

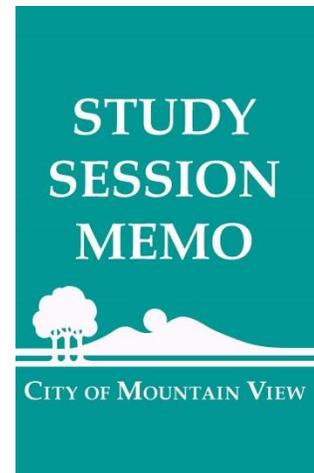
DATE: September 4, 2018

TO: Honorable Mayor and City Council

FROM: Martin Alkire, Principal Planner
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VIA: Daniel H. Rich, City Manager

TITLE: **North Bayshore Cost of Development Update**



PURPOSE

The purpose of this Study Session is to provide Council an update regarding the cost of new residential development in North Bayshore and to receive Council direction on potential options regarding this issue.

BACKGROUND

The City Council adopted the North Bayshore Precise Plan (NBSPP) in December 2017. The NBSPP represents a community vision for future change in the area and provides a long-term vision and strategy for the development of complete, urban, mixed-use communities. This includes transportation improvements, infrastructure investment, sustainability outcomes, schools, parks, retail, and the addition of nearly 10,000 housing units with a district-wide affordable housing goal of 20 percent affordable housing units. The NBSPP includes policies and actions to implement the desired changes over time, and, as such, is expected to be updated as needed in the future.

Since the adoption of the Precise Plan, staff has continued to work on potential new residential development in the area, namely the Sobrato project at 1255 Pear Avenue and is now exploring a different mix of units. Sobrato pulled their project in June due to concerns over its economic viability. Other developers and property owners in North Bayshore and elsewhere have also informally raised concerns about the cost of residential development in the area and elsewhere in Mountain View. The information in this staff report provides a summary of the NBSPP policies, key factors, updated analysis, and potential options to consider regarding the cost of residential development in North Bayshore.

Bonus FAR Program

A key component of the NBSPP is a two-tier Bonus Floor Area Ratio (FAR) program for residential development. The program is intended to facilitate the development of new residential projects by significantly increasing a project’s allowable FAR above its base FAR of 1.0 in return for certain project elements desired by the Precise Plan. The amount of FAR depends on the location of the project within the Precise Plan area. Project elements include affordable housing, a local school strategy, green building measures, and community benefits, as shown in Table 1 below.

Table 1. Bonus FAR Tier Structure

Character Area	Edge	General		Core	
Tier	Tier 1	Tier 1	Tier 2	Tier 1	Tier 2
FAR	1.85	2.5	3.5	3.2	4.5
% Affordable Housing Units	15%	15%	20%	15%	20%
Local School Strategy	Financial contribution or land donation	Financial contribution or land donation	Minimum requirement to donate land	Financial contribution or land donation	Minimum requirement to donate land
Green Building Measures	X	X	X	X	X
Community Benefit	X	X	X	X	X

A financial feasibility analysis was conducted to help inform the Bonus FAR program during the NBSPP update. The analysis indicated that, even with the provision of additional FAR, it would be challenging for new residential development to meet the affordable housing requirements, particularly the 20 percent requirement, due primarily to high construction and land costs. Council discussed the analysis at the December 2017 hearing and approved the affordable housing strategy, noting that 20 percent is a district-wide goal and that other strategies, such as developing 100 percent affordable housing projects or the use of new building technologies or other innovations, could help make projects more feasible and achieve the district-wide affordable housing goal.

The feasibility analysis did not include costs related to all of the other Bonus FAR project elements, as some were added to the Precise Plan later during the update process:

- **Local school strategy.** During the update of the NBSPP, there were many discussions with the local school district on how the Precise Plan could address current and future school infrastructure needs given the planned growth in the area. As part of the Tier structure, a local school strategy policy was developed for the Precise Plan to address this issue and to respond to the community's desire to support local schools. The local school strategy could include a financial contribution and/or donation of land to the school districts by residential developers as part of their community benefit. The City did not conduct a separate study at the time to determine an appropriate amount of funding or space needed for a school, and the policy assumes that the school district and developers would work collaboratively to determine the appropriate strategy. However, this has proven to be challenging due to differences between developers and school districts in determining an agreeable local school strategy. A key factor inhibiting consensus is the amount or proportion that developers should contribute towards local school development as part of their community benefit obligation. In other words, is 100 percent of the cost of developing a new school (land and construction) expected to be covered by the developers' school strategy. If so, it is a substantial amount that impacts project viability.

- **Green building measures.** The NBSPP includes green building standards for residential buildings. These standards included:
 - Green building rating—Minimum Green Point Rating of 120 for new buildings;
 - Water (CalGreen voluntary)—Install energy star appliances;
 - Landscape design to reduce heat island (CalGreen voluntary)—Green roofs, high reflectance roof, and paving and vegetation to shade paved areas; and
 - Energy (LEED for Homes)—Submeters or other technology that can track individual energy use for each unit.

These measures add to the overall development cost, but it is not expected to be a primary factor. Additionally, the NBSPP is clear about requiring high levels of sustainability in all new North Bayshore development to reflect Council/community expectations.

- **Community benefit.** A general category for community benefit was added to the Bonus FAR section later in the Precise Plan process. The idea is that this requirement would give maximum flexibility for the City Council to require community benefits for projects maxing out at the highest FAR tier. Conversely, Council could require less community benefits for projects at the lower end of a FAR tier. The NBSPP provides examples of potential community benefits, such as public art, transportation, or other benefits.

DISCUSSION

Seifel Consulting conducted the original NBSPP feasibility analysis and was hired to provide an updated analysis based on recent developer input and other data gathered on development costs in the area. Staff also organized an August 14, 2018 developer forum to gather input from a number of developers on the issue. For developers, the increased costs of residential development are due to building and land costs; development requirements, including infrastructure/facilities, transportation demand management and improvements, and parks and open space requirements; and the local school strategy. These issues are summarized in the Discussion section below.

Developer Input

The following is a summary of recent developer input regarding factors that have increased the cost of residential development.

1. Building/Construction Costs

- Construction costs have been rapidly increasing over the past two to three years, with reported increases ranging from 5 percent to 12 percent per year, and costs for taller buildings (85+ feet) are significantly higher.
- Costs in the NBSPP area are higher than in other parts of Mountain View because most sites have existing buildings that need to be demolished and potentially remediated, sites are not “infrastructure ready” given North Bayshore standards, and the high water table and challenging soil conditions make it more expensive to build below grade (including parking).

2. Land Costs

- Land and property acquisition costs have rapidly increased due to significant economic growth in Silicon Valley. Based on recent transactions, market

values for property have increased from \$5.2 million per acre assumed for the first NBSPP financial feasibility analysis to at least \$10 million per acre.

- Additionally, as property values increase, the cost to meet the NBSPP requirements for parks, schools, and infrastructure also increases.

3. Development Requirements

- *Public Infrastructure and Facilities*
 - The NBSPP requires a substantial amount of new public infrastructure and new facilities. For example, many sites require substantial upfront investments in utility upgrades and street reconfigurations to transform them into complete streets for pedestrian, bicycle, and transit use.
 - Increased sewer and water capacity is needed to accommodate new residential growth, and the same factors that affect building construction costs increase the cost of public infrastructure/facility improvement costs.
 - Often the first developers to build housing in an area undergoing significant transition must undertake needed infrastructure improvements and are not able to share costs with other developers, so they have a higher upfront burden. In order to provide the required infrastructure or facilities, developers often need to dedicate portions of land to public ownership or provide right-of-way easements, which can reduce development potential of property or make it more expensive to develop.
- *Transportation Demand Management and Transportation Management Association*
 - The NBSPP anticipates substantial transportation improvements and programs to help minimize use of Single Occupancy Vehicles (SOV) in order for development to occur. In addition to providing transportation infrastructure and meeting building requirements for bike storage/transit access to address the impacts of the projects, developers are required to participate in Transportation Demand Management (TDM) programs to implement and monitor transportation performance to assure compliance with the NBSPP. Such strategies have ongoing operating costs, such as transit passes, that might not be able to be passed on to tenants. Residential developers must also join and help

pay for the North Bayshore Transportation Management Association (TMA), which could result in additional costs as it expands.

- *Parks and Open Space Requirements/Credits*
 - The City’s parkland requirements were established many years ago and do not reflect the type of compact housing development envisioned in the NBSPP. The NBSPP also requires that a new system of parks, open space, trails, and public plazas be developed for the three new residential neighborhoods.
 - However, many NBSPP sites cannot provide sufficient open space and parkland on-site to meet these requirements, which means that many residential developers may have to pay a parkland dedication fee. As property values have increased, the fee levels have doubled or tripled based on the market value for multi-family residential land, with estimated increases from about \$20,000 to 30,000 per unit to more than \$60,000 per unit in the past few years. This rapid increase in park fee levels was unexpected and is significantly affecting residential development feasibility. Given that park fees in Mountain View are established at the end of the land use/building approval process based on current residential market values, developers have indicated that these fee level increases are unpredictable and cannot be reliably factored into their financial feasibility analysis.

4. Local school strategy

- The NBSPP requires residential developers to negotiate directly with the local school districts to develop and provide funding, land, or other assistance to support a local school strategy to address future student generation created by residential development as part of their community benefit for increased FAR.
- Based on initial information provided by the school districts, up to four new schools may be needed to meet the needs of future students in North Bayshore from new housing (the school districts are assuming smaller, more “urban” campuses).
- The cost of building new schools and acquiring land has rapidly increased in recent years. Taking into account the school districts’ projections of future school needs, the upfront funding obligation for the local school strategy is

estimated to be significantly higher than the current State-mandated school fee obligation for housing (currently \$3,000 to \$4,000 per unit) and could range from \$30,000 to \$60,000 per unit depending on school development costs (including land acquisition costs), residential unit type, and associated student generation rates.

- As the ultimate cost of the local school strategy is currently unknown because the schools and developers have not reached consensus, developers cannot predictably factor these costs into their financial feasibility analysis.

Given all of the factors discussed above, residential development costs have increased significantly, and developers state it is much more difficult to make projects financially feasible, which inhibits housing production. If less housing is built, then less affordable housing will be built.

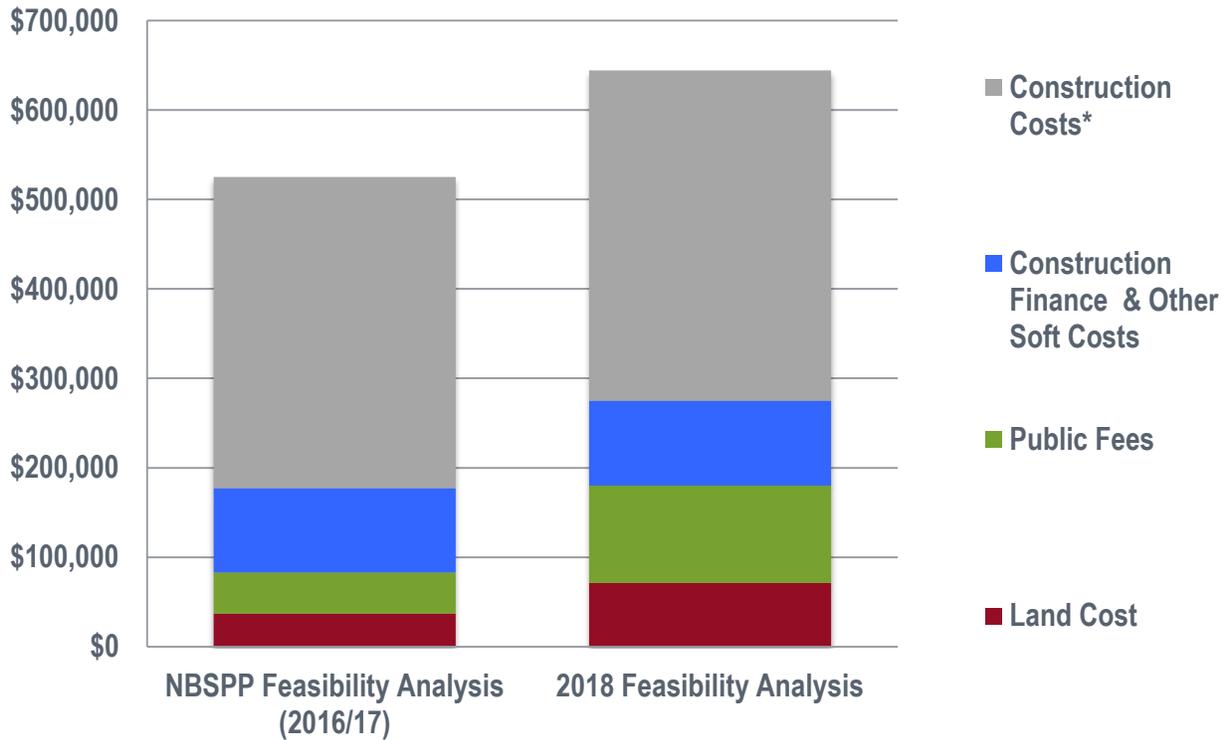
Summary of Updated Financial Feasibility Analysis

The following is a summary of the changes in the cost of residential development assumed for the original feasibility analysis and the updated feasibility analysis. It is important to caveat that the development data used for the updated feasibility analysis is aggregated based on input from developers and can vary significantly depending on the specifics of any particular project or developer. Data from comparable projects along the Peninsula were also used by the consultant to supplement Mountain View-specific data. Additionally, the cost per unit for certain variables, such as for land, can change depending on the density of the project. The information below includes cost estimates for a seven-story Tier 1 residential development, which is representative of the type of development the NBSPP seeks to facilitate. Finally, the updated feasibility analysis had to include certain costs per unit to estimate the cost associated with adopted policy, such as for the local schools strategy, even though the exact costs are unknown at this time and is not a recommendation for what the actual cost should be. Despite the caveats, the aggregated data used for the updated feasibility analysis illustrates the overall trend that costs have increased to a level where projects are severely financially challenged.

Overall Increase in Total Development Cost

The original feasibility analysis estimated the total cost to build a residential unit on average in North Bayshore would be approximately \$525,000 per unit. The updated feasibility analysis indicates that the current cost to build a unit is about \$645,000 per unit, an increase of \$120,000 per unit. See Chart 1 below.

Chart 1. Change in Total Cost of Development per Apartment Unit

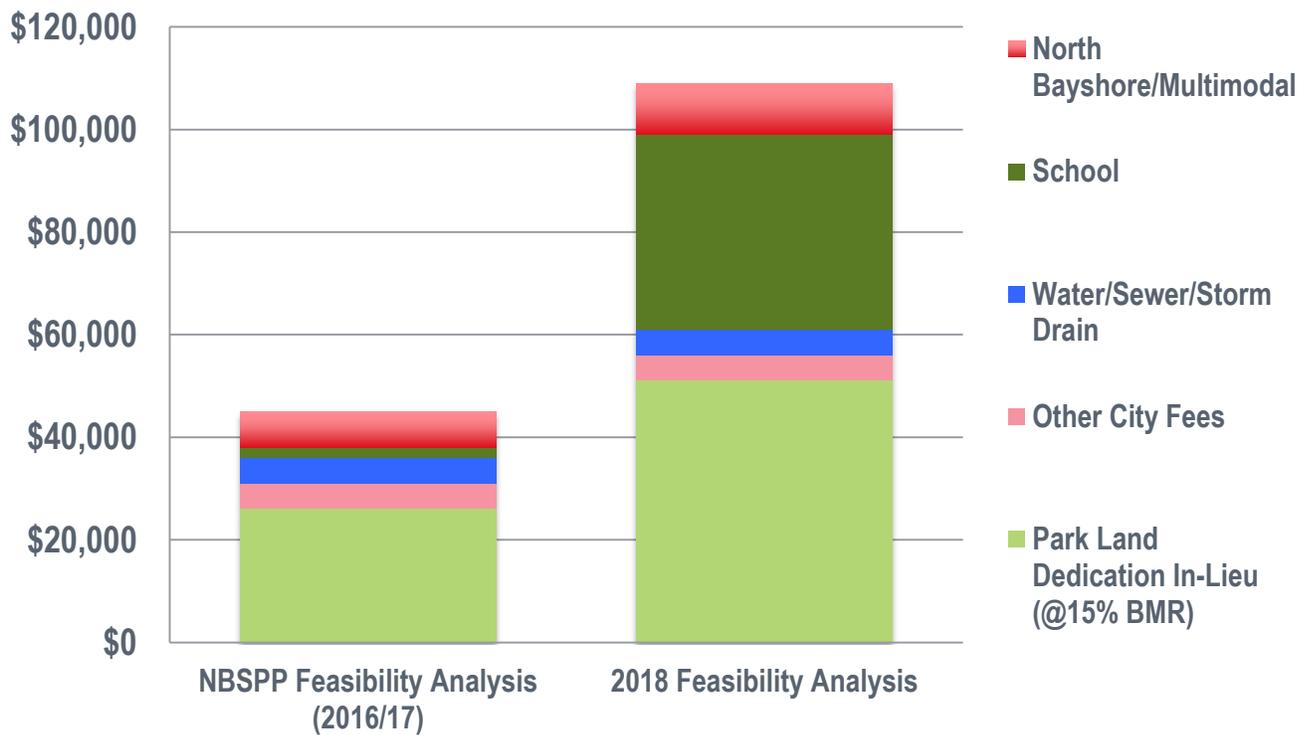


Construction costs comprise the bulk of the total development cost and have increased approximately 6 percent since the original feasibility analysis was conducted. However, the increased cost of land and park fees, as well as the local school strategy, represents the primary changes in the cost of development.

Specifically, the assumed cost of land has nearly doubled, from \$5.2 million to \$10 million. Public fees comprise approximately 20 percent of the total development cost (\$110,000 of the \$645,000 total cost). The park fee and costs associated with a strategy to support new local schools comprise approximately 85 percent of all public fees. Because park fees are based on land costs, the assumed park fee amount has also increased from approximately \$30,000 to \$60,000 per market-rate unit. Based on an assumed on-site affordability mix of 15 percent BMR units and 85 percent market-rate units, the park fee would average approximately \$50,000 per unit (as only the market-rate units would need to pay the park fee of \$60,000 per unit).

Finally, the local school strategy was included as part of the NBSPP late in the process. The potential cost to developers was not part of the original feasibility analysis. The updated feasibility analysis includes a \$40,000 per unit cost to represent the potential cost of the local school strategy and includes the current state school fee obligation of approximately \$3,000 per unit, but it could range from \$30,000 to \$60,000 per unit depending on the total cost of school development and the percentage paid by developers. Based on current estimates, the combined cost of providing parks and local schools could range between \$90,000 to \$120,000 per unit. See Chart 2 below.

Chart 2. North Bayshore Comparison of Public Fees per Apartment Unit



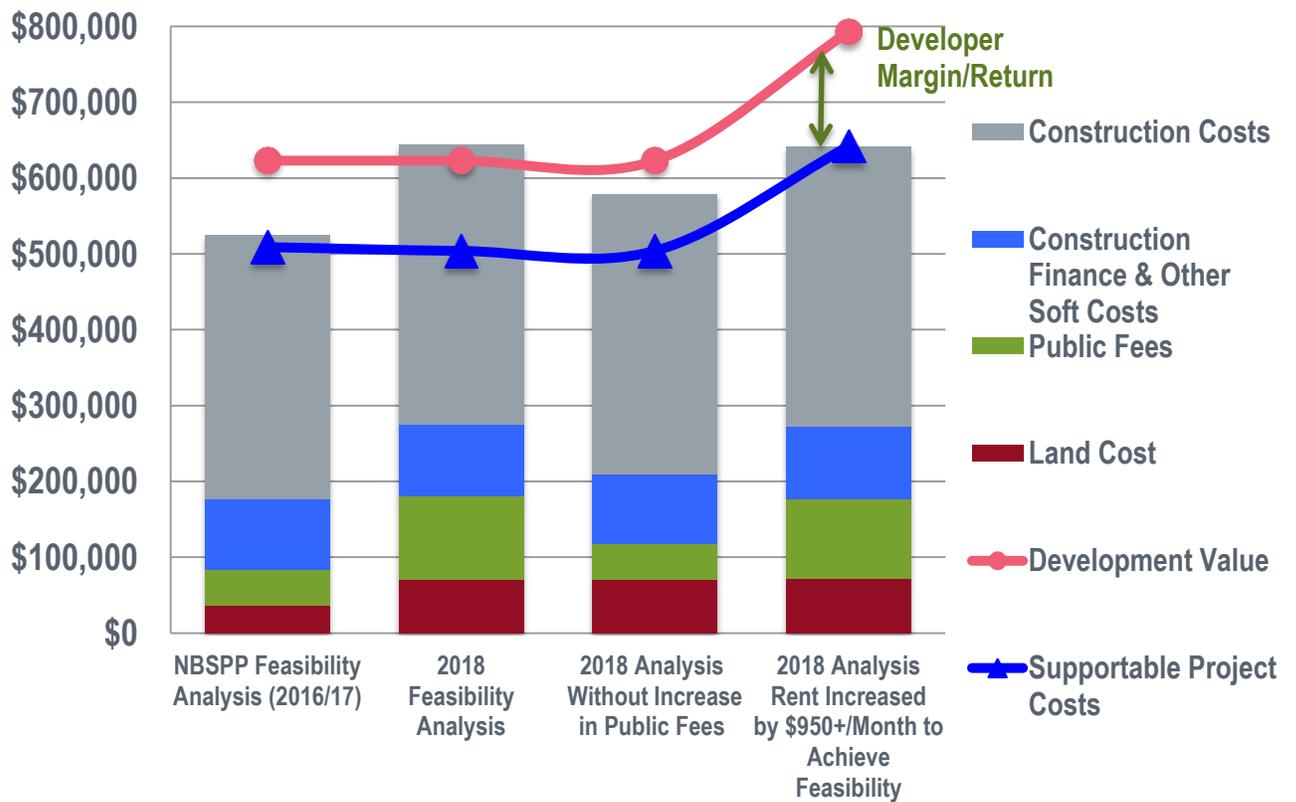
Total Development Cost Exceeds Maximum Supportable Cost

A residential project has a maximum cost that it can support in order to be financed and viable. A project becomes feasible if: 1) actual development costs are less than this maximum supportable cost; and 2) the development value of the project is sufficiently higher than the cost, i.e., there is sufficient margin. Chart 3 provides data regarding the changes in total development costs (represented by the columns), the maximum cost

that a project can support (blue line), and the value of the project (red line). As mentioned, the total cost of development has increased by approximately \$120,000 per unit, from \$525,000 per unit to \$645,000 per unit. However, the updated feasibility analysis factors additional operating costs not included in the original feasibility analysis, which means that a project can currently only support approximately \$505,000 per unit in cost. Therefore, the total cost of development (\$645,000 per unit represented by Chart 3, Column 2) exceeds the supportable cost (\$505,000 per unit represented by the blue line) by \$140,000.

Chart 3. Total Development Cost per Apartment Unit & Project Feasibility

**North Bayshore Comparison of Development Feasibility
 Per Apartment Unit**



To support the development cost at the current level, the average market-rate rent would need to increase over 24 percent (over \$950 per month), from approximately \$3,900 per month to \$4,850 per month (Chart 3, Column 4).

However, rents are determined by the market and not by the developer. Absent a significant increase in rents, a decrease in development costs could improve the financial feasibility of projects. Overall costs would need to be reduced by \$140,000 for projects to be economically feasible. Construction and site improvement costs comprise the majority of the total development cost, representing \$370,000 per unit. Based on developer input, the potential for new building technologies to reduce costs are long-term solutions. Residential developers and general contractors are exploring the use of such technologies, and while many are currently using off-site prefabricated construction, the most innovative building technologies are still being explored. Additionally, the design and permitting process can take longer depending on the type of technology, particularly when not previously utilized in a city.

Land costs are another major factor in development costs, and are determined by the marketplace, by what residential developers can afford to pay for land after taking into account all other development costs (commonly referred to as residual land value), and by what a property owner would accept from a sale. The value of land as a future residential use must exceed the property's value given their current use. As most North Bayshore properties have existing buildings with office/R&D uses that generate significant cash flow. The cost of land in North Bayshore is high. Based on a seven-story development and land values at \$10 million per acre, land values are assumed at \$70,000 per unit. Thus, the cost of construction and land comprise nearly 70 percent of the total development cost.

As mentioned, the park fee and local school strategy obligations comprise over 80 percent (\$90,000 per unit) of all public fees (\$110,000 per unit). For the purpose of discussion, even assuming no increase in the amount of park fees and no local school strategy, that reduction in cost would still not be sufficient to make a project feasible (Chart 3, Column 3 representing total development cost exceeds the blue line representing maximum supportable cost). Even if all City fees were waived, that would still not be enough of a cost reduction to close the gap, and an additional reduction in cost or increase in revenues would be needed to make a project feasible. However, the purpose of City fees is to fund the development and delivery of the infrastructure and services required to accommodate the proposed development and the new residents. These fees are imposed to address the impacts of the development. A reduction in City fees would need to be replaced in another manner to deliver the infrastructure and services.

Ownership Housing

The updated feasibility analysis also studied ownership housing. While condo developments performed better than rental developments, they were still infeasible to

develop as almost all of the scenarios had development costs that exceeded the maximum supportable amount and were estimated to yield a negative return.

RECOMMENDATION

Given the increase in development costs, it may be appropriate to consider options to help facilitate residential development in North Bayshore, consistent with and to achieve the goals, guiding principles, and framework of the NBSPP. Staff seeks Council direction on potential options regarding the cost of residential development. The options below seek to improve the financial feasibility of residential development in North Bayshore while maintaining and implementing the existing NBSPP vision and development policy framework (the options may require further study).

- Local school strategy. Clarify the expected school strategy support obligation per student, or establish a clear expectation proportion of total cost expected to be paid by developers as their community benefit obligation to obtain higher FAR.
- Park fees. Consider modifications to the parkland dedication ordinance. For example, this could include a reduction in the amount of park fee given the amount of open space in North Bayshore or change the methodology to reflect higher density housing. Council could also change when the amount is set, or modify what private project open elements could count towards a project's parkland dedication requirement.
- Explore other opportunities to modify the cost structure of residential development, potentially shifting the cost structure towards office development. For example, the NBSPP counts above-grade parking towards a residential project's FAR, but this provision does not apply towards office FAR. Shifting this requirement from residential to office projects could facilitate the feasibility of residential development. Additionally, impact fees could be increased for office development and reduced for residential development.
- Use of additional Shoreline Regional Park Community funds to finance more of the cost of infrastructure in North Bayshore, thus lowering the impact fee on developers.

It should be noted that it is not certain any of these strategies will ensure the viability of residential development.

NEXT STEPS

Staff would move forward on or further study the options identified by the City Council. An update on the cost of development issue would be brought back to the City Council at a later date. The modified Sobrato project is expected to be reviewed by the City Council in a Study Session on September 11.

PUBLIC NOTICING – Agenda posting and copies to North Bayshore stakeholders.

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