



Memorandum

Date: October 28, 2019
To: Eric Anderson, City of Mountain View
From: Seifel Consulting, Inc.
Re: Mountain View East Whisman Residential Development Financial Feasibility Analysis

The City of Mountain View retained Seifel Consulting to evaluate the financial feasibility of residential development in the East Whisman Precise Plan (EWPP) area and various Precise Plan policies. This memorandum summarizes key findings of the financial feasibility analysis. Attachment 1 at the end of this memorandum presents the key financial assumptions that were used to perform this analysis.

The financial analysis indicates that many residential developments may not be financially feasible without significant reductions in project costs and/or financial assistance. Residential feasibility in East Whisman is challenging due to the following factors:

Land Prices

- Land prices have increased significantly over the past five years.
 - While land was valued at about \$5–\$6 million per acre, recent land transactions have ranged from \$10–\$15 million per acre.
 - The rapid increase in land prices has also dramatically increased the cost of parkland dedication fees from historical levels.
 - The October 2019 EWPP financial analysis assumes land costs for residential development range between \$10–\$12 million per acre. This results in land costs for housing ranging from about \$70,000–\$130,000/unit, and park fees ranging from \$60,000–\$72,000/market rate unit.

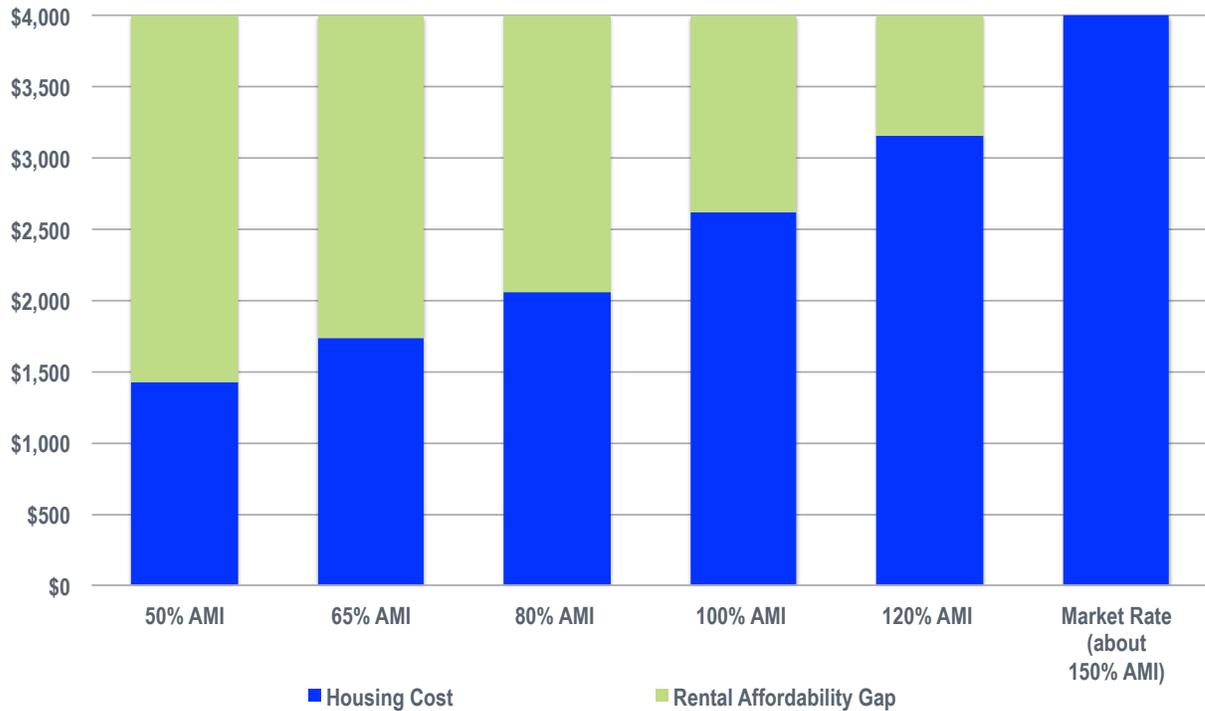
Development Revenues

- Sales prices of homes in Mountain View, as well as apartment rents and values are currently being sold and rented at historically high levels. However, apartment rents have not increased at the same pace as development costs in recent years.
 - Market rents for new apartments have reached levels that many people cannot afford, which limits future rent increases.
 - For example, market rents for new two-bedroom apartments range from \$4000 to \$5200 per month depending on size, location and amenities, with highest rents typically being charged for two bedroom/two bath apartments.
 - Based on typical affordability standards, a household needs to earn between \$150,000 to \$200,000 to afford market rent for a new two-bedroom apartment.

- Based on recent comparable apartment developments with a 40% mix of two bedroom or larger units, the EW analysis assumes an average monthly market rent of about \$4,000 based on an average sized unit of about 800 net square feet at \$5 per net square foot.
- Figure 1 compares the projected average monthly market rent with what households at various income levels can afford to pay for rent based on Santa Clara County Areawide Median Income (AMI) levels given the assumed mix of units and corresponding average household sizes.

Figure 1

**Comparison of Monthly Rent Levels Per Apartment Unit
Mountain View East Whisman Precise Plan**

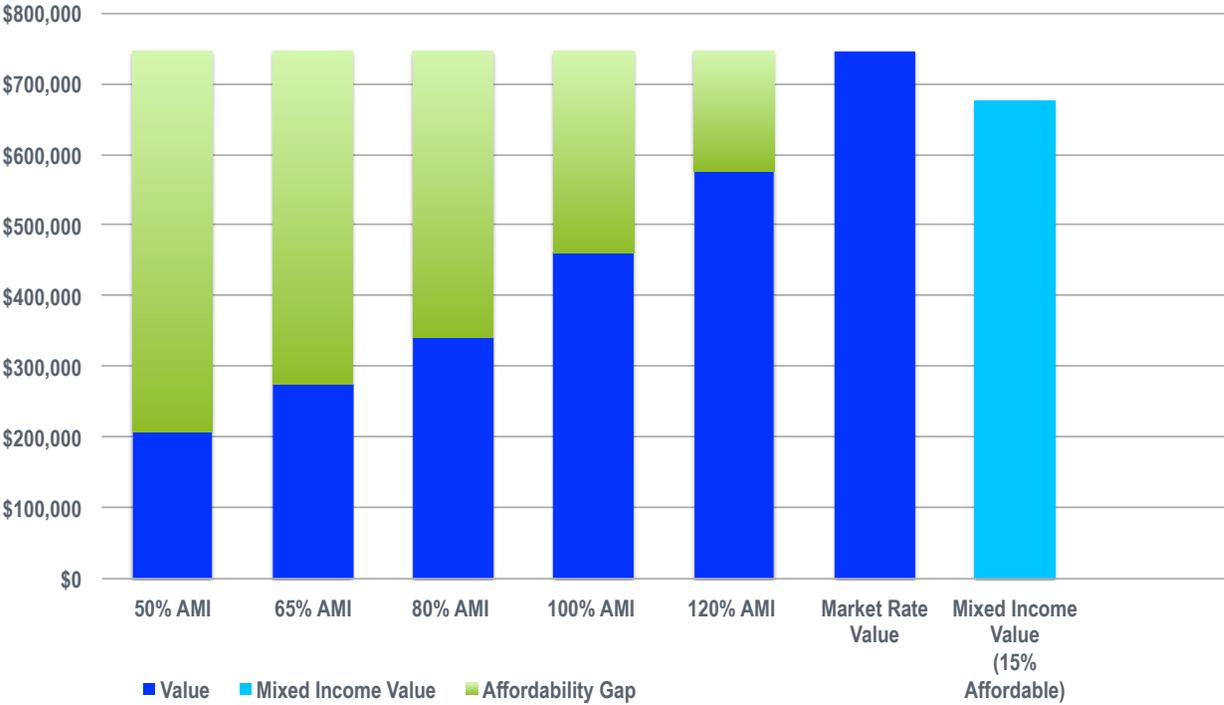


Note: Calculated based on assumed unit mix by bedroom size and 2019 Areawide Median Income (AMI) Limits.

- Given strong demand and historically low interest rates, capitalization (cap) rates for income property in Mountain View are at historically low levels which results in higher values of apartment developments compared to the net income that they generate.
 - Many economists expect that both cap rates and interest rates will increase in the future, which will make feasibility for apartment developments more challenging.
 - However, the EW financial analysis assumes a capitalization rate of 4.25% for apartments and a yield on cost of 5.25%, which reflect historically low levels for these financial metrics.
- Based on these assumptions, the EW financial analysis projects the value for market rate apartments to be approximately \$750,000/unit, or about \$930/NSF.

- As rents and housing prices have increased, the City has intensified its focus on providing housing for those who are most cost-burdened, requiring 15% to 20% of rental units to be affordable to very low and low income renters and ownership units to be affordable to low and moderate income households.
 - This restricts potential revenues, which in turn restricts housing values and may increase the shortfall between development costs and revenues.
 - Per the proposed EWPP policy for on-site inclusionary housing, the EW financial analysis assumes that 15% of apartment units would be affordable units that are rented to households at an average AMI of 65%.
- Figure 2 shows the difference between the value for a market rate apartment and the restricted value for apartments based on affordable rents to households at various target AMI levels. It also compares the potential value for a mixed income development that includes 15% on-site units that are affordable to households at an average AMI of 65%. As Figure 2 shows, the value for a mixed income development in EW is projected to be about \$670,000 per unit.

Figure 2
Comparison of Apartment Value and Affordability Gap Per Apartment Unit
Mountain View East Whisman Precise Plan



Note: Calculated based on assumed unit mix by bedroom size and 2019 Areawide Median Income (AMI) Limits.

- Most for-sale housing in Mountain View consists of single family homes and townhomes.
 - A number of new condominium developments are being proposed, and developers are projecting new sales values at \$1,000–\$1100/NSF, but the condo market is not yet well-established, particularly in East Whisman.
 - While condos have the potential to yield greater revenues than apartments, they are inherently riskier given their higher price points and lack of an established market place.
 - Typically homes are sold with parking included as part of the home price, so it’s difficult to estimate the value of an unbundled parking space.
 - The EW analysis projects the market prices for condos at about \$1.04 million/unit and assumes that a parking space would be purchased for an additional \$50,000 per space.

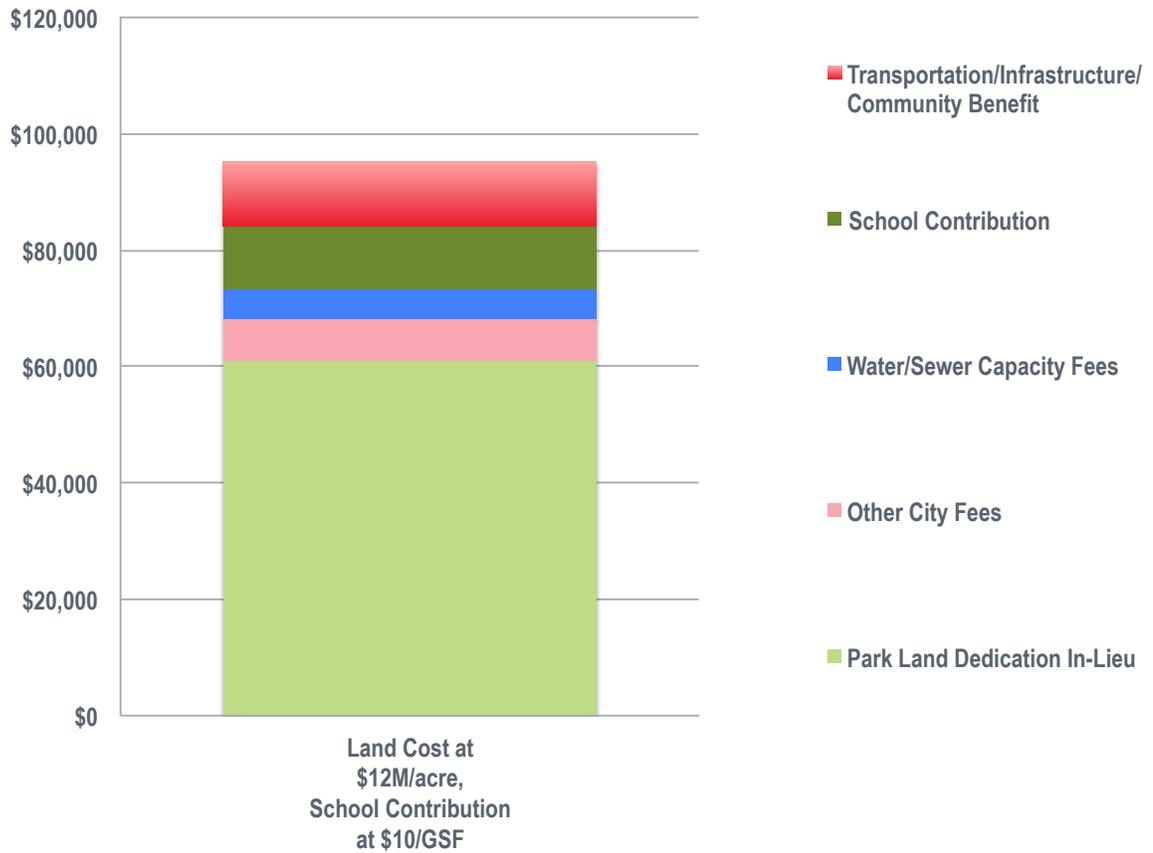
Development Costs

- Site improvement costs in EW are relatively high as it has historically been the site of industrial development and is located near areas of environmental contamination that affects some of the residential development sites.
- Multifamily infill projects have higher construction costs as they require structured parking, often include concrete and steel construction, and must adhere to higher life and safety standards associated with taller buildings.
 - Given the Bay Area construction labor and subcontractor shortage, construction costs have increased significantly over the past five years.
 - This tight construction market could continue into the future, given the ongoing South Bay construction boom coupled with the rebuilding of fire-damaged areas across California.
- Significant public fee payments and public infrastructure improvements are needed to achieve the EWPP vision, which also increases development costs and adds uncertainty if these costs substantially increase over time.
 - As described above, parkland dedication fees are currently assumed to range between \$60,000–\$72,000/market rate unit given current market land prices at \$10 million to \$12 million per acre. As park fees are assumed to be waived for affordable units provided onsite, the average park fee for a mixed income development with 15% affordable housing in EW is assumed to range between \$51,000– \$61,000/unit.
 - Given recent City Council guidance, the school contribution is assumed to be about \$11,000 per apartment unit, inclusive of the current development impact fees to both School Districts. Prior analyses assumed that developers paid school impact fees without any additional contributions.
 - The City recently added a new Transportation Impact Fee, increased its water and sewer capacity fees, and often requires developers to install public infrastructure prior to constructing new housing if significant offsite improvements are required.
- The uncertainty about future public fee levels, public infrastructure improvements and community benefit requirements can add significant risk and could delay residential development if these changes increase costs significantly.

- Figure 3 summarizes the development impact fees, school contributions and community benefit contributions assumed in the EW financial analysis based on a land cost of \$12 million per acre, which are estimated to total about \$95,000 per apartment unit.

Figure 3

**Summary of Public Fees and Contributions per Apartment Unit
Mountain View East Whisman Precise Plan**



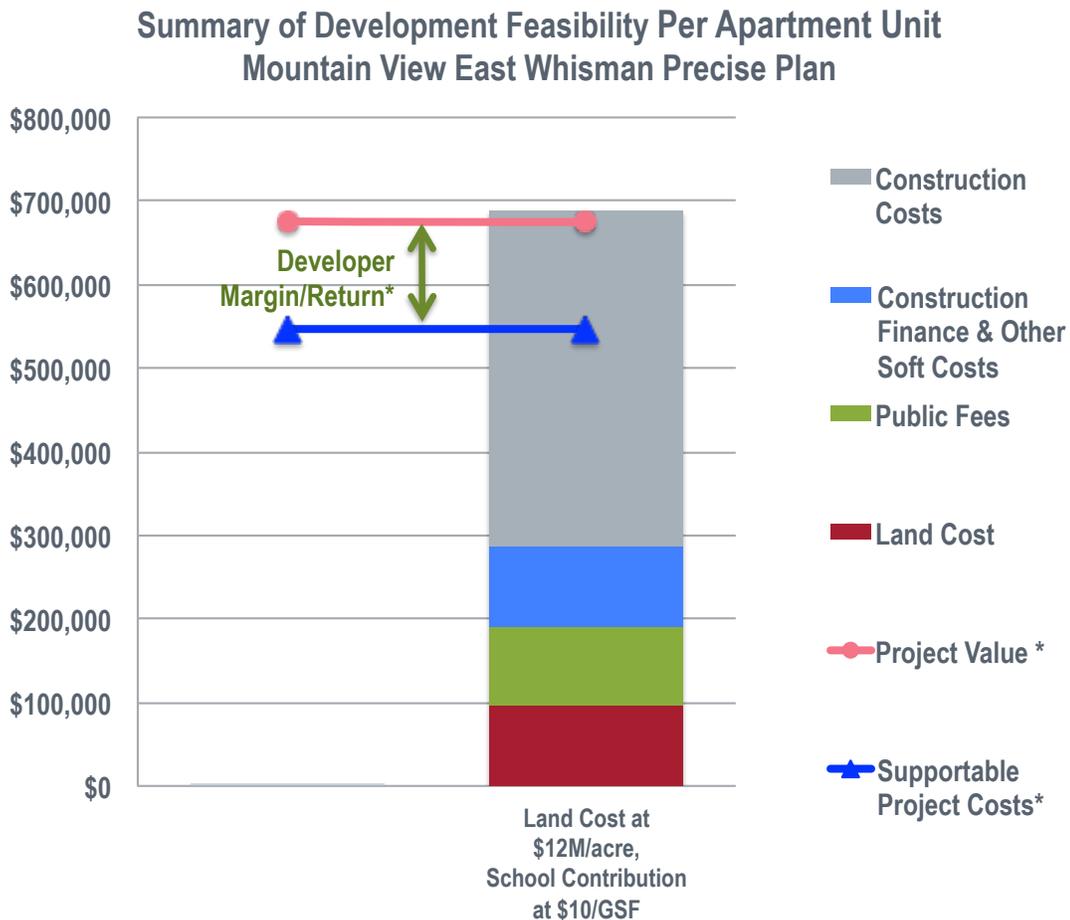
Development Feasibility Analysis

- As described by the Urban Land Institute, the infill development process in neighborhoods like East Whisman is often complex, challenging and expensive to undertake. In order to build infill housing, developers must fund the preparation of numerous technical analyses and design concepts for review by City staff and stakeholders prior to securing development approval, which can take several years. In addition, development sites are often relatively expensive as infill sites frequently have existing uses that generate income to their property owners.¹
- This predevelopment period is usually the most risky phase of development, and developers typically need to raise private investor capital (equity) to fund predevelopment costs.
 - Given the high risks associated with new development not occurring or not occurring as planned, developers must be able to generate sufficient returns or profit to attract private equity commensurate with these risks.
 - Private equity must also be raised during the construction and the sales or lease-up period, as private lenders typically require a 35% to 40% equity contribution for infill housing projects.
- Since most infill sites in East Whisman that could be developed as housing have existing buildings which generate rental income, the developer must typically pay an amount that is significantly higher than the existing property value based on this rental income to incentivize the owner to sell.
- Throughout the predevelopment process, and most importantly before starting construction, a developer must be able to demonstrate to its private capital sources (private investors and lenders) that there is sufficient developer margin or return to take into account potential risks and to repay capital at specified levels of return.
 - In other words, the future project value from apartments or project revenues from condominium sales must exceed development costs by a sufficient margin to attract private capital and generate sufficient funds to repay all loans and equity contributions at market interest rates and returns commensurate with development risk.
 - In most capital structures, the priority of capital repayment is as follows: 1) construction and permanent lenders, 2) private investors who typically receive a preferred return and a share of profits that are generated by the development and 3) the developer.
- As described above, development costs in Mountain View have increased significantly in recent years. While rents and home prices have increased, the EW financial analysis indicates that revenues from apartments and condominiums are not likely sufficient to meet anticipated development costs taking into account current EWPP, City and School District requirements, including the City's affordable housing requirements.
 - As land prices, construction costs and public requirements and fees have changed over time, residential development feasibility has become much more challenging.
 - The financial feasibility analysis indicates that projected revenues for apartments in a mixed income development with 15% affordable housing will not likely generate sufficient revenues to meet development costs and yield a sufficient developer margin or return to proceed at current land costs and school contribution requirements.

¹ <https://urbanland.uli.org/development-business/making-infill-work-floridas-urban-cores/>

- Figure 4 below illustrates the development feasibility framework and results for the EWPP residential feasibility analysis for apartments assuming a land value of \$12 million per acre and a parking ratio of about 1 space per unit.
 - This figure compares the projected project value for apartments with the supportable project costs, and the projected developer margin/ return after taking into account all development costs.² As it indicates, development would not likely proceed because the value for apartments is not high enough to cover development costs including a sufficient developer margin/return to attract private capital.

Figure 4



* "Project value" is based on capitalized value at a cap rate (4.25%), while "Supportable Project Cost" is based on return (yield) on cost (5.25%). This analysis does not reflect additional operating expenses for TDM. The difference between Project Value and Supportable Project Cost is the Developer Margin/Return.

² "Project value" is based on capitalized value at a cap rate (4.25%), while "Supportable Project Cost" is based on return (yield) on cost (5.25%). The difference between Project Value and Supportable Project Cost is the Developer Margin/Return. The analysis is based on a typical apartment development with 15% affordable housing onsite and 1.025 parking spaces/unit.

- While condominium developments have the potential to generate higher revenues, they are inherently more risky than apartments, and the financial analysis indicates that condominiums also likely have a financial shortfall between revenues and costs.
- While the financial feasibility gap will vary from development to development depending on the proposed development and ultimate development revenues and costs, the EWPP financial analysis indicates that the financial shortfall could range between \$50,000–\$150,000/unit depending on the housing unit mix and revenue generation, amount of parking, land acquisition cost, building construction type and cost, and the combined cost of public requirements, contributions and fees.
- Based on the results of the feasibility analysis and the City’s goals for the EWPP, including the provision of significant parkland and school contribution, the maximum recommended community benefit contribution should be \$5 per square foot of bonus FAR in East Whisman.

Attachment 1– Key Financial Assumptions for Residential Financial Analysis East Whisman Precise Plan

The following are key financial assumptions that were used to evaluate the financial feasibility of apartment and condominium developments in the East Whisman Precise Plan area.

Development Program

- Approximately 2.5 acre site at a 3.5 Floor Area Ratio including Bonus FAR, 7-8 Stories
- Apartment Program– 311 to 340 apartments
 - Average unit size of about 800 Net Square Feet (NSF) or 1,067 Gross Square Feet (GSF) based on 40% of units being 2 Bedrooms or larger
 - Parking ratio analyzed at 1.025 spaces/unit and 0.7 spaces/unit
 - 15% affordable units at average target household income of 65% AMI
- Condominium Program– 231 to 262 condominiums
 - Average condo size of about 1,040 NSF or 1,387 GSF
 - Parking ratio analyzed at 1.5 spaces/unit and 0.9 spaces/unit
 - 15% affordable units at average target household income of 100% AMI

Development Revenue Assumptions

Apartment

- Market rate rents average about \$4,000/unit or \$5/NSF
- Affordable rents at 65% AMI average about \$1,740/unit or \$2.17/NSF
- Unbundled monthly parking revenues average \$100/space
- Capitalization rate of 4.25% for apartments and a yield on cost of 5.25%

Condominium

- Market condo sales prices average about \$1,040,000/unit or \$1,000/NSF
- Affordable sales prices at 100% AMI average about \$436,000/unit or \$419/NSF
- Unbundled parking value average \$50,000/space

Development Cost Assumptions

- Land costs are assumed at \$10 million to \$12 million per acre
 - Residential land cost is typically measured on a per unit basis, which varies based on the density of units per acre.

Apartment

- Land prices for apartments are assumed to range between \$72,000–\$95,000/unit.
- Hard construction costs vary depending on amount of parking
 - \$483/NSF (parking ratio of 0.7/unit) to \$501/NSF (parking ratio of 1.025/unit)
 - Includes structured parking construction costs of about \$50,000/space
- Public fees include both City and School District FY 2019/20 fees
 - **Park fees.** Parkland dedication requirement ranges from 1.6 acres to 1.7 acres for market rate units. Park fees range from \$60,000 to \$72,000/market rate unit. Park fees on affordable housing units are assumed to be waived.
 - **School contributions.** School contributions are assumed at \$10/GSF, inclusive of current development impact fees of \$3.79/GSF to both School Districts, or about \$11,000/unit
 - **Infrastructure fees.** Sewer and Water Capacity Fees are assumed at about \$5,000/unit, Citywide Transportation Impact fees are assumed at about \$3,000/unit and developer contributions to East Whisman offsite public infrastructure and community benefits are estimated at about \$8,000/unit.
 - **Other City fees.** Other City planning and building permit fees are assumed at \$7,000/unit

- Construction financing assumes a 5% interest rate and 30 month construction loan period
- Other indirect and soft costs (including design, engineering, legal, insurance, marketing, predevelopment and soft cost contingency) are estimated at about 16% of hard costs

Condominium

- Land prices for condos are assumed to range between \$94,000–\$127,000/unit.
- Hard construction costs similarly vary depending on amount of parking
 - \$495/NSF (parking ratio of 0.9/unit) to \$526/NSF (parking ratio of 1.5/unit)
 - Assumes higher level of finish for condos and structured parking construction costs of about \$50,000/space.
- Public fees include both City and School District fees, and some fees are higher given larger average unit size for condos
 - **Park fees.** Parkland dedication requirement ranges from 1.2 acres to 1.3 acres for market rate units. Park fees are the same as for apartments (\$60,000 to \$72,000/market rate unit)
 - **School mitigation.** School contributions are estimated at \$14,000/unit given larger unit sizes
 - **Infrastructure fees.** Sewer and Water Capacity Fees, as well as Citywide transportation fees are the same as apartments, while developer contributions to East Whisman offsite public infrastructure and community benefits are estimated at about \$11,000/unit.
 - **Other City fees.** Other City planning and building permit fees are assumed at \$10,000/ unit given larger unit sizes and higher building costs per unit.
 - Construction financing assumes 5% interest rate and 29 month construction loan period
- Other indirect and soft costs (including design, engineering, legal, construction insurance, condo liability insurance, condo sales/marketing expenses, predevelopment and soft cost contingency) are estimated at 21% of hard costs.