STRATEGICECONOMICS INC

DRAFT MEMORANDUM

Date:	July 17, 2014
To:	Aaron Welch, Raimi + Associates Eric Anderson, City of Mountain View
From:	Sujata Srivastava and Alison Nemirow
Project:	#1310 Mountain View El Camino Real Precise Plan
Subject:	Revised Community Benefits Strategy Memorandum Report

Introduction

The purpose of this memorandum report is to provide guidance on the structure and implementation of a community benefits strategy for the El Camino Real Precise Plan, based on three key elements:

1) **Policy direction** from the General Plan update, city staff, Environmental Planning Commission, and City Council;

2) **Financial analysis** measuring the potential for private development to provide community benefits; and

3) **Case studies** of similar community benefits strategies in other California cities.

Following an overview of recommendations for the implementation of a community benefits strategy in the El Camino Real Precise Plan Area, the memo provides summaries of the policy direction received from the City, the financial analysis, and the case studies. Appendix A provides additional detail on the case studies. Appendix B provides a detailed discussion of the methodology for financial analysis. This memo may be further revised in the future to incorporate additional stakeholder feedback.

Recommendations for Implementation

Based on policy direction from the City as well as the results of the financial feasibility analysis and lessons learned from case studies of other communities, Strategic Economics developed the following recommendations for the implementation of a community benefits strategy in the El Camino Real Precise Plan Area.

Process A

It is reasonable to expect a contribution in the range of $15-$20 per square foot of bonus FAR under Process A. Based on the financial analysis and input received from developers, Strategic Economics determined that $15-$20 per square foot of additional FAR (over and above the FAR

permitted by the base zoning) is a reasonable level of contribution for Process A, because it meets the following key criteria:

- Provides a reasonable developer return: Assuming a contribution of $15-$20 per bonus square foot, developer return on cost is expected to remain above the threshold for feasibility (above 5.5 percent for apartments, and between 8 and 10 percent for condominiums), ensuring that private investments occur on the corridor and provide the desired community benefits.
- Ensures that overall development costs in Mountain View remain competitive with other Silicon Valley communities: The level of contribution by the developer is expected to fall in the range of 1.0-1.1 percent of total project costs.
- Takes into account existing fees: Existing impact fees and exactions are estimated to cost approximately $60,000 per multi-family unit. Based on the prototype analysis, a contribution in the range of $15-$20 per square foot of bonus FAR would work out to between $10,000 and $20,000 per bonus unit, or less than $5,000 per total unit included in the project.

This contribution could be provided either in the form of a financial payment to a centralized fund managed by the City, or directly by building public facilities of equivalent value.

In order to have a significant impact on the provision of community benefits, Process A would need to be more of an incentive to developers than the existing State Density Bonus law. Under the California Density Bonus Law, local jurisdictions must provide density bonuses (ranging from five to 35 percent) and other incentives if the project provides affordable units to moderate- income-, low-income-, and/or very-low-income households. Based on a review of the way that the State Density Bonus has historically been used in Mountain View, developers are likely to perceive the incentive offered by the community benefits program as more economically advantageous than the State Density Bonus program. However, a project pursuing the community benefits program may provide fewer low- and very low-income housing units than it would under the State Density Bonus program.

Modified development standards can help to encourage redevelopment of small sites on the corridor. The financial analysis shows that small sites of under two acres are challenging to develop under current economic conditions even with an increased FAR of 1.85. Certain modifications in the development standards, such as allowing non-retail uses on the ground floor and reducing on-site parking requirement, can help to achieve financial feasibility, and may be appropriate to implement in certain locations and sites. The expectations of public benefit contributions may also need to be adjusted for challenging development sites.

Contribution levels should be reviewed periodically in order to account for changing economic conditions. The level of expected contribution should be reviewed every two years to account for changes in construction costs, land prices, unit sales price/rent levels, and other market conditions that may affect the amount available for community benefit contributions.

Process B

Process B, as a negotiated developer contribution structure for community benefits, could be more effective if the types of desired improvements and amenities are more predictable for developers and if negotiations begin early in the application process. Establishing a clear list of expected contributions and creating expectations for community benefits as early in the development application process as possible can help to create a more streamlined, transparent process.

Policy Direction

The 2030 General Plan establishes El Camino Real corridor as an area of change, and allows more intensive development in "key locations" in return for significant public benefits. This General Plan framework has been reaffirmed in public meetings with the Environmental Planning Commission meetings and City Council hearings. Mountain View officials and community members have identified affordable housing targeted to low-income, moderate-income, and middle-income households as a top priority for public benefits. The City has also identified other improvements and amenities desired in the Plan Area, which include (but are not limited to) pedestrian and bicycle infrastructure enhancements, public parking, parks, plazas, and open space, community facilities, support for small businesses, and funding for City programs and other public infrastructure

Figure 2 describes the City's existing requirements related to each type of improvement, and provides examples of additional public benefits that would go above and beyond existing requirements.

In the Draft Precise Plan, projects may exceed the base intensity and height only in Moderate Intensity Zones and in Village Centers, if they provide significant community benefits. Depending on the intensity and location of the proposed project, the community benefits strategy may be implemented through either an administrative process (Process A) or a legislative process (Process B):

- "Process A" – Projects in Moderate Intensity Zones and in Village Centers are eligible for increased FAR and height up to a maximum intensity of 1.85 FAR and height of four stories, in exchange for specifically defined developer contributions. The intent of Process A is to enable a predictable community benefits strategy for the Precise Plan Area, without the need for the City to engage in individually negotiated agreements for each project.

- "Process B" – Projects in designated Village Centers (higher intensity zones) are eligible for increased intensities up to a maximum height of six stories and FAR of 2.3 (or 1.0 for office), if public benefits are provided. However, the specific amount and type of public benefits provided in exchange for higher intensity would be defined on a case-by-case basis through negotiations between the developer and the City.

The table below (Figure 1) summarizes the density and height allowed under the base scenario, Process A, and Process B.

Figure 1. Summary of Intensity and Heights Allowed for Residential/Mixed-Use and Hotel Development in Exchange for Community Benefits (Draft Standards)

	Base	**Process A (Administrative)**	**Process B (Legislative)[a]**
Eligible Locations	All	Medium Intensity Zones and Village Centers	Village Centers
Minimum Project (Lot Size) Area	None	To be decided	60,000 sq. ft.
Maximum Floor Area Ratio (FAR)[b]	1.35	1.85	2.3
Maximum Stories	3 stories	4 stories	6 stories
Maximum Height	45 feet	55 feet	75 feet
Community benefits strategy	By right with no developer contribution	Administrative with pre-determined developer contribution	Legislative with negotiated developer contribution[c]

Note that intensity and height standards are still under development, and may change in the final Precise Plan.
[a] Office development is also eligible for an FAR of up to 1.0 under Process B.
[b] Floor area ratio (FAR) is calculated as a ratio of gross floor area to parcel size. All above-grade floor area is included in the FAR calculation, including parking area.
[C] Additional community benefits are required over and above the pre-determined benefits required to achieve Process A heights and intensities, and will be agreed upon through a negotiation between the developer and the City.

Figure 2. Expected Public Benefits

Type of Improvement	Existing Fees and Standards	Examples of Additional Public Benefits
Affordable Housing	Rental Impact Fee: New market-rate rental housing development must pay a fee of $10 per square foot of net leasable area to support the development of new affordable housing. Projects may choose to provide inclusionary units, but most opt not to. Below-Market Rate (BMR) Housing Ordinance/In-Lieu Fee: New market-rate ownership housing projects must provide at least 10 percent of the total dwelling units at BMR prices, or pay an in-lieu fee equivalent to three percent of the actual sale prices of each unit in the project. Commercial Housing Impact Fee: New commercial development must pay a fee on net new floor area to support the development of new affordable housing. The fee amounts to $10 per net square foot of floor area for office, high-tech, and industrial uses and $2.47 per square foot for retail, hotel, and entertainment uses.	Development additional affordable units on- or off-site, or contributions to the city's affordable housing funds over and above the amount required under existing ordinances and fees.
Pedestrian and bicycle amenities	Development standards require on- and off-site frontage improvements, right-of-way dedication, and other improvements necessary to serve the project, mitigate development impacts on the community, and bring the project into compliance with City standards. These improvements may include (but are not limited to) constructing new or replacing damaged curbs, gutters, and sidewalks; widening sidewalks to meet streetscape standards; planting street trees; improving street signs and lighting; and providing a minimum amount of bicycle parking.	On-site and off-site pedestrian and bicycle improvements, above and beyond those required by the development standards. These may include but are not limited to: • Enhanced pedestrian and bicycle-oriented streetscapes and landscapes, including widened sidewalks, bulb-outs, pedestrian refuges, pedestrian and bicycle signals, enhanced (high visibility) pedestrian crosswalks, street trees and landscaping, pedestrian-scaled lighting, bicycle rack facilities, etc. • Protected bicycle lanes and pedestrian pathways, improved bicycle and pedestrian crossings/signals, bicycle racks/shelters. • New pedestrian and bicycle connections to transit facilities, neighborhoods, trails, commercial areas, etc. • Removal of existing pedestrian and bicycle barriers (e.g. cul-de-sacs). • Replacing end of life traffic signals to enhance pedestrian and bicycle safety.

Type of Improvement	**Existing Fees and Standards**	**Examples of Additional Public Benefits**
Public parking facilities	Development standards require a set amount of parking to serve residential and commercial space included in a project.	Providing publicly accessible parking to serve district-wide parking needs.
Public parks and open space	Park Land Dedication or In-Lieu Fee: New residential development must dedicate land for public park or recreational fee, or pay a fee in lieu thereof. The fee typically amounts to $15,000-$25,000 per unit.	Publicly accessible parks, plazas, tot lots, etc., above and beyond existing Park Land Dedication/In-Lieu Fee.
Other		• Contributions to community facilities projects (e.g. Community Center Renovation, Rengstorff Aquatics Center Restoration/Renovation, Rengstorff pool replacement, providing land/construction of new community gardens). • Support for small businesses. • Additional funding for City programs and infrastructure.

Financial Feasibility Analysis

The ability of a project to contribute towards community benefits is tied to the economic performance of the project, as measured by developer profit or residual land value. Strategic Economics built a pro forma model and conducted financial feasibility analysis to provide guidance on key questions for the community benefits strategy, including:

- What are the types of development projects that can be reasonably expected to provide community benefits in the project area?
- What is the value of additional intensity or height from a developer's perspective?
- What is the order of magnitude of the contributions that developers can provide towards community benefits?

The financial analysis tested the developer return of mixed-use and residential projects at different intensities and heights, on parcels ranging in size from one-quarter acre to over four acres.[1] The prototypes represent potential development projects that could be built on parcels in the Plan Area under the proposed development standards. However, the prototypes are not intended to be inclusive of every possible project on El Camino Real. Actual projects may be designed differently, and achieve different financial performance, depending on the specifics of the site, adjacent uses, project design, and other factors. The methodology, assumptions, and findings of the financial analysis are described in more detail in Appendix B.

Figures 3 and 4 describe the results of the financial feasibility analysis by development prototype. The highlights of the findings from the financial feasibility analysis and implications for designing a community benefits program in the Plan Area are as follows:

Sites of less than two acres in size are not feasible to develop under current market conditions, and will likely require assembly in order to be developable. Because of the physical limitations presented by small parcels, it is infeasible to develop mixed-use projects at FARs of 1.35 and 1.85 under current market conditions. Development at an FAR of 1.85 may become feasible on some sites if condominium prices appreciate in the medium-term (3-5 years). However, even with significant price increases, development on sites of this size is likely to remain challenging, as they can only accommodate very small projects (less than 50 units), which are generally unattractive to investors. Given these challenges, developers will likely need to aggregate small parcels in order to make development feasible. The City could encourage lot consolidation by providing flexibility on development standards and the level of community benefit contribution required to achieve higher intensities for aggregated sites.

Development on sites larger than two acres is financially feasible and can contribute to community benefits. For all of the scenarios tested on larger sites of over two acres, the higher intensity projects achieve strong developer returns, which suggest that they could potentially contribute towards community benefits.

The economic incentive to developers of an FAR increase from 1.35 to 1.85 varies depending on the circumstances of particular development projects. For example, on Large Site D, the 1.85 FAR project (Scenario 12) actually generates lower returns than the 1.35 FAR project (Scenario 11).

[1] Single-use office projects were not tested because these projects would only be eligible for community benefits negotiated under Process B.

This is largely due to the additional 10,000 square feet of retail and associated structured parking, which add significantly to the FAR and to the overall project costs, while providing only a marginal amount of new revenues. The City could work closely with developers to ensure that parking demand is met in a way that balances the cost of providing needed parking with the community's preference for underground or structured rather than surface parking. Shared parking policies or a parking district approach may also help achieve this balance.

It is reasonable to expect a contribution in the range of $15-$20 per square foot of additional FAR (over and above the FAR permitted by the base zoning) for Process A. Figure 5 shows how a contribution could be calculated based on bonus residential square feet, and the potential impact that a contribution of $15 to $20 per bonus residential square foot would have on development feasibility. For example, the 1.80 FAR project (Scenario 10) on the medium-sized site has approximately 43,500 more residential square feet than a 1.35 FAR project (Scenario 9). A contribution of $20 per bonus square foot results in a total contribution of $870,500.

As shown, this level of contribution does not adversely impact the financial performance of the projects, and could result in the provision of significant community benefits. For the medium and large site projects, the developer return on cost remains above 5.5 percent (the threshold for developer feasibility), indicating that the contribution is unlikely to deter development. In addition, the contribution accounts for no more than 1.1 percent of total project costs, suggesting that this level of contribution is unlikely to create the perception that Mountain View is a significantly higher cost city for development compared to its neighbors.[2]

[2] Strategic Economics also tested the potential contribution levels to ensure that total soft costs remained between 35 and 37 percent of project costs, and that the average contribution per housing unit remained below 1.0 percent of average unit value.

Figure 3. Development Prototypes and Financial Feasibility Results: Small Sites A and B (Condominium Development Projects)

	Small Site A: 0.45 Acre Neighborhood Corner		**Small Site B: 1.0 Acre Neighborhood Corner**			**Small Site B: 1.0 Acre Village Center**		
	Scenario 1	*Scenario 2*	*Scenario 3*	*Scenario 4*	*Scenario 5*	*Scenario 6*	*Scenario 7*	*Scenario 8*
FAR	1.33	1.81	1.34	1.85	1.86	1.34	1.83	2.58
Building Type	Three-story mixed-use residential over podium; no on-site retail parking provided	Four-story mixed-use residential over podium; no on-site retail parking provided	Three-story mixed-use residential over podium; no on-site retail parking provided	Four-story mixed-use residential over podium; fully parked	Four-story mixed-use residential over podium; no on-site retail parking provided	Three-story mixed-use residential over podium; fully parked	Four-story mixed-use residential over podium; fully parked	Six-story mixed-use residential over podium; fully parked
Developer Return as Percent of Total Costs	-7.6%	4.6%	1.3%	-1.6%	7.3%	-17.5%	-1.0%	8.5%
Financially Feasible?[1]	No	No	No	No	No	No	No	Yes
Potential for Community Benefits?	N/A	No	N/A	No	No	N/A	No	Limited (Process B)
Potential for Community Benefits in Medium Term (3-5 Years)?[2]	N/A	No	N/A	Yes	Yes[3]	N/A	Yes	Yes (Process B)

[1] Condominium projects are considered financially feasible if the developer profit is above 8 to 10 percent.
[2] Assuming annual condominium price appreciation of 7-9 percent and annual construction cost increases of 3 percent.
[3] Development projects that do not provide parking for retail uses, while financially feasible, may be more challenging to absorb and market.
Analysis is based on current market conditions.
Sources: Strategic Economics & VMWP, 2014.

Figure 4. Development Prototypes and Financial Feasibility Results: Medium Site C and Large Site D (Apartment/Mixed-Use Development Projects)

	Medium Site C: 2.9 Acres Moderate Intensity Zone		**Large Site: 4.24 Acres Village Center**		
	Scenario 9	*Scenario 10*	*Scenario 11*	*Scenario 12*	*Scenario 13*
FAR	1.34	1.79	1.35	1.85	2.60
Building Type	Three-story residential over podium	Four-story residential over podium	Three- and four-story mixed-use residential with surface retail parking	Three-story mixed-use residential over podium	Six-story mixed-use residential
Annual Return on Cost	5.9%	6.1%	6.1%	5.6%	6.2%
Financially Feasible?[1]	Yes	Yes	Yes	Yes	Yes
Potential for Community Benefits?	N/A	Yes	N/A	Yes	Yes (Process B)

[1] Apartments projects are considered financially feasible if the annual return on cost exceeds 5.5 percent.
Analysis is based on current market conditions.
Sources: Strategic Economics & VMWP, 2014.

Figure 5. Potential Impacts of Process A Contribution Levels on Project Feasibility: Scenarios 10 and 12

	Medium Site C: 2.9 Acres Moderate Intensity Zone	**Large Site: 4.24 Acres Village Center**
	Scenario 10	*Scenario 12*
FAR	1.79	1.85
Additional Residential Floor Area (Compared to 1.35 FAR Prototype)	43,523	6,092
Additional Residential Units (Compared to 1.35 FAR Prototype)	48	8
$15 per bonus residential sq. ft.[1]		
Total Contribution	$652,850	$91,380
Average Contribution per Unit[2]	$3,383	$459
Average Contribution per Additional Unit[3]	$13,601	$11,423
Developer Return on Cost	6.0%	5.6%
Contribution as % of Total Development Costs	0.6%	0.1%
$20 per bonus residential sq. ft. [1]		
Total Contribution	$870,500	$121,800
Average Contribution per Unit[1]	$4,500	$600
Average Contribution per Additional Unit[3]	$18,100	$15,200
Developer Return on Cost	6.0%	5.6%
Contribution as a % of Total Development Cost	0.9%	0.1%

[1] Contribution could be provided either in the form of a financial payment to a centralized fund managed by the City, or directly by building public facilities of equivalent value.
[2] Calculated based on total number of units in prototype.
[3] Compared to 1.35 FAR prototype.
Analysis is based on current market conditions.
Source: Strategic Economics, 2014.

Case Studies

Strategic Economics has reviewed a number of existing and proposed community benefits programs in California, focusing on those that provide additional density or FAR bonuses in exchange for the provision of community benefits. These included programs in San Diego, Santa Monica, Menlo Park, and Dublin. Appendix A provides more detailed descriptions of these programs. Based on a review of the case studies, the following are important lessons on the structure and implementation of community benefits programs:

- **Programs that offer increased density in exchange for specific community benefits must be structured carefully to avoid being subject to the Mitigation Fee Act.** Cities with established community benefits programs have taken care to ensure that the expected level of contribution is reasonable, both to achieve desired outcomes and avoid potential legal and political challenges.[3] For example, San Diego negotiated extensively with developers prior to adopting its FAR Payment Bonus Program. These negotiations resulted in a fee that had the support of the development community.

- **Contributions may be made on-site and/or off-site.** Some programs ask developers to provide community benefits directly by building public facilities, while other programs encourage developers to make financial contributions to a centralized fund. The former approach places responsibility for implementation on the developer, and may result in more immediate provision of desired benefits. However, having a centralized fund can enable the city to have more flexibility in directing resources to larger projects or at a district scale.

- **The magnitude of the community benefits that can be expected depends on the overall value of the bonus density to developers.** The increased density or height may or may not result in greater developer returns. The actual value of the increased FAR or height depends on a range of factors, including the relative profitability of the base density, construction costs for different building types, and strength of the real estate market. If the bonus density offered by the program provides a substantial economic incentive, developers are more likely to participate, resulting in the provision of more significant public benefits.

- **Mechanism for implementation:** Density bonus programs may establish processes for exchanging community benefits for additional intensity that apply to all projects, or rely on project-by-project negotiations.[4] Determining the appropriate mechanism requires making a tradeoff between predictability and flexibility. For example, programs that pre-establish the level of contribution expected in exchange for specific increments of density set clear expectations for developers and can offer a more straightforward process. However, these programs also tend to set exchange values well below the actual value generated by increased density, to avoid legal challenges and ensure that the contribution will be reasonable over time given different project characteristics, changing market conditions, and changing

[3] In most cases, cities have not demonstrated a legal nexus – i.e., a direct relationship between the impacts created by the project and the size and nature of the developer contribution – prior to establishing density incentive programs because participation in the program is voluntary. However, there is some legal uncertainty around whether density incentive programs require the establishment of a nexus; this issue should be addressed with the assistance of a city attorney.

[4] If process is pre-established, the exchange value of community benefits for bonus density can be stipulated in direct terms (e.g., one square foot of open space can be exchanged for one bonus square foot of project area); through a point system (i.e., the developer receives points for providing different items on a list of desired benefits, and these points are translated into bonus density); or as a dollar amount per square foot of additional density or floor area.

construction costs. Negotiating on a project-by-project basis provides less certainty for developers, but allows the city to retain flexibility to respond to changing market conditions and site-specific conditions. Some cities, like Santa Monica, have taken a tiered approach that establish a process and pre-set level of contribution for projects up to a certain density or height; above that threshold, projects must be negotiated on a case-by-case basis.

- **Community benefits programs should include language that specifies the relationship between the program and the State Density Bonus.** Most programs differentiate between the community benefit program and the State Density Bonus Program, and explicitly describe whether or not the two programs can be combined to achieve greater intensities.

Ultimately, the structure of a community benefits program is policy decision that must be informed not only by market and financial feasibility analysis, but also by the community's priorities for achieving public benefits and regulating height and density, the City's desired approach to administering the program, and legal considerations.

Appendix A. Community Benefits Programs

This appendix provides a brief overview of community benefits programs and a description of models from the Cities of San Diego, Santa Monica, Menlo Park, and Dublin.

How Community Benefits Programs Work

A community benefits program (also sometimes known as a public benefits program, density incentive program, or density bonus program) allows developers to build at increased densities or heights over a base amount, in return for providing community benefits. Community benefits programs can take a number of different forms. For example:

- The community benefits can be provided either **on-site** as part of the project, or located **off-site**.
- Developers may be asked to **build the public benefits directly** (often known as an "in-kind" contribution) or **contribute to a fund** that the City then uses to make district-wide improvements.
- Contributions may be **defined in advance** or **negotiated** for individual projects.

Community benefits programs are distinct from the other types of conditions that cities place on development projects in that:

- Community benefits go **above and beyond** what would normally be required for project approval.
- Community benefits are provided **voluntarily** by developers in exchange for receiving higher densities, providing more flexibility for cities. Unlike an impact fee, for example, cities have not typically been required to conduct nexus studies to establish public benefit programs (although there is some legal uncertainty around this issue).

Figure A-1 describes the different tools for implementing community benefits programs, including the extent to which they provide predictability and flexibility for the city and developers.

Figure A-1. Potential Tools for Implementing Community Benefits Programs

Tool	Description	Predictability for City & Developers	Flexibility for City & Developers
Development Agreements	Structured, bilateral negotiations with developers in order to obtain desired improvements in exchange for granting development rights	Low	High
Density Bonus Program	Development is eligible for a pre-defined increase in density in exchange for providing public benefits, which may be selected from a list. Different levels of density ("tiers") may be available in exchange for providing additional public benefits	Medium	Medium
Density Purchase Program	Developers can purchase bonus density at a pre-determined, per-square-foot price; the City uses the funds to pay for district-wide improvements	High	Low

Examples of Existing and Proposed Community Benefits Programs

San Diego's FAR Bonus Payment Program for the Downtown Community Plan Area
This program collects a dollar amount per square foot of bonus density, up to a maximum. The payments go into a fund that is used for parks and local infrastructure improvements. The program was initially authorized in the 2006 Downtown Community Plan and implemented in 2007, following a financial feasibility analysis that determined that the average value of the bonus to developers was $30 per square foot. The initial fee amount of $15 per square foot was set after a negotiation with the local development community, and has since increased to $16.16 based on consumer price index adjustments. The fee is significantly lower than the calculated value of the bonus FAR from the financial analysis, but it saves the city considerable time by eliminating extensive negotiations on a project-by-project basis. The program was vetted by the City's legal department and has the support of the local development community; it has not been legally challenged.[5]

For more information on San Diego's FAR Bonus Payment Program:

- City of San Diego, "The Centre City Planned District," San Diego Municipal Code, Chapter 15, Article 6, Division 3, http://docs.sandiego.gov/municode/MuniCodeChapter15/Ch15Art06Division03.pdf.

The City of Santa Monica's Community Benefits Program
Santa Monica's program is an example of a tiered approach that requires different levels of community benefits for different levels of bonus height and intensity. The Land Use and Circulation Element in the City's 2010 General Plan established baseline height and densities (known as Tier 1), and created a general framework to allow for increased height and intensities in specific areas in exchange for community benefits through two optional processes. The Tier 2 process is intended to allow for moderate increases in height and intensity in exchange for community benefits, subject to a discretionary approval process that is currently in development. Tier 3 projects can request additional densities in exchange for incrementally greater benefits, to be determined through a development agreement process.

Four years after the 2010 General Plan established this general framework, the City of Santa Monica is still in the process of developing specific implementation mechanisms for the Tier 2 process. City staff considered a "point and menu" system for Tier 2 – i.e., assigning height or intensity bonus values to specific benefits using a point system – but did recommend such a system because it would be overly complex, challenging to administer, and difficult to make attractive relative to Tiers 1 and 3.[6] Instead, the draft citywide Zoning Ordinance Update and Downtown Specific Plan (both of which are currently under review) build on the City's existing impact and linkage fee programs for affordable housing, transportation, open space, and child care facilities. In order to achieve bonus height and intensity, Tier 2 projects are required to pay additional fees above the amount required by the existing impact fees for that portion of the floor area that is above the maximum floor area allowed under Tier 1.[7] This approach reflects City staff's conclusion that tying benefits to existing fee programs would make the program easier to implement and administer. In addition, tying the program

[5] Personal communication with Brad Richter (Assistant Vice President, Centre City Development Corporation), January 2012.
[6] Jory Phillips, "Zoning Ordinance Update: Implementing Tier 2 Community Benefits," Planning Commission Staff Report, City of Santa Monica, April 3, 2013, http://www.smgov.net/departments/pcd/agendas/planning-commission/2013/20130403/s2013040309b.pdf.
[7] City of Santa Monica, "Chapter 9.23 Community Benefits," *Zoning Ordinance Update*, Public Review Draft, November 2013; City of Santa Monica, *Draft Downtown Specific Plan*, February 2014.

to existing impact fees addresses staff concerns that the program could be construed as an exaction subject to California's Mitigation Fee Act.[8]

For more information on Santa Monica's Community Benefits Zoning:

- City of Santa Monica, "Chapter 9.22: Affordable Housing Incentives" and "Chapter 9.23: Community Benefits," *Zoning Ordinance Update*, Public Review Draft, November 2013, http://www.smgov.net/Departments/PCD/Zoning/Zoning-Update/.
- City of Santa Monica, "Chapter 8: Community Benefits," *Draft Downtown Specific Plan*, February 2014, http://www.smgov.net/Departments/PCD/Plans/Downtown-Specific-Plan/.

Proposed Community Benefits Programs in Menlo Park and Dublin

Menlo Park's El Camino Real/Downtown Specific Plan for Menlo Park, and Dublin's Downtown Specific Plan both have proposed community benefits programs that set up a framework for obtaining desired community benefits in exchange for additional density. Both programs involve individual negotiation with developers, to ensure that city officials will able to respond to market conditions and assert community priorities. The benefits may be provided directly as part of a development project or in the form of a contribution to a special fund.

For more information, see:

- City of Menlo Park, *Draft El Camino Real/Downtown Specific Plan*, http://www.menlopark.org/159/Draft-Specific-Plan.
- City of Dublin, *Downtown Dublin Specific Plan*, http://dublinca.gov/index.aspx?NID=203.

[8] In most cases, Santa Monica's existing impact fees are lower than the actual cost of mitigating a project's impact on public facilities and infrastructure (i.e., the maximum potential fees calculated in nexus studies). As a result, it is possible for the City to impose higher fees that are still within the range of fees authorized by previous nexus studies. Source: Jory Phillips, "Zoning Ordinance Update: Implementing Tier 2 Community Benefits."

Appendix B. Financial Feasibility Analysis: Key Findings and Methodology

This appendix describes the methodology and key assumptions used in the financial feasibility and community benefits analysis. The following sections describe the analytical approach taken to model feasibility and the potential for community benefits, the development scenarios, development cost assumptions, and revenue assumptions. All of the assumptions described below are based on market research, and have been vetted by local developers to the extent possible. The pro forma models are provided at the end of Appendix B.

Methodology

Measuring Feasibility

The analysis utilized a static pro forma model, which tallies all development costs including construction costs, "soft" costs (e.g., entitlement, architecture and engineering, city fees, sales and marketing, etc.), and land. In order to reflect the different business models for condominium versus apartment development, different measures of development feasibility were used for each product type. For condominiums, the analysis assumed that projects were only financially feasible if the developer could expect to make a profit of at between eight and ten percent of costs (including the cost of land). While profit margin expectations change depending on a variety of factors including market conditions, perceived risks including entitlements processes, global financial markets, and many other factors, an estimated return of eight to ten percent is considered a reasonable threshold in Mountain View.

For apartments, financial feasibility was tested using a threshold "return on cost," representing the minimum required return to make a development project worth pursuing and to attract investors. The return on cost is calculated as the developer's annual net operating income – i.e., income from rental revenues, net of expenses – divided by the total cost of constructing the project (including the cost of land). Based on discussions with developers and a review of current capitalization rates[9] for apartment projects in the Mountain View area, apartment projects were considered financially feasible if the annual return on cost exceeded a threshold of 5.5 percent.

Development Prototypes

Parcel Sizes

The analysis tested a range of parcel sizes, which were selected to represent the range of site sizes available in the Plan Area. Parcel sizes tested included 0.45 acres (Small Site A); 1.0 acres (Small Site B); 2.9 acres (Medium Site C); and 4.24 acres (Large Site D).

Land Uses

The analysis tested residential and residential/mixed-use development; single-use retail and office would not be eligible for the proposed community benefits program and were therefore not tested. The development prototypes on medium and large sites (over two acres) were assumed to be rental apartments, reflecting the fact that apartments currently generate higher revenues on a per-square-foot basis than condominiums in Mountain View and vacancy rates remain very low. Moreover, most of the recently built projects have been rental apartments, generally located on sites of two acres or more. Development prototypes on sites under two acres were assumed to be for-sale condominiums. For-sale housing is typically more viable than apartments for small sites because condos and

[9] The "capitalization rate" is the ratio of net operating income to property sale value expected in the general real estate market. The current capitalization in the Mountain View market area is approximately 4.75 percent.

townhouses do not require the same level of ongoing property management by development or management companies.

Building Types and Densities

Figures B-1 through B-3 show the building types and densities tested on the four sites. These building types represent potential development projects that could be built on the prototypical parcels given the proposed development standards and physical limitations of size, configuration, and other characteristics, but they are not intended to be inclusive of every possible building type, nor predictive of how the study area will be developed in the future.

Development Standards

The building prototypes shown in Figures B-1 through B-3 incorporate proposed development standards from the various land use designations included Administrative Draft of the El Camino Real Specific Plan (Neighborhood Corner, Moderate-Intensity Zones, and Village Centers). Key parameters of the development standards that were tested include:

- **Community benefits structure:** The maximum base height permitted throughout the corridor is 3 stories (or 40 feet), with a maximum base intensity of 1.35 FAR. In designated Moderate-Intensity Zones and Village Centers, developers could pursue heights of up to 4 stories (50 feet) and an FAR up to 1.85 through Process A. Process B would provide an option for densities above 1.85 in most Village Centers.
- **Ground-floor active space requirement:** The prototypes tested the following proposed requirements for ground-floor active space:
    - Village Centers: 15 to 20 percent of lot area dedicated to ground-floor active use.
    - Neighborhood Corners: A minimum of 2,500 square feet ground-floor active use.
    - Moderate-Intensity Zones: Ground-floor active use is allowed but not required.
- **Retail parking requirement:** For Village Center prototypes, retail space is assumed to be fully parked. For Neighborhood Corner prototypes, the analysis generally assumed that no retail parking would be provided. However, Scenario 4 tests the impact of fully parking the ground-floor retail space in a Neighborhood Corner.

Figure B-1. Small Site A Development Scenarios

	Small Site A: 0.45 Acre	
Land Use Designation	Neighborhood Corner	
Scenario	*Scenario 1*	*Scenario 2*
FAR	1.33	1.81
Building Type	Three-story mixed-use residential over podium	Four-story mixed-use residential over podium
Lot Area (s.f.)	19,299	19,299
Street Frontage (s.f.)	1,800	1,800
Residential		
Unit Type	Condos/Townhouses	Condos/Townhouses
Residential Units	16	18
Net Residential Building Area (s.f.)	18,350	25,750
Average Unit Size (s.f.)	1,147	1,431
Residential Common Area (s.f.)	4,588	6,438
Retail and Active Space		
Retail (s.f.)	2,400	2,400
Other Active Space (s.f.)	400	400
Total Retail/Active Space as % of Land Area	15%	15%
Retail Customer Parking Provided?	No	No
Parking and Landscaping		
Total Parking Spaces	32	36
Underground Podium Parking (s.f.)	13,820	13,820
Paved Parking or Landscaped Area (s.f.)	5,511	5,511
Podium Landscaped Area (s.f.)	2,578	2,578

Source: Strategic Economics & VMWP, 2014.

Figure B-2. Small Site B Development Scenarios

	Small Site B: 1.0 Acre			Small Site B: 1.0 Acre		
Land Use Designation	Neighborhood Corner			Village Center		
Scenario	*Scenario 3*	*Scenario 4*	*Scenario 5*	*Scenario 6*	*Scenario 7*	*Scenario 8*
FAR	1.34	1.85	1.86	1.34	1.83	2.58
Building Type	Three-story mixed-use residential over podium	Four-story mixed-use residential over podium	Four-story mixed-use residential over podium	Three-story mixed-use residential over podium	Four-story mixed-use residential over podium	Six-story mixed-use residential over podium
Lot Area (s.f.)	43,289	43,289	43,289	43,289	43,289	43,289
Street Frontage (s.f.)	440	440	416	440	440	416
Residential						
Unit Type	Condos	Condos	Condos	Condos	Condos	Condos
Residential Units	38	50	53	30	40	60
Net Residential Building Area (s.f.)	44,250	56,000	62,000	35,600	52,400	78,500
Average Unit Size (s.f.)	1,164	1,120	1,170	1,187	1,310	1,308
Residential Common Area (s.f.)	11,063	14,000	15,500	8,900	13,100	19,625
Retail and Active Space						
Retail (s.f.)	2,500	2,600	2,400	2,600	2,600	2,600
Other Active Space (s.f.)	400	300	500	3,900	3,900	3,900
Total Retail/Active Space as % of Land Area	7%	7%	7%	15%	15%	15%
Retail Customer Parking Provided?	No	Fully parked	No	Fully parked	Fully parked	Fully parked
Parking and Landscaping						
Total Parking Spaces	82	123	106	97	97	137
Underground Podium Parking (s.f.)	32,000	44,250	44,250	32,000	32,000	48,000
Above-Ground Podium (s.f.)	0	7,198	0	7,198	7,198	7,198
Paved Parking or Landscaped Area (s.f.)	8,062	8,062	11,317	8,062	8,062	8,062
Podium Landscaped Area (s.f.)	8,486	8,486	9,834	8,486	8,486	8,486

Source: Strategic Economics & VMWP, 2014.

Figure B-3. Medium Site C and Large Site D Development Scenarios

	Medium Site C: 2.9 Acres		**Large Site: 4.24 Acres**		
Land Use Designation	**Moderate Intensity Zone**		**Village Center**		
Scenario	*Scenario 9*	*Scenario 10*	*Scenario 11*	*Scenario 12*	*Scenario 13*
FAR	1.34	1.79	1.35	1.85	2.60
Building Type	Three-story residential over podium	Four-story residential over podium	Three- and four-story mixed-use residential with surface retail parking	Three-story mixed-use residential over podium	Six-story mixed-use residential
Lot Area (s.f.)	126,937	126,937	184,488	184,488	184,488
Street Frontage (s.f.)	250	250	1,100	1,100	1,100
Residential					
Unit Type	Apartments	Apartments	Apartments	Apartments	Apartments
Residential Units	145	193	191	199	320
Net Residential Building Area (s.f.)	131,477	175,000	177,350	183,442	294,135
Average Unit Size (s.f.)	907	907	929	922	919
Residential Common Area (s.f.)	32,869	43,750	44,338	45,861	73,534
Retail and Active Space					
Retail (s.f.)	0	0	27,000	37,000	37,000
Other Active Space (s.f.)	6,198	8,250	0	0	0
Total Retail/Active Space as % of Land Area	5%	6%	15%	20%	20%
Retail Customer Parking Provided?	N/A	N/A	Fully parked	Fully parked	Fully parked
Parking and Landscaping					
Total Parking Spaces	197	296	366	434	597
Underground Podium Parking (s.f.)	0	41,136	0	87,108	149,660
1/2 Subgrade Podium Parking (s.f.)	81,364	81,364	103,740	19,700	19,700
Structured retail parking (s.f.)	0	0	0	75,000	75,000
Paved Parking or Landscaped Area (s.f.)	38,547	38,547	111,000	51,800	51,800
Podium Landscaped Area (s.f.)	27,500	27,500	19,300	36,275	36,275

Source: Strategic Economics & VMWP, 2014.

Development Cost Assumptions

Hard Costs

VMWP estimated project construction costs based on recent experience with development projects in Silicon Valley and elsewhere in the Bay Area. Figure B-4 shows the hard cost assumptions used for this analysis.

Figure B-4. Hard Cost Assumptions

	Unit	Cost
Site Prep/Demo	Per s.f.	$5
Street frontage	Per s.f.	$25
Retail Area (podium)	Per s.f.	$175
Retail Area (single-story shell)	Per s.f.	$200
Tenant Improvements	Per s.f.	$25
Residential Area	Per s.f.	$175
Common Area	Per s.f.	$175
Podium Below Grade	Per s.f.	$115
Podium At Grade	Per s.f.	$175
Podium 1/2 Subgrade	Per s.f.	$95
Structured Parking	Per s.f.	$95
Paved Parking/Landscaped Area	Per s.f.	$25
Podium Landscaped Area	Per s.f.	$75
Contingency	Total Hard Costs	10%

Source: VMWP, 2014.

Soft Costs

Estimated soft costs include items such as permits, architectural fees, engineering fees, developer overhead, insurance, taxes, legal, accounting fees, and marketing costs. In total, soft costs were estimated at 35 percent of hard costs based on standard industry ratios.

Financing Costs

Financing costs were estimated assuming that a construction loan would be obtained for 65 percent of the cost of development, with a 6.5 percent interest rate and a 1.5 percent loan fee. Given that the construction loan would be drawn down over the course of the project, the total financing cost was estimated assuming an average outstanding loan balance of 55 percent. Construction time was assumed to range from 12 to 18 months, depending on the scenario (see detailed pro formas, below).

Land Costs

Based on a review of current and historic property transactions, Small Sites A and B were assumed to sell for $100 per square foot; Medium Site C and Large Site D were assumed to sell for $120 per square foot. Developers are typically willing to pay less for smaller sites because of they are more challenging to develop.

Revenue Assumptions

Condominiums

Condominium sales prices and sizes were estimated based on the results from Strategic Economics' market analysis[10] and updated information from companies that track condominium sales, including Zillow.com and Polaris Pacific. Average current townhouse values (for Scenarios 1 and 2) were set at $550 per square foot, or about $630,000 to $785,000 per unit. Average current condominium values (for Scenarios 3 through 8) were estimated at $600 per square foot, or about $670,000 to $785,000 a unit.

Apartments

Based on rents from several relatively recent development projects in and around the Precise Plan Area (including Carmel The Village, Avalon Towers on the Peninsula, and Madera Apartments), rents for new apartments on El Camino Real were estimated at $3.90 per square foot. The rental rates were translated into a per-square foot capitalized value using the income capitalization approach. In this approach to property valuation, a building's anticipated operating expenses are removed from anticipated operating revenues to derive net operating income; this net operating income is then divided by a "capitalization rate," which is the ratio of net operating income to property sale value expected in the general real estate market. This calculation is shown in Figure B-5.

Figure B-5. Pricing Assumptions for Apartments

	Unit	Apartments
Monthly Rent	Per s.f.	$3.90
Vacancy	Percent	5.0%
Operating Expenses	Percent	20.0%
Capitalization Rate	Percent	4.75%
Estimated Value		
Gross Annual Income	Per s.f.	$46.80
Less Vacancy	Per s.f.	-$2.34
Less Non-Reimbursable Exp	Per s.f.	-$9.36
Annual Net Operating Income	Per s.f.	$35.10
Capitalized Value	Per s.f.	$738.95

Source: CoStar Group, Property Analytics, March 2014; Marcus & Millichap, 2014 National Apartment Report; National Apartment Association, 2012 Survey of Operating Income & Expenses in Rental Apartment Communities; Strategic Economics, 2014.

Retail

Based on findings from the market study, Strategic Economics estimated that ground-floor retail along the corridor would rent for $2.60 per square foot per month triple net.[11] As with apartment values, the retail rental rates were translated into a per-square foot capitalized value using the income capitalization approach, shown in Figure B-6.

[10] See Strategic Economics, "Citywide Market Analysis," Mountain View El Camino Real Precise Plan, October 21, 2013.

[11] Triple-net leases require the tenant to pay for net real estate taxes on the leased asset, net building insurance and net common area maintenance.

Figure B-6. Pricing Assumptions for Retail

	Unit	Retail
Assumptions		
Monthly Rent (NNN)	Per s.f.	$2.60
Vacancy	Percent	5.0%
Non-Reimbursable Expenses	Percent	10.0%
Capitalization Rate	Percent	6.0%
Estimated Value		
Gross Annual Retail Income	Per s.f.	$31.20
Less Retail Vacancy	Per s.f.	-$1.56
Less Non-Reimbursable Exp	Per s.f.	-$3.12
Annual Net Operating Income	Per s.f.	$26.52
Capitalized Value	Per s.f.	$442.00

Source: Terranomics, Santa Clara Retail Report, Fourth Quarter 2013; Marcus & Millichap, 2013 National Retail Report; Strategic Economics, 2014.

Pro Forma Models

Figure B-7. Small Site A Pro Forma

	Small Site A: 0.45 Acre Neighborhood Corner	
	Scenario 1	*Scenario 2*
FAR	1.33	1.81
Building Type	Three-story mixed-use residential over podium	Four-story mixed-use residential over podium
Product Type	Condos/ Townhouses	Condos/ Townhouses
Net Residential Sq. Ft.	18,350	25,750
Residential Units	16	18
Retail (s.f.)	2,400	2,400
Other Active Space (s.f.)	400	400
Total Retail/Active Space as % of Land Area	15%	15%
Retail Customer Parking Provided?	No	No
Revenues		
Residential	$10,092,500	$14,162,500
Retail	$1,060,800	$1,060,800
Total Revenues	$11,153,300	$15,223,300
Costs		
Hard Costs	$7,288,581	$9,069,206
Soft Costs	$2,551,003	$3,174,222
Financing Costs	$306,995	$381,995
Land Costs	$1,929,900	$1,929,900
Total Costs	$12,076,479	$14,555,323
Net Revenues (Developer Return)	($923,179)	$667,977
Developer Return as % of Total Costs	-7.6%	4.6%

Source: VMWP & Strategic Economics, 2014.

Figure B-8. Small Site B Pro Forma Analysis

	Small Site B: 1.0 Acre Neighborhood Corner			Small Site B: 1.0 Acre Village Center		
	Scenario 3	*Scenario 4*	*Scenario 5*	*Scenario 6*	*Scenario 7*	*Scenario 8*
FAR	1.34	1.85	1.86	1.34	1.83	2.58
Building Type	Three-story mixed-use residential over podium	Four-story mixed-use residential over podium	Four-story mixed-use residential over podium	Three-story mixed-use residential over podium	Four-story mixed-use residential over podium	Six-story mixed-use residential over podium
Product Type	Condos	Condos	Condos	Condos	Condos	Condos
Net Residential Sq. Ft.	44,250	56,000	62,000	35,600	52,400	78,500
Residential Units	38	50	53	30	40	60
Retail (s.f.)	2,500	2,600	2,400	2,600	2,600	2,600
Other Active Space (s.f.)	400	300	500	3,900	3,900	3,900
Total Retail/Active Space as % of Land Area	7%	7%	7%	15%	15%	15%
Retail Customer Parking Provided?	No	Fully parked	No	Fully parked	Fully parked	Fully parked
Revenues						
Residential	$26,550,000	$33,600,000	$37,200,000	$21,360,000	$31,440,000	$47,100,000
Retail	$1,105,000	$1,149,200	$1,060,800	$1,149,200	$1,149,200	$1,149,200
Total Revenues	$27,655,000	$34,749,200	$38,260,800	$22,509,200	$32,589,200	$48,249,200
Costs						
Hard Costs	$16,494,646	$22,259,980	$22,512,677	$16,494,605	$20,537,105	$28,840,757
Soft Costs	$5,773,126	$7,790,993	$7,879,437	$5,773,112	$7,187,987	$10,094,265
Financing Costs	$694,754	$937,590	$948,234	$694,753	$865,023	$1,214,773
Land Costs	$4,328,900	$4,328,900	$4,328,900	$4,328,900	$4,328,900	$4,328,900
Total Costs	$27,291,426	$35,317,463	$35,669,248	$27,291,369	$32,919,014	$44,478,695
Net Revenues (Developer Return)	$363,574	($568,263)	$2,591,552	($4,782,169)	($329,814)	$3,770,505
Developer Return as % of Total Costs	1.3%	-1.6%	7.3%	-17.5%	-1.0%	8.5%

Source: VMWP & Strategic Economics, 2014.

Figure B-9. Medium Site C and Large Site D Pro Forma Analysis

	Medium Site C: 2.9 Acres Moderate Intensity Zone		Large Site: 4.24 Acres Village Center		
	Scenario 9	*Scenario 10*	*Scenario 11*	*Scenario 12*	*Scenario 13*
FAR	1.34	1.79	1.35	1.85	2.60
Building Type	Three-story residential over podium	Four-story residential over podium	Three- and four-story mixed-use residential with surface retail parking	Three-story mixed-use residential over podium	Six-story mixed-use residential
Product Type	Apartments	Apartments	Apartments	Apartments	Apartments
Net Residential Sq. Ft.	131,477	175,000	177,350	183,442	294,135
Residential Units	145	193	191	199	320
Retail (s.f.)	0	0	27,000	37,000	37,000
Other Active Space (s.f.)	6,198	8,250	0	0	0
Total Retail/Active Space as % of Land Area	5%	6%	15%	20%	20%
Retail Customer Parking Provided?	N/A	N/A	Fully parked	Fully parked	Fully parked
Revenues					
Residential	$97,154,350	$129,315,789	$131,052,316	$135,553,983	$217,350,284
Retail	$0	$0	$11,934,000	$16,354,000	$16,354,000
Total Revenues	$97,154,350	$129,315,789	$142,986,316	$151,907,983	$233,704,284
Costs					
Hard Costs	$45,366,087	$61,437,563	$65,502,858	$78,658,261	$113,206,544
Soft Costs	$15,878,130	$21,503,147	$22,926,000	$27,530,391	$39,622,290
Financing Costs	$2,239,242	$3,032,520	$3,707,380	$4,451,959	$6,407,349
Land Costs	$15,232,440	$15,232,440	$22,138,560	$22,138,560	$22,138,560
Total Costs	$78,715,899	$101,205,670	$114,274,798	$132,779,172	$181,374,743
Net Revenues	$18,438,450	$28,110,120	$28,711,518	$19,128,812	$52,329,541
Developer Return on Cost (Apartments Only)					
Total Annual Net Operating Income	$4,614,832	$6,142,500	$6,941,025	$7,420,054	$11,305,379
Annual Return on Cost	5.9%	6.1%	6.1%	5.6%	6.2%

Source: VMWP & Strategic Economics, 2014.