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CITY HALL
10300 TORRE AVENUE
CUPERTINO, CA 95014-3255
WWW.CUPERTINO.ORG

PRESS RELEASE

FOR IMMEDIATE RELEASE
September 23, 2019

CONTACT: Brian Babcock, CO
TELEPHONE: (408) 777-3262

Cupertino Conducts Economic Analysis of New Vallco Zoning, Affirms Housing Development Financially Feasible for Developer

CUPERTINO, CA – Today, the City of Cupertino released a new economic analysis report related to the revised zoning recently adopted by the City Council for the Vallco Shopping Special District Area. The analysis, conducted by independent consultant Hausrath Economics Group, establishes the economic feasibility for a developer to build at least 459 housing units on 13.1 acres of the Vallco site. The City's analysis is a direct response to a feasibility analysis that had been prepared on behalf of Vallco Property Owner, LLC.

The new analysis by Hausrath used the same methodology used by Vallco's economic consultant for determining whether two potential development scenarios under the new zoning designations for the Vallco site would be economically feasible. The Hausrath memo explains, "Economic feasibility means that given the price the developer paid for the land, a development scenario would produce a sufficient profit to the developer to attract financing."

The City commissioned this updated economic analysis after the City Council adopted zoning allowing residential development by-right at a density of 35 dwelling units per acre on 13.1 acres of the site. This new zoning allows development of up to 459 housing units, with up to 620 units allowed under State density bonus laws.

"The City Council's decision to update the General Plan and zoning for the Vallco site allows the developer to move forward quickly with the construction of as many as 620 units without requiring additional negotiations with the City," City Manager Deb Feng said. "In the meantime, City staff is working in good faith to support the developer's efforts to move forward with site preparation and construction of the Vallco SB 35 project. The City continues to diligently process Vallco's demolition and building permit applications for the project."

Although the developer and Hausrath took the same general approach, the Hausrath report relied on more realistic market data for both construction costs and projected sale prices for condominiums. The Hausrath analysis showed that the analysis by Vallco's consultant veered significantly from mainstream industry construction cost estimates for this type of housing development and are "fully 50% higher than [such] estimates," making Vallco's analysis "not credible." The City's consultant found, instead, that a developer could build either of the following scenarios while realizing a substantial profit under the City's new zoning for the site:

- 459 condominium units; 15 percent affordable (50 percent median income and 50 percent moderate income); no density bonus.
- 620 condominium units allowed with density bonus; 40 percent affordable including 7.5 percent affordable to median income households and the balance affordable to moderate income households.

The City's consultant agreed with Vallco's consultant that the development of rental housing on the Vallco site would not be economically feasible.

The City of Cupertino commissioned this additional economic analysis in response to concerns that its new zoning for Vallco would impede the development of at least 389 housing units on the site, which is the number of dwellings Cupertino has slated for the site in its state-mandated Housing Element. Although Cupertino has already approved a project for the Vallco site under SB 35, that project is currently facing a legal challenge by a community group. The City Council amended the zoning for the site to ensure that, should the SB 35 project not move forward for any reason, housing could be built at a density of 35 units per acre on 13.1 acres of the site by right, without requiring the developer to complete a Specific Plan for the project.

Under these changes, any application to develop housing according to the new zoning regulations could be immediately processed by the City so that the planning and construction process could move forward quickly. The City Council also directed staff to begin developing a Specific Plan for the remainder of the site that would allow up to 1,500 housing units within the entire Vallco Shopping District Special Area and it directed City Manager Deb Feng to work with Vallco Property Owner, LLC on other project alternatives.

"The City of Cupertino continues to act in good faith and in full accordance with State housing laws in planning for development of the Vallco Shopping District Special Area," concluded Cupertino City Attorney Heather Minner. "The City is committed to meeting its regional housing needs allocation. This latest Hausrath analysis makes clear that development of a significant housing project on the Vallco site is economically feasible and would return a profit to a developer."

A memo from Hausrath Economics Group that describes its recent analysis and its critique of the developer's analysis is attached below and uploaded here.

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HAUSRATH ECONOMICS GROUP

MEMORANDUM

Date: September 23, 2019

To: Deb Feng, City Manager, City of Cupertino

From: Sally Nielsen

Subject: **Feasibility of General Plan Amendment Scenarios for Portions of the Vallco Shopping District Special Area in Cupertino, California**

Introduction

Hausrath Economics Group (HEG) submits this updated analysis of the feasibility of residential development under the General Plan and Zoning Amendments recently adopted by the Cupertino City Council for the Vallco Shopping District Special Area (GPA). This feasibility analysis responds to the August 19 and September 3, 2019 evaluations prepared on behalf of the property owner, Vallco Property Owner, LLC (Vallco), by The Concord Group (TCG). TCG analyzes four residential development scenarios on the 13.1 acres where residential development would be allowed by right according to the GPA, concluding that each of the four residential development scenarios is economically infeasible. In this memorandum and the attached Table 1 and Tables A.1-A.4, HEG evaluates the same four development scenarios for the 13.1 acres of the Vallco property under the GPA and demonstrates that under more accurate, market-based assumptions than TCG's assumptions, the following scenarios are feasible:

- 459 condominium units; 15% affordable (50% median income and 50% moderate income); no density bonus

- 620 condominium units allowed with density bonus; 40% affordable including 7.5% affordable to median income households and the balance affordable to moderate income households

HEG's analysis and TCG's use identical land residual methodologies to determine whether the development scenarios are economically feasible. Economic feasibility means that given the price the developer paid for the land, a development scenario would produce a sufficient profit to the developer to attract financing.[1] Both analyses use the same data from the Economic & Planning Systems Memorandum to Catarina Kidd, City of Cupertino, "Financial Feasibility Assessment of the Vallco Specific Plan", September 11, 2018 (EPS Memo) for unit size, number of parking spaces, vacancy, operating expense, capitalization rate, disposition cost, soft costs, and other project costs. Both also use the same land cost for the 13.1 acres. The two analyses differ significantly, however, in their costs for construction of the residential units and sale prices for condominiums.

Residential Construction Costs

In reaching the conclusion that none of its four residential development scenarios is feasible, TCG overstates the cost to construct residential units. TCG presents construction cost data from three Bay Area builders before site costs and parking of $346 per square foot for apartments and $387 per square foot for condominiums.[2] TCG's construction costs are inconsistent with other reliable sources of construction cost information.

The EPS Memo assumed residential construction costs of $223 per square foot for apartments and $256 per square foot for condominiums before site costs and parking "based on data from Saylor Current Construction Costs 2018. The analysis reflects the type of construction anticipated for the Vallco site, using unique cost estimates for each building type (e.g., residential, office, hotel) as well as the building format (i.e., low-, mid-, or high-rise construction)."[3] Saylor Construction Costs is one of a few recognized sources for planning-level construction cost estimates used in feasibility analysis. Their estimates are specific to labor and material supply conditions in the Bay Area.

TCG's costs are fully 50% higher than the estimates assumed in the EPS Memo and are not credible. An annual increase of this magnitude is roughly equivalent to the total increase in Bay Area construction costs experienced in the 12-year-period from 2005 – 2018. The California Construction Cost index maintained by the Real Estate Services Division of the California Department of General Services shows a 3.2% annual increase from August 2018 to August 2019. The Turner & Townsend survey indicates that the annual increase in construction cost in San Francisco is only 5%—one-tenth of the increase suggested by TCG. TCG's costs are out of alignment with the costs derived from other well-established and reliable sources.

In contrast to TCG's inflated costs, this analysis bases residential construction costs on pro forma analysis completed within the last two months for active projects in San Jose provided to HEG by BAE Urban Economics, a leading economics firm with extensive experience analyzing development feasibility in the Bay Area. These projects consist of four stories of Type V residential construction over two floors of Type I concrete podium parking. These costs include parking costs. The updated cost for apartments

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[1] The tables attached also show that development of rental housing on the Vallco site is not feasible, but is not as infeasible as TCG purports to show. This difference is due primarily to TCG's inflated construction costs.

[2] The three terse letters sent to TCG by contractors contain little information as to the nature of the projects referenced. Accordingly, it is difficult to ascertain whether these projects are comparable.

[3] Economic & Planning Systems, Memorandum to Catarina Kidd, City of Cupertino, "Financial Feasibility Assessment of the Vallco Specific Plan", September 11, 2018, p. 10.

(including parking cost) is $366 per square foot and the updated cost for condominiums (including parking cost) is $374 per square foot. Compared to costs per square foot inclusive of parking in 2018, in the updated analysis, total cost per square foot inclusive of parking is about 20% higher for apartment construction and about 10% higher for condominium construction. In sum, TCG's construction cost numbers are out of line with established cost indicators while the costs in this analysis are based on a variety of reliable sources that indicate a consistent pattern of recent construction cost increases.

Condominium Sale Prices

Recent data on re-sales of existing condominiums in Cupertino provided to HEG by BAE and a July 2019 Strategic Economics report to the City indicates higher prices than assumed in 2018 and used by TCG in their recent analysis. The newest condominiums in Cupertino (originally built in 2003 and 2006) are re-selling in 2018 and 2019 for an average of $1.4 million. Upward price pressure in the Silicon Valley housing market is expected to continue for the foreseeable future. Because values for new construction will likely be higher than re-sale values of older condominiums, a value of $1.4 million per unit here is conservative.

The below-market-rate condominium values for the scenario without a density bonus are based on application of Cupertino's Below Market Rate (BMR) Housing Mitigation Program Procedural Manual. The values assume 50% of the affordable units are for median income households and 50% are for moderate income households. To qualify for the density bonus, 40% of total housing units are affordable and the pricing is established based on affordability to median and moderate-income households as would be required by the City under the State Density Bonus Law.

Conclusion

At least two residential development scenarios for the Vallco site are economically feasible. The differing conclusions of HEG and TCG regarding the feasibility of residential development on the Vallco site are the result of TCG's overstating the costs of construction and undervaluing the condominiums that could be developed on the site.

Table 1 - GPA Development Scenarios And Density Bonus Scenarios, both with Updated Market Values, BMR Pricing, and Costs

Vallco Special District - Financial Feasbility of GPA Development Scenarios for Regional Shopping/Residential Land Use Designation

The 13.1 acre site area is 26% of the 50.82 acre planning area, resulting in a 26% cost adjustment factor.[1]

	GPA Development Scenario (HEG 8/14/2019)			Scenario 1: GPA Development Scenario All Rental with 2019 Values and Costs			Scenario 2: Density Bonus 620 Units All Rental with 2019 Values and Costs[2]			Scenario 3: GPA Development Scenario All Condo with 2019 Values and Costs			Scenario 4: Density Bonus 620 Units All Condo with 2019 Values and Costs		
Project Factors	**Development Program**	**Residual Land Value Per Unit or Per Square Foot[3]**	**Total Value**	**Development Program**	**Residual Land Value Per Unit or Per Square Foot[4]**	**Total Value**	**Development Program**	**Residual Land Value Per Unit or Per Square Foot[4]**	**Total Value**	**Development Program**	**Residual Land Value Per Unit or Per Square Foot[4]**	**Total Value**	**Development Program**	**Residual Land Value Per Unit or Per Square Foot[4]**	**Total Value**
Apartment Units															
Market Rate	-	$197,167	$0	390	$64,106	$25,001,513	551	$64,106	$35,322,651	-	$64,106	$0	-	$64,106	$0
BMR Apartment	-	($322,732)	$0	69	($516,224)	($35,619,436)	69	($521,449)	($35,979,960)	-	($516,224)	$0	-	($521,449)	$0
Condominium Units															
Market Rate	390	$356,834	$139,165,260	-	$563,907	$0	-	$563,907	$0	390	$563,907	$219,923,667	436	$563,907	$245,863,381
BMR Condominium	69	$117,984	8,140,896	-	($262,374)	$0	-	($198,349)	$0	69	($262,374)	($18,103,780)	184	($198,349)	($36,496,146)
Total Residential Units/Value	**459**		**$147,306,156**	**459**		**($10,617,923)**	**620**		**($657,310)**	**459**		**$201,819,887**	**620**		**$209,367,235**
Office Square Feet															
Traditional Office	-	$162													
Retail Square Feet[5]															
Traditional	25,000	$22	$550,000												
Entertainment	-	($365)	$0												
Combined Retail/Entertainment	25,000		$550,000												
Hotel Square Feet	-	($37)													
Total Commercial Space/Value	**25,000**		**$550,000**												
Residual Value before Site Costs			**$147,856,156**			**($10,617,923)**			**($657,310)**			**$201,819,887**			**$209,367,235**
Impact Fee Credits - none assumed															
Site Costs[6]															
Demolition			($4,600,000)			($4,922,000)			($4,922,000)			($4,922,000)			($4,922,000)
Basic Site Work			($6,600,000)			($7,062,000)			($7,062,000)			($7,062,000)			($7,062,000)
Open Space Improvements			$0			$0			$0			$0			$0
Park land in lieu fee[7]			($21,060,000)			($21,060,000)			($29,754,000)			($21,060,000)			($23,544,000)
Right of Way and Back Bone Infrastructure			($12,900,000)			($13,803,000)			($13,803,000)			($13,803,000)			($13,803,000)
Additional Off-Site Improvements/Mitigation			$0			$0			$0			$0			$0
			($45,160,000)			($46,847,000)			($55,541,000)			($46,847,000)			($49,331,000)
Site Development Financing Cost		6%	($2,709,600)		6%	($2,810,820)		6%	($3,332,460)			($2,810,820)		6%	($2,959,860)
Developer Return on Site Costs		12%	($5,744,352)		12%	($5,958,938)		12%	($7,064,815)			($5,958,938)		12%	($6,274,903)
Financing Costs and Developer Return on Site Costs			($8,453,952)			($8,769,758)			($10,397,275)			($8,769,758)			($9,234,763)
Total Site Costs including ROI			**($53,613,952)**			**($55,616,758)**			**($65,938,275)**			**($55,616,758)**			**($58,565,763)**
Approximate Land Cost Basis (includes 12% ROI)[8]			**($93,184,000)**			**($93,184,000)**			**($93,184,000)**			**($93,184,000)**			**($93,184,000)**
Estimated Project Residual			**$1,058,204**			**($159,418,681)**			**($159,779,585)**			**$53,019,128**			**$57,617,472**

Notes:

1. The Regional Shopping/Residential land use designation applies to 13.1 acres within the Vallco Shopping District. This site area represents 26% of the 50.82 acres owned by Vallco Property Company that was the subject of the 2018 planning effort and feasibility assessment used for some of the assumptions below. Allocating costs by this cost adjustment factor is the same as assuming that costs per acre are the same for the 13.1 acre site area and the balance of the 50.82-acre planning area.
2. Scenario 2 is based on the density bonus assumptions used in the TCG September 3, 2019 analysis: 11% affordable to very low income households and 4% affordable to low income households to meet the minimum requirement established in State law for a 35% density bonus. The City of Cupertino would not accept this scenario and would require the minimum 11% affordable to very low income **plus** the base 6% affordable to low income households, resulting in BMR units at 17% of total units proposed before the density bonus.
3. Residual values before site costs and land costs from Economic & Planning Systems, "Financial Feasibility Assessment of the Vallco Specific Plan", Memorandum to Catarina Kidd, City of Cupertino, September 11, 2018.
4. Residual values before site costs and land costs from EPS (September 11, 2018) with updates to market value, BMR pricing, construction costs, and permits and fees by Hausrath Economics Group, September 2019.
5. Retail development is not required under the proposed Regional Shopping/Residential land use designation. Retail shops, restaurants, coffee shops and similar uses might be developed to activate the ground floor of the residential development.
6. Total costs for demolition, basic site work, and right of way and backbone infrastructure from EPS September 11, 2018 memorandum, adjusted because only 26% of the plan area is developed under this land use designation.
7. Park land in-lieu fee calculated based assumptions in the EPS September 11, 2018 memorandum. 390 market rate units require 2.11 acres of park land. The cost of the in-lieu fee is assumed at $10 million per park acre. Improved parks and open space could also be provided on site, at a lower cost to the project. In the Density Bonus Scenarios 2 and 4, the park land in-lieu fee is higher due to the the higher park land requirement associated with more market rate residential units in those development scenarios.
8. Total land cost basis from EPS September 11, 2018 memorandum, adjusted because only 26% of the plan area is developed under this land use designation.

Source: Hausrath Economics Group

Appendix Tables

Table A.1

Development Pro Forma Assumptions, Per Unit with updates highlighted

Market Rate Apartment	Assumption		Per Unit
Development Program Assumptions			
Dwelling Units			
Gross Building Area (sq. ft.)	1,250	per unit	1,250
Rentable Area (sq. ft.)	80%	of GBA	1,000
Structured Parking Spaces	2	per unit	
Surface Parking Spaces			
Building Value per Unit			
Gross Potential Rent	$4.00	per sq. ft. per month	$48,000
Losses to Vacancy	5%	of GPR	($2,400)
Collection Losses	0%	of GPR	$0
Losses to Concessions	0%	of GPR	$0
Gross Residential Revenue			$45,600
Operating Expenses	30%	of gross revenue	($13,680)
Net Operating Income - Residential			$31,920
Net Operating Income - Parking	$47.51	per occupied space/month	$1,140
Net Operating Income			$33,060
Building Value per Unit	4.0%	capitalization rate	$826,509
Disposition Cost	1.5%	of building value	($12,398)
Net Value per Unit			**$814,111**
Project Costs per Unit			
Construction Costs			
Building Direct Cost, including parking	$366	Cost per sf GBA	$457,500
Structured Parking Direct Cost	$46,972	per space	-
PLA Cost Premium	5%	of total construction cost	24,079
Total Construction Cost			*$481,579*
Soft Costs			
Architecture and Engineering	4%	of construction cost	$19,263
Other Professional Services	2%	of construction cost	9,632
Permits and Fees	$35,691	per dwelling unit	35,691
Taxes and Insurance	2%	of construction cost	9,632
Financing	6%	of construction cost	28,895
Marketing/Leasing	1%	of construction cost	4,816
Developer Fee	4%	of construction cost	19,263
Total Soft Costs			*$127,191*
Other Project Costs			
Development Contingency	10%	of hard and soft costs	$60,877
Developer ROI	12%	of development costs	80,358
Total Other Costs			*$141,235*
Total Project Cost			**$750,005**
Residual Land Value			
Per Dwelling Unit			**$64,106**
Per Square Foot (gross building area)			**$51**

Table A.2

Development Pro Forma Assumptions, Per Unit with updates highlighted

Below Market Rate Apartment	**Assumption**		**Per Unit**
Development Program Assumptions			
Dwelling Units			
Gross Building Area (sq. ft.)	1,250	per unit	1,250
Rentable Area (sq. ft.)	80%	of GBA	1,000
Structured Parking Spaces	2	per unit	
Surface Parking Spaces			
Building Value per Unit			
Gross Potential Rent	$1.51	per sq. ft. per month	$18,091
Losses to Vacancy	5%	of GPR	($905)
Collection Losses	0%	of GPR	$0
Losses to Concessions	0%	of GPR	$0
Gross Residential Revenue			$17,187
Operating Expenses	50%	of gross revenue	($8,593)
Net Operating Income - Residential			$8,593
Net Operating Income - Parking	$0.00	per occupied space/month	$0
Net Operating Income			$8,593
Building Value per Unit	4.0%	capitalization rate	$214,835
Disposition Cost	1.5%	of building value	($3,223)
Net Value per Unit			**$211,612**
Project Costs per Unit			
Construction Costs			
Building Direct Cost, including parking	$366	Cost per sf GBA	$457,500
Structured Parking Direct Cost	$46,893	per space	-
PLA Cost Premium	5%	of total construction cost	24,079
Total Construction Cost			*$481,579*
Soft Costs			
Architecture and Engineering	4%	of construction cost	$19,263
Other Professional Services	2%	of construction cost	9,632
Permits and Fees	$17,697	per dwelling unit	17,697
Taxes and Insurance	2%	of construction cost	9,632
Financing	6%	of construction cost	28,895
Marketing/Leasing	1%	of construction cost	4,816
Developer Fee	4%	of construction cost	19,263
Total Soft Costs			*$109,197*
Other Project Costs			
Development Contingency	10%	of hard and soft costs	$59,078
Developer ROI	12%	of development costs	77,982
Total Other Costs			*$137,060*
Total Project Cost			**$727,836**
Low Income Housing Tax Credit	0.0%	of eligible costs	**$0**

Residential Land Value without Density Bonus	
Per Dwelling Unit	**($516,224)**
Per Square Foot (gross building area)	**($413)**

Residual Land Value with State Density Bonus (based on rent at $1.47 per sq. ft. per month)	
Per Dwelling Unit	**($521,449)**
Per Square Foot (gross building area)	**($417)**
Residual Land Value with State Density Bonus and City Requirements for Income Split (based on rent at $1.49 per sq. ft. per month)	
Per Dwelling Unit	**($518,068)**
Per Square Foot (gross building area)	**($414)**

Table A.3

Development Pro Forma Assumptions, Per Unit with updates highlighted

Market Rate Condominium	**Assumption**		**Per Unit**
Development Program Assumptions			
Dwelling Units			
Gross Building Area (sq. ft.)	1,250	per unit	1,250
Living Area (sq. ft.)	80%	of GBA	1,000
Structured Parking Spaces	2	per unit	
Surface Parking Spaces			
Building Value per Unit			
Condominium Sale Value	$1,400	market value/sq. ft.	$1,400,000
Other Value Additions	$0	market value/unit	-
Unit Value			$1,400,000
Disposition Cost	1.5%	of building value	($21,000)
Net Value per Unit			**$1,379,000**
Project Costs per Unit			
Construction Costs			
Building Direct Cost, including parking	$374	Cost per sf GBA	$467,500
Structured Parking Direct Cost	$46,952	per space	-
PLA Cost Premium	5%	of total construction cost	24,605
Total Construction Cost			*$492,105*
Soft Costs			
Architecture and Engineering	4%	of construction cost	$19,684
Other Professional Services	2%	of construction cost	9,842
Permits and Fees	$43,974	per dwelling unit	43,974
Taxes and Insurance	3%	of construction cost	14,763
Financing	6%	of construction cost	29,526
Marketing/Leasing	3%	of construction cost	14,763
Developer Fee	4%	of construction cost	19,684
Total Soft Costs			*$152,237*
Other Project Costs			
Development Contingency	10%	of hard and soft costs	$64,434
Developer ROI	15%	of development costs	106,316
Total Other Costs			*$170,751*
Total Project Cost			**$815,093**
Residual Land Value			
Per Dwelling Unit			**$563,907**
Per Square Foot (gross building area)			**$451**

Table A.4

Development Pro Forma Assumptions, Per Unit with updates highlighted

Below Market Rate Condominium	**Assumption**		**Per Unit**
Development Program Assumptions			
Dwelling Units			
Gross Building Area (sq. ft.)	1,250	per unit	1,250
Rentable Area (sq. ft.)	80%	of GBA	1,000
Structured Parking Spaces	2	per unit	
Surface Parking Spaces			
Building Value per Unit			
Condominium Sale Value	$537	market value/sq. ft.	$537,000
Other Value Additions	$0	market value/unit	-
Unit Value			$537,000
Disposition Cost	1.5%	of building value	($8,055)
Net Value per Unit			**$528,945**
Project Costs per Unit			
Construction Costs			
Building Direct Cost, including parking	$374	Cost per sf GBA	$467,500
Structured Parking Direct Cost	$46,973	per space	-
PLA Cost Premium	5%	of total construction cost	24,605
Total Construction Cost			*$492,105*
Soft Costs			
Architecture and Engineering	4%	of construction cost	$19,684
Other Professional Services	2%	of construction cost	9,842
Permits and Fees	$35,022	per dwelling unit	35,022
Taxes and Insurance	3%	of construction cost	14,763
Financing	6%	of construction cost	29,526
Marketing/Leasing	1%	of construction cost	4,921
Developer Fee	4%	of construction cost	19,684
Total Soft Costs			*$133,443*
Other Project Costs			
Development Contingency	10%	of hard and soft costs	$62,555
Developer ROI	15%	of development costs	103,215
Total Other Costs			*$165,770*
Total Project Cost			**$791,319**
Residual Land Value without Density Bonus			
Per Dwelling Unit			**($262,374)**
Per Square Foot (gross building area)			**($210)**
Residual Land Value with Density Bonus (based on condo sale price of $602,000 per unit)			
Per Dwelling Unit			**($198,349)**
Per Square Foot (gross building area)			**($159)**