

The Economics of Land Use



Report

Vallco Special Area Real Estate Market Assessment

Prepared for:

City of Cupertino

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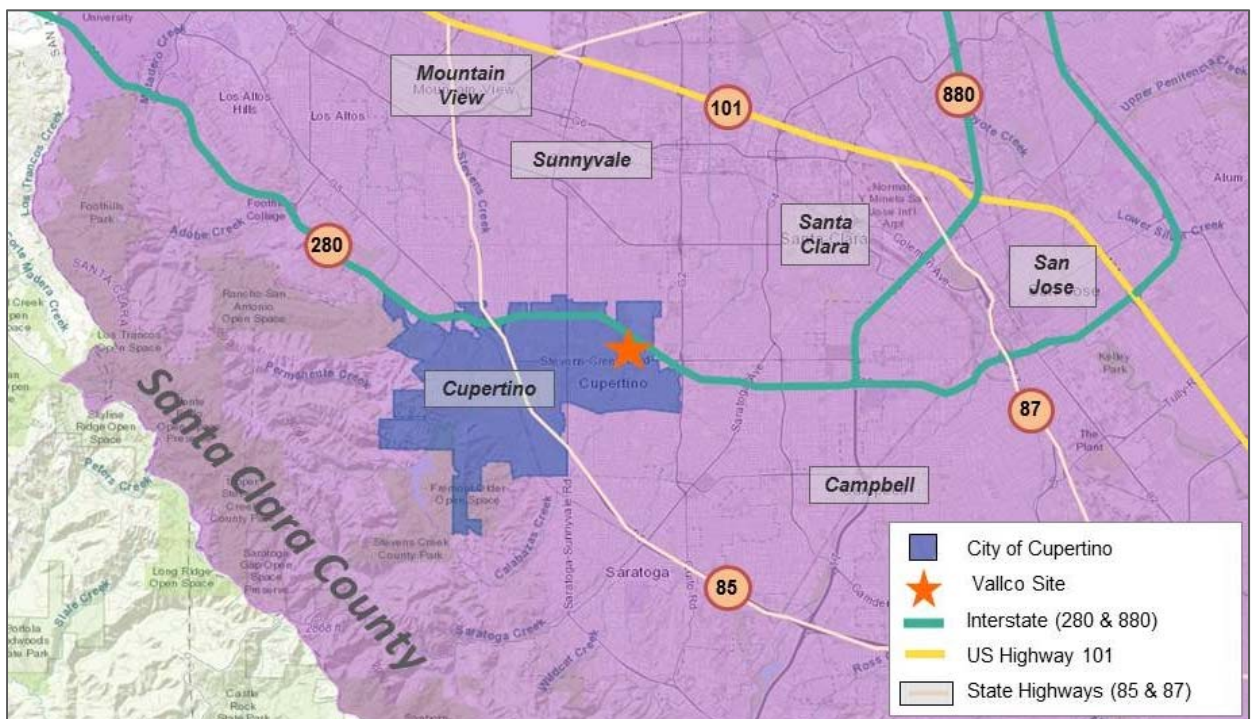
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1. INTRODUCTION AND KEY FINDINGS

The 58-acre Vallco Special Area (Site) is home to the 1970s-era Vallco Shopping Mall, located off of Interstate 280 in the City of Cupertino, as shown in **Figure 1**. The Mall's decline was reaffirmed with the closure of its anchor tenants including Macy's, Sears, and J.C. Penney during 2015 and 2016. As of early 2018, the 1.2 million-square foot Vallco Mall was about 85 percent vacant, with AMC Theatres, Cupertino Ice Center, Bowlmor Lanes, Cold Stone Creamery, Dynasty Seafood Restaurant, and Benihana remaining as tenants.¹ As part of an effort to revitalize the Vallco Special Area (Site), the City is working to develop a Specific Plan, along with an Environmental Impact Report (EIR) that evaluates possible alternative reuses.

Figure 1 Site Location Relative to Highways and Freeways



Source: ArcGIS Online; Economic & Planning Systems, Inc.

The City of Cupertino retained Economic & Planning System (EPS), as part of a larger consultant team (Team), to assist with the preparation of a Specific Plan for the Site. This initial assessment of market conditions and reuse opportunities seeks to provide essential, foundational local and regional market information to inform land use options. This report focuses on four primary land use types which EPS agreed upon with City staff, including office, retail, residential, and hotel uses. As part of this market assessment, EPS has considered socioeconomic and real estate market trends as well as detailed information concerning new, high-performing local and regional projects, including their market positioning, architectural format, amenity offerings, and market

¹ AMC Cupertino Square 16 closed during March, after data collection for this report had concluded.

value. In subsequent tasks, EPS will coordinate with City staff and the Team to prepare detailed development options for the Site and to evaluate the financial viability of those alternatives.

Key Findings

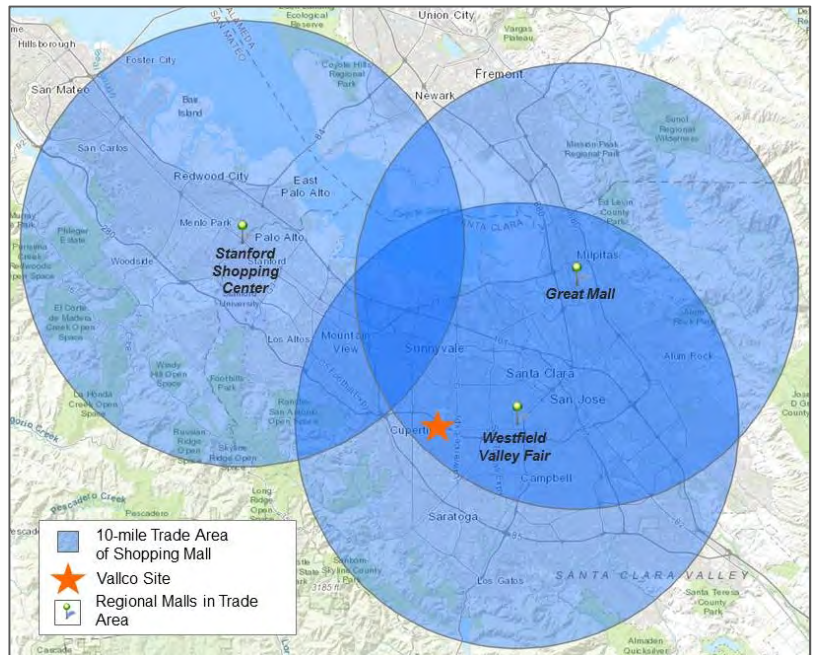
1. *Cupertino's economic performance and competitive market position is strong, primarily fueled by the dominant high-tech sector of Silicon Valley.*

Between 2006 and 2015, Cupertino experienced a 46.3 percent increase in jobs, largely driven by growth in the technology-driven sectors. In contrast, population growth in Cupertino over the last decade has lagged behind employment growth, and has been modest compared to growth rates of neighboring cities and Santa Clara County overall. While job growth has benefitted some residents, over 90 percent of Cupertino jobs are held by nonresidents. Despite the growth imbalance, the City's jobs-to-resident ratio remains below some of the most employment rich jurisdictions in the County.

The region's strong economic climate has positioned Cupertino as a highly attractive location for development, with strong market performance across residential, office, and hotel land uses. Retail development potential is more limited, largely owing to national shopping trends that are negatively affecting brick-and-mortar retailers. Nonetheless, excluding Vallco from the market data reveals that retail vacancy in Cupertino is a very low 2 percent Citywide and there likely are strategic opportunities for new retail development.

2. *The location of the Vallco Site is likely to successfully capture demand for office and housing but being between nearby, well-established "super-regional malls" and "lifestyle centers" limits the potential for a significant retail project.*

The growing high-tech sector in the South Bay has catalyzed significant demand for housing and office space, evidenced by Countywide real estate development and market price escalation. Demand for these land uses likely would be strong at the Site, given its convenient freeway access and central location in Silicon Valley. While the Site location also is appropriate for retail, the competitive landscape for retailing at Vallco has become more challenging over time as major super-regional malls and lifestyle centers now serve this



Source: CoStar Group; ArcGIS Online; Economic & Planning Systems, Inc.

trade area. These centers include Westfield Valley Fair and Santana Row in San Jose, the Stanford Shopping Center in Palo Alto, and the Great Mall in Milpitas, all of which are located within a 20-minute drive of Cupertino.

3. The closure of retail anchors at the Vallco Site reflect broader national trends affecting retail, with traditional mall stores and indoor retail formats needing to evolve to meet current consumer preferences for experiences and services.

Retail reuse of the Site would require unique positioning that complements rather than competes with regional and local retailers. After the 2008 recession, consumers altered their spending habits. Shifting spending patterns and competition from online retail have resulted in a sustained demand for luxury and value-oriented retail real estate, with internet purchases now capturing a significant share of mid-market retail sales. In general, successful malls have evolved tenant mixes and formats to cater to luxury or value consumers. Regional examples of luxury lifestyle centers include Santana Row and the Stanford Shopping Center.

At struggling retail centers, mall managers go to great lengths to sustain high occupancy rates and may discount lease rates in order to avoid losing anchor tenants. When this tactic is no longer effective, malls are often pushed to close or renovate and reposition in the market, often adding a mix of new uses. Despite the well-publicized retail store closures, some retail businesses with unique market positioning and customer service offerings continue to outcompete and expand. Successful, growing retailers often are seeking to locate in high-barrier-to-entry markets with strong consumer demographics, such as in Cupertino. Examples of new development, including Sunnyvale Town Center and Santa Clara Square, indicate potential for mixed-use development with a retail component.

There has been limited retail development in Cupertino over the last decade. The Main Street project, the City's most significant retail addition in recent years, comprises about 130,000 square feet of retail space. While the project is near full occupancy, at least one restaurant has closed, an indication of the challenges face new retail and restaurant uses. Currently, there is an additional 14,500 square feet of retail space in the City's development pipeline. These figures are dwarfed by the 1.2 million square feet of retail within Vallco. Accordingly, while full-fledged reuse of Vallco as a shopping center appears highly unlikely, significant opportunities for retail likely exist along with growth in the City and additional mixed-use development in the Vallco Special Area.

4. Although the City historically has supported single-family and lower density multifamily developments, the recent construction of the Apple Campus II and ongoing economic expansion in Silicon Valley have intensified demand for housing.

With an insufficient supply of available residential inventory and resulting price escalation, housing affordability challenges in Silicon Valley continue to amplify. While residential permitting data reveal a historical bias toward single-family housing development in Cupertino, both County and City data reveal a significant rise in multifamily permitting since 2009, indicating a shift towards more compact and affordable housing options. Despite this new housing, residential development in Cupertino has lagged relative to the economic expansion. Clearly, the strong demand for housing in the South Bay and desirable Vallco location suggest great potential for housing at the Site, with demand across the full spectrum of affordability.

Over the last eleven years, the City has issued 870 residential unit permits, accounting for just over 1 percent of the County total. Of these units, the City has delivered 200 units in multifamily projects, with another 135 units aimed to be completed in early 2018. With limited supply growth, multifamily lease rates are relatively strong in Cupertino. With new multifamily housing generating rents approaching \$4.00 per square foot per month, the market likely can support denser housing formats, although new multifamily projects in the City have been limited to five stories.

5. *While the City of Cupertino has permitted few office developments in recent years, robust local regional economic performance suggests significantly greater development potential.*

Strong regional economic indicators and associated market demand for office space in core Silicon Valley locations have spurred significant new office development in Silicon Valley. However, Cupertino has purposely limited new office development in recent years, with the notable exception of the recently opened 2.8-million-square foot Apple Campus II. Due to growth control measures in Cupertino (i.e., General Plan Amendments required for new office development), market performance does not fully reveal the potential for new development. Today, the City has no office projects in the pipeline, office vacancy is only 2 percent, and lease rates are above the County average.

In Santa Clara County overall, over the past decade office stock grew by 23 million square feet, and meanwhile vacancy rates fell from 2009 highs of 17 percent to current rates of roughly 10 percent (February 2018). Even after seven consecutive years of positive net absorption, investor demand remains strong for office space that is well-designed and strategically located. Despite mounting concerns about oversupply (roughly 22 million square feet of office is in the pipeline countywide²) the Vallco location on I-280 and proximity to Apple's global headquarters suggest significant potential for office development at the Site.

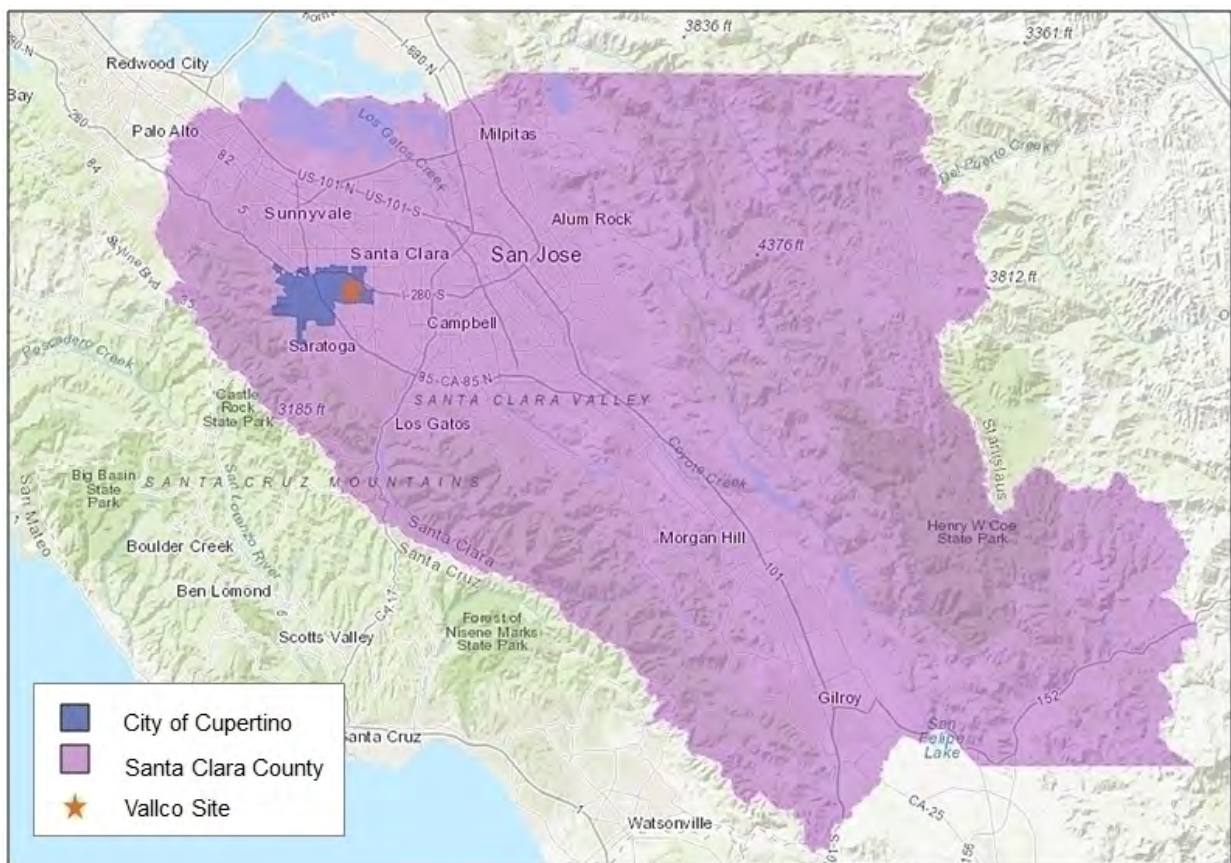
6. *Along with the growing Silicon Valley economy, demand for lodging in Cupertino also will grow to meet the needs of business travelers.*

Cupertino's hotel market has seen markedly high occupancy rates and strong room rates in recent years. The City's hotels primarily cater to business travelers, with weekday occupancy rates regularly reaching 90 percent and demand remaining fairly consistent year-round. Hotel demand may be satisfied in the near term, given the 2013 opening of the Aloft Hotel, the 2017 opening of the Residence Inn, the Hyatt House currently under construction, and two additional proposed hotels in the City. However, there likely will be additional opportunities for well-positioned hotels to satisfy future visitor needs over the longer term.

² Includes projects currently Proposed and Under Construction in Santa Clara County, as reported by CoStar Group.

2. SOCIOECONOMIC CONTEXT

Cupertino is a city of roughly 60,000 residents located in Santa Clara County, directly west of San Jose, at the intersection of Highway 85 and Interstate 280. The City is at the core of Silicon Valley, with numerous technology companies located in the vicinity. Cupertino has become well-known as the headquarters location of Apple, Inc., the City's largest employer. Apple has had a growing presence in Cupertino, particularly owing to the Apple's multibillion dollar headquarters, Apple Campus II, completed in 2017. In addition to its importance to the Silicon Valley economy, Cupertino has a good reputation as a residential location, largely due to its high-performing schools and well-cared for residential communities. Furthermore, DeAnza Community College is one of the City's largest public sector employers, as well as one of the largest community colleges in the United States, attracting local and international students.



Source: ArcGIS Online; Economic & Planning Systems, Inc.

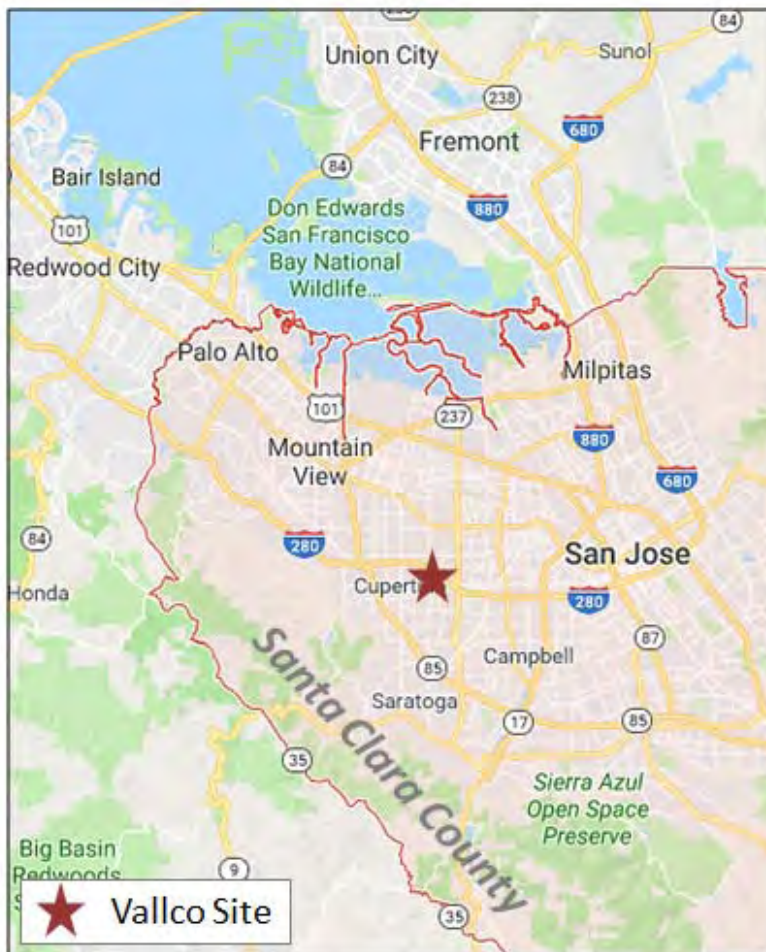
Population

Over the last decade, the City has seen modest population growth averaging just 0.6 percent per year, which is well below that of neighboring jurisdictions. While the City experienced growth of roughly 1 percent average annual growth in the period from 2007 to 2012, there was a significant slowdown from 2012 to 2017. During this period, Cupertino had average annual growth of just 0.07 percent, as compared to the average for the County's cities of 1.1 percent. In

fact, Cupertino experienced the lowest growth rate of all Santa Clara cities over the last five years (2012 to 2017). **Table 1** presents population trends in Santa Clara County from 2007 through 2017.

Employment

Cupertino has evolved with the rise of Silicon Valley and the influx of businesses. With regard to the composition of employment, the City's economy continues to be fueled by science and technology-related businesses. In addition to being home to Apple headquarters, Cupertino is the corporate headquarters of CRC Health, DURECT, Mirapath, Seagate Technology, and others. As of 2015, the City was home to approximately 40,000 jobs and a relatively healthy jobs-to-working residents ratio of 1.59, as seen in **Table 2**.



Source: ArcGIS Online; Economic & Planning Systems, Inc.

Employment in Cupertino increased 46.3 percent from 2006 to 2015, as shown in **Figure 2**. While the City does not have a CalTrain stop, it does have easy freeway access, allowing for regional commuting. Cupertino is well-integrated into the regional economy with 93 percent of the City's employees commuting from outside the City. **Table 3** presents commuting trends for Cupertino.

The dominant industry in Santa Clara County is Manufacturing, followed Professional, Scientific, and Technical Services, with jobs in those sectors accounting for 15.9 percent and 14.5 percent of total jobs, respectively. The County's other dominant industries include Health Care and Social Assistance, Information, and Accommodations and Food Services, as seen in **Figure 3** and **Table 4**.

Over the last decade, the County has seen relatively modest job growth, which is largely attributable to the significant loss of jobs resulting from the 2008 recession. From 2006 to 2011, Santa Clara County saw a loss in the total number of jobs, while the next five-year period, from 2011 to 2016, saw a 3 percent increase in total jobs, as detailed in **Table 4**.

Table 1 Santa Clara County Historical Population Growth Trends

Place / Item	2007	2012	2017	Change 2007-2012		Change 2012-2017		Change 2007-2017	
				Change	Annual Growth Rate	Change	Annual Growth Rate	Change	Annual Growth Rate
Cupertino	55,611	58,714	58,917	3,103	1.1%	203	0.1%	3,306	0.6%
Campbell	38,382	40,050	42,726	1,668	0.9%	2,676	1.3%	4,344	1.1%
Gilroy	47,047	50,695	55,936	3,648	1.5%	5,241	2.0%	8,889	1.7%
Los Altos	27,831	29,696	31,402	1,865	1.3%	1,706	1.1%	3,571	1.2%
Los Altos Hills	7,772	8,127	8,634	355	0.9%	507	1.2%	862	1.1%
Los Gatos	28,177	30,142	31,314	1,965	1.4%	1,172	0.8%	3,137	1.1%
Milpitas	62,684	67,613	75,410	4,929	1.5%	7,797	2.2%	12,726	1.9%
Monte Sereno	3,314	3,383	3,501	69	0.4%	118	0.7%	187	0.6%
Morgan Hill	36,467	39,426	44,145	2,959	1.6%	4,719	2.3%	7,678	1.9%
Mountain View	71,410	75,188	79,278	3,778	1.0%	4,090	1.1%	7,868	1.1%
Palo Alto	61,385	65,882	68,691	4,497	1.4%	2,809	0.8%	7,306	1.1%
San Jose	913,310	980,347	1,046,079	67,037	1.4%	65,732	1.3%	132,769	1.4%
Santa Clara	111,507	119,399	123,983	7,892	1.4%	4,584	0.8%	12,476	1.1%
Saratoga	29,727	30,247	30,569	520	0.3%	322	0.2%	842	0.3%
Sunnyvale	134,232	143,006	149,831	8,774	1.3%	6,825	0.9%	15,599	1.1%
Balance Of County Incorporated	96,210	86,581	87,764	-9,629	-2.1%	1,183	0.3%	-8,446	-0.9%
	<u>1,628,856</u>	<u>1,741,915</u>	<u>1,850,416</u>	<u>113,059</u>	<u>1.4%</u>	<u>108,501</u>	<u>1.2%</u>	<u>221,560</u>	<u>1.3%</u>
County Total	1,725,066	1,828,496	1,938,180	103,430	1.2%	109,684	1.2%	213,114	1.2%

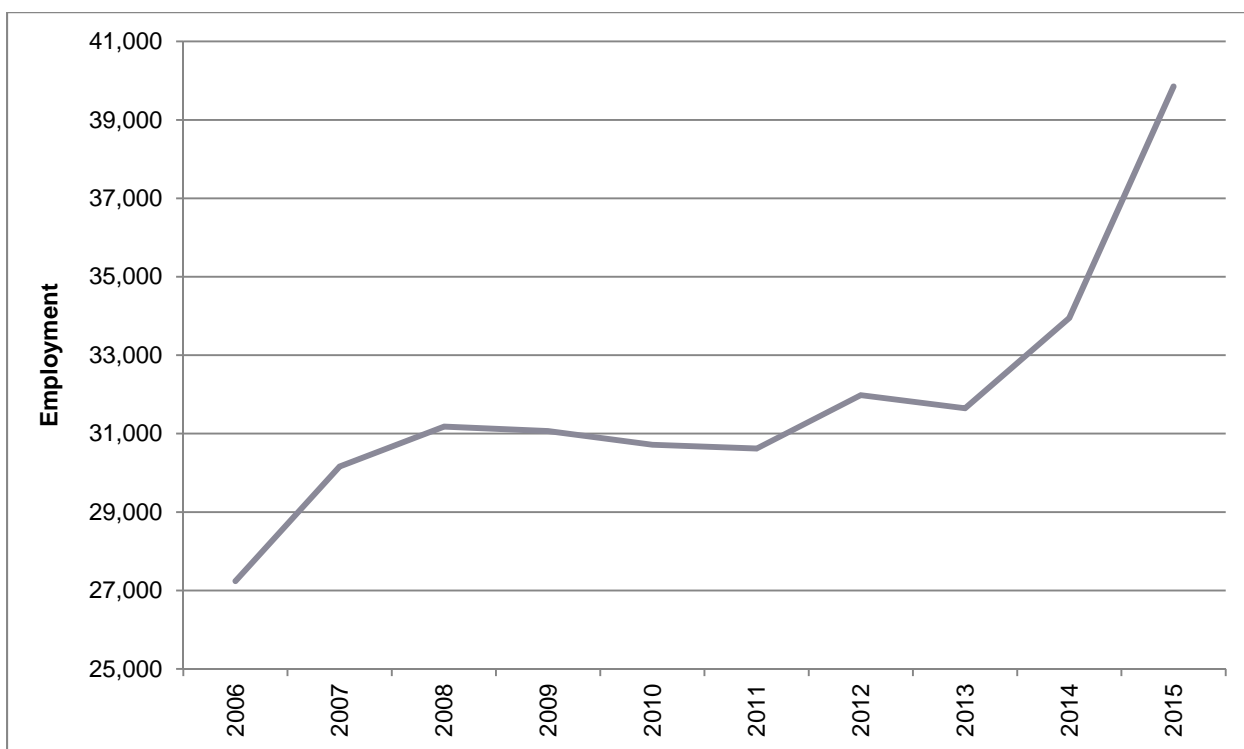
Source: California Department of Finance; Economic & Planning Systems, Inc.

Table 2 Santa Clara County Jobs-to-Working Residents Ratios

County / City	Jobs	Employed Residents	Jobs : Employed Resident
Cupertino	41,934	26,486	1.58
Campbell	28,261	20,967	1.35
Gilroy	16,780	23,067	0.73
Los Altos	11,393	13,004	0.88
Los Altos Hills	2,032	3,325	0.61
Los Gatos	17,791	13,694	1.30
Milpitas	47,538	36,012	1.32
Monte Sereno	365	1,718	0.21
Morgan Hill	14,467	19,495	0.74
Mountain View	73,205	40,948	1.79
Palo Alto	111,968	30,223	3.70
San Jose	411,008	474,260	0.87
Santa Clara	111,954	61,257	1.83
Saratoga	7,529	12,979	0.58
Sunnyvale	90,730	73,514	1.23
Balance of County	<u>19,913</u>	<u>36,468</u>	0.55
Santa Clara County	1,006,868	887,417	1.13

Source: LEHD OnTheMap 2015; Economic & Planning Systems, Inc.

Figure 2 Cupertino Employment Trend



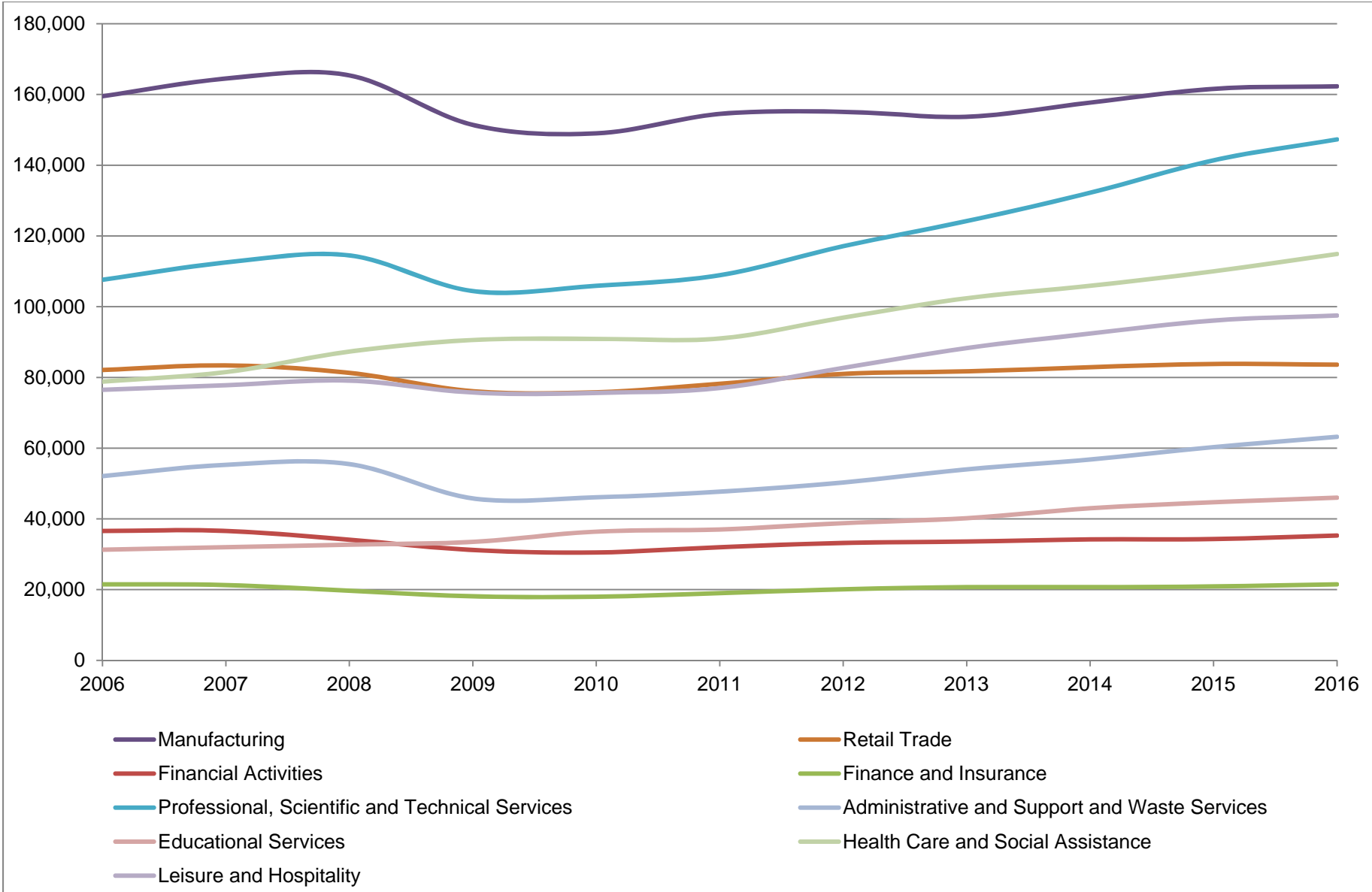
Source: LEHD OnTheMap 2015; Economic & Planning Systems, Inc.

Table 3 Cupertino Commute Patterns

Employment Destinations for Cupertino Residents			Commute Origins for Cupertino Employees		
Place	Number	Share	Place	Number	Share
San Jose	4,902	19.6%	San Jose	10,960	27.5%
Cupertino	2,698	10.8%	Sunnyvale	3,340	8.4%
Sunnyvale	2,419	9.7%	San Francisco	2,720	6.8%
Santa Clara	2,329	9.3%	Cupertino	2,698	6.8%
Palo Alto	1,982	7.9%	Santa Clara	2,398	6.0%
Mountain View	1,525	6.1%	Mountain View	1,247	3.1%
San Francisco	1,081	4.3%	Fremont	1,016	2.5%
Fremont	778	3.1%	Campbell	771	1.9%
Milpitas	572	2.3%	Palo Alto	649	1.6%
Menlo Park	558	2.2%	Milpitas	601	1.5%
All Other Locations	6,198	24.8%	All Other Locations	13,449	33.7%
Total	25,042	100%	Total	39,849	100%

Source: LEHD OnTheMap 2015; Economic & Planning Systems, Inc.

Figure 3 Employment Sector Trends in Santa Clara County



Source: California Economic Development Department; Economic & Planning Systems, Inc.

Table 4 Santa Clara County Employment Trends by Industry

Industry	2006	2011	2016	2006-2011		2011-2016		2006-2016	
				Change	Annual Growth Rate	Change	Annual Growth Rate	Change	Annual Growth Rate
Construction	45,500	30,400	47,700	-15,100	-7.7%	17,300	9.4%	2,200	0.5%
Manufacturing	159,500	154,500	162,300	-5,000	-0.6%	7,800	1.0%	2,800	0.2%
Wholesale Trade	37,800	33,500	37,500	-4,300	-2.4%	4,000	2.3%	-300	-0.1%
Retail Trade	82,100	78,200	83,600	-3,900	-1.0%	5,400	1.3%	1,500	0.2%
Transportation, Warehousing and Utilities	12,700	11,900	14,700	-800	-1.3%	2,800	4.3%	2,000	1.5%
Financial Activities	36,600	32,000	35,300	-4,600	-2.7%	3,300	2.0%	-1,300	-0.4%
Finance and Insurance	21,500	19,000	21,500	-2,500	-2.4%	2,500	2.5%	0	0.0%
Real Estate and Rental and Leasing	15,100	13,000	13,800	-2,100	-3.0%	800	1.2%	-1,300	-0.9%
Professional, Scientific and Technical Services	107,600	108,900	147,300	1,300	0.2%	38,400	6.2%	39,700	3.2%
Management of Companies and Enterprises	10,000	8,800	13,000	-1,200	-2.5%	4,200	8.1%	3,000	2.7%
Administrative and Support and Waste Services	52,100	47,700	63,200	-4,400	-1.7%	15,500	5.8%	11,100	2.0%
Educational Services	31,300	37,000	46,000	5,700	3.4%	9,000	4.5%	14,700	3.9%
Health Care and Social Assistance	78,800	91,000	114,900	12,200	2.9%	23,900	4.8%	36,100	3.8%
Leisure and Hospitality	76,500	77,000	97,500	500	0.1%	20,500	4.8%	21,000	2.5%
Other Services	25,300	24,200	27,000	-1,100	-0.9%	2,800	2.2%	1,700	0.7%
Government	94,500	93,300	93,000	-1,200	-0.3%	-300	-0.1%	-1,500	-0.2%
Total, All Industries	886,900	860,400	1,018,300	-26,500	-0.6%	157,900	3.4%	131,400	1.4%

Source: California Department of Finance; Economic & Planning Systems, Inc.

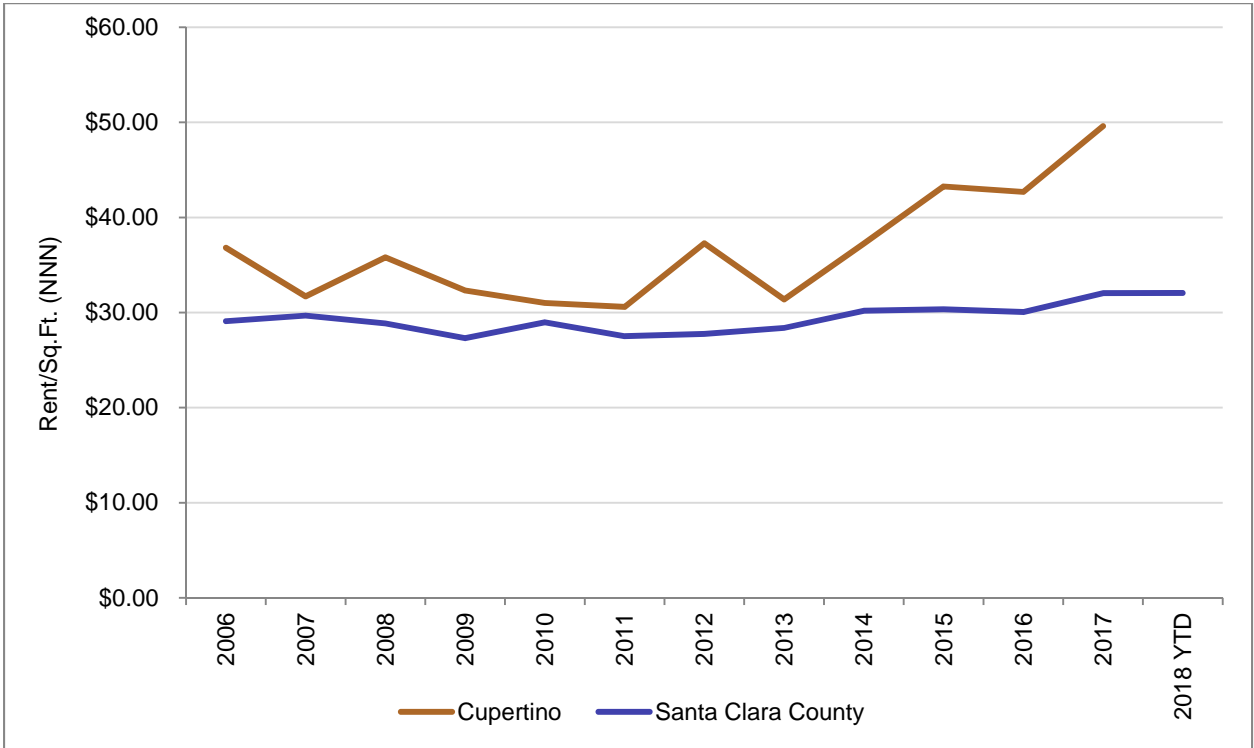
3. RETAIL REAL ESTATE MARKET CONDITIONS

The Silicon Valley region's strong economic climate has positioned Cupertino as a highly attractive location for development for most land uses. Although the potential for retail development is more limited, largely due to national shopping trends, when excluding vacancies at Vallco the City's retail real estate market appears healthy. Lease rates per square foot in the City are also significantly higher than that of the County's, an indication of the desirability of the location. However, due to the Site's location between various established regional retail centers, retail will likely need to be a component of a larger mixed-use development. In the last decade, the City has seen limited retail development deliveries with the exception of the Main Street project.

Market Trends

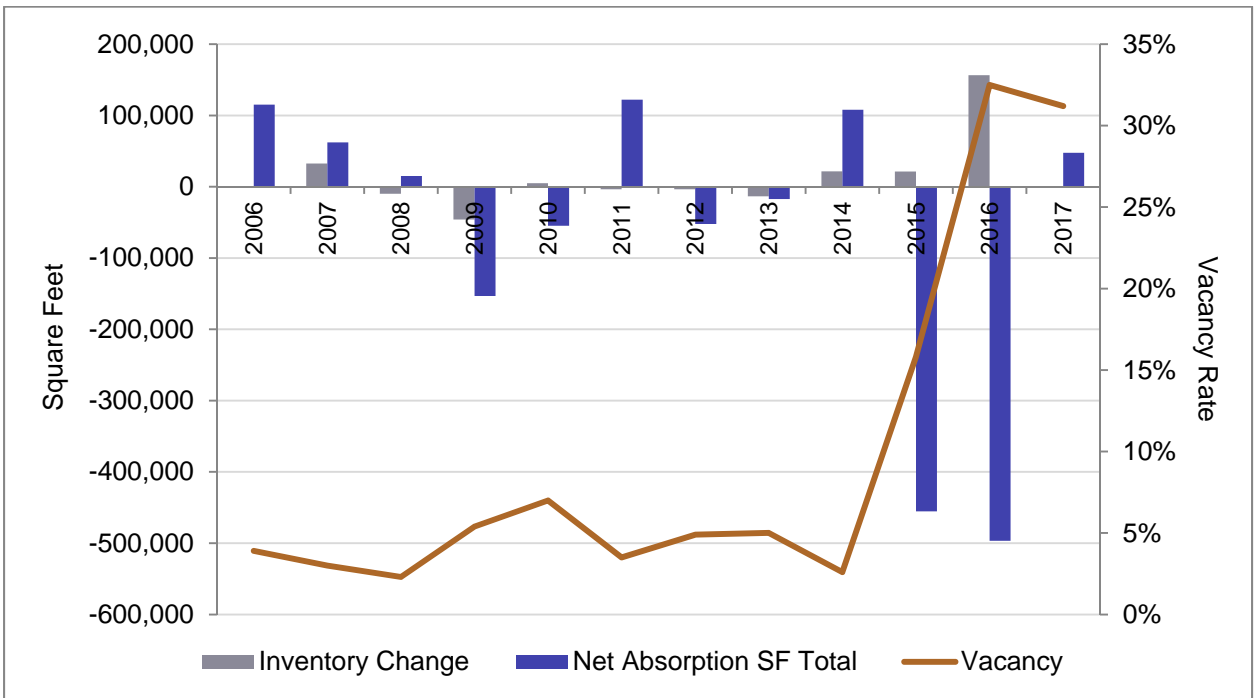
Cupertino has seen minor fluctuations in retail inventory over the last decade, aside from the 2016 delivery of Main Street Cupertino. The Main Street development, built by Sand Hill Property Company, consists of over 130,000 square feet of retail space across over a dozen buildings in an open-air, walkable, town center environment located adjacent to the Vallco Site. Retail at Main Street is nearly fully leased, with its opening marking a downturn in vacancy rates caused by the closing of Vallco's anchors. The City's retail lease rates have been on the rise since 2013 and currently stand at an average of \$50 per square foot per year, well above the County average at above \$30 per square foot, as seen in **Figure 4**. The high vacancy rates in 2015 and 2016 (see **Figure 5**) are largely attributable to the closing of Sears, Macy's and J.C. Penney, with smaller Vallco Mall retailers following subsequently. When removing the effect of Vallco vacancy, the vacancy rate in the City is close to 2 percent. Santa Clara County has seen strong retail performance over the last decade, building approximately 6.7 million square feet with vacancy rates hovering around 5 percent and new inventory being consistently absorbed, as detailed in **Figure 6**.

Figure 4 Average Retail Rental Rate per Square Foot in Cupertino and Santa Clara County



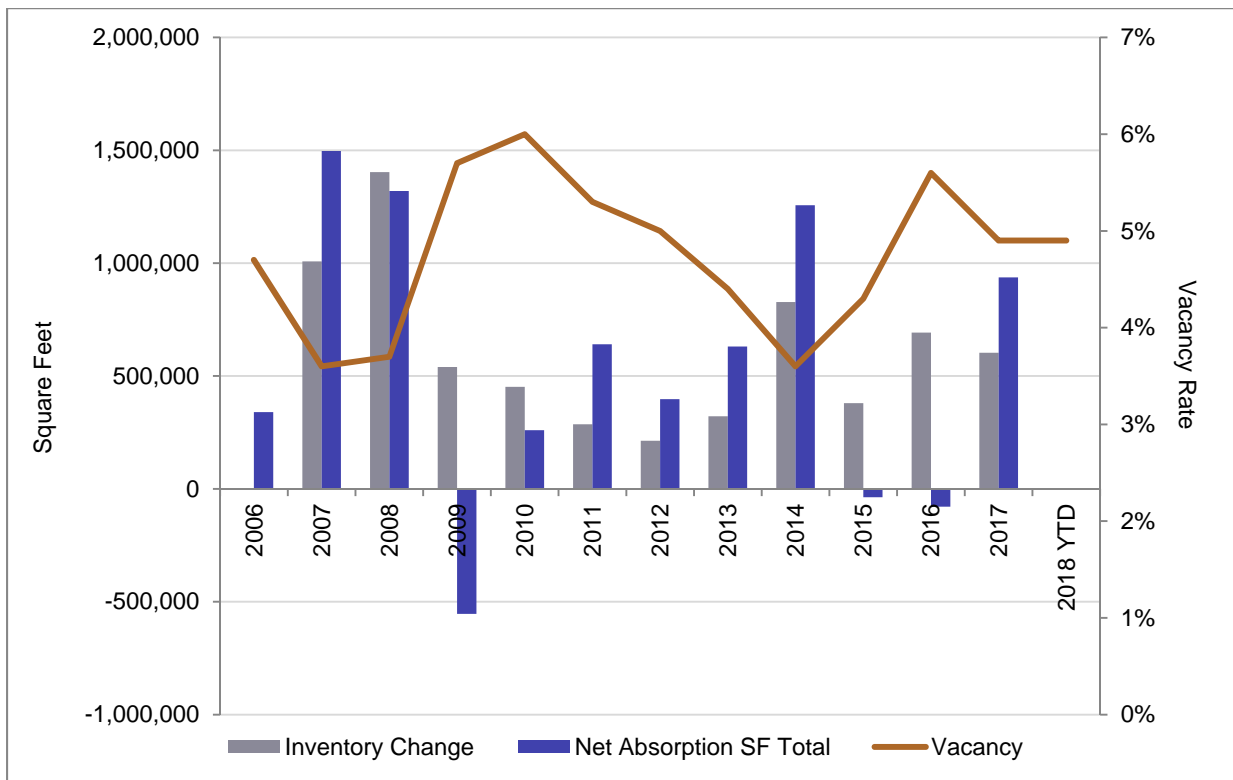
Source: CoStar Group; Economic & Planning Systems

Figure 5 Retail Market Performance in Cupertino



Source: CoStar Group; Economic & Planning Systems

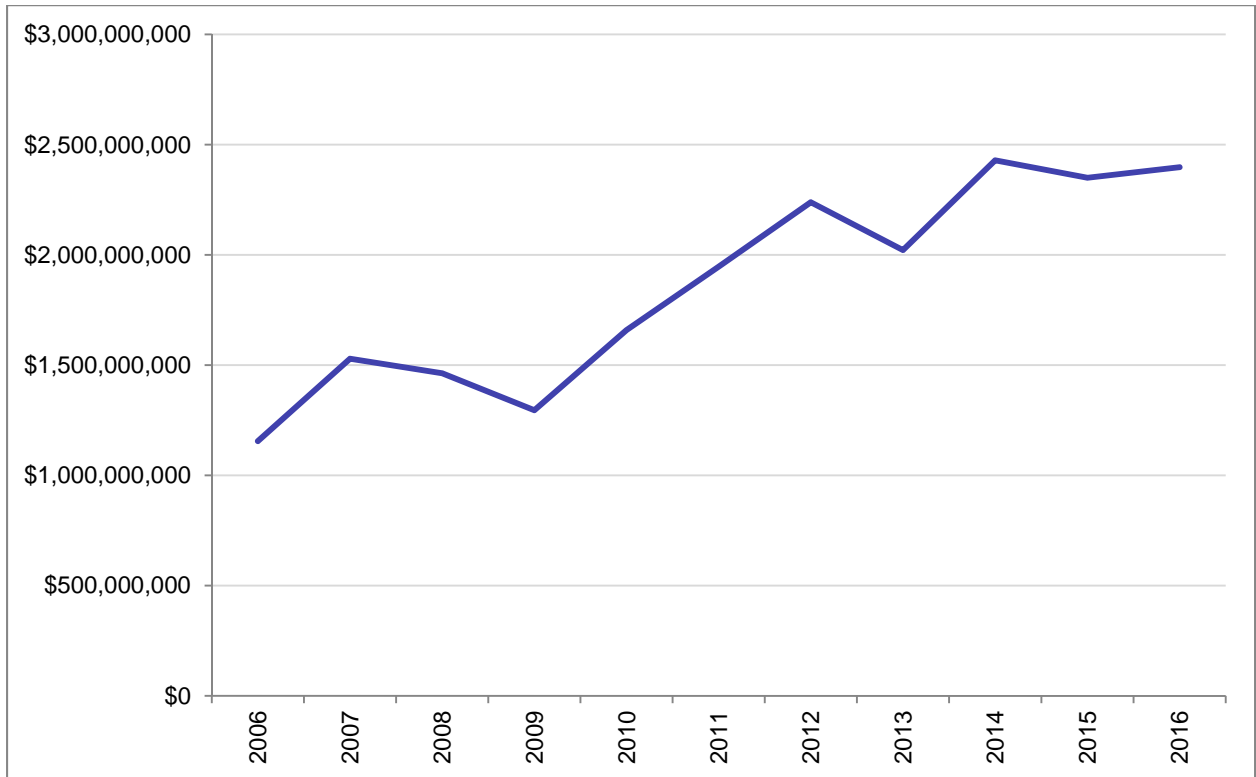
Figure 6 Retail Market Performance in Santa Clara County



Source: CoStar Group; Economic & Planning Systems

Even with the closing of Vallco anchors and high retail vacancy, Cupertino’s taxable sales experienced just a modest dip of 1 percent in the period from 2014 to 2016, as seen in **Figure 7**. This dip is negligible when considering that the City experienced over 100 percent increase in taxable sales over the last decade. The City’s taxable sales, however, include business-to-business sales and have benefitted tremendously from Apple’s success.

Figure 7 Taxable Retail Sales in Cupertino



Source: CA Board of Equalization; Economic & Planning Systems

As is the case for retail throughout the country, the nature of new retail offerings has evolved from the traditional indoor mall and strip mall formats. In Silicon Valley alone, there are a number of recently renovated retail centers, including Westfield Valley Fair located in San Jose and the Stanford Shopping Center located in Palo Alto (see case study detail below), that have set the bar high for lifestyle shopping centers that have high profile retailers, amenities, and extensive restaurant offerings that are key traits of this new retail format. That isn't to say that there isn't successful retail being delivered outside modern formats. However, most other retail is stand-alone and site-specific, or catering to the value-oriented or convenience market.

Pipeline Projects

There is nearly 1.25 million square feet of retail currently under construction countywide with another 1.03 million proposed, as seen in **Table 5**. As for Cupertino, data from CoStar Group indicate that one retail project is currently in the pipeline, located west of Highway 85 on Stevens Creek Boulevard. While project tenancing has not yet been disclosed, it will consist of roughly 14,500 square feet of rentable retail space. In addition, a proposal for redevelopment of the Oaks Shopping Center might bring upwards of 50,000 square feet in retail space.

Table 5 Santa Clara County Pipeline Retail Development³

Property Type	Total Sq. Ft.
Proposed	
General Retail	344,060
Community Center	314,898
Neighborhood Center	133,258
Power Center	198,500
Strip Center	<u>42,601</u>
Sub-Total	1,033,317
Under Construction	
General Retail	367,797
Community Center	155,080
Lifestyle Center	216,855
Neighborhood Center	275,055
Power Center	214,091
Strip Center	<u>19,360</u>
Sub-Total	1,248,238
Total New Retail in Pipeline	2,281,555

Source: CoStar Group; Economic & Planning Systems, Inc.

Retail Conclusion

Adjusting for effects of Vallco on Citywide retail real estate performance metrics, it is evident that Cupertino's retail market is performing well with low vacancy and healthy rental rates. However, the changing nature of retail must be accounted for when considering possible retail reuse of the Vallco Site. Research and observed trends suggest that retail-dominant centers must either fit into one of two extremes, luxury or value, with the middle market struggling to compete with online retailers. Retail reuse of the Site would require unique positioning that complements rather than competes with regional and local retailers or positions retail in a mixed-use development that may fulfill local demand while providing convenience to other on-site uses.

³ As of March 8, 2018, CoStar Group reports retail pipeline development that includes phase I of Related Santa Clara (a 240-acre mixed use development). The total proposed retail square footage in the project is 1.1 million square feet at buildout.

Project Profiles

Westfield Valley Fair

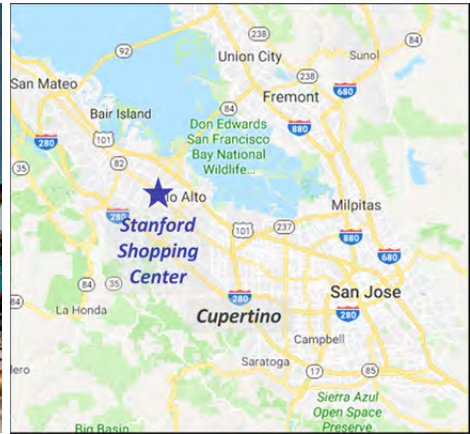


Location	2855 Winchester Boulevard
Year Built	1987 (renovated in 2002)
Jurisdiction	City of San Jose
Rentable Building Area	1,415,765 Square Feet
Year Built	1987 (renovated in 2002)
Anchors	Nordstrom, Macy's
Vacancy	0%

Westfield Valley Fair is a super-regional mall located in the Winchester area of San Jose. The upscale, indoor, shopping mall is anchored by Nordstrom and Macy's. Since the Mall was first constructed, it has undergone numerous renovations and remodels. The most recent renovation is a \$1.1 billion ongoing project that will expand the Center's footprint by roughly 650,000 square feet and add an outdoor dining area, a Bloomingdales department store, a luxury cinema, and other features to enhance the walkability and lifestyle orientation of the Center.⁴ The Mall is host to numerous retailers, restaurants, and service providers, while also providing additional services such as valet parking, phone charging stations, and family play areas.

⁴ [Silicon Valley Business Journal](#), 6/30/2017

Stanford Shopping Center



Location	500-680 Stanford Shopping Center
Year Built	1972
Jurisdiction	City of Palo Alto
Rentable Building Area	928,607 Square Feet
Vacancy	0%
Parking	1,910 Surface, 600 Covered
Anchors	Bloomingdales, Macy's, Neiman Marcus, Nordstrom

The Stanford Shopping Center is an open-air super-regional mall located near downtown Palo Alto on the campus of Stanford University. The upscale center is anchored by Bloomingdales, Macy's, Neiman Marcus, and Nordstrom. The Mall recently underwent a two-year renovation that added 45 new stores along with place-making improvements such as floral planters and public fireplaces. The Center is home to numerous luxury retailers as well as alternative retail, including exercise studios, pop-up shops and varied dining options. The Center is owned and operated by Simon Property Group, an internationally recognized owner of high-end shopping and entertainment centers.

Main Street Cupertino



Location	19419 Stevens Creek Boulevard
Year Built	2016
Jurisdiction	City of Cupertino
Uses	Retail , Office, Residential, Hotel
Retail Sq. Ft.	133,000
Office Sq. Ft.	160,000
Apartment Units	120 (Under Construction)
Stories	1-story retail, 4-5 stories for other uses
Retail Vacancy	3%
Retail Parking Spaces	350
Anchors	Target

Main Street Cupertino is mixed-use development located near Interstate 280, adjacent to the Vallco Site. This development includes a town square, public park and open spaces, restaurant and retail offerings, 120 residential units, a 180-room hotel, and office spaces. The development marks the first phase of Sand Hill's plans to develop the area into a mixed-use entertainment and retail district.

Santana Row



Location	377 Santana Row, San Jose, CA
Year Built	2002 (Phase I) - Present
Uses	Residential, Retail, Dining, Entertainment, Hotel, Public Space
Stories Above Ground	4
Retail Sq. Ft.	680,000 (55,640 planned)
Residential Units	622 (1,182 planned)
Type of Units	Lofts, Townhomes, Villas, Flats
Hotel Rooms	220 (404 planned)
Office Sq. Ft.	65,000 existing, 284,000 under construction (zoning approved for an additional 226,000)
Parking Spaces	4,182
FAR	0.7
Anchors	Best Buy, Crate & Barrel

This development includes a six-screen movie theater, multiple parks and public open spaces, and pedestrian amenities development on 18-blocks with parking obscured from site.

Santana Row is located adjacent to Westfield Valley Fair in San Jose's Winchester neighborhood. This mixed-use development includes 680,000 square feet of ground floor retail, 622 residential units, 214 hotel rooms, and 65,000 square feet of office. Santana Row also includes an entertainment component with a six-screen movie theater. There are plans to grow the site by adding an additional 1,182 residential units, 404 hotel rooms, and 700,000 square feet of office (284,000 square feet of office currently is under construction).

Santa Clara Square



Location	2082 El Camino Real, Santa Clara, CA
Year Built	2016
Uses	Office, Dining, Retail, Residential
Stories Above Ground	Office (6/8), Retail (1), Apartment (4)
Retail Sq. Ft.	120,000
Residential Units	2,000
Type of Units	Apartments
Office Sq. Ft.	1.7 million
Parking Spaces	Office (3,600)
Anchors	Whole Foods (50,000 sf)

Santa Clara Square, a mixed-use planned development located adjacent to Highway 101 in the City of Santa Clara, was delivered in 2016. The site's 120,000 square foot retail component provides amenities for the 1.7 million square feet of office space and 2,000 residential units. The development is a horizontally mixed-use format with connectivity via pedestrian walkways. All offerings are highly amenitized with office spaces featuring floor-to-ceiling glass and indoor-outdoor working spaces and apartment communities featuring resort-style pools, spas and gyms as well as integrated social and co-working spaces.

4. OFFICE REAL ESTATE MARKET CONDITIONS

Cupertino and the County have experienced very strong office performance as indicated by low vacancy rates. Even as the County delivered over 20 million square feet of office space in the last ten years, vacancy has decreased, indicating strong and lasting demand for office products. Despite speculation that the office market is overbuilt, trends suggest that the market has potential to grow. Roughly 22 million square feet of office space is currently in the County's development pipeline.

Market Trends

Cupertino has seen minimal development of office properties over the last decade, which has resulted in consistently low vacancy rates of just 2 percent since 2015, as seen in **Figure 8**. Apple Campus II, completed in 2017, added 2.8 million square feet to Cupertino's office inventory, accounting for over 30 percent of 2017 office development deliveries in Santa Clara County. Countywide, over 23 million square feet of office space has been delivered in the last decade, 36 percent of which was delivered since 2016 (see **Figure 9**).

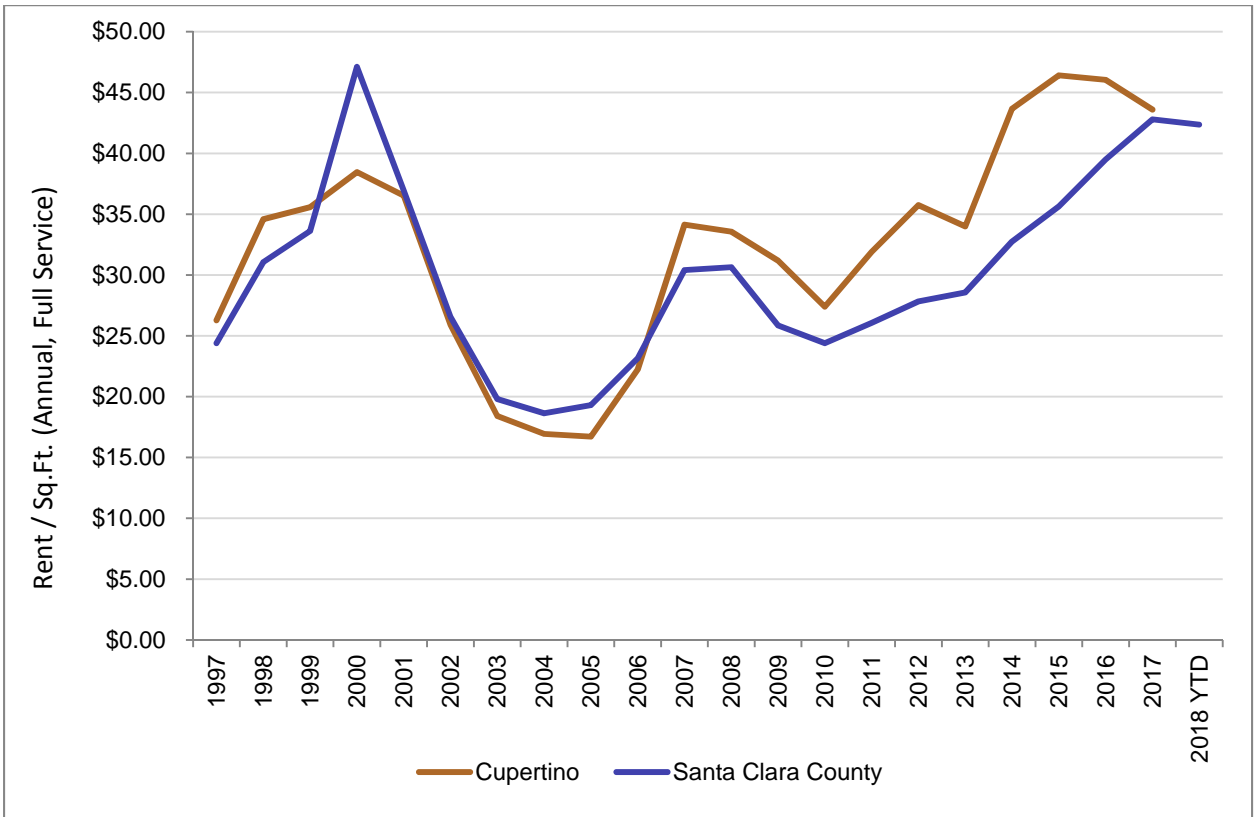
While the County's office stock grew by 23 million square feet, vacancy rates fell from 2009 highs of 17 percent to current rates of roughly 10 percent. These data indicate high demand for office space throughout the region. In 2016, lease rates reached over \$45 per square foot in Cupertino, slightly above the County's average of about \$42 per square foot, as seen in **Figure 10**.

Despite some speculation that the strong Silicon Valley office market is overbuilt, given the significant new inventory and nature of economic cycles, recently observed trends and continued building suggests market confidence. A primary concern is the mismatch between housing growth and job growth, with costly and undersupplied housing posing a threat to the continued expansion of high-tech sectors in the South Bay. However, net office absorption increased last year relative to the previous year, even while the Silicon Valley market ended its seventh consecutive year of positive net absorption.⁵ Investor demand continues to remain strong for office product that is well-designed, strategically located, and has a long-term tenant in place. Real estate professionals do expect office rents to flatten in 2018 as a result of the significant increase in supply, especially with the delivery of developer-led speculative space.⁶

⁵ [Why Silicon Valley Isn't headed for a recession any time soon, Economist Predicts](#), Janice Bitters, Silicon Valley Business Journal, 2/14/2018

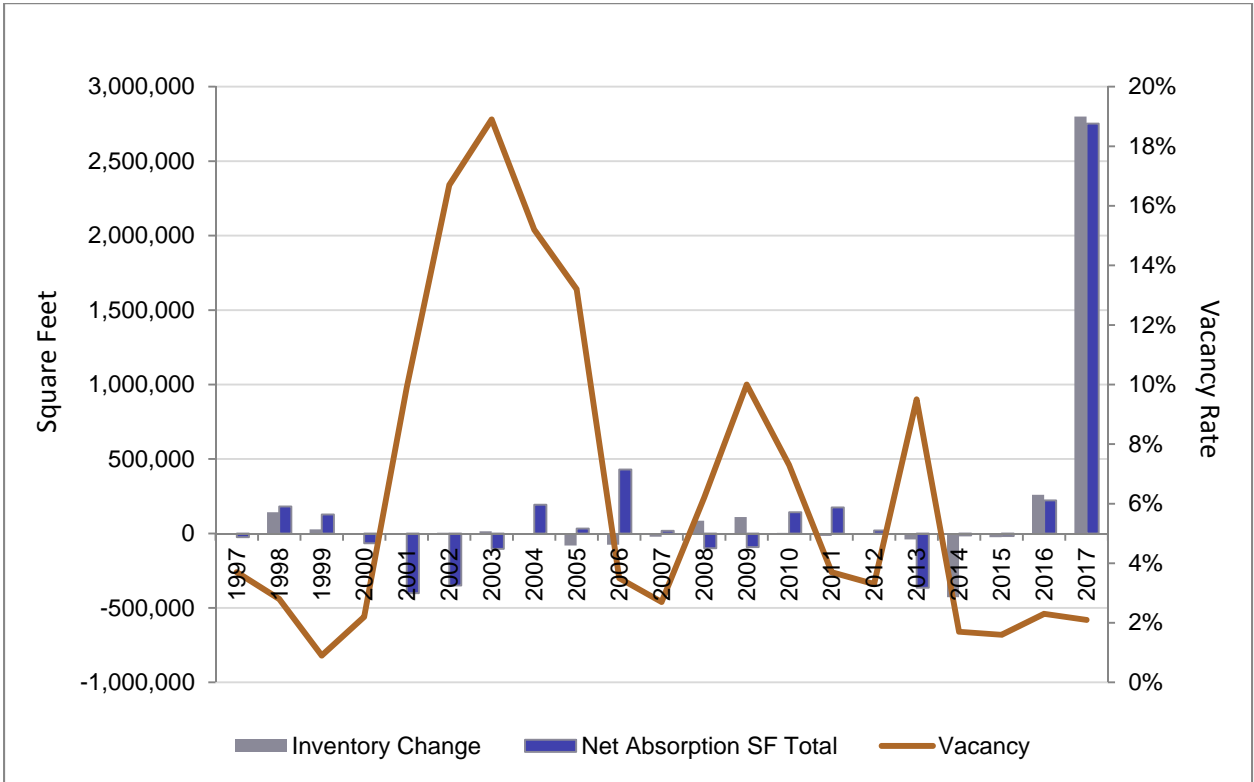
⁶ Cushman and Wakefield, Silicon Valley Office Q4 2017

Figure 8 Office Lease Rates in Cupertino and Santa Clara County



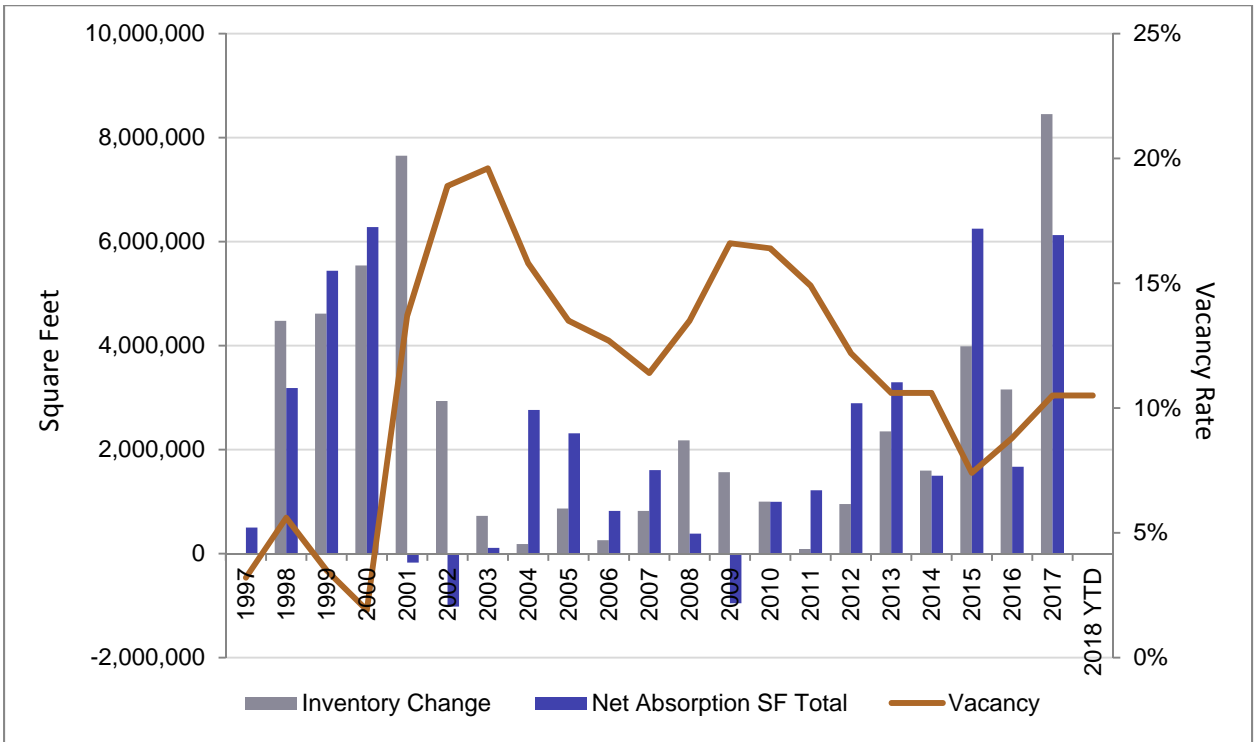
Source: CoStar Group; Economic & Planning Systems

Figure 9 Office Market Performance in Cupertino



Source: CoStar Group; Economic & Planning Systems

Figure 10 Office Market Performance in Santa Clara County



Source: CoStar Group; Economic & Planning Systems

Pipeline Projects

There continues to be significant office projects in the pipeline for Santa Clara County. Roughly 5.6 million square feet of office space is currently under construction in Santa Clara County with another 16.7 million square feet proposed, as detailed further in **Table 6**. Cupertino, however, has no major office projects currently planned or under development.

Table 6 Santa Clara County Pipeline Office Development

Building Address / Item	Building Park / Name	City	Rentable Building Area
Proposed			
Largest Building Parks			
1100 Campus Way	North First Campus	San Jose	1,824,500
2890 N 1st St	The Station on North First	San Jose	1,756,200
N Shoreline Blvd	Google	Mountain View	1,600,000
Coleman Ave	Coleman Highline	San Jose	1,178,459
Wright Ave	NASA Ames Research Center	Moffett Field	1,100,000
Other Office Developments		N/A	<u>9,296,145</u>
Total Office Sq.Ft. Proposed			16,755,304
Under Construction			
Largest Building Parks			
1190 Discovery Way	Moffett Towers II	Sunnyvale	1,752,652
222 N Wolfe Rd	Central & Wolfe	Sunnyvale	777,170
1152 Bordeaux Dr	Moffett Place	Sunnyvale	630,544
900 Santana Row	Santana Row	San Jose	545,840
N 1st St	Midpoint@238	San Jose	415,000
Other Office Developments		N/A	<u>1,487,907</u>
Total Office Sq.Ft. Under Construction			5,609,113
Total Office Sq.Ft. in Pipeline			22,364,417

Sources: CoStar Group; Economic & Planning Systems, Inc.

Office Conclusion

Cupertino has added very little new office inventory in the last decade, which is surprising when considering that office inventory in Santa Clara County grew by 23 million square feet over the same period. Given the strong business climate in the Silicon Valley and the strong observed market conditions for office real estate in Cupertino and the greater region, the Vallco Site is well positioned for office development. The Site is especially attractive given its convenient freeway access and central location in Silicon Valley.

Project Profiles

Sutter Health



Location	596 Carroll St, Sunnyvale
Year Built	2013
Uses	Class B Office
Stories Above Ground	3
Building Sq.Ft.	116,450
Land Acreage	3.24
Parking Format	100 covered, 100 subterranean
Parking Spaces	200
Parking Ratio per 1,000 Sq.Ft.	1.72
Average Lease Rates (per Sq.Ft.)	Owner Occupied
Occupancy Rate	n/a

Apple (Building A)



Location	5409 Stevens Creek Blvd, Santa Clara
Year Built	2014
Uses	Class A Office
Stories Above Ground	6
Building Sq.Ft.	187,500
Land Acreage	2.54
Parking Format	640 Subterranean, 19 Surface
Parking Spaces	659
Parking Ratio per 1,000 Sq.Ft.	3.30
Average Lease Rates (per Sq.Ft.)	Owner Occupied
Occupancy Rate	100%

Main Street Cupertino



Location	19319 Stevens Creek Blvd, Cupertino
Year Built	2016
Uses	Class B Office
Stories Above Ground	4
Building Sq.Ft.	130,000
Land Acreage*	17.40
Parking Format	Subterranean
Parking Spaces	200
Parking Ratio per 1,000 Sq.Ft.	3.75
Average Lease Rates (NNN/ per Sq.Ft.)	\$47.40
Occupancy Rate	100%

*Acreage applies to entire Main Street Site

5. RESIDENTIAL REAL ESTATE MARKET CONDITIONS

While Cupertino has seen little multifamily development over the last decade, rental rates and performance metrics suggest a healthy market. The 2014 delivery of Nineteen800 and the development of the Lofts at Main Street reveal potential for mixed-use residential development. Additionally, the statewide housing crisis has magnified effects on Silicon Valley's housing market due to the influx of jobs and investment without a commensurate increase in housing supply, leading to lengthy commutes and a constrained talent supply for local businesses. Most of the region's new multifamily housing supply caters to the upscale market. Real estate professionals predict that multifamily demand will remain strong as the region remains under-supplied and job growth remains positive.⁷

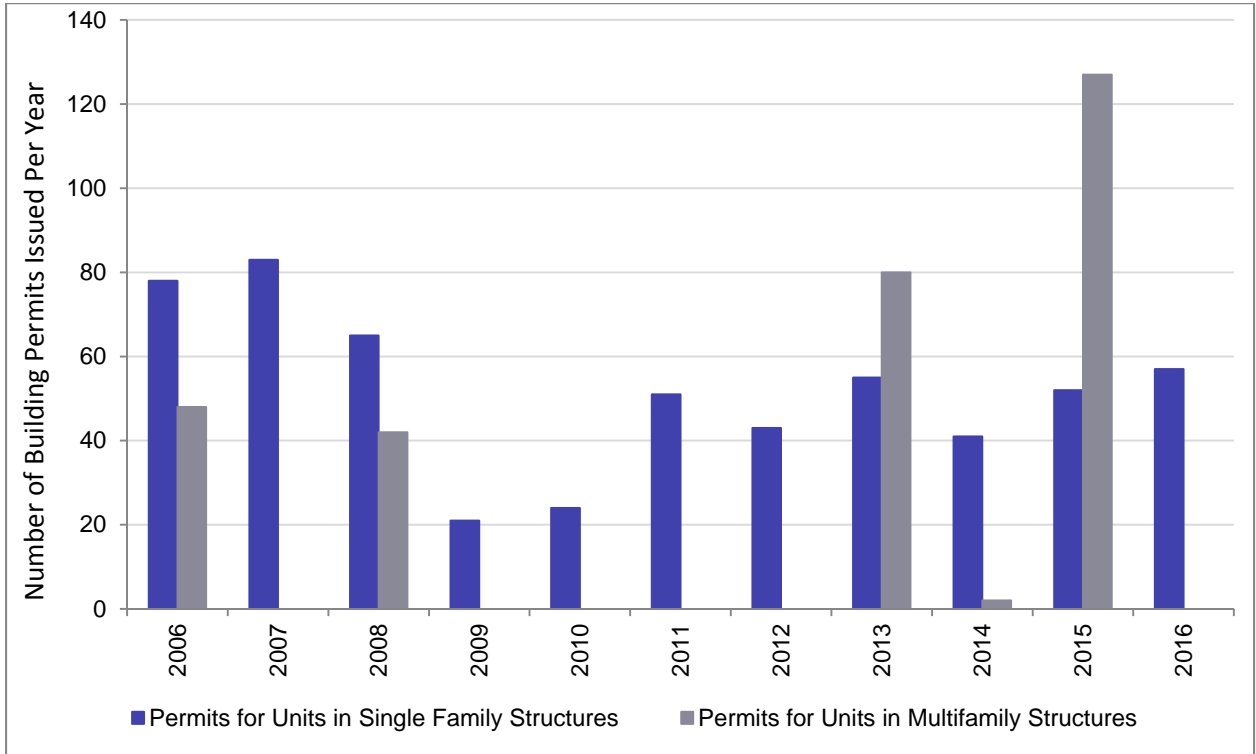
Residential Permitting

The issuance of single-family residential building permits in the City of Cupertino has been relatively steady over the last decade, with annual permits for units in single-family structures ranging from 20 to 80 permits per year. While historically Cupertino has not delivered many multifamily units, there was an uptick in 2013 that marked the first multifamily building permitting in five years, as seen in **Figure 11**.

Cupertino appears to be building relatively less residential units than its neighbors. In Santa Clara County, residential building permits increased sharply after the 2008 recession, with multifamily building permits increasing by nearly 90 percent over 2009 lows, as seen in **Figure 12**. Over ten years, the total building permits issued in Cupertino (roughly 870) account for just over 1 percent of the County total. Cupertino has issued 66 percent single-family permits, as compared to the County's 28 percent. **Figure 13** illustrates building permit trends in selected Cities proximate to Cupertino. Despite the relatively low level of housing production in Cupertino, it is likely that these data reveal City policy and planning for housing, more so than market demand.

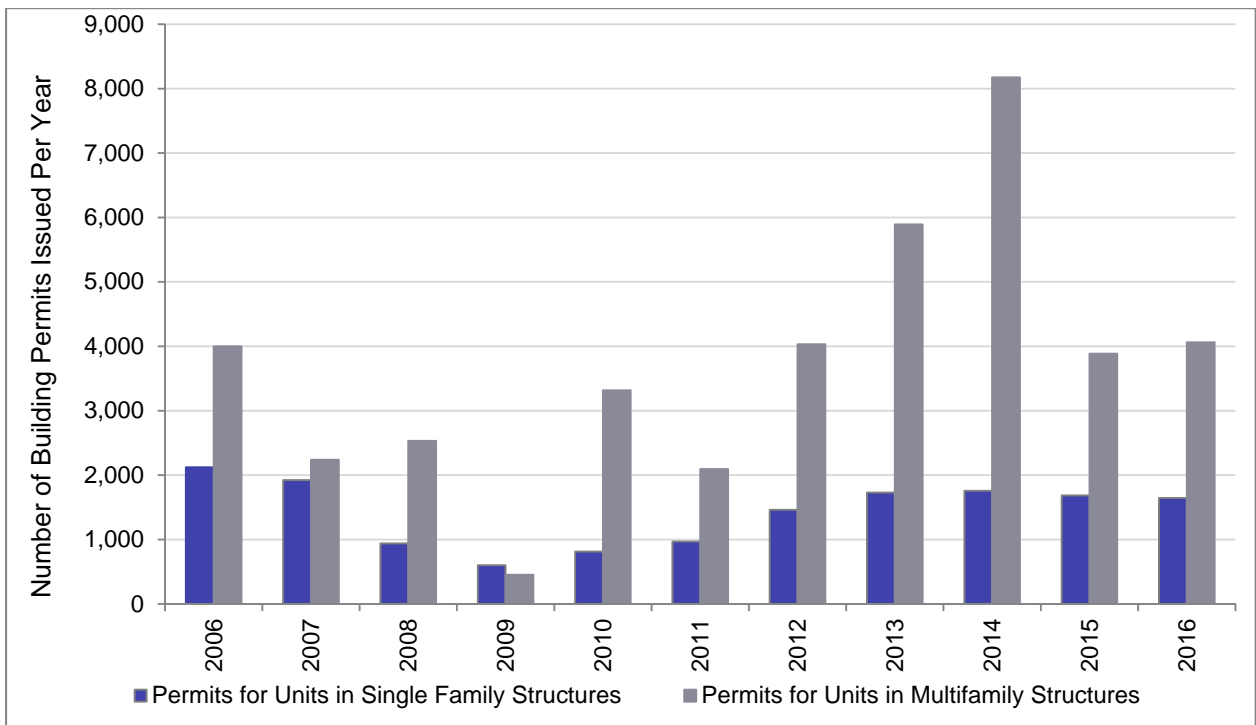
⁷ [Will 2018 Be another Good Year for Multifamily](#), Julie Littman, Bisnow Bay Area, 1/3/2018

Figure 11 Residential Building Permits in Cupertino



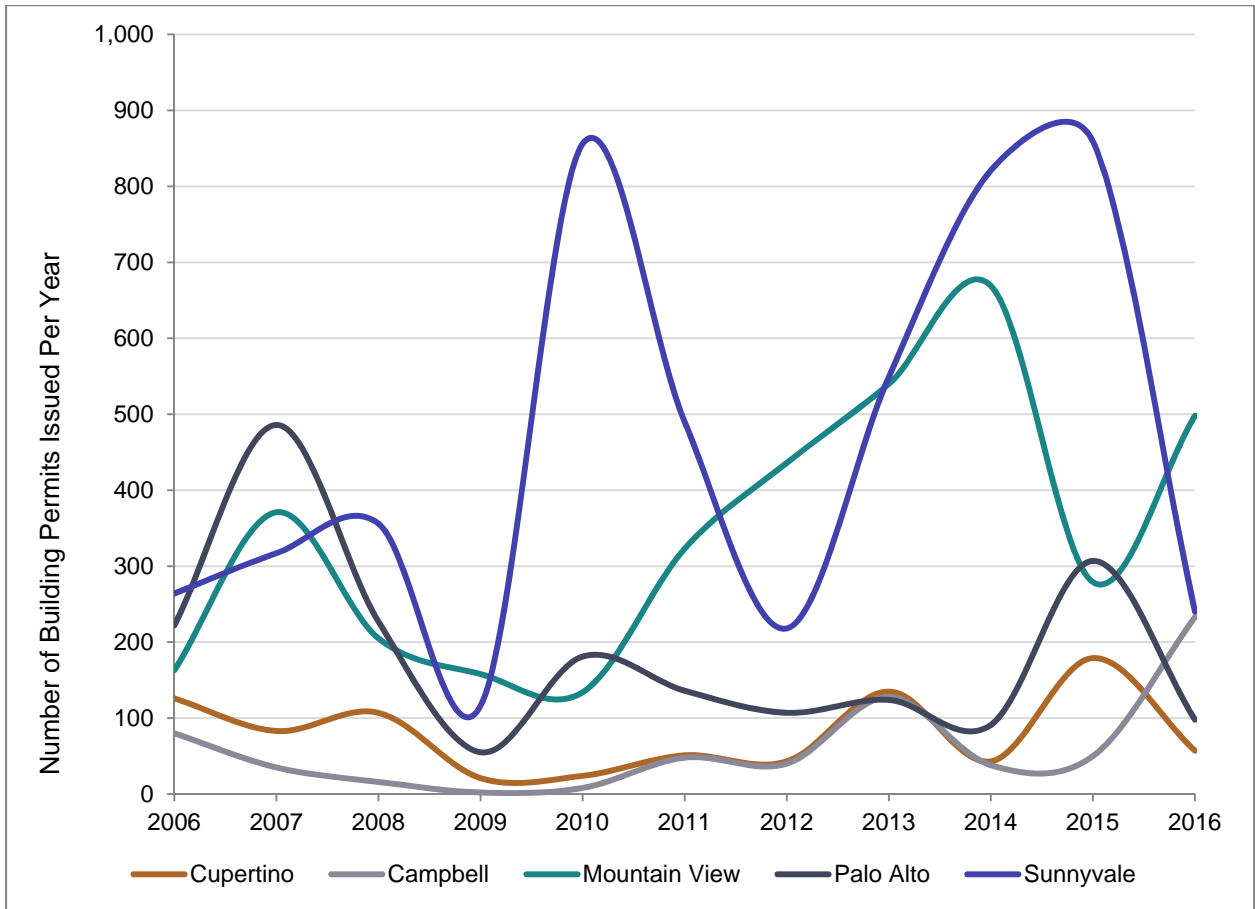
Source: State of the Cities Data System Building Permits Database (HUD USER); Economic & Planning Systems, Inc.

Figure 12 Residential Building Permits in Santa Clara County



Source: State of the Cities Data System Building Permits Database (HUD USER); Economic & Planning Systems, Inc.

Figure 13 Total Residential Building Permits in Selected Jurisdictions



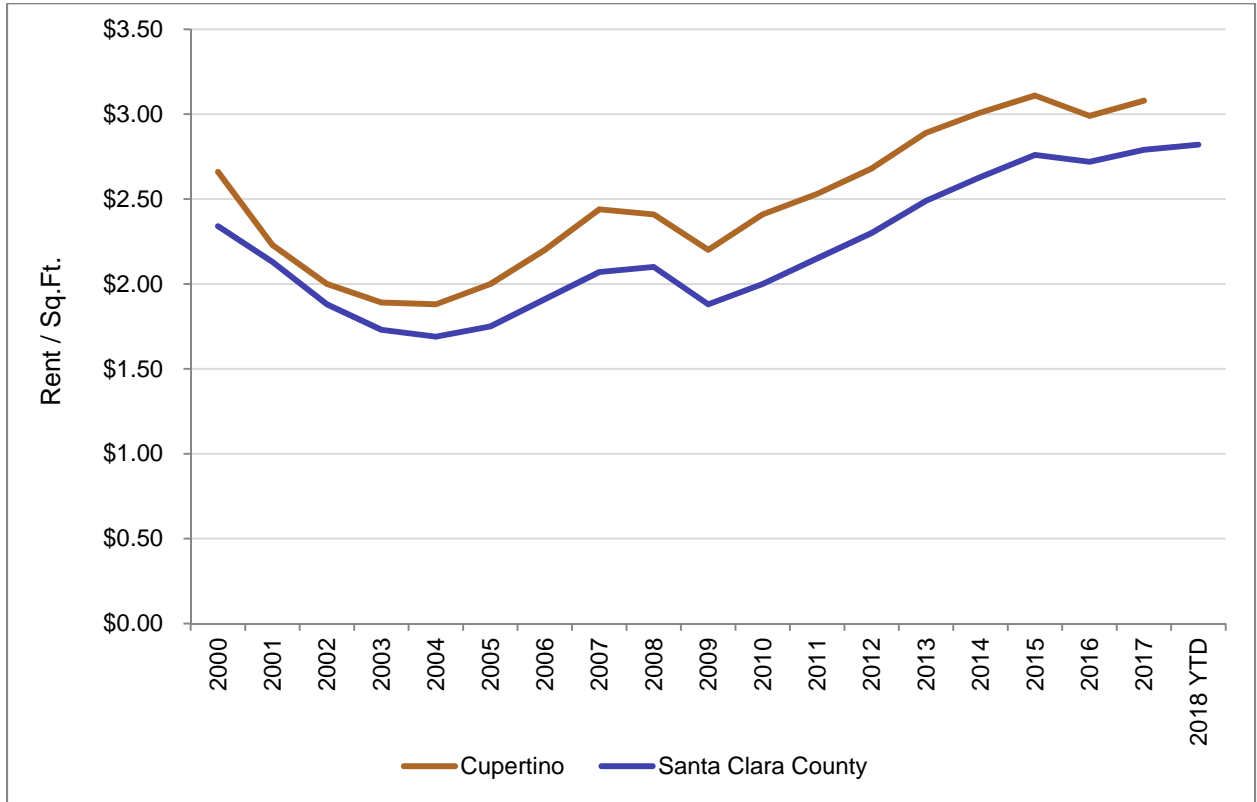
Source: State of the Cities Data System Building Permits Database (HUD USER); Economic & Planning Systems, Inc.

Market Trends

Multifamily Rental Product

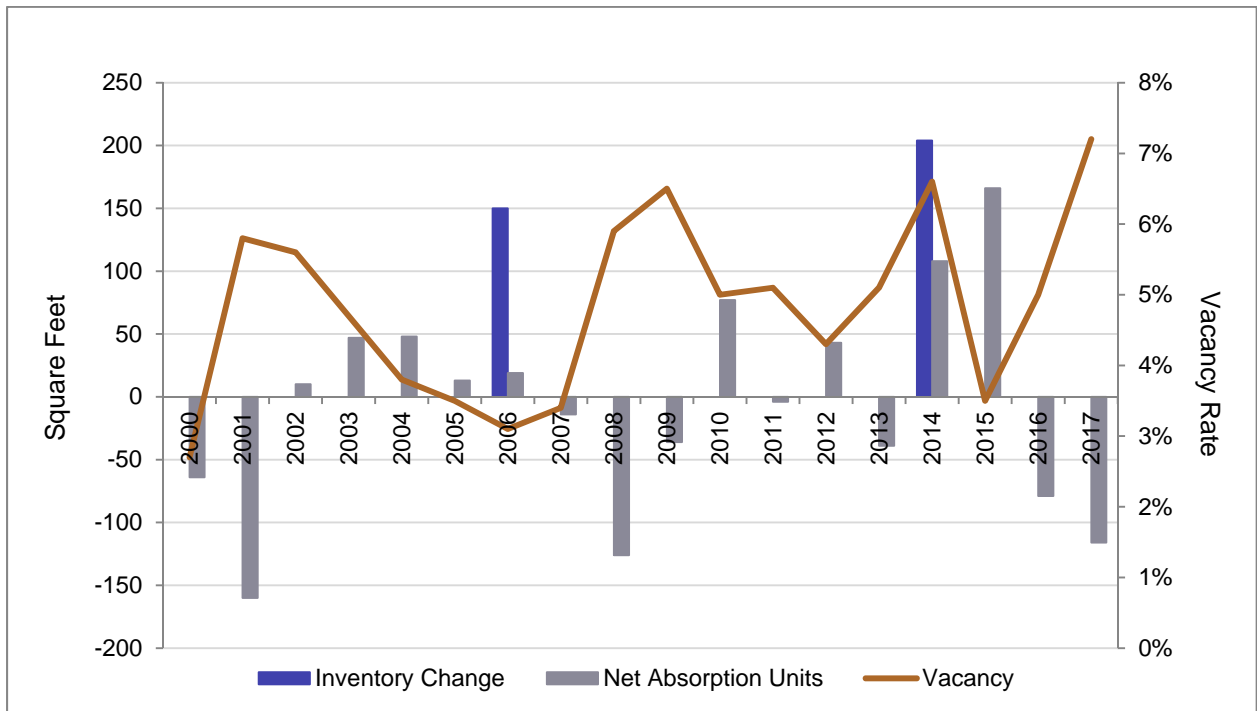
Delivery of new inventory has been modest and residential demand has put upward pressure on rental rates, with average monthly rent per square foot currently at \$3.08, an increase of roughly 40 percent since recessionary lows of 2009, as shown in **Figure 14**. New product rents for roughly \$3.50 to \$3.80 per square foot. Rental rates in Cupertino have remained roughly 10 percent above the Santa Clara County average, although, the County has seen much greater development over the same period. While Cupertino added just 204 rental units since 2008, Santa Clara County has delivered about 27,600 units while exhibiting relatively consistent vacancy rates hovering around 5 percent, as seen in **Figures 15** and **16**.

Figure 14 Average Multifamily Rental Rate per Square Foot in Cupertino and Santa Clara County



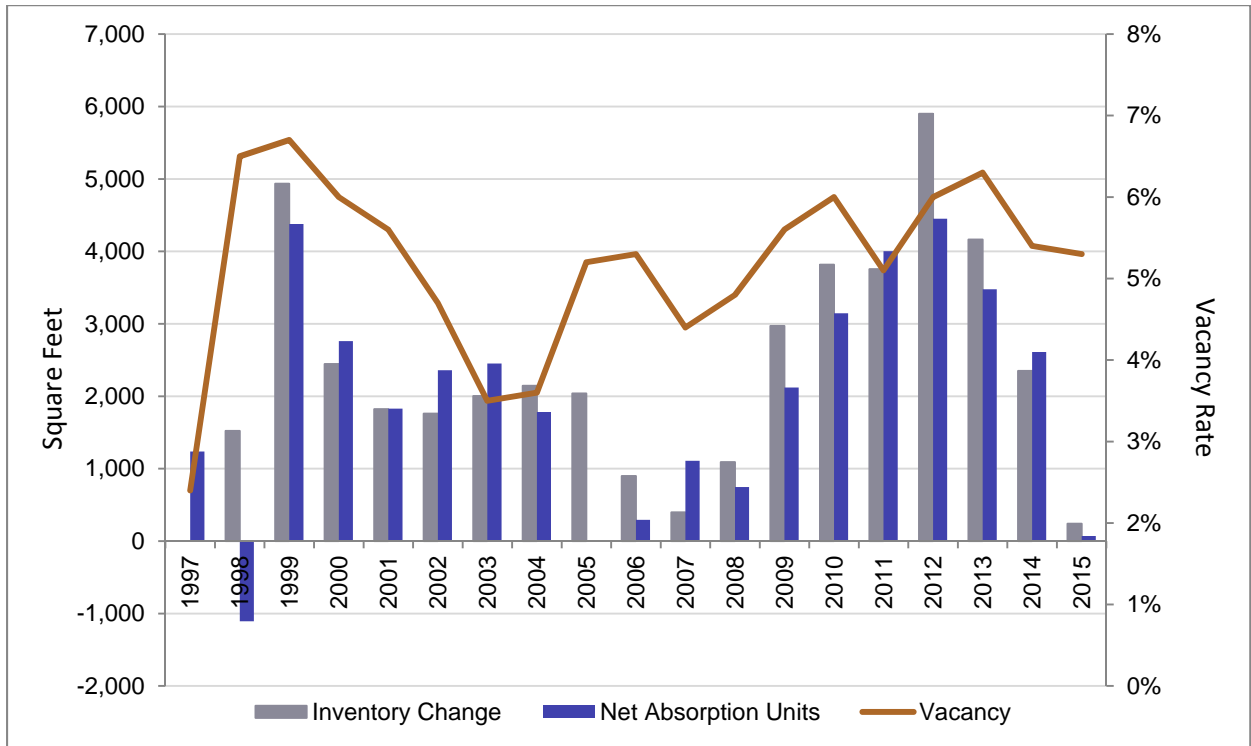
Source: CoStar Group; Economic & Planning Systems, Inc.

Figure 15 Multifamily Market Performance in Cupertino



Source: CoStar Group; Economic & Planning Systems, Inc.

Figure 16 Multifamily Market Performance in Santa Clara County

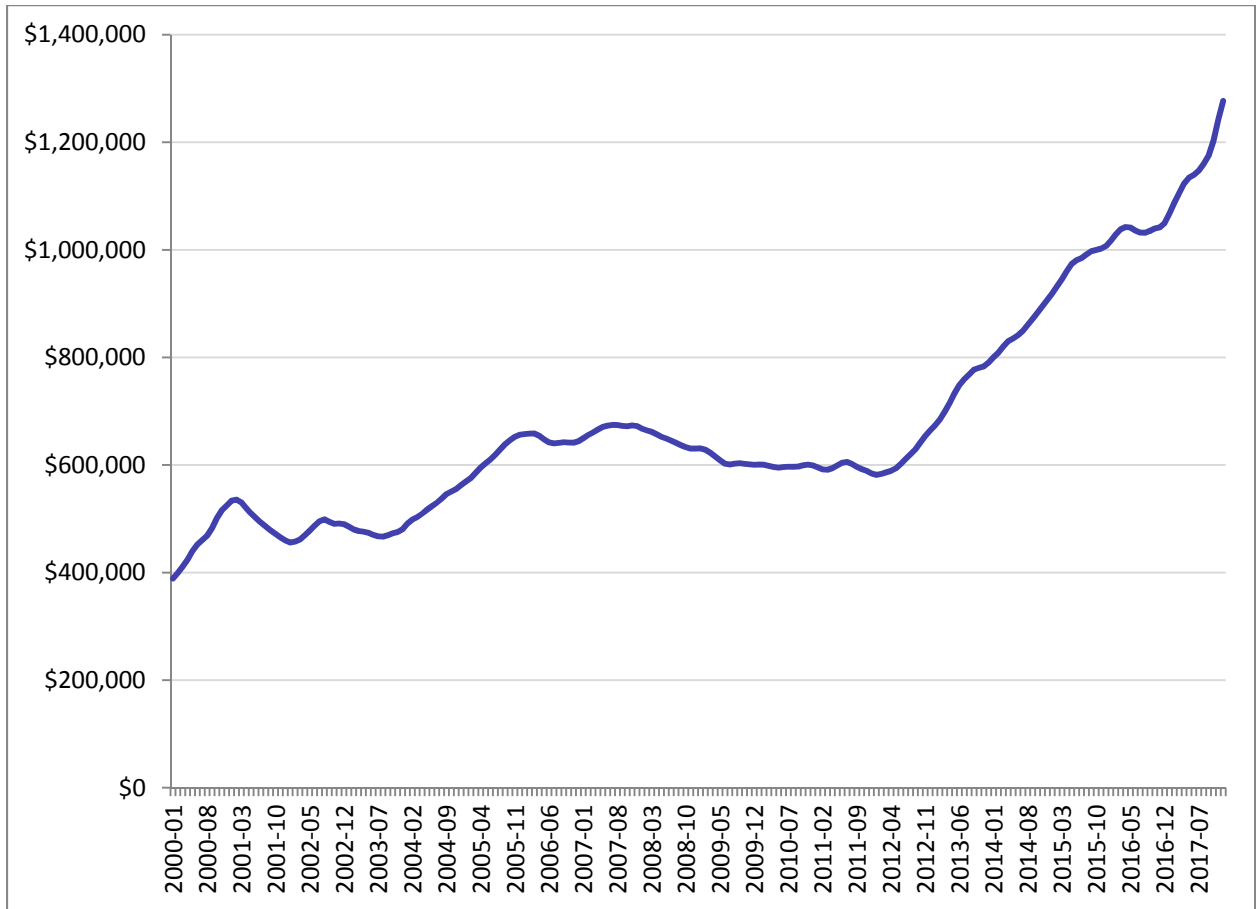


Source: CoStar Group; Economic & Planning Systems, Inc.

Multifamily For-Sale Market

Cupertino has a number of condominium developments, including within mixed-use projects and in traditional residential communities. Condominium units have an average valuation of nearly \$1.2 million as of 2017, which marks a 120 percent increase since 2012, as seen in **Figure 17**. The existing condominium units in the City are all relatively low-density, with no projects identified over four stories.

Figure 17 Value of Condominium (For-Sale) Units in Cupertino



Source: Zillow Data; Economic & Planning Systems, Inc.

Pipeline Projects

Cupertino has two multifamily projects under construction and another two proposed, while Santa Clara County has 9,900 units under construction and another 17,700 units proposed, as seen in **Table 7**. The residential portion of Main Street Cupertino, which is currently under construction, will add roughly 120 units. Additionally, a multifamily development located at 10121 N Foothill Blvd is nearing completion, which will add another 15 units to the City's housing stock. Two projects proposed for Cupertino, the Hamptons and Marina Plaza, are part of larger mixed-use developments and could potentially add a cumulative 1,130 units by 2020, if approved and constructed.

Table 7 Santa Clara County Pipeline Multifamily Development

Building Status	# of Projects	# Of Units	Rentable Building Area
Campbell			
Under Construction	2	135	115,400
Cupertino			
Proposed	2	1,130	1,047,800
Under Construction	2	135	120,504
Gilroy			
Under Construction	2	100	245,000
Milpitas			
Proposed	3	1,633	1,529,200
Under Construction	4	1,815	1,989,390
Morgan Hill			
Proposed	1	61	70,000
Under Construction	13	228	672,113
Mountain View			
Proposed	9	2,715	3,048,330
Under Construction	6	1,651	1,624,981
Palo Alto			
Proposed	2	64	91,600
San Jose			
Proposed	35	8,519	7,819,019
Under Construction	16	3,128	2,908,889
Santa Clara			
Proposed	9	2,434	2,206,801
Under Construction	2	2,476	1,894,000
Sunnyvale			
Proposed	6	1,152	1,557,211
Under Construction	3	198	406,310
TOTAL Proposed	67	17,708	17,369,961
TOTAL Under Construction	<u>50</u>	<u>9,866</u>	<u>9,976,587</u>
TOTAL Pipeline	117	27,574	27,346,548

Source: CoStar Group; Economic & Planning Systems, Inc.

Residential Conclusion

While Cupertino has historically offered primarily low-density housing product, the recent completion of Apple Campus II and the ongoing economic activity in Silicon Valley have intensified the need for housing at a local and regional scale. In the last decade, Cupertino has added just 200 units in multifamily rental projects, even while experiencing high rental rates and consistently low vacancy. Observed multifamily performance trends in the City and County suggest that the Vallco Site could successfully accommodate residential uses and support denser housing formats than are currently offered in the City.

Project Profiles

Nineteen800



Location	19800 Vallco Pkwy, Cupertino
Year Built	2014
Uses	47,228 square feet of ground floor retail/ residential above
Stories Above Ground	6
Building Sq.Ft.	n/a
Land Acreage	n/a
Units	204
Average Unit Size (Sq.Ft.)	1,356
Parking Format	surface/ subterranean
Parking Spaces*	896
Parking Ratio per Unit	4.39
Average Lease Rates (per Sq.Ft.)	\$3.59
Occupancy Rate	96.1%
Sale Price/ Date	n/a

Amenities available to residents include a theater, a conference room, a yoga room, game room, fitness room, shared kitchen & dining facilities as well as an outdoor playground, fire pit, dog-washing area, and multiple barbeques.

*Includes parking for commercial uses

Main Street Cupertino Lofts



Location	19550 Vallco Pkway, Cupertino
Year Built	2018
Uses	10,000 sq.ft. of retail/ residential
Stories Above Ground	4
Building Sq.Ft.	100,000
Land Acreage	1.60
Units	120
Average Unit Size (Sq.Ft.)	1,031
Parking Format	2 levels of subterranean

The project is organized around a central courtyard which includes a BBQ area and outdoor movie theater.

Sunnyvale Loft House Apartments



Location	150 S Taaffe St, Sunnyvale
Year Built	2014
Uses	6,891 sq.ft. of ground floor retail/ residential above
Stories Above Ground	5
Building Sq.Ft.	146,000
Land Acreage	1.59
Units	133
Average Unit Size (Sq.Ft.)	924
Parking Format	2 levels of subterranean parking
Parking Spaces	235
Parking Ratio per Unit	1.77
Average Lease Rates (per Sq.Ft.)	\$4.18
Occupancy Rate	94%
Sale Price/ Date	\$104,000,000/ June 17, 2017

The property includes a sundeck with a poolside bar, social Lounge with fireside retreat, complimentary Wi-Fi, business center, modern fitness center, car charging station, pub-style billiards room, resident bike storage, and outdoor grill/dining area.

Oakwood



Location	881 E El Camino Real, Mountain View
Year Built	2015
Uses	residential
Stories Above Ground	4
Building Sq.Ft.	130,000
Land Acreage	2.31
Units	149
Average Unit Size (Sq.Ft.)	868
Parking Format	Subterranean
Parking Spaces	153
Parking Ratio per Unit	1.03
Average Lease Rates (per Sq.Ft.)	n/a
Occupancy Rate	n/a
Sale Price/ Date	\$110,000,000/ December 9, 2015
This property includes a business center, fitness center, conference room, central court yard, pool/jacuzzi, pet play area, and bike storage.	

6. HOTEL MARKET CONDITIONS

Over the last couple years, Silicon Valley has experienced strong demand for visitor accommodations, generated primarily by the strong and growing regional economy. As of 2017, Silicon Valley⁸ had a hotel inventory of roughly 46,800 rooms across 420 properties.⁹ The market experienced year-over-year RevPAR (revenue per available room) growth in the period from 2010 to 2016, with just minor slow-downs in occupancy and daily room rates over those years, mostly attributable to new supply.¹⁰ As of early 2017, Silicon Valley hotel occupancy stood at 78 percent with average daily rates at roughly \$203 and RevPAR at \$158.¹¹

With demand for accommodations in this market primarily driven by business travel, many operators reported being fully booked on Tuesdays and Wednesdays with average annual occupancy rates at over 91 percent on Tuesdays and Wednesdays.¹² Furthermore, hotel demand appears fairly consistent year-round, February to October, with some declines over the Holiday months.

The City of Cupertino has six existing hotels, as depicted in **Figure 18**, with one hotel currently under construction and located on the Project Site. These six hotels supply the City with roughly 970 rooms and range in scale from Upscale to Upper Upscale, as defined by Smith Travel Research, seen in **Table 8**. Furthermore, the City's existing hotels have experienced remarkable performance over the last year with average occupancy rates over 80 percent and room rates averaging \$223 per night, as seen in **Table 9**. These data suggest that the City could absorb more demand, though there are two hotels in the City's development pipeline. In the long-run, the addition of more accommodation options likely will be supported by the local and regional market at the Vallco Site.

Hotel Conclusion

Cupertino's hotel market has seen markedly high occupancy rates and strong room rates in recent years. The City's hotels primarily cater to business travelers and demand remains fairly consistent year-round. There are likely additional opportunities for well-positioned hotels to satisfy future visitor needs over the longer term.

⁸ Silicon Valley defined here as southern portion of San Francisco Bay, including San Mateo County, Santa Clara County and portions of Alameda County.

⁹ HVS Market Pulse: Silicon Valley

¹⁰ HVS Market Pulse: Silicon Valley

¹¹ Development demand has Silicon Valley hotels trending, Bryan Wroten, Hotel News Now, 4/6/2017

¹² Smith Travel Research average for Silicon Valley Hotels in 2017, excluding economy and midscale offerings.

Figure 18 Cupertino Hotels

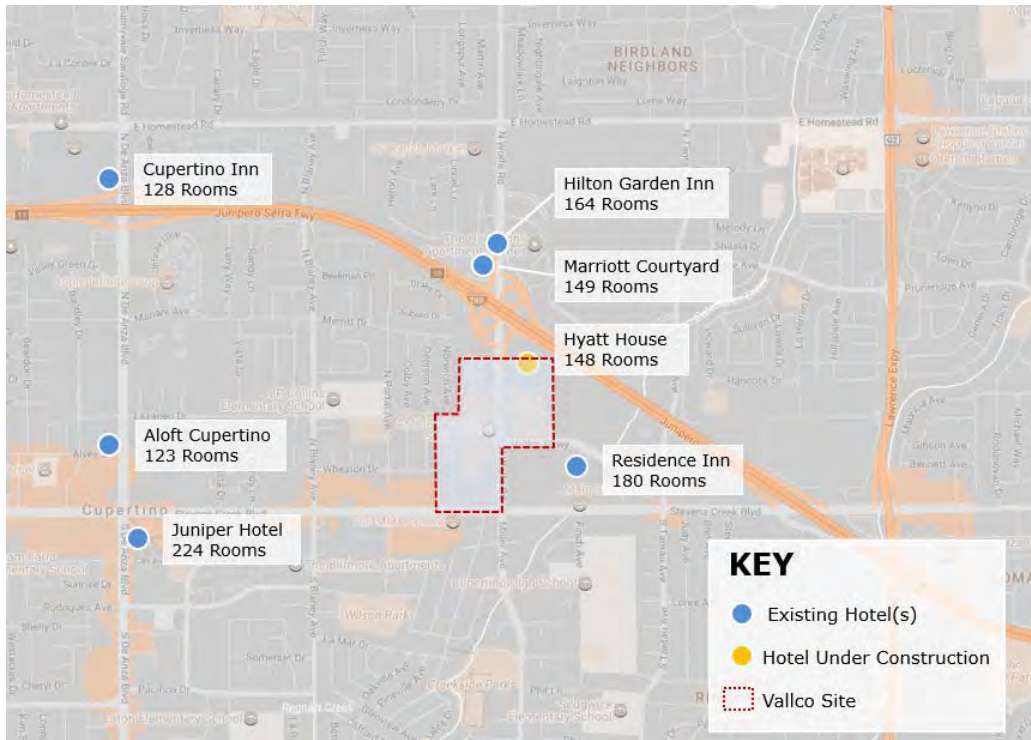


Table 8 Hotel Inventory in Cupertino

Hotel	Address	Chain Scale ¹	Rooms
Existing			
Cupertino Inn (Cupertino Hotel)	10889 N. De Anza Blvd.	Upper Upscale	128
Hilton Garden Inn	10741 N. Wolfe Rd.	Upscale	164
Marriott Courtyard	10605 N. Wolfe Rd.	Upscale	149
Juniper Hotel by Curio	10050 S. De Anza Blvd.	Upper Upscale	224
Aloft Cupertino Hotel	10165 N. De Anza Blvd.	Upscale	123
Residence Inn by Marriott	19429 Stevens Creek Blvd.	Upscale	<u>180</u>
Total			968
Under Construction			
Hyatt House	10380 Perimeter Road (Vallco Park)	Upscale	<u>148</u>
Total, All Hotels			1,116

¹STR Categorization

Source: Westport Cupertino Hotel Proposal, 2017; Economic & Planning Systems, Inc.

Table 9 Cupertino Hotel Performance (2017)

Hotel	Chain Scale¹	Occupancy Estimate²	Avg. Rate Estimate²	Meeting Space (SF)²
Existing				
Cupertino Inn (Cupertino Hotel)	Upper Upscale	81%	\$200	1,720
Hilton Garden Inn	Upscale	83%	\$210	1,650
Marriott Courtyard	Upscale	82%	\$215	1,248
Juniper Hotel by Curio	Upper Upscale	80%	\$260	4,897
Aloft Cupertino Hotel	Upscale	<u>80%</u>	<u>\$230</u>	1,101
Residence Inn by Marriott	Upscale	-	-	<u>4,138</u>
Total/Average		81%	\$223	2,459

¹STR Categorization

²Market Study and Product Recommendation, Proposed Westport Cupertino Hotel, Hospitality Link International, Inc; Economic & Planning Systems, Inc.

Source: Westport Cupertino Hotel Proposal, 2017; Economic & Planning Systems, Inc.

Project Profiles

Residence Inn



Location	19429 Stevens Creek Blvd, Cupertino, CA 95014
Year Built	2017
Number of Rooms	180
Hotel Type / Class	Extended Stay
Amenities	kitchenettes, fitness center, meeting space

The Residence Inn, opened in October 2017, is located within the Main Street Cupertino development. This new extended stay hotel includes 180 guest rooms featuring kitchenettes with limited cooking equipment, an on-site fitness center, and over 4,000 square feet of meeting space. The hotel offers studio, one-bedroom, and two-bedroom suites that are designed for extended stays of five-nights or more.¹³ This hotel is primarily marketed towards employees relocating to the area for a limited time or seeking interim accommodations as they find more permanent housing, and thus, is uniquely positioned amongst the other Cupertino hotel offerings.

¹³ [Residence Inn Hotel Opened in Cupertino](#), Travel Daily News, October 27, 2017

Aloft Cupertino



Location	10165 N De Anza Blvd, Cupertino, CA 95014
Year Built	2013
Number of Rooms	123
Hotel Type / Class	Upscale
Amenities	ocus, meeting spcae, fitness cener, restaurant and bar
Average Occupancy	80%
Average Room Rate	230

Aloft Cupertino, a 123-room hotel, was well-received upon opening in 2013 due to its unique technology-focused positioning. The hotel features robotic butlers that act as a guest concierge, delivering extra towels to guestrooms or assisting hotel employees with tasks in the back of house. Additionally, the hotel offers amenities like apple-TVs in every room, keyless door entry, 1,100 square feet of meeting space, an on-site gym, live-music at their branded W XYZ bar and an on-site café. The hotel has seen consistently strong performance metrics with estimated occupancy of roughly 80 percent and average daily room rates of about \$230 in 2016.¹⁴

¹⁴ Market Study and Product Recommendation, Proposed Westport Cupertino Hotel, Hospitality Link International, Inc; Economic & Planning Systems, Inc.