HAUSRATH ECONOMICS GROUP

MEMORANDUM

Date: August 14, 2019

To: Benjamin Fu, Director of Community Development, City of Cupertino

From: Sally Nielsen

Subject: **Preliminary financial feasibility assessment of the proposed General Plan Amendment for the Vallco Shopping District**

Hausrath Economics Group (HEG) has been asked to evaluate the financial feasibility of a development scenario that would be allowed under the proposed General Plan Amendment (GPA) for the Vallco Shopping District. Specifically, the analysis focuses on the feasibility of development allowed under the proposed Regional Shopping/Residential land use designation; a land use mix and development program for the proposed Regional Shopping land use designation that would cover the rest of the plan area remains to be determined under a future specific plan. The following analysis does not evaluate any uses on this remainder area.

The Regional Shopping/Residential designation would accommodate the General Plan and Housing Element residential allocation for the Vallco Shopping District at a maximum density of 35 dwelling units per acre. Retail use, such as ground floor retail beneath residential use, would be allowed but would not be required. City of Cupertino Planning staff determined that 13.1 acres designated Regional Shopping/Residential would be consistent with State Department of Housing and Community Development and City of Cupertino Housing Element development efficiency assumptions. To achieve the target residential allocation of 389 dwelling units, the City needs to allow a total of 459 dwelling units on 13.1 acres.[1]

The following financial feasibility analysis is suitable for general plan-level decision-making. It is based on feasibility metrics for market values and development costs generated over the multi-year planning

[1] City of Cupertino, *Planning Commission Staff Report*, Meeting Date: July 30, 2019. The Housing Element assumes Priority Housing Sites yield 85% of the maximum unit count. Therefore enough acres need to be designated to accommodate 459 units (at 35 units per acre) in order to ensure that at least 389 units would be developed.

1212 BROADWAY, SUITE 1500, OAKLAND, CA 94612-1817
T: 510.839.8383 F: 510.839.8415

process for the Vallco Town Center Specific Plan. HEG did not undertake any new market or feasibility assessment for this assignment.

Assumptions for preliminary financial feasibility analysis

HEG reviewed the real estate market assessment and financial feasibility assessment prepared by Economic & Planning Systems (EPS) in 2018 for the Vallco Town Center Specific Plan.[2] The assumptions used in the feasibility assessment are informed by the real estate market assessment and by reasonable estimates of lease rates, sale values, development costs, operating costs, and permits and fees. The approach to evaluating feasibility is reasonable and appropriate for a planning-level evaluation of development alternatives. The assumptions for capitalization rates, development contingency, financing, and developer return on investment are appropriate for a project of this scale and complexity.

The following preliminary feasibility analysis of a GPA development scenario is based on residual land values by land use derived from the September 11, 2018 EPS analysis of the Tier 1 development program. The evaluation also relies on site costs, park land requirements and costs, and land cost basis estimates presented in the EPS memorandum.

Preliminary conclusions about the feasibility of development under the proposed General Plan Amendment Regional Shopping/Residential land use designation

The development program evaluated consists of 459 residential units on 13.1 acres. There would be 390 market rate units. To satisfy City of Cupertino BMR requirements, 15% of the units (69 units) would be affordable to moderate income households. (15% of 459 = 68.85 units. Rounded up to 69 units.) The development scenario also includes some traditional retail development (shops, restaurants, coffee shops) as would be expected to fill in ground floor spaces under the residential units. [3] No entertainment retail development or hotel development is assumed.

A program of 100% condominium residential development with ground floor retail generates a positive residual land value considering only market values and building development costs (see **Table 1**). For condominium units, the EPS analysis indicates that both market rate and BMR units generate a positive residual land value per unit. For this development program, the residual value totals $148 million. No impact fee credits are assumed in this analysis.

Site costs and land costs reduce this residual value. Site cost estimates for demolition, basic site work, and right of way and back bone infrastructure improvements are based on the total costs estimated for the Vallco Town Center Specific Plan, pro-rated based on the relative size (in acres) of the development area.

[2] Economic & Planning Systems, *Vallco Special Area Real Estate Market Assessment*, prepared for the City of Cupertino, May 14, 2018 and "Financial Feasibility Assessment of Vallco Specific Plan", memorandum to Catarina Kidd, City of Cupertino, September 11, 2018.

[3] The proposed General Plan Amendment does not require retail development under this land use designation. Some development is allocated to this use on the assumption that uses to activate the ground floor would be desirable.

The 13.1-acre GPA Regional Shopping/Residential area represents 26% of the 50.82-acre area evaluated in the Tier 1 / Tier 2 feasibility analysis. The same percentage factor is used to adjust the land cost basis.

Consistent with the approach in the EPS September 11, 2018 feasibility analysis for the Vallco Town Center Specific Plan, park land in-lieu fees are calculated based on the 390 market-rate residential units assumed for the GPA Regional Shopping/Residential designation. No impact fee credits are assumed.

As indicated in Table 1, adjusted site costs (including developer return on investment) total $54 million. At $21 million, park land in-lieu fees are 40% of total site costs.[4] The adjusted land cost basis is $93 million. The estimated project residual (residual value minus site costs and land costs) is positive at about $1 million.

Comparison to preliminary feasibility impact prepared by The Concord Group, July 29, 2019

The Concord Group (TCG) prepared a preliminary assessment of the feasibility of the proposed GPA, using the same assumptions and valuation conclusions from the EPS September 11, 2018 memorandum. The TCG analysis concluded that the proposed GPA would be "clearly infeasible".

There are a number of reasons for the difference between the TCG conclusion and the HEG analysis presented above. First, the TCG analysis assumes that condominium development would not be permitted; all of the residential units are assumed to be apartments, generating substantially lower residual values per unit. The proposed GPA does not require residential rental development. HEG assumes that the residential development would be condominiums. Second, the TCG development analysis includes all of the retail and hotel development proposed for the Tier 1 program (consisting in total of a wide range of development over 50.82 acres). These commercial uses in total contribute negative residual value to the site. The HEG analysis assumes a modest amount of ground floor retail consistent with the limited development program for this component of the total plan area. Third, the TCG analysis assigns all of the site development costs and land costs associated with developing 50.82 acres to a development program that applies to only 13.1 acres. Finally, there is an error in the TCG calculation of "Residual Value Before Site Costs / Fee Credits". The project is not "underwater…in negative territory at $17 million." In fact, the residential rental scenario combined with the negative residual value associated with retail and hotel uses generates positive residual value before site costs on the order of $16.3 million.

---

[4] Park land requirements could also be satisfied by dedicating improved open space and plazas on-site to public use. This would reduce project development costs.

Table 1

Vallco Special District - Financial Feasbility of GPA Development Scenario 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]

Project Factors	Development Program	Residual Land Value Per Unit or Per Square Foot[2]	Total Value
Apartment Units			
Market Rate	-	$197,167	$0
BMR Apartment	-	($322,732)	$0
Condominium Units			
Market Rate	390	$356,834	$139,165,260
BMR Condominium	69	$117,984	8,140,896
Total Residential Units/Value	**459**		**$147,306,156**
Office Square Feet			
Traditional Office	-	$162	
Retail Square Feet[3]			
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**
Impact Fee Credits - none assumed			
Site Costs[3]			
Demolition			($4,600,000)
Basic Site Work			($6,600,000)
Open Space Improvements			$0
Park land in lieu fee[5]			($21,060,000)
Right of Way and Back Bone Infrastructure			($12,900,000)
Additional Off-Site Improvements/Mitigation			$0
			($45,160,000)
Site Development Financing Cost		6%	($2,709,600)
Developer Return on Site Costs		12%	($5,744,352)
Financing Costs and Developer Return on Site Costs			($8,453,952)
Total Site Costs including ROI			**($53,613,952)**
Approximate Land Cost Basis (includes 12% ROI)[6]			**($93,184,000)**
Estimated Project Residual			**$1,058,204**

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.

2. 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.

3. 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.

4. 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.

5. 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.

6. 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