404 Euclid Avenue, Suite 212
San Diego, CA 92114
(619) 236-0612
www.LeSarDevelopment.com

To: Kerri Heusler, Housing Manager, City of Cupertino
From: Diana Elrod, Principal
Date: June 26, 2019
Re: Peer Review of Draft Economic Feasibility Study for the City of Cupertino's BMR Program

---

Thank you for the opportunity to provide comments on the economic feasibility study drafted by Strategic Economics (SE) for the update of the City's BMR Program requirements. It is my understanding that SE conducted this study to discern whether, and to what extent, inclusionary requirements for residential development and commercial impact fees may be modified from the baselines established in 2015. That year, Keyser Marston Associates (KMA) completed an extensive nexus study on both commercial and market-rate residential development to assess the impacts of new development on the need for affordable housing.

As the nexus was established in 2015, a further nexus study was not required here. Rather, SE's current study is intended to analyze the feasibility of applying different inclusionary percentages (from the current requirement of 15%), as well as analyze whether the current mitigation fees for new market rate residential and commercial development can be increased.

I have reviewed SE's draft in conjunction with a review of KMA's analyses from 2015 to help evaluate the report's conclusions. I have identified a set of questions to assist in further understanding SE's work, and more information about SE's methodology is needed before I finalize my assessment of the report's recommendations.

Residential Analysis

1. It is hard to understand the step-by-step process that SE used for its methodology. The report lacks a clear narrative how it got from point A to point B to point C. It would be helpful to explain in simple language how the process works and why the particular data points are used.

2. Most inclusionary feasibility studies we typically see are based on a residual land cost analysis, rather than on a return on cost (ROC) or yield on cost (YOC). Can SE provide more background as to why ROC and YOC analysis were used rather than a residual land cost analysis and if that difference would meaningfully change any of the reported results?

3. The ROC analysis's sources on page 10 reference "recent project proformas" and developer interviews. Can further documentation be provided on what recent proformas were analyzed, and what developers were interviewed?

4. I am curious about the use of Redfin for data in the analysis. There are a number of professional data aggregators that one typically sees, such as DataQuick, Costar, etc. which SE does use for some of the analysis. What was the thought behind using Redfin (which I personally experienced containing incorrect data in reporting sales)?

5. The report uses comps for townhomes and other housing types in Cupertino that are quite old. Typically, if the review of comps finds that no development is currently taking place, then adding an additional requirement would further constrain the development of housing. Is that the case here, or are there other market factors influencing the types of projects proposed and approved in Cupertino?

6. Figure A-3 in the appendix is titled "Recent Re-Sales of Condominium Comparables" when in fact the table shows rents. Figure A-4 repeats this information but calls the table "Recently Built Rental Comparables." Can SE update the table to include the dates when these comps were built?

7. On page 11, the sales prices per unit are in some cases significantly different than what was shown in the KMA report just four years ago. For example, condominiums in the 2015 report were on the order of $800,000. What accounts for the more than 100% increase in four years? Is this the result of construction cost escalation, and can SE say more about the market's ability to sustain the higher current sale prices while absorbing additional affordability requirements?

8. In addition, rents shown on that page are also substantially higher than in KMA's study. Can SE provide some additional explanation about the market forces that are driving these increases?

9. On page 13, should the income limits be updated to the 2019 counts? Would showing increased rents using the 2019 data result in higher affordability requirements being feasible?

Non-Residential Analysis

1. KMA provided information on mitigation fees as a percentage of total development cost as one way to measure a fee's reasonableness. How does SE's methodology compare?

2. The pool of comparables used in the analysis is quite small. Would that impact the resulting outcomes?

Summary

Based on the questions and comments outlined above, additional information is necessary to assess whether there may be additional potential to feasibly modify the City's affordability requirements. I am happy to provide additional input and further evaluation once these questions are fully fleshed out.