Based on information provided by Habitat, Habitat purchased the Site for \$580,000, which equates to a purchase price of \$36 per square foot of land area. Habitat did not provide an appraisal and/or purchase and sale agreement to confirm the purchase price.

#### DIRECT COSTS

The direct costs assume that the Project will not be subject to State of California and/or Federal Davis Bacon prevailing wage requirements. The direct costs can be summarized as follows:

1. The site improvement costs are estimated at \$581,000, or \$36 per square foot of land area.
2. The building costs are estimated at \$1.58 million. This equates to \$196 per square foot of GBA, or \$263,000 per unit. KMA assumes that the general conditions and Habitat supervision costs are included in this line item.
3. A direct cost contingency allowance equal to 10% of other direct costs is provided.

KMA estimates the total direct costs at \$2.38 million. This equates to \$295 per square foot of GBA or \$396,000 per unit.

### INDIRECT COSTS

KMA utilized the following assumptions in estimating the indirect costs:

1. The architecture, engineering and consulting costs are estimated at 12% of direct costs, or \$285,000.
2. Habitat estimates the public permits and fees costs at \$40,000 per unit, or \$240,000. City staff should verify the accuracy of this estimate.
3. The taxes, legal and accounting costs are estimated at 3% of direct costs, or \$71,000.
4. The insurance costs are based on Habitat's estimate of \$7,200 per unit, or \$43,000.
5. The Developer Fee is set at \$480,000, which equates to 13% of net development costs (excluding the Developer Fee). This estimate is within the range of similar projects.
6. An indirect cost contingency allowance equal to 10% of other indirect costs is provided.

KMA estimates the total indirect costs at \$1.23 million.

### FINANCING COSTS

The financing costs for the Project are estimated as follows:

1. The interest costs to be incurred during the construction period are estimated at \$32,000. This cost estimate is based on the following assumptions:
  - a. KMA assumes that Habitat will obtain a construction loan from a 3<sup>rd</sup> party lender for the Project. KMA estimates the construction loan amount at \$765,000, which is calculated based on the total development costs less 90% of the City's financial assistance, Habitat fundraising assistance, Developer Fee, closing costs, and warranty costs.
  - b. KMA assumes that the construction loan will carry the following terms:

- i. A 7.0% interest rate;
  - ii. A 12-month construction period; and
  - iii. A 60% average outstanding balance.
2. The financing fees for the construction loan are estimated at 1.0 point, or \$8,000.
3. The closing costs are set at 2% of affordable sales revenue, or \$21,000.
4. The warranty costs are estimated at \$43,000, or approximately \$7,200 per unit.

KMA estimates the total financing costs at \$104,000.

#### TOTAL DEVELOPMENT COSTS

As shown in Table 1, KMA estimates the total development costs at \$4.29 million, which equates to a \$21,000, or less than 1%, differential from Habitat's estimated development costs.

It is important to note that the construction industry is currently experiencing extreme volatility with substantially high inflation. This analysis may need to be revised if the construction costs vary from the estimates utilized in the analysis.

#### Estimated Available Revenue (Table 2)

The revenue available to the Project is estimated as follows:

#### AFFORDABLE SALES PRICE CALCULATIONS

Habitat is proposing to sell all six units to Low Income households. KMA estimates the Affordable Sales Price based on the H&SC Section 50052.5 calculation methodology and the following assumptions (Table 5):

1. The household income used in the calculations is based on the 2022 Orange County median incomes distributed by the California Department of Housing and Community Development (HCD).

2. Since the Project consists of more than four units, the Project is required to have a homeowner's association (HOA). Based on a similar project recently developed by Habitat, the HOA dues are estimated at \$425 per month, or \$5,100 per year.
3. KMA estimates the homeowner's insurance costs at 0.35% of the direct costs per unit, or \$1,400 per year.
4. KMA estimates the monthly utilities costs at \$227 per month for a three-bedroom unit based on the 2022-2023 Utility Allowance Schedule published by the Santa Ana Housing Authority on October 1, 2022.
5. The property tax cost estimate is based on 1.25% of the estimated Affordable Sales Price.
6. The mortgage interest rate is set at 7.22%. The mortgage is assumed to be fully amortizing over 30-years and provided by a conventional lender.
7. The home buyer down payment is set at 5% of the Affordable Sales Price.

Based on the assumptions outlined above, KMA estimates the Low Income Affordable Sales Price at \$175,500. The resulting affordable sales revenue is estimated at \$1.05 million for the six Low Income units.

In comparison, Habitat estimates the affordable sales price at \$185,000. Additionally, it is important to note that affordable sales price information that Habitat provided did not entirely follow the H&SC Section 50052.5 affordable sales price calculation methodology for calculating the estimated affordable sales prices. As such, the KMA and Habitat affordable sales price calculations may differ more materially in the future.

However, the affordable sales prices will ultimately be determined immediately prior to the sale of each unit. This analysis may need to be revised if the affordable sales prices differ from the sales prices utilized in this analysis.

### ADDITIONAL REVENUE

Habitat proposes to utilize fundraising contributions to off-set a portion of the construction costs. As such, Habitat estimates the financial assistance that they can provide to the Project at \$1.0 million, or \$167,000 per unit.

### ESTIMATED AVAILABLE REVENUE

The Project's estimated total available revenue is equal to the sum of the Affordable Sale Price revenue and the Project's additional revenue. KMA estimates the total available revenue as follows:

Affordable Sales Price Revenue	\$1,053,000
Habitat Financial Assistance	\$1,001,000
Estimated Available Revenue	\$2,054,000

### Financial Gap Calculation

The financial gap is estimated by deducting the Project's available revenue from the Project's total development costs. Based on the preceding analysis, KMA estimates the Project's financial gap as follows:

	KMA
Total Development Costs	\$4,290,000
(Less) Total Available Revenue	(2,054,000)
Estimated Financial Gap	\$2,236,000
Per Unit	\$372,700

As shown in the preceding table, KMA estimates the Project's financial gap at \$2.24 million. Comparatively, Habitat estimates the Project's financial gap at \$2.20 million. This equates to a \$36,000, or less than 2% differential, which is primarily due the difference in affordable sales price calculations between KMA and Habitat.

Per Habitat's assistance request, the City proposes to provide up to \$2.20 million in Inclusionary Housing Funds to the Project. Since this amount is less than the financial gap identified by KMA, it is therefore KMA's conclusion that the proposed assistance package will not provide a windfall profit to Habitat.

## SILENT SECOND MORTGAGE REVENUE CALCULATION (TABLE 4)

As a basic premise it must be assumed that the total of the liens accepted by a home buyer cannot exceed the unrestricted market value of the home. Furthermore, based on previous City homeownership projects, the City will record a second trust deed equal to the difference between the defined Affordable Sales Price and the estimated market value of the home.

KMA assumes that the City's second trust deed will be structured as a deferred payment loan which are commonly known as silent second mortgages. These loans typically become due and payable when the home is resold to a non-affordable home buyer. KMA assumes that the City's silent second trust deed will fall second in the lien hierarchy behind the conventional first trust deed mortgage.

The calculations used to estimate the supportable silent mortgages are presented in the following sections of this analysis.

### Market Rate Sales Prices

In Summer 2022, KMA conducted a survey of recent home sales comparables for the Project's nearby market area for the purpose of estimated the current silent second mortgage amount. Based on this survey, KMA estimates the market rate sales price for an attached three-bedroom unit at \$680,000.

### Available Silent Second Mortgage Revenue

Based on the estimated market rate sales prices, the available silent second mortgage revenue is estimated at as follows:

	Three-Bedroom Unit
Market Rate Sales Price	\$680,000
(Less) Affordable Sales Price	(175,500)
Silent Second Mortgage Amounts (Per Unit)	\$504,500



It is important to note that this calculation will need to be revisited once sales of the units commence. At that point, the appraised market values of the homes and the defined Affordable Sales Prices will be utilized to determine the silent second mortgage amount.

## CONCLUSIONS / ISSUES FOR CONSIDERATION

The following summarizes the conclusions of the KMA analysis:

1. Habitat is requesting \$2.20 million in financial assistance from the City. Based on the currently available information, it is KMA's conclusion that the Project exhibits a \$2.24 million financial gap. This represents a \$36,000, or less than 2% differential. Thus, it can be concluded that Habitat's proposed financial assistance request is supported by the Project's current economics.
2. The Affordable Sales Prices cannot be finalized until the Project commences sales activities. It is likely that the actual Affordable Sales Prices will vary from the amounts estimated in this analysis.
3. KMA recommends that the City retain 10% of the City's financial assistance amount (or \$220,000) until after the completion of construction. If the assumptions utilized in this analysis change materially, the financial gap analysis should be re-evaluated prior to the release of that amount to ensure that the \$220,000 is still warranted by the Project.
4. It is important to note that the construction industry is currently experiencing extreme volatility with substantially high inflation. In addition, the financial markets are also experiencing volatility with respect to interest rates and underwriting standards. This analysis may need to be revised if the construction costs and/or financing assumptions vary from the estimates utilized in the analysis.

TABLE 1

## ESTIMATED DEVELOPMENT COSTS

## 6 FOR-SALE LOW INCOME UNITS

## HABITAT FOR HUMANITY - WASHINGTON AVE

## SANTA ANA, CALIFORNIA

<b>I. Acquisition Costs</b>	<sup>1</sup>	15,973 Sf Land	\$36 /Sf Land	<b>\$580,000</b>
<b>II. Direct Costs</b>	<sup>2</sup>			
On-Site Improvements		15,973 Sf Land	\$36 /Sf Land	\$581,000
Building Costs		8,053 Sf GBA	\$196 /Sf GBA	1,578,000
General Conditions	<sup>3</sup>	0% Construction Costs		0
Habitat Supervision	<sup>3</sup>	0% Construction Costs		0
Contingency Allowance		10% Other Direct Costs		216,000
<b>Total Direct Costs</b>		<b>6 Units</b>	<b>\$395,833 /Unit</b>	<b>\$2,375,000</b>
<b>III. Indirect Costs</b>				
Architecture, Engineering & Consulting		12% Direct Costs		\$285,000
Public Permits & Fees	<sup>4</sup>	6 Units	\$40,000 /Unit	240,000
Taxes, Legal & Accounting		3% Direct Costs		71,000
Insurance		6 Units	\$7,200 /Unit	43,000
Developer Fee	<sup>5</sup>	13% Net Development Cost (Excl. Dev Fee)		480,000
Contingency Allowance		10% Other Indirect Costs		112,000
<b>Total Indirect Costs</b>				<b>\$1,231,000</b>
<b>IV. Financing Costs</b>				
Interest During Construction	<sup>6</sup>	\$765,000 Loan	7.0% Interest	\$32,000
Loan Origination Fee		\$765,000 Loan	1.0 Point	8,000
Closing Costs		2.00% Sales Revenues		21,000
Warranties		6 Units	\$7,183 /Unit	43,000
<b>Total Financing Costs</b>				<b>\$104,000</b>
<b>IV. Total Development Costs</b>		<b>6 Units</b>	<b>\$715,000 /Unit</b>	<b>\$4,290,000</b>

<sup>1</sup> Based on Habitat estimate. An appraisal or purchase and sale agreement was not provided for review.

<sup>2</sup> Based on Habitat estimates. Assumes that prevailing wage requirements will not be imposed on the Project.

<sup>3</sup> Assumes that the general conditions and supervision costs are included in the Building Costs line item.

<sup>4</sup> Based on Habitat estimates. City staff should verify the accuracy of this estimate.

<sup>5</sup> Based on estimate provided by Habitat.

<sup>6</sup> The total loan amount is equal to the total development costs less the Developer Fee, closing costs, warranties, Habitat fundraising and 90% of the City's financial assistance amount. The construction loan interest is based on a 12-month construction period and is estimated to have a 60% average outstanding balance.

TABLE 2

ESTIMATED AVAILABLE REVENUE  
 6 FOR-SALE LOW INCOME UNITS  
 HABITAT FOR HUMANITY - WASHINGTON AVE  
 SANTA ANA, CALIFORNIA

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I. <u>Projected Sales Revenue</u>	1			
Low Income Three-Bedroom Unit	6 Units	\$175,500 /Unit	\$1,053,000	
II. <u>Habitat Financial Assistance</u>	2			
	6 Units	\$166,833 /Unit	\$1,001,000	
III. <u>Estimated Available Revenue</u>	6 Units	\$342,330 /Unit	\$2,054,000	

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<sup>1</sup> See TABLE 5 for the KMA affordable sales price calculations.

<sup>2</sup> Per Habitat.

TABLE 3

ESTIMATED FINANCIAL GAP  
 6 FOR-SALE LOW INCOME UNITS  
 HABITAT FOR HUMANITY - WASHINGTON AVE  
 SANTA ANA, CALIFORNIA

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I.	Total Development Costs	See TABLE 1	\$4,290,000	
II.	(Less) Estimated Available Revenue	See TABLE 2	(\$2,054,000)	
III.	Estimated Financial Gap	6 Units	\$372,670 /Unit	\$2,236,000

TABLE 4

**SILENT SECOND MORTGAGE REVENUE SAMPLE CALCULATION**  
**6 FOR-SALE LOW INCOME UNITS**  
**HABITAT FOR HUMANITY - WASHINGTON AVE**  
**SANTA ANA, CALIFORNIA**

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**I. Silent Second Mortgage Amounts**

**Available Silent Mortgage Revenue**

Estimated Market Rate Sales Price	<sup>1</sup>	\$638,000
(Less) Low Income Affordable Sales Price	<sup>2</sup>	<u>(175,500)</u>

**II. Available Silent Mortgage Revenue (Per Unit) \$462,500**

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<sup>1</sup> Based on KMA survey of sales comparables for attached three-bedroom units in Summer 2022. The market rate sales price will be determined by a fair market value appraisal that assumes no income restrictions prior to the sale of each unit.

<sup>2</sup> The final Affordable Sales Prices will be set prior to the sale of each unit.

TABLE 5

## AFFORDABLE SALES PRICE CALCULATIONS

## LOW INCOME SALES PRICES

HABITAT FOR HUMANITY - WASHINGTON AVE

SANTA ANA, CALIFORNIA

	Low Income Sales Price <sup>1</sup>
	Three-Bedroom Unit
<b>I. <u>Income Available for Housing Expenses</u></b>	
Benchmark Household Size	4
Median Household Income	\$119,100
Income as % of Median	70.00%
% Income Allotted to Housing Costs	30.00%
<b>Total Income Available for Housing Expenses</b>	<b>\$25,011</b>
<b>II. <u>Ongoing Expenses</u></b>	
HOA Fees	\$5,100
Insurance @ 0.35% of Direct Costs Per Unit	1,385
Annual Utilities Allowance <sup>2</sup>	2,724
Property Taxes @ 1.25% of Affordable Sales Price	2,194
<b>Total Ongoing Expenses</b>	<b>\$11,403</b>
<b>III. Income Available for Mortgage Debt Service</b>	<b>\$13,608</b>
<b>IV. <u>Affordable Sales Prices</u></b>	
Supportable Mortgage @ 7.22% Interest Rate <sup>3</sup>	\$166,700
Home Buyer Down Payment @ 5.00% of Affordable Sales Price	8,800
<b>V. <u>Affordable Sales Prices</u></b>	<b>\$175,500</b>

<sup>1</sup> Based on the California Health and Safety Code Section 50052.5 definition. The affordable sales prices will ultimately be determined immediately prior to the sale of the units.

<sup>2</sup> Based on the utility allowances published by the Santa Ana Housing Authority on October 1, 2022.

<sup>3</sup> Based on the interest rate published by Bankrate.com on October 24, 2022.