KEYSER MARSTON ASSOCIATES.
ADVISORS IN PUBLIC/PRIVATE REAL ESTATE DEVELOPMENT

MEMORANDUM

To: Kimiko Lizardi, Rincon Consultants

Michael Rocque, Rincon Consultants

From: Kevin Engstrom

Date: June 27, 2022

Subject: Peer Review – 8825 Washington Market Study & FIA

Pursuant to your request, Keyser Marston Associates, Inc. (KMA) a conducted a peer of the market study and fiscal impact analysis for a proposed development located on a 2.85-acre parcel at 8825 Washington Boulevard (Site) in the City of Pico Rivera (City). The May 4, 2020 market analysis (Market Study) prepared by RCLCO Real Estate Advisors (RCLCO) evaluated the market demand for the 255-unit apartment development (Project) on the Site. KMA also reviewed the findings of the December 2021 fiscal impact analysis (FIA) prepared by Kosmont Companies (KC) for the Project. As KMA understands the situation, the City would like to understand the key issues affecting their findings. To this end, KMA summarized the Market Study and FIA and reviewed their salient findings.

RCLCO MARKET STUDY

The salient findings of the Market Study are summarized below:

- Pico Rivera has not experienced any new development in recent years, and as a result, has a low vacancy rate of 3.3% in 2019.
- Rent growth averaged 5.2% from 2015-19.

- The project will include 255 units, with an average size of 726 square feet. The units range from 544 square feet for studios to 1,581 square feet for three-bedroom units.[1]

- A summary of the projected rents is provided below:

Project Summary - Market Study

	Units	Rent	Rent/SF
Studio	24	$1,890	$3.42
1-Bedroom Jnr	32	$1,940	$3.37
1-Bedroom	122	$2,015	$3.27
2-Bedroom	73	$2,695	$2.73
3-Bedroom	4	$3,925	$2.48
Project Total/Average	**255**	**$2,220**	**$3.06**

- The study projected a 5% vacancy factor for the project, which would be achieved in less than 16 months after opening.

KMA reviewed the key assumptions and findings of the Market Study:

- RCLCo indicates an average effective rent of $1,454 for Pico Rivera and $1,706 for the Gateway Cities. Data provided by Costar for the Southeast Los Angeles market area indicates the same average effective rent of $1,454 (2020), with 4- and 5-star properties averaging $2,084.

- Data provided by Costar for the Southeast Los Angeles market area indicates an average effective apartment rent of $2.00 per square foot (PSF) (2020). Rents for 4- and 5-Star properties average $2.14 PSF (2020).

- RCLCo indicates an average vacancy rate of 3.2% for Pico Rivera and 3.7% for the Gateway Cities. Data provided by Costar for the Southeast Los Angeles market area indicates an average vacancy rate of 3.4% (2020). For 4-and 5-Star properties the average vacancy rate is 2.0%.

[1] The analysis was prepared in May 2020, so changes have occurred to impact the average, mix and sizing of the units. Please note, the different unit mix than the Market Study.

- RCLCo identified nine projects as the "Competitive Set" for the Project. The projects are in Pico Rivera, Alhambra, Santa Fe Springs, Whittier, West Covina, Cerritos and La Habra. The market area for the 88 at Alhambra Place (Alhambra) and The Colony at the Lakes (West Covina) are different than the subject site, as such their inclusion in the comparable project analysis is likely unwarranted.

- The average rent PSF for the Alhambra project ($3.31 PSF) well exceeds the weighted average of the comparative set, which is $2.80 PSF. The Market Study projected a weighted average rent of $3.06 PSF for the Project, which is 9.2% higher than the competitive set and 43% higher than the average for 4- and 5-star properties in the market area.

- The average asking rent for the Project is $2,220, which is lower than the competitive set average of $2,410, but 6.5% higher than the average for 4- and 5-star properties in the Southeast LA market area and 53% higher than the market area average.

- The average unit size for the Project is 726 square feet, which is 16% smaller than the competitive set average of 862 square feet. To this end, the unit mix for the Project indicates 22% of the units are under 575 square feet while only 13% of the competitive set units are below this threshold. Further, the one-bedroom (617 square feet compared to 740 square feet) and two-bedroom (988 square feet compared to 1,066+ square feet) in the Project are much smaller than the comparable projects.

- The Market Study indicates the "renters are likely to view the smaller unit sizes as a viable trade-off for the site's retail-rich location, attractive lifestyle, high quality units and community amenities." The developer indicates they own and manage nearly 1,000 units throughout Los Angeles County, and finds studio and one-bedroom units rent more quickly that two- and three-bedroom units.

- Based on a February 11, 2022 memo from RCLCo, the projected average household income level for the Project ranges from $76,100 to $88,800. The average household income in the City is $78,900; however, the median household income is $65,200.[2] Further, approximately 9.0% of City

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[2] Esri Business Analyst

households earn over $150,000 annually, while nearly 14% of the Project households are projected to exceed this threshold.

- Based on the February 11, 2022 RCLCO memorandum, the Market Study assumes the following average household sizes:

Average Household Size	
	Persons
Studio/Junior 1-Bedroom	1.00
1-Bedroom	1.25
2-Bedroom	1.75
3-Bedroom	2.25
Average	**1.35**

  For context, the average household size in the City is 3.79 persons. Countywide, the average is 3.00 persons. Approximately one-third of the occupied housing units in the City has one to two persons.

- The Market Study indicates the Project would capture between 35% and 50% of the income qualified demand potential in the City. In addition, the Market Study assumes an additional 25% of other demand induced by the Project due to its high quality and being first to the market. These assumptions are all relatively aggressive, as new developments both inside and outside of the City could materially impact the projected capture rates.

Market Study Key Issues

Some key issues for the City to consider:

- Due to the lack of development over the past few years, apartment vacancy rates in the City and market area are very low.

- The average rent per square foot for the Project is extremely aggressive. To achieve these projections, the apartments would need to generate rents per square foot that are 43% higher than the 4-and 5-star projects in the market area. Further, these rents are higher than the Competitive Set, even when it includes the Alhambra project, which generates rents of $3.31 per square foot.

- The average asking rent for the Project is $2,220 per month, which is only 6.5% higher than the 4- and 5-star projects in the market area, but still over 50% higher than the market area average.
- The average unit sizes are relatively small, hence the extremely high per square foot rents. In fact, the units are much smaller than the Competitive Set. The market depth for units at these sizes is very much unproven in the City.
- While the developer's experience may indicate studio and one-bedroom units rent more quickly, the proposed unit sizes are still much smaller in the Project than those in the competitive set.
- The Project will have a larger share of higher income households when compared to the City. These households would be making a choice to rent rather than buy in the City. While a highly amenitized Project may be appealing, the demand for these units is unproven.
- The Project would need to capture a large share of the potential market area demand. As competition increases, this may prove challenging over time.
- The proposed density for the Project is 89 units per acre. This is an extremely high-density level for the City, as most projects in similar markets will be less than 60 units per acre.

Overall, vacancy rates in the market area are very low and rents have increased at a healthy rate over recent years, indicating apartment demand. However, the market depth for the unit sizes and pricing of this Project is unproven, thus indicating there is significant risk that the rent and absorption targets will not be achieved.

KC FISCAL IMPACT ANALYSIS

The approach used in a fiscal analysis is to estimate public revenues based on specific parameters of the proposed development where appropriate (i.e. number and value of residential units, commercial square footage, value and sales per square foot for commercial uses), or based on the projected number of residents or employees for revenues that generally vary by population and/or employment. City service costs are estimated based on the number of persons served (a combination of residents and employees). The public service costs are deducted from the public revenues to derive the net benefit of the Project to the City. To that end, the FIA methodology follows typical industry standards. For the peer review, KMA evaluated the reasonableness of the KC assumptions given our understanding of the Project and experience with similar developments in the region. The salient findings of the FIA are summarized below:

- The Project will include the following:

Project Summary – FIA[1]	
	Units
Studio	35
1-Bedroom	159
2-Bedroom	57
3-Bedroom	4
Total	**255**

- Approximately 5% of the units (13) may be set aside for low/moderate household incomes.

- The net impact calculated by KC to the City General Fund is summarized below[3]:

Net Impact to the City General Fund	
	KC
Project City Revenues	$346,600
Project City Expenditures	($178,300)
Net Annual City Revenues	**$168,300**

The FIA indicates the Project would have a net positive impact on the City's General Fund of $168,000 annually.

[3] Estimate is based on rounded numbers.

City Revenues

The City revenues generated by the Project are $346,600 annually at stabilization. Based on the proposed development and tax allocations, the major source of public revenues are property taxes.

- The analysis assumes an $80.0 million assessed value for the Project, which equates to $314,000 per unit.
- The Site's assessed value of $4.45 million is consistent with the LA County Assessor.
- The tax rates utilized to estimate the General Fund property taxes and Motor Vehicle In Lieu Fees are accurate.
- The Pico Rivera LTG Maintenance revenues ($17,000) requires further clarification and substantiation. Typically, an FIA will focus solely on General Fund revenues. In addition, a review of the revenue distribution for the Project's Tax Rate Area indicates a rate of .87% for the Pico Rivera LTG Maintenance Zone 2 and not the 2.2% of the base levy utilized in the KC analysis.
- The FIA assumes the 5,500 square feet of retail in the Project will generate taxable sales of $300 per square foot ($1.65 million). Meeting this projection will be challenging, as space in similar mixed-use projects is often leased to service providers (e.g. dry cleaners, nail salons, etc.), which do not generate significant taxable sales. Further, a transfer of sales is typically assumed when preparing FIA projections. Assuming, the net new, taxable sales generated by the Project are 20% less than projected herein and only 80% of the sales are taxable, then the actual impact would be $20,000 to $25,000 compared to the $35,000 estimated in the FIA.
- Residents are projected to spend $25,000 annually on taxable sales of which 60% would be captured by the City. These assumptions appear to be very aggressive, as $25,000 is approximately 30% of the average household income identified in the Market Study. KMA would expect the taxable retail sales to be closer to 15% to 20% of the average household income, based on the Bureau of Labor Statistics – Consumer Expenditure Survey for households earning from $70,000 to $90,000. In addition, the Cit's capture rate is also likely to be lower at 40% - 50% of these expenditures, particularly as some of these sales are being captured in the on-site

sales projections. Assuming these factors, the off-site sales tax generated by the Project would only be $40,000 to $45,000 compared to $80,000 in the FIA.[4]

- The average household size utilized in the FIA is significantly different than the information provided by RCLCo:

Average Household Size (Persons)		
	KC	**RCLCo**
Studio/Junior 1-Bedroom	1.50	1.00
1-Bedroom	2.00	1.25
2-Bedroom	2.50	1.75
3-Bedroom	3.50	2.25
Average	**2.10**	**1.35**

- The per capita factors utilized to project the Other Tax Revenue (e.g. Utility Users Tax, Franchise Fees, etc.) appear to be reasonable.[5]

- A comparison of the KMA and Kosmont assumptions is provided in the table below:

Project Revenue Summary		
Property Tax	**KC**	**KMA**
Property Tax - General Fund	$51,400	$51,400
Property Tax - Lighting District	$17,000	$6,700
Project VLF Replacement	$120,500	$114,900
Total City Property Tax Revenue	$188,900	$173,000
Sales Tax		
On-Site Commercial	$34,700	$21,100
Resident Expenditures	$80,300	$40,800
Use Tax	$0	$6,200
Total City Sales Tax Revenue	$115,000	$68,100
Other City Revenues		
Utility Users Tax	$22,100	$22,100
Franchise Fees	$12,500	$12,500
Business Licenses	$1,700	$1,700
Fines/Forfeitures	$6,400	$6,400
Total Other City Revenue	$42,700	$42,700
Annual City Revenue	**$346,600**	**$283,800**

[4] Assuming the City's base 1.0% share of taxable sales plus the 1.0% sales tax override for Measure P.
[5] Franchise fees include Rubbish fee.

City Expenses

The City expenses generated by the Project are $178,300 annually at stabilization.

- The projected general fund expenditures rely on a per equivalent resident methodology. As such, the estimated population and employment base in the City appear to be reasonable. Further, assuming an equivalency factor of .50 for the employees is typical within the industry.

- The General Fund expense allocations appear to be reasonable, except for Public Safety. Typically, Public Safety costs are allocated at 100% of the City's PER costs, as these costs often increase at a rate faster than inflation and ensuring the provision of fully-funded fire and police services is key to a City's well-being. The KC analysis assumes 80% of the PER costs. Assuming 100% of these costs, would increase the City's expenses approximately $18,000 annually.

Project Expense Summary

	KC	KMA
Administration	$6,800	$6,800
Public Safety	$71,700	$89,700
Community & Economic Dev.	$8,100	$8,100
Administrative Services	$9,600	$9,600
Human Resources	$3,800	$3,800
Non-Departmental	$21,500	$21,500
Parks & Recreation	$22,600	$22,700
Public Works	$30,400	$30,500
Sales Tax Pledge	$3,800	$3,800
City Operating Expenses	**$178,300**	**$196,500**

Key Issues

Some key issues for the City to consider:

- The Report methodology conforms to industry standards for fiscal impact analyses.

- The average household sizes in the Market Study and the FIA are inconsistent. Overall, the households are much smaller than the City average. If the households end up being larger, the City's property tax won't increase and it's unclear if the other City revenues (e.g. off-site sales tax, Other City revenues) would be sufficient to offset the increases in City service costs.

- The unit mix in the Market Study is not consistent with the FIA; however, the FIA was prepared after the Market Study, reflecting the evolution of the Project.

- The Pico Rivera LTG Maintenance line item in the FIA appears to be overstated and requires clarification.

- The sales tax projections appear to be very aggressive. Successful retail will generate sales of $300 per square foot; however, tenants in mixed use space such as this will often be a mix of service and retail establishments. The service establishments will not generate taxable sales at these levels. Further, a transfer of sales from other establishments in the City is likely.

- The off-site sales appear overstated, due to the high retail sales generated by Project residents. Consequently, the potential taxable expenditures captured by the City are likely to be closer to $40,000, than the $80,000 projected in the FIA.

- The public safety cost estimates in the FIA are relatively low, particularly given the rapid cost increases for these services over the past decade for Southern California cities.

- The analysis is <u>static</u>; therefore, it does not capture revenue and cost increases over time. For instance, recent years have seen public safety costs increase at a rate much faster than inflation for many Southern California cities. Over 50% of the Project revenues are generated by property taxes, which are <u>capped</u> at 2.0% annually; therefore, the surplus generated by the Project may disappear over time, particularly given the relatively slim surplus estimated by KMA, as shown below.

Project Net Fiscal Impact		
	KC	**KMA**
Annual City Revenue	$346,600	$283,800
City Operating Expenses	($178,300)	($196,500)
Net Fiscal Impact	**$168,300**	**$87,300**

KEYSER MARSTON ASSOCIATES.
ADVISORS IN PUBLIC/PRIVATE REAL ESTATE DEVELOPMENT

MEMORANDUM

To: Kimiko Lizardi
Michael Rocque
Rincon Consultants

From: Kevin Engstrom

Date: January 6, 2022

Subject: Preliminary Review – 8825 Washington Boulevard Project

Pursuant to your request, Keyser Marston Associates, Inc. (KMA) a conducted a preliminary review of the May 4, 2020 market analysis (Report) prepared by RCLCO Real Estate Advisors (RCLCO) for a proposed development located at 8825 Washington Boulevard (Site) in the City of Pico Rivera (City). The analysis evaluates market demand for a 255-unit apartment development (Project) on the Site. As KMA understands the situation, the City would like to understand the key issues affecting the Report Findings. To this end, KMA prepared the following comments and questions for the developer and RCLCO:

1. Based on the date of the Report, what changes in the market could/would impact its findings?

2. The Report indicated two communities in Pico Rivera that were undergoing renovations in 2020, have these been completed? If so, what are the current asking rents and vacancy levels in these properties?

3. The Report indicated numerous new projects coming on-line in the Gateway Cities, what is the status of this inventory?

4. The market for the 88 at Alhambra Place and The Colony at the Lakes appear significantly different than the subject site, please fully detail the rationale to

include these projects in the competitive set, as they appear well outside the Competitive Market Area.

5. The projected rents for the subject site are much higher than the two existing developments in Pico Rivera. What contingency is there in the current development pro forma if the projected rents are not achieved?

6. How did RCLCO and the development team identify the mix and size of the units in the Project? Specifically:

    a. The unit mix and rents for the comparable projects shown on pages 18 and 19 show 22% of the units are under 575 square feet while only 13% of the market area units are below this threshold. Why is the share of smaller units in this Project so high?

    b. Consistent with the previous question both the one-bedroom (617 square feet compared to 740 square feet) and two-bedroom (988 square feet compared to 1,066+ square feet) in the Project are much smaller than the comparable projects, please explain.

    c. The study indicates the "renters are likely to view the smaller unit sizes as a viable trade-off for the site's retail-rich location, attractive lifestyle, high quality units and community amenities." What experience does the developer have with a project attempting to hit this target? In addition, what experience does the developer have leasing smaller units in this market area?

    d. Given the small unit sizes, how will the developer address potential issues regarding overcrowding?

7. Please detail the factors assumed to arrive at the total capture rates shown on Page 24. Specifically:

    a. What is the City's historical and projected share of renter households in the primary market area?

    b. What shift in trends was assumed?

    c. What is the basis for the rent as a percent of income estimates shown in Exhibit III-3?

   d. What is the basis for the share of annual rental demand pool that chooses multi-family rentals shown in Exhibit III-3?

8. The proposed income levels required to afford the projected rents appear relatively high, particularly given the unit sizes. To that end:

   a. What is the average household income level assumed for the Project?

   b. What is the projected average household income for each of the unit types?

   c. How do the projected average household income levels for the unit types compare to existing household income levels in Pico Rivera?

   d. Approximately 8.9% of City households earn over $150,000 per year. Based on the graph shown on page 24, it appears nearly 14% of the Project households would earn over $150,000, is this correct? If so, please explain the rationale for these higher income households choosing this project over other units in the City and market area.

   e. What is the developer's experience with multi-family, rental projects that would require income levels much higher than surrounding environs?

9. What are the projected household sizes for the Project? Specifically:

   a. What is the household size for each of the unit types in the Project?

   b. How do the projected household sizes for the Project compare to existing household sizes by room count in Pico Rivera?

10. Has a fiscal analysis for the project been prepared? Typically, a thorough evaluation of the project would address the following:

   a. Projection of Annual Revenues – Provide an estimate of the gross annual recurring tax revenues and subvention revenues to be generated by the build out of the project, which are allocated to the City's General Fund.

b. Projection of Annual Plan Service Costs – This would be an assessment of annual General Fund operating and maintenance costs related to providing services.

c. Preparation of a basic set of general fund revenues and costs generated by the project. Often a comparison analysis is prepared to evaluate the fiscal impact of a “by right” development