

Attachment No. PC 3

Economic Feasibility Analysis

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MEMORANDUM

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SENT VIA EMAIL

To: City of Newport Beach Community Development Department
Liz Westmorland, AICP, Principal Planner

From: Houseal Lavigne Associates
Robert Kain, Project Manager

Re: City of Newport Beach Economic Feasibility Analysis

This memorandum evaluates the development feasibility of conceptual scenarios across three mixed-use study sites in the City of Newport Beach: Dover Drive, Cannery Village, and McFadden Square. The analysis assesses the relationship between current zoning standards, site constraints, and overall project viability.

This market-rate analysis relies on 2026 regional benchmarks for coastal Orange County, and the following market metrics and rules of thumb establish the baseline for the pro forma analyses: Therefore, this high-level feasibility analysis is evaluated through the lens of programmatic efficiency, maximum yield potential, and the regulatory costs or risks associated with entitlement pathways.

Furthermore, it incorporates recent localized data from affordable housing developers to contrast market-rate benchmarks with the realities of Low-Income Housing Tax Credit (LIHTC) development, specifically regarding the viability of mandated ground-floor commercial spaces.

Financial Feasibility Framework & Methodology

To stress-test the economics of the conceptual plans, this analysis relies on a dual-framework approach, assessing both market-rate and affordable housing development metrics for coastal Orange County.

Market-Rate Development Benchmarks:

- **Construction (Hard) Costs:** Regional benchmarks range from \$350 to \$550+ per square foot. For coastal lots in Newport Beach, costs lean heavily toward the top of this range due to the need for marine-grade exterior materials, specialized site preparation, and the logistical challenges of staging construction in tight, high-traffic coastal alleys. Larger transitional corridor sites utilizing split-level structured parking podiums typically blend closer to \$350 to \$500 per square foot due to the scale of the concrete work.
- **Soft Costs & Entitlement Risk:** Modeled at 25% to 35% of Hard Costs. This accounts for extended timeline holding costs and the legal consulting necessary to secure discretionary approvals. Coastal California entitlements require developers to account for extended timeline holding costs (often 6-12 months for design and permits), Coastal Development Permit fees, and the legal and consulting expenditures necessary to secure discretionary approvals, such as Conditional Use Permits (CUP) for parking waivers.
- **Revenue Projections:** Prime visitor-serving street retail commands a heavy premium averaging \$4.50 to \$6.00 per square foot (NNN) per month. Lower-intensity transitional office or neighborhood commercial space commands \$3.00 to \$4.50 per square foot, per month.
- **Residential Revenue Projections (Gross):** The overall average rent in Newport Beach is approximately \$3,148, but new-build, ocean-adjacent multifamily units are modeled at premium pricing of \$4.50 to \$5.50 per square foot, per month. Similar high-end, two-bedroom units in the area range from \$4,000 up to \$6,800+ monthly.
- **Target Return Thresholds:** Ground-up development is highly complex, requiring an Internal Rate of Return (IRR) of 18% to 25% levered to justify the heavy entitlement and construction risks. Assuming stabilized mixed-use cap rates are hovering around 5.0% to 5.25%, a developer will require the stabilized net operating income (NOI) divided by total project costs to yield at least 6.5% to 7.0%.

Affordable Housing (LIHTC) Benchmarks:

- **Construction / Development Costs:** Based on recent Newport Beach Type V projects with surface parking, Hard Costs sit at approximately \$320 per square foot. Soft Costs run higher, consuming roughly 35% of the Total Development Cost (TDC). The TDC ranges from \$650,000 to \$850,000 per unit depending on target demographics (large-family vs. senior).

- **Revenue Assumptions:** Affordable LIHTC rents range from \$1,000 to \$3,300 per month depending on unit size and Area Median Income (AMI) bands. Ground-floor commercial spaces are highly difficult to lease and are typically underwritten conservatively at \$0 in early years.
- **Target Returns:** Most LIHTC deals are structured to break even with minimal cash flow. Feasibility is dictated by a Permanent Loan Debt Service Coverage Ratio (DSCR) of 1.15x, Investor Yields around 0.82 to 0.87 per credit, and Developer Fees capped at \$2.5M for 9% projects or 10% of TDC for 4% projects.

Feasibility Analysis by Study Area

Dover Drive Site (MU-DW District)

The Dover Drive study area consists of a 56,664 square foot parcel currently occupied by an underutilized office building and surface parking.

Development Scenarios Evaluated:

- **Housing-Led Scheme (Maximized):** Proposes 34 residential units and 19,500 square feet of commercial space, utilizing a split-level podium parking structure providing 132 total spaces.
- **By-Right Scheme:** Proposes 31 residential units and 14,100 square feet of commercial space to fully accommodate the 135 required parking spaces on-site without discretionary action.

Feasibility & Regulatory Impediments:

- **Market-Rate Feasibility:** A 4.63% yield on cost falls well below the 6.5%+ target developers require to greenlight ground-up construction. Because conventional parking minimums are incredibly high, developers are forced to spend tens of millions on non-rent-generating structured parking.
- **Affordable Housing Feasibility:** A 34-unit affordable project utilizing State Density Bonus Law provides the most viable path forward for the residential component. However, forcing an affordable developer to build 19,500 square feet of commercial space creates a massive liability. Because affordable ground-floor commercial is typically underwritten at \$0 revenue, the project cannot support the debt required to construct that space.

Cannery Village Site (MU-CV/15th St. District)

This site consolidates approximately 5,584 square feet of land to introduce vertical mixed-use development.

Development Scenarios Evaluated:

- **2-Story Scheme:** Features 3 residential units and 2,813 square feet of commercial space, achieving a total FAR of approximately 1.33.
- **3-Story Scheme:** Features the same program mix but utilizes a 31-foot sloped roof condition to maximize residential FAR (1.00) and commercial FAR (0.50).

Feasibility & Regulatory Impediments:

- **Market-Rate Feasibility:** While the 3-story Cannery Village concept is more efficient, pushing 69% of the building into rent-generating space, a 4.91% estimated yield still falls short of the target threshold.
- **Parking Dead Weight:** Both scenarios accommodate the 7 required residential parking spaces via alley-loaded access. However, the commercial space generates a demand for 12 parking spaces with 0 provided on-site. Project feasibility depends entirely on securing a Conditional Use Permit (CUP) because the Director can only waive up to 20% of non-residential parking by right. This discretionary risk destroys the project economics.

McFadden Square Site (MU-W2 District)

Located across from a public beach parking lot, this concept consolidates two narrow parcels into a 6,250 square foot development footprint.

Development Scenario Evaluated:

- **2-Story Mixed-Use:** Proposes 3 residential units and 2,776 square feet of visitor-serving commercial space.

Feasibility & Regulatory Impediments:

- **FAR Limitations:** The proposed residential FAR of 0.76 slightly exceeds the 0.75 maximum. Strict FAR limits on residential uses inadvertently force the reduction of sellable or leasable square footage.
- **Market-Rate Feasibility:** An estimated 4.05% yield before land acquisition is a non-starter. The project's efficiency ratio is low, with only about 55% of the building generating rent. The other 45% of the budget is swallowed by code-mandated covered parking, oversized balconies, and circulation space.

Key Findings and Regulatory Impediments

Based on conceptual testing, the following regulatory standards directly impede overall project viability:

- **Suburban Parking Standards in Urban Contexts:** Base parking requirements for mixed-use projects are derived from suburban standards and serve as the primary constraint across all study areas. Unmet commercial parking demand forces developers into discretionary review processes, increasing holding costs and timeline risks.
- **Mandated Commercial Space:** True "mixed-use" development is rarely a market-driven decision; it is primarily a local jurisdiction requirement. Ground-floor commercial spaces, particularly in affordable housing developments, are notoriously difficult to lease and sit vacant without significant subsidies. Mandating large commercial footprints burdens projects with heavy construction costs that generate \$0 in underwriting revenue.
- **Residential FAR Caps:** Regulating residential FAR to 1.0 or less restricts project scaling. When combined with existing density limits, FAR caps reduce the feasibility of redevelopment.
- **Height Restrictions:** Current height limits (e.g., 26 feet for flat roofs) restrict vertical integration and unit yields. Expanding allowable height would permit more efficient development patterns.

Recommendations to Improve Economic Viability

To incentivize development and improve financial feasibility across both market-rate and affordable housing typologies, the following code refinements are recommended:

- **Redefine "Commercial" for Affordable Housing:** Allow community-serving uses, such as community rooms, fitness centers, property management/leasing offices, and resident services, to satisfy ground-floor non-residential requirements. This aligns with the operational mission of affordable housing and eliminates the financial drag of un-leasable retail space.
- **Amend Parking Requirements:** Establish a base reduction for mixed-use minimum parking requirements to accurately reflect shared parking behavior. Consider administratively waiving or reducing parking requirements for non-residential uses within mixed-use projects.

- **Increase Base Height Limits:** Consider increasing the MU-DW district base height to 55 feet for flat roofs and 60 feet for sloped roofs (with upper-floor step-backs) to allow for higher density without discretionary action.
- **Eliminate Residential FAR Maximums:** Consider removing or increasing FAR maximums for residential uses in mixed-use developments to prevent redundant constraints on unit yields.