



MEMORANDUM

Date: August 11, 2020

To: Winter King, City Attorney's Office

From: Sally Nielsen

Subject: **Westport Cupertino: Peer Review of Economic Justifications for a Density Bonus Concession**

Introduction

Hausrath Economics Group (HEG) has been asked to provide peer review of the economic justifications provided by the project applicant for a proposed concession for the Westport Cupertino Enhanced Senior and Family Living Project. These justifications are set forth in July 31, 2020 letters to City of Cupertino Planning Services from KT Urban, Atria Senior Living, and Related California and from Berliner Cohen, LLP.

This peer review evaluates the information and justifications presented in the material submitted by an applicant in support of requested concessions and provides a professional opinion on whether or not they describe actual cost reductions attributable to the concession that enable the production of the affordable housing units proposed.

The proposed Westport Cupertino Enhanced Senior and Family Living Project (Revised June 25, 2020) would develop an approximately eight-acre (7.9 net developable acres) former shopping center site with a mixed-use urban village project, adding single family housing, senior assisted living and senior independent living apartments, and retail space to Cupertino's development inventory. The residential component consists of 88 market-rate single family units in rowhouse and townhouse configurations and two six-story buildings with senior residential apartments over ground floor retail/commercial space. Building 1 consists of 131 market-rate licensed senior assisted living units, 27 memory-care licensed assisted living residences, and 17,600 square feet of ground floor retail/commercial space. Building 2 consists of 48 below market-rate (BMR) senior independent living units and 2,400 square feet of ground floor retail/commercial space. The 48 lower-income BMR units comprise 20 percent of the base density of 237 units, entitling the project to a density bonus of 35 percent; therefore, the proposed project is eligible for the requested density bonus of 30 units, a bonus of 13 percent.

The project described above, which was revised in June 2020, involves relocating nine BMR units from Building 1 to Building 2 as had been originally proposed in May 2020. This change is not consistent with the requirement in Cupertino Municipal Code Section 19.56.050.G.1 and the City of Cupertino BMR Housing Mitigation Program Procedural Manual ("BMR Manual") (Section 2.3.4(D)) that affordable units be dispersed throughout the project.

State Density Bonus law requires the City to grant the applicant up to two proposed incentives or concessions. Concessions are reductions in development standards, modifications of zoning code or architectural design requirements, or other concessions "that result in identifiable and actual cost reductions to provide for affordable housing costs." Gov. Code § 65915(k). The City is required to grant a proposed concession unless it finds, based on substantial evidence, that the concession does not result in identifiable or actual cost reductions, would have a specific adverse impact on public health and safety, or is contrary to state or federal law. Gov. Code § 65915(d)(1).

Following the Planning Commission's recommendation to deny the project as inconsistent with the BMR dispersal requirement, the project applicant submitted information in support of granting a concession modifying the BMR dispersal requirement for the Westport Cupertino project. The information submitted is the subject of this peer review: July 31, 2020 letter to Gian Martire, Senior Planner from KT Urban, Atria Senior Living, and Related California regarding Westport Project, Council Meeting 8-18-20, and July 31, 2020 letter from Berliner Cohen, LLP to Gian Martire, Senior Planner, Westport Project Application, City Council Meeting, August 18, 2020; email from Steven Ohlhaber, C2K Architecture, to Gian Martire, City of Cupertino, August 6, 2020 regarding Prep for City Council meeting; C2K Architecture, Westport Cupertino Plan Sheets, G202A and G202B (submitted August 6, 2020).

HEG also reviewed the following documents related to Westport Cupertino: Westport Cupertino Enhanced Family and Senior Living Project (REVISED) Project Description, June 25, 2020; Westport Cupertino Enhanced Family and Senior Living Project (REVISED) BMR Program Description, June 25, 2020; Density Bonus Waiver Request, letter to Gian Paolo Martire, City of Cupertino, from C2K Architecture, April 23, 2020, revised June 4, 2020 and revised June 25, 2020; Westport Project Review: June 17, 2020, letter to Gian Paolo Martire, City of Cupertino, from C2K Architecture, June 25, 2020; Planning Commission Staff Report on the Westport Cupertino project, May 12, 2020; Westport Cupertino.

The KT Urban July 31, 2020 letter provides three justifications for the concession related to the dispersal of BMR units: 1) building construction cost differentials, 2) service cost differentials associated with the proposed licensed senior assisted living facility, and 3) complexity and cost of obtaining financing for affordable housing development. Each justification is discussed below.

The type of construction required for Building 1 results in higher unit construction costs that are avoided by consolidating BMR units in Building 2, thereby contributing to the provision of affordable units

Building 1 is proposed as a State-licensed assisted living community. According to KT Urban, the State of California requires such facilities to be Type I construction. Structural elements for Type I construction are steel and/or concrete; hard construction costs are highest for these types of buildings. The July 31, 2020 KT Urban letter states that Building 2 would be wood frame (Type V) over a concrete podium, a less costly building construction type used frequently for multi-family housing construction, particularly affordable multi-family housing construction.

The Westport Cupertino plan drawing set submitted by the applicant in June 2020 indicated Construction Type IB for both Building 1 and Building 2; however, email communication subsequent to the July 31, 2020 letter was required to clarify the differences between the two buildings. In that communication, the project architect clarified that Building 1 would be Type IB and Building 2 would be Type IIIA—joisted masonry construction. This construction type is less costly than Type I but more costly than Type V (wood frame). The table below uses national average square foot construction costs by construction type (used by local jurisdictions for building permit valuations) to illustrate these cost differentials. According to the International Code Council (ICC) that prepares this report every six months, the factors “reflect relative value of one construction classification / occupancy group to another so that more expensive construction is assessed greater permit fees than less expensive construction.” The table also references Saylor square foot building costs that are more specific to Northern California and the Bay Area.

Square Foot Construction Cost by Construction Type and Occupancy Group

	Type IB (steel frame)	Type IIIA (reinforced concrete frame)	Percent Difference IB vs. IIIA
International Building Code (IBC) Occupancy Group			
R-2 Residential, Multi Family	\$160	\$134	20%
Saylor Commercial Square Foot Building Costs (includes general contractor's overhead and profit)			
6-Story Apartment, precast panels	\$238	\$200	19%

Source: International Code Council, Building Valuation Data, February 2020 and Saylor, *Current Construction Costs*, 2019.

National average data indicate that Construction Type IB (Building 1) is 20 percent more costly per square foot than Construction Type IIIA (Building 2). The cost differential is confirmed by the Saylor cost factors. These factors are generally consistent with the numbers presented in the KT Urban July 31, 2020 letter.

KT Urban cites a total project cost for Building 1 of \$129,500,000 or \$820,000 per unit. The total project cost estimated for Building 2 is \$29,000,000 or (according to the July 31, 2020 letter) \$620,000 per unit. If the cost estimate is correct at \$29,000,000, the correct cost per unit for Building 2 is lower at \$604,000 per unit. [$\$29,000,000 \div 48 = \$604,000$] The corrected cost differential is about \$216,000 per unit. Costs per unit are 36 percent higher for Building 1 compared to Building 2.

As indicated in the KT Urban letter and substantiated in the table above, a primary factor in this cost differential is the construction type. Hard construction costs for Building 1 are at least 20 percent greater on a per square foot basis than they are for Building 2. Modifying the dispersal requirement and allowing the nine BMR units to be constructed with the rest of the BMR units in Building 2 results in construction cost savings of at least 20 percent on a per square foot basis. This represents an actual cost reduction that supports the provision of affordable units. Cost savings of this magnitude and more (in the case of wood frame construction) are one of the main reasons affordable housing is most often developed in low- and mid-rise buildings that do not require steel structural elements.

KT Urban notes that the high cost per unit for Building 1 is also a function of the relatively large amount of gross building area required for common areas, kitchen and dining facilities, and “back of the house” administrative functions in a State-licensed senior assisted living facility. This is confirmed by comparing building gross square feet per unit. For Building 1, there are 1,208 gross square feet per residential unit. For Building 2, there are 995 gross square feet per unit. This last point, however, is not a conclusive justification for the proposed concession. These costs are fixed and are not a function of the number of BMR units that might be included in Building 1. These Building 1 costs will be incurred whether or not the BMR units are built in Building 1. Consolidating the BMR units in Building 2 does not result in any cost savings for common areas and facilities in Building 1.

License-required services provided to BMR households in Building 1 represent a substantial potential cost that is not incurred when the BMR units are located in Building 2

State-licensed assisted senior living residences such as that proposed for Westport Cupertino offer an array of services beyond simply shelter. These facilities offer three meals a day, housekeeping services, educational and social activities, transportation, emergency alert systems, utilities, and access to care services. On-site amenities include a library, theater, lounge, restaurant, medical offices, and exercise rooms.

Market-rate monthly prices at licensed senior facilities can be at least two-to-three times higher than market-rate rents in new or recently renovated apartments in Cupertino and a substantially higher multiple of the housing allowance affordable to low and very-low income households. A senior assisted living project in San Jose that is comparable to Building 1 (opening Fall 2020) advertises monthly prices starting at \$5,495 for studio units with kitchenette, \$8,495 for one-bedroom units with kitchen, and \$10,995 for two-bedroom units with kitchen.¹ These prices cover monthly rent and a full array of services: meals, housekeeping services, apartment maintenance, utilities, 24-hour staff, events,

¹ Pricing and floor plans for the Atria Almaden at 4610 Almaden Expressway in San Jose, now preleasing prior to opening in fall 2020. <https://www.atriaseniorliving.com/retirement-communities/atria-almaden-san-jose-ca/>

transportation services, and an emergency alert system. Average market-rate rents for newer apartments in Cupertino range from \$2,800 per month for studio and one-bedroom units up to \$3,800 per month for two-bedroom units.² The BMR unit housing allowance (rent plus utilities) is set substantially lower—at levels affordable to low- and very-low-income senior households. The estimated monthly housing allowance, based on 2020 household income limits by household size, would be \$1,239 (very low income) and \$1,487 (low income) for studio units, \$1,416 (very low income) and \$1,700 (low income) for one-bedroom units, and \$1,593 (very low income) and \$1,912 (low income) for two-bedroom units.³ The market-rate senior assisted living monthly price is four to seven times the monthly BMR housing allowance.

A cost of assisted living services is a significant component of the differential between the assisted living market prices cited above and the BMR housing allowance. If the BMR units were included in Building 1, these on-going operating costs provided to those households would add to the subsidy needed to cover the gap between the value supported by BMR housing allowance and building development costs. KT Urban states that the unfunded cost of services provided to BMR households would be several thousand dollars per resident per month. Allowing the BMR units to be consolidated in Building 2 as independent living units eliminates this identified and actual cost burden and supports provision of affordable independent living units.

Project financing considerations justify eliminating the requirement that affordable units be developed in Building 1

KT Urban cites the costs associated with financing affordable housing development as justification for the dispersal concession. The Low-Income Housing Tax Credit would not be available for the types of units and services proposed in Building 1. This is documented in a June 24, 2020 memorandum from Atria Senior Living to KT Urban, Inc. Sale of federal low-income housing tax credits is an essential source of low-cost capital financing for affordable housing development. A limited supply of tax credits is made available every year and there is significant competition among the projects that come before the Tax Credit Allocation Commission.

Without access to this funding source, the applicant would incur additional costs to secure other scarce and competitive sources for project financing. Financing costs are likely to be higher than they would be with access to federal tax credits. In addition, there are personnel resources required to pursue these sources, and it takes time to secure the financial commitments, adding to the carrying costs of the development. The March 2020 Turner Center report cited in the KT Urban letter identifies complexity of affordable housing funding streams as adding significantly to development costs. In the 2008 – 2019 data

² Averages derived from current monthly rents advertised at Apartments.com: Main Street Lofts (2018), Nineteen800 (2014), Arioso (1999, renovated 2020), Glenbrook Apartments (1971, renovated 2017), and The Hamptons (1998, newly remodeled).

³ The maximum rents are estimated using the assumptions set forth in the BMR Manual (Section 2.3.5.B).

analyzed, 80 percent of projects relied on 4 – 8 different sources of financing and almost 10 percent of projects relied on more than eight sources.⁴

Requiring BMR units to be dispersed between Buildings 1 and 2 would impose significant additional costs on the project in terms of both the cost of financing and the cost to secure mostly likely several sources of competitive financing. Modifying the dispersal requirement would eliminate these additional costs for Building 1 development. Costs associated with financing for Building 2 would not increase because development of that building is predicated on complex financing regardless of the number of units. As a result, consolidating BMR units in Building 2 results in identifiable and actual financing cost savings that offset the cost of providing the BMR units.

Conclusion

The current proposal for Westport Cupertino consolidates the BMR units in Building 2 requiring a concession to modify the City of Cupertino BMR dispersal requirement. The applicant provided economic justifications for this concession in a July 31, 2020 letter clarified by subsequent e-mail communication and revised plan set pages. HEG has reviewed the materials prepared by the project applicant and concludes that the concession is justified. Allowing the nine BMR units to be consolidated with the other BMR units in Building 2 would result in actual cost reductions that support providing affordable senior housing in this project.

First, as a state-licensed assisted living facility, Building 1 requires steel frame construction that can be at least 20 percent more costly per square foot than the reinforced concrete frame construction specified for Building 2. These costs are not imposed on BMR units developed in Building 2. Second, there is a substantial on-going operating cost to provide the services associated with a state-licensed assisted living facility. These costs far exceed the BMR housing allowance for rent and utilities and represent substantial cost savings if the units were relocated to Building 2 as senior independent living units. Finally, affordable housing production depends on assembling multiple sources of debt, equity, grant, and other financial support. One of the most significant sources of capital for affordable housing is the sale of tax credits and this funding is not available for the nine BMR units if they were developed in Building 1 as state-licensed assisted living units. Higher total financing cost plus the additional time and cost of delay would be incurred to fill this gap. These costs are saved by consolidating the BMR units in Building 2 as senior independent living units.

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⁴ Turner Center for Housing Innovation, *The Costs of Affordable Housing Production; Insights from California's 9% Low-Income Housing Tax Credit Program*, March 2020.



Overview

Hausrath Economics Group (HEG) specializes in urban economics, real estate economics, market and financial feasibility analysis, economic revitalization and economic development, industry analysis and forecasting, economic benefit/impact assessment, economic and land use development forecasting, property use and reuse analysis, and fiscal and public finance analysis. The majority of the firm's work is in northern California and the San Francisco Bay Area, and includes a large share of ongoing work in Oakland, the East Bay, and San Francisco. In all our project work, HEG maintains a reputation for thorough analysis, creative strategies, realistic implementation programming, and responsiveness to both client and community concerns.

The firm was founded in 1978 and has been located in downtown Oakland since 1982. The firm has two owners and principals and is a 100 percent woman-owned business. Linda Hausrath is founding principal and Sally Nielsen has been with HEG since 1981.

HEG works for a broad spectrum of clients in the public and private sectors: local and regional governments, other public agencies, landowners and real estate developers, nonprofit entities, merchants' and business associations, attorneys, and citizen groups. Because of that range of exposure and the quality of our work, HEG is recognized for providing objective analysis that addresses the often multi-faceted perspectives on a given project.

Expertise in Development Feasibility Analysis

HEG is qualified to undertake the following types of assignments related to analysis of mixed use development projects:

- ◆ Real estate market assessments for residential, office, commercial, and industrial uses
- ◆ Financial feasibility analysis
- ◆ Development pro forma analysis and review
- ◆ Financing plans, including public improvements and infrastructure
- ◆ Property use and reuse analysis; highest and best use analysis
- ◆ Public/private development projects: implementation and funding programs; evaluation of public participation; developer/City negotiations
- ◆ Land residual/land value analysis; land acquisition or disposition strategies/terms
- ◆ Economic benefit analysis; community benefit funding

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HEG recently completed an extensive series of consulting services for a large mixed-use urban campus project in the City of Oakland. HEG prepared market analysis for office and residential uses and financial feasibility analysis and public financial analysis for a range of project alternatives. Site assembly involved acquisition of a large city-owned parcel complicating the review and approval process. HEG was a key member of the team negotiating development terms and conditions for the project with city staff and decision makers. HEG's products included technical analysis on market, financial, and public benefit topics, technical reports, and summary materials for public and community meetings.

In 2016, Oakland adopted a new citywide development impact fee program. HEG was the prime contractor for the nexus and economic feasibility studies needed to support fee adoption. Technical work centered around the development of pro forma cash flow models for representative development projects throughout Oakland (housing, office, retail/commercial, industrial), and using these models to analyze the impacts of fee program options on development feasibility. HEG was also responsible for aspects of the Affordable Housing Nexus Analysis, focusing on equivalencies between a mitigation fee and on-site mitigation options.

SALLY NIELSEN



Sally Nielsen has extensive experience defining and analyzing land use and planning policies from the economic perspective. Since joining HEG in 1981, she has prepared forecasts of employment, population, and future development patterns; economic impact analyses; market studies; as well as fiscal impact and public financing studies, including development impact fee nexus analyses. She has developed complex, well-documented models for estimating the cost implications of proposed policies and plans.

Recent work has focused on evaluating the local benefits of major development projects. This includes estimating on-going local public revenues and one-time impact fees, as well as economic development benefits from jobs, additions to the housing inventory, and increased retail and services spending.

Ms. Nielsen's experience with development impact fee nexus analysis includes a transportation systems improvement development impact fee nexus study and a park, recreation, and open space development impact fee nexus study for the *Transit Center District Plan* in San Francisco—a plan to concentrate new downtown development potential around the Transbay Transit Center regional transit hub. After evaluating the public facility, infrastructure, and community improvement programs that exist in San Francisco and the applicability of existing standards to the *Transit Center District Plan*, she devised appropriate service population estimates, investigated means of allocating costs equitably across plan participants and beneficiaries, and prepared the required documentation.

For over 20 years, Ms. Nielsen provided on-going economic consulting services for the Planning Department and the County Executive Office in Placer County—one of the fastest-growing counties in the state. She prepared detailed analysis of the County's budget for project-specific fiscal impact studies and conducted more broad-based assignments related to the implications of annexations for the County's tax base and for maintaining on-going countywide services. This work required designing detailed, flexible models of the complex County budget as well as preparing special analysis for County staff use in annexation tax-sharing negotiations, taking a broader perspective on County service and funding responsibilities and the constraints of the tax base.

Ms. Nielsen has a particular interest and expertise in the complex and collaborative efforts to develop habitat conservation plans in California. She has worked on multi-agency, multi-species plans affecting development in Placer County, Santa Clara County, Yolo County, East Contra Costa County, San Joaquin County, and El Dorado County. The level of scrutiny has been high and the many interested parties diverse. Ms. Nielsen has prepared growth and land development projections for use in impact assessment, complex implementation cost models, land acquisition cost analysis, economic and fiscal impact analyses, and feasibility assessments in support of habitat conservation planning.

In Yolo County, Ms. Nielsen directed a study of policy options for increasing agricultural land mitigation requirements. She studied the planning policy and implementation history of the current County program designed to protect farmland from development and recognize the costs of agricultural land conversion. She conducted technical analysis to derive a defensible basis for increasing the ratio of mitigation land required, evaluating a variety of policy approaches to meeting agricultural land conservation objectives.

EDUCATION

Masters in City and Regional Planning, Kennedy School of Government, Harvard University, 1981.
B.A., magna cum laude, History and Literature, Harvard University, 1976.