COUNCIL AGENDA: 6/11/24
FILE: 24-120632
ITEM: 8.1

CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: HONORABLE MAYOR AND CITY COUNCIL

FROM: Nanci Klein
Jon Cicirelli
Chris Burton
John Ristow
Erik L. Soliván

SUBJECT: **DOWNTOWN RESIDENTIAL HIGH-RISE PROGRAM**

DATE: May 28, 2024

Approved Jennifer A. Maguire

Date 5/31/24

COUNCIL DISTRICT: 3

RECOMMENDATION

(a) Adopt a resolution authorizing an extension of the Downtown Residential High-Rise Program applicable to projects located in the Downtown Planned Growth Area as described in the Envision San José 2040 General Plan that are 10 or more floors or stories in height (not including any nonresidential uses) where the highest occupied floor has a floor level elevation that is at least 150 feet above street level, and reducing the in-lieu fees due for those projects under the Inclusionary Housing Ordinance to the amount of $0 for up to 4,078 units that obtain a building permit by December 31, 2026, and pass first inspection within 12 months of obtaining the building permit.

(b) Approve an ordinance waiving the Building and Structure Construction Tax and the Commercial-Residential-Mobilehome Park Building Tax for up to 1,000 units in qualified residential high-rise projects located within the Downtown Planned Growth Area that obtain a building permit by December 31, 2025, and pass first inspection within 12 months of obtain a building permit and providing a 50% reduction of the Building and Structure Construction Tax and the Commercial-Residential-Mobile home Park Building Tax for up to 3,078 units in qualified residential high-rise projects that obtain a building permit between January 1, 2026 and December 31, 2026 and pass first inspection within 12 months of obtaining the building permit.

(c) Adopt a resolution providing a 50% reduction in the Parkland In-Lieu Fee for up to 1,000 units in qualified residential high-rise projects located within the Downtown Planned Growth Area that obtain building permits by December 31, 2025, and pass first inspection within 12 months of obtaining a building permit and providing a 30% reduction in the Parkland In-Lieu Fee for up to 3,078 units in qualified residential high-rise projects that obtain building permits between January 1, 2026 and December 31, 2026.

(d) Direct staff to analyze options and study potential impacts of a temporary multifamily residential fee reduction program to support housing production outside of Downtown and return to City Council by December 2024 with the analysis and recommendations for City Council consideration, including public financing mechanisms for public infrastructure.

SUMMARY AND OUTCOME

Approval of the first three recommendations ((a), (b), and (c) above) will result in a two-phased program to support the production of high-rise residential development in the City's Downtown Planned Growth Area. The first phase of the program will reduce a project's Inclusionary Housing Ordinance Fee to $0, provide a 100% reduction in a project's two major construction taxes, and provide a 50% reduction in a project's Parkland In-Lieu Fee. The second phase of the program will reduce a project's Inclusionary Housing Ordinance Fee to $0, provide a 50% reduction in a project's two major construction taxes, and provide a 30% reduction in a project's Parkland In-Lieu Fee.

Approval of the recommendation (d) above will also direct staff to explore and analyze potential mechanisms within the City's control to support the production of multi-family housing outside of the Downtown core, including public financing mechanisms.

BACKGROUND

The purpose of the Downtown Residential High-Rise Program (High-Rise Program) remains to support Downtown residential high-rise development to complement job growth, catalyze the use of transit, including future BART connections, and support retail uses. The High-Rise Program also intends to create a strong residential base to support the continued development of a vibrant city center. **Attachment A** shows the High-Rise Program area - the Downtown Planned Growth Area Boundary.

Recent versions of the high-rise program were approved in 2012, 2016, 2019, and 2022. The 2012 version included a Parkland In-Lieu Fee (Parks Fee) reduction and a reduction in the Building and Structures (B&S) and Commercial-Residential-Mobilehome Park Building (CRMP) construction taxes. The High-Rise Program was later expanded in subsequent iterations to include a reduction in the Affordable Housing Impact Fee in 2017 before the Inclusionary Housing Ordinance Fee was adopted in 2021, which replaced the Affordable Housing Impact Fee.

In 2017, a permanent reduction in the Parks Fee to $14,600/unit was adopted for Downtown residential high-rise development. With this new fee in place, a reduction in Parks Fee is no longer included in the current High-Rise Program. The 2017 High-Rise Program also included a reduction in the Affordable Housing Impact Fee and has since resulted in 890 units completed and 336 units currently under construction.

On November 5, 2019, the City Council accepted a report on Downtown residential high-rise feasibility. The City Council extended by resolution the deadline for the Affordable Housing Impact Fee exemption and directed staff to return with the appropriate resolutions to establish a $0 in lieu fee under the new Inclusionary Housing Ordinance for Downtown residential high-rise projects with annual increases starting in 2023 to transition to the full amount by June 30, 2025. City Council approved an ordinance creating 50% reductions of the B&S and CRMP construction taxes for eligible Downtown residential high-rise projects with a matching deadline of June 30, 2025.

On November 15, 2022, the City Council passed a resolution extending the High-Rise Program again, this time establishing a deadline for developers to pull building permits by June 30, 2025, and receive certificates of occupancy by June 30, 2028, in order to qualify for the $0 Inclusionary Housing Ordinance Fee reduction and 50% reduction in construction taxes. This is the High-Rise Program currently in place.

On October 26, 2023, the City Council held a Study Session[1] and received the latest report on the Cost of Residential Development prepared by Century Urban consultants[2]. The City Council memorandum summarizing this report is included in **Attachment B**. The October 2023 memorandum concluded that current economic conditions remain a significant barrier to the construction of new market rate and affordable housing within Downtown and Citywide. Construction costs and interest rates continued to rise significantly and remain the biggest barrier to new housing development throughout the Bay Area. The City Council heard a detailed presentation and had a follow-up question/answer session with a panel of experts on the topic. During this discussion, City Council members suggested the possibility of staff further analyzing options and additional steps that might support housing production outside of Downtown.

ANALYSIS

High-Rise Program

Since 2017, the City Council has approved nine High-Rise Project Completion Agreements. To date, two towers have been completed (The Graduate 260 units and Miro 630 units), and one tower is currently under construction (The Faye 336 units). Two additional projects have valid entitlements (The Carlysle and 27 West). Four projects had entitlements that expired in March 2024. There are currently 14 entitled high-rise projects in the Downtown Planned Growth Area, totaling 4,078 units. **Table A** outlines the project developer, project name, and number of units in the entitled project.

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[1] October 26, 2023, City Council Study Session: https://sanjose.legistar.com/MeetingDetail.aspx?ID=1126420&GUID=83F22B7C-A594-45F4-BF43-92E51BDEF837&Options=info|&Search=10%2f26%2f23

[2] Century | Urban [consultants] – "Cost of Development" – Conceptual Feasibility Analysis - https://sanjose.legistar.com/View.ashx?M=F&ID=12388875&GUID=10CF8DCD-BAF9-44F4-9892-5B53AB28103B

Table A. Currently Entitled Downtown Residential High-Rise Development

Developer	Project Name	Number of Units
Urban Catalyst	Echo (2022-11/2026)*	415
Urban Catalyst	The Mark (2021-10/2025)	240
Westbank	Energy Hub (2022-12/2026)	194
Westbank	The Orchard ("Bo Town") (2022-11/2026)	540
Acuity Realty	The Carlysle (2020-7/2024)	290
Brent Lee	SJSU Student Housing Tower (2023-10/2027)	298
ROYGBIV	19 North 2nd St (2023-3/2027)	220
ROYGBIV	Montgomery Plaza I (2022-12/2026)	126
Urban Community	420 South 2nd (2022-12/2026)	254
Westbank	Westbank Terraine (2022-11/2026)	345
Core Companies	Gateway Tower (2016 - 12/2024)	300
ROYGBIV	Montgomery Plaza II (2022-12/2026)	264
Nelly Amas	4th Street Metro Station (2024-3/2028)	218
Alterra Worldwide	27 West (2019-3/2025)	374
	Total # Units	**4,078**

*Year entitled - Month/Year most recent entitlement or extension expires

Market Rate Housing Infeasible in Downtown

The results from the Cost of Residential Development Report are summarized in **Attachment B** and were discussed by City Council during the October 2023 Study Session. The report evaluated three different building prototypes for construction: low-rise, mid-rise, and high-rise. The report concluded that Citywide, all three of the studied prototypes showed significant negative residual land values. In other words, when all the costs associated with development (i.e., planning, construction, and leasing/selling with the developer/investor's required return), no funds remain left to purchase land. The estimated dollar figure needed to make the various prototypes feasible is known as the "feasibility gap." The feasibility gap is shown to be the second highest in Downtown (with North San José slightly higher) for the high-rise building prototype, with a gap of $495,000 per unit for rental projects and $570,000 per unit on for-sale projects. The low-rise and mid-rise prototypes show a feasibility gap ranging from $323,000 to $435,000 in other parts of the City outside Downtown.

The report also included a "waiver" analysis that considered the effect of waiving the Inclusionary Housing In-Lieu Fee and reducing construction taxes by 50% on a project pro forma. While this resulted in decreased total costs and improved feasibility, residual values were still determined to be negative. When panelists attending the October Study Session were questioned in more detail regarding the possible benefit of reducing/waiving fees, several indicated that while a reduction in fees might not immediately trigger the feasibility of any individual project, fee waivers carry the potential to accelerate recovery and lead to construction start sooner on new projects.

Feasibility Study Compliance with San José Municipal Code

Chapter 14.10 of the San José Municipal Code sets "*Minimum Labor Standards for a Private Construction Project Accepting a City Subsidy*." Chapter 14.10 defines a subsidy to include any "*reduction, permanent suspension or exemption of any fee or tax"* that applies to single or multiple projects. Construction projects receiving a City subsidy are required to pay all workers employed on the construction prevailing wage rates, as well as subject to other provisions such as requiring apprenticeships and local hire, among others. There are exemptions to the definition of a subsidy that include the reduction of a fee or tax that is applied uniformly across all private construction projects within a specific subcategory of use, e.g., high-rise residential, when the City Council determines, based on specified criteria, that construction of the projects is not financially feasible. The specified criteria are as follows:

A. City Council must determine that a fee or tax reduction is not a subsidy supported by findings following a public hearing;

B. City Council's findings must be supported by the evidence presented at the public hearing, including a study analyzing whether construction within the subcategory of use is financially infeasible;

C. The financial feasibility study must be performed by a consultant qualified to provide real-estate analytic services selected and retained by the City using its normal procurement process;

D. City Council must use reasonable efforts to conduct the hearing within 90 calendar days following the completion of the financial feasibility study.

The October 2023 Cost of Development study addressed the required issues outlined below.

	Issue	*Consultant Analysis* (**Attachment C**)
a.	Whether construction of Private Construction Projects in the specified Subcategory of Use is Financially Infeasible.	*"The conceptual feasibility analysis indicates that none of the prototypes support positive estimated residual land value in any of the submarkets. These results suggest a challenging environment for ground-up residential development projects similar to the prototype projects in the selected submarkets."* (pg. 13)
b.	The reason(s) for any conclusion that construction of the Private Construction Projects in the specified Subcategory of Use is Financially Infeasible.	*"The conceptual analyses' findings indicate that similar to the findings in 2022, residential development economics are challenging under current market conditions. Since the last analysis was prepared, the cost of construction has continued to increase, while rising interest rates have increased capital costs, along with target returns for achieving feasibility. Rental rates and condominium sale prices have increased since the last analysis, but the magnitude of these increases is insufficient to offset the effect of higher development costs."* (pg. 2)
c.	The anticipated duration of any condition(s) making construction of the Private Construction Projects in the specified Subcategory of Use Financially Infeasible.	*"Engineering News Record and TBD Consultants publish indices which track construction costs quarterly in the Bay Area. Both indices reflect major increases in cost since 2014 and even more significant increases since 2020. Since 2014, the total increase has been over 200%. Between the first quarter of 2020, when the COVID-19 pandemic began, and the second quarter of 2023, the latest available data, TBD Consultants estimates an increase of 27%. To a limited extent, these hard cost increases have been offset by rental rate and sale price growth, but construction cost growth has outpaced rental rate and sale price growth."* (pg. 14)

	Issue	*Consultant Analysis (***Attachment C***)*
d.	The estimated size of the financial gap between the Private Construction Projects in the specified Subcategory of Use being Financially Infeasible and financially feasible.	The report shows a negative land residual of $495,000 per unit for rental projects and $570,000 per unit on for-sale projects in Downtown.
e.	Options for making the construction of the Private Construction Projects in the specified Subcategory of Use financially feasible, including the following: i. Providing the proposed fee or tax reduction without requiring the payment of prevailing wages; ii. Providing the proposed fee or tax reduction along with requiring the payment of prevailing wages; and iii. Any additional options, other than the proposed fee or tax reduction, that would make the construction of the Private Construction Projects within the specified Subcategory of Use financially feasible, provided that any such options must comply with all applicable laws and regulations, including the City's current General Plan.	*"To provide additional context, sensitivities were prepared to analyze the potential effect of 5% variations in hard costs, soft costs, rental rates, and sale prices by construction type. The results of these sensitivity analyses, which are summarized in Exhibit C, indicate that 5% improvements in hard costs, soft costs, rental rates, and sale prices do not bridge the feasibility gap for any of the prototypes."* (pg. 16)
f.	The consultant's preparation of the required study will include the opportunity for stakeholder input.	Meetings with development community members were held on September 28 and October 12, 2023. A draft version of the report was shared with participants at these meetings.

Staff has made every effort to bring forward recommendations regarding the High-Rise Program within the prescribed 90-day window. However, due to the complexity of this conversation, the multitude of objectives to consider, and the extent of the necessary analysis, it was not possible to arrive at a High-Rise Program recommendation earlier than this time.

Recommended Adjustments to the High-Rise Program

In alignment with the City Council's "Attracting Investment in Jobs and Housing" Focus Area, the Community and Economic Development Core Service Area priority is housing production. The fees associated with housing production support multiple City objectives, including park and

trail improvements, maintaining and upgrading transportation infrastructure, regular upkeep of public facilities, and attracting and retaining competent staff. Trying to address these several important objectives at once adds costs that contribute to making housing too expensive to build in current economic conditions. The cost for City permits and fees is approximately nine percent of the total project cost per unit for high-rise rental developments in Downtown. Within the cost structure of City permits, inclusionary housing fees account for approximately 60 percent of the expense, Parks Fees are approximately 20 percent, construction taxes are close to 10 percent, and City permit costs are the remaining 10 percent.

Based on the results of the analysis in the Cost of Development Report, staff recommends continuing the waiver of the Inclusionary Housing In-Lieu Fee, a more significant reduction in construction taxes, and a reduction in Parks Fees to spur high-rise housing production in the City's urban center. The proposed High-Rise Program parameters are outlined in **Table B** below compared to the current High-Rise Program.

Table B. Current vs. Proposed High-Rise Program

	CURRENT PROGRAM	**PROPOSED PROGRAM**	
HEIGHT / BUILDING TYPE	150 feet / 10 stories	150 feet / 10 stories	
GEOGRAPHY	Downtown Planned Growth Area	Downtown Planned Growth Area	
INCLUSIONARY HOUSING	$0 in-lieu fee	<u>Phase 1</u> $0 in-lieu fee	<u>Phase 2</u> $0 in-lieu fee
CONSTRUCTION TAXES	50% reduction of CRMP and B&S	<u>Phase 1</u> 100% reduction of CRMP and B&S	<u>Phase 2</u> 50% reduction of CRMP and B&S
PARKS FEES	Not included - special category for high-rise is $14,600/unit *(able to reduce up to 50% with private recreation credits)*	<u>Phase 1</u> 50% reduction - $7,300/unit *(private recreation credits up to 50% against the reduced fee allowed, resulting in a reduction to $3,650)*	<u>Phase 2</u> 30% reduction - $10,220/unit *(private recreation credits up to 50% against the reduced fee allowed resulting in a reduction to $5,150)*

PROGRAM HORIZON	Building permit by June 2025 Certificate of Occupancy by June 2029	Phase 1 1,000 units with building permit issued by December 31, 2025, and first inspection passed within 12 months of building permit issuance.	Phase 2 Up to 3,078 units with building permits issued in the 12 months following Phase 1, and the first inspection passed within 12 months of building permit issuance *(January 1, 2026 - December 31, 2026)*.
TIMING OF PAYMENT	Taxes at Certificate of Occupancy Parks Fees at permit issuance	Taxes and Parks Fees at Certificate of Occupancy or five years from the date a building permit is issued, whichever is sooner.	

This more substantial reduction or waiver of impact fees for the High-Rise Program will reinforce the City's intention to do what it can to encourage high-density development that adds new housing units, increases tax revenue and transit use, fosters vibrancy, and minimizes the City's carbon footprint in its urban core. While City fees are not the sole reason for development infeasibility, they are a contributing factor that is within the City's control. Given the results of the latest high-rise feasibility analysis, it is important that no additional costs be added to the new high-density development Downtown and that the City proactively supports housing production in the city center. In addition to contributing to the vibrancy and economic success of the area, new high-rise developments will deliver more residential capacity consistent with the City's Housing Crisis Work Plan and stated Regional Housing Needs Assessment goal of producing 62,200 units of housing by 2031.

It is important to note that careful consideration was given to formulating staff recommendations given the City's multiple objectives. Significant concerns were weighed against the need to spur high-rise housing production, including loss of revenue to mitigate impacts of new development and deferred infrastructure and maintenance (parks); the reduction in construction taxes available to fund projects and staff in the Capital Improvement Program as well as funds to match external transportation-related grants; and the continued waiver of production of affordable housing.

Deeper fee reductions were initially contemplated (e.g., a 100% reduction in Parks Fees in Phase 1 and a 75% reduction in construction taxes in Phase 2) but were revised after assessing the impacts these reductions might have on the City's ability to deliver services and park improvements. Staff believes that the proposed two-phase High-Rise Program, with an overall timeline of 30 months and a cap on the number of units that qualify for substantial reductions in

impact fees and construction taxes, achieves the necessary balance of reducing development costs within the City's control while still maintaining an acceptable level of staffing and commitments to transportation, housing, and parks.

While a waiver or reduction in impact fees is the most significant financial lever the City controls, there are other ways in which the City can facilitate the production of high-rise housing Downtown. For instance, the City currently requires a Local Transportation Analysis for new development projects; in areas like Downtown with an adopted comprehensive transportation plan, staff is exploring streamlining that analysis to focus on safety and site circulation practices, with other transportation needs already identified in the comprehensive plan.[3] Staff anticipates bringing a recommendation to City Council in fall 2024. Also, Planning, Building, and Code Enforcement Department staff continue to focus on how to effectively facilitate coordinated review of major development projects through the permitting process. Developments in the High-Rise Program will continue to be a priority for Building Division staff, and the Development Services team will work to ensure that the City's process is not a barrier to projects moving forward.

City Council Approval Required for Fee Waivers

In 2014, the City Council adopted Resolution No. 77135, which requires that a public hearing be conducted for any fee waiver over $1,000,000 and that notice of such public hearing be in the form of a memorandum addressed to the City Council posted on the City's website 28 calendar days in advance of the City Council meeting at which a fee waiver is to be considered. The resolution requires that the staff memorandum contain detailed information about cost and implications. In addition, California Government Code Section 53083 (Assembly Bill 562) was enacted in 2014 which requires local agencies to provide specified information to the public before approving a fee waiver over $100,000. Staff will also include subsidy information pursuant to California Government Code Section 53083 in the aforementioned City Council memorandum in conjunction with a required Project Completion Agreement.

Policy Alternative

Alternative: Remove the timeframe of 18 months for Phase 1 and 12 months for Phase 2 and provide tiered tax and fee waivers and reductions based on the number of units developed – up to 1,000 units for Phase 1 and 3,078 additional units for Phase 2.

***Pros*:** Removing the timeframe in which development must obtain its building permit to be eligible for the fee and tax waivers and reductions offered in the High-Rise Program maximizes the opportunity for 4,078 units of high-rise housing to be developed. Removing the timeframe allows more time for other contributing economic factors outside of the City's control, such as interest rates, labor and materials costs, and achievable rents to achieve levels that are favorable to triggering development.

[3] The City's Downtown Transportation Plan was adopted in November 2022 and established key transportation priorities, programs, and infrastructure needs.

***Cons**:* Removing the proposed High-Rise Program timeframe prolongs the period in which little or no revenue is generated by the City and, in turn, places continued pressure on the City's ability to deliver programs and services at a time when the affected funds are already falling short. Another potential drawback of removing the proposed High-Rise Program timeframe is that it may lead to a less predictable schedule for City planning and resource allocation.

Reason for not Recommending: Staff recognizes that fees and taxes are only two of the many factors impacting development feasibility and has therefore sought to balance fee and tax waivers and reductions with the need to maintain sufficient staffing levels and continue to provide sufficient programs, services, and infrastructure maintenance. Without the recommended timeframes, staff is concerned that the revised High-Rise Program would not incent development enough to get projects under construction quickly in line with policy goals. Removing the High-Rise Program timeframe could also potentially create challenges in budget forecasting and project coordination and may hinder staff's ability to effectively manage and monitor the progress of development projects.

Consideration of a Citywide Multifamily Housing Support Program

As part of the Cost of Development Report, the consultant assessed the feasibility of low-rise, mid-rise, and high-rise development in the south and east, central, west, and north submarkets of San José. The results showed that multifamily residential development is currently infeasible.

Councilmembers comments and questions to staff at the October 2023 Study Session suggested an interest in exploring levers within the City's control that could be adjusted to assist housing production throughout San José. At this time, staff seeks to confirm the City Council's desire to identify potential programs and process improvements that might support the production of new housing throughout the City until outside market conditions change. If so, staff seeks City Council direction to analyze options and study the impacts of any such potential programs. Staff recommends analyzing options and impacts around the following program components:

- Geography of project;
- Project entitlement/application status;
- Project density;
- Term of program;
- Performance metrics;
- Fees/construction taxes/park impact fees,
  Inclusionary Housing Ordinance
  Construction Taxes
  Parkland Dedication and Park Impact Ordinances;
- Timing of payment; and
- Alternative financing mechanisms.

Analyzing the potential impacts of a residential program outside of Downtown seems prudent at this time as new residential development of all densities and throughout all areas of the City have been determined to be infeasible under current market conditions.

EVALUATION AND FOLLOW-UP

The City Manager's Office of Economic Development and Cultural Affairs staff will ensure that each project that receives the High-Rise Program benefits will have an executed Project Completion Agreement. Housing Department staff will track the number of units that are in the High-Rise Program and will coordinate closely with Building Division staff to track when a building permit is issued on a specific project in the High-Rise Program. Staff will provide a High-Rise Program status update to City Council in August 2025.

If City Council directs staff to study the potential expansion of a housing production support program Citywide, staff will conduct analysis and stakeholder engagement meetings from August to October 2024. Staff intends to return to City Council by December 2024 with the results of this work and seek further direction on which components to include in an expanded program.

COST SUMMARY/IMPLICATIONS

The full fiscal impact of the proposed High-Rise Program will not be completely understood until development moves forward in the construction process because the development of 4,078 units can be achieved through a combination of different projects. Pursuant to California Government Code Section 53083, the City must disclose information related to any fee waiver over $100,000 through a public hearing, and pursuant to City Resolution No. 77135, must also disclose any fee waiver over $1,000,000 through a public hearing. These disclosures must include detailed information on the estimated total amount of expenditure of public funds or revenue lost, and project tax revenue resulting from the project. Staff will bring back these disclosures for individual projects in conjunction with the required Project Completion Agreement.

The Inclusionary Housing Ordinance In- Lieu Fee for any residential developments adding 20 or more units is $49.99 per square foot per rental unit in Strong Market Areas and $28.81 per square foot for for-sale units. Although these changes would result in fewer fees collected on the high-rise developments, these fees are already considered foregone under the current High-Rise Program and are not included in budget projections or in the Five-Year Affordable Housing Investment Plan.

The B&S Construction Tax is based on the valuation of the building at a tax rate of 1.54% for residential. The CRMP Construction Tax is also based on building valuation at a rate of 2.42% for residential. The construction taxes fund a significant portion of the Traffic Capital Improvement Program. Although these changes would result in less tax revenue collected on the high-rise developments, these revenues are not included in projections included in the 2025-2029 Proposed Traffic Capital Improvement Program.

The current Parks Fee obligation for new Downtown development is $14,600 per unit. All new developments can qualify for up to a 50% reduction in their Parks Fee obligation by providing on-site recreational amenities. A 20-25% fee reduction is typically achieved by providing on-site amenities. Parks Fee collections are budgeted on an annual basis. None of the 14 currently entitled high-rise projects are included as potential revenue in 2024-2025. However, Parks, Recreation, and Neighborhood Services Department staff does depend on estimates of future collections to pair long-term planning and park construction efforts with funding needs.

Conservative valuation estimates on currently entitled high-rise projects show that each would result in approximately $600,000 in annual revenue to the City in taxes alone (property tax, utility user tax, business tax, and on-site sales tax), notwithstanding the additional indirect revenue generated through the purchase of goods and services in Downtown by each new resident living in these developments.

PUBLIC OUTREACH

In addition to public commentary received at the Cost of Development Study Session on October 26, 2023, staff held meetings to discuss an extension and possible expansion of the High-Rise Program with labor community leadership on November 15, 2023 and the development community on December 14, 2023. In addition, staff held two stakeholder outreach meetings with transportation, housing, and park advocates on February 29, 2024 and May 29, 2024 and met with labor community leadership on May 28 and 31, 2024. Staff also agendized the High-Rise Program at the Developers and Construction Roundtable meeting on May 23, 2024 and will hold an online question and answer session with developers who have entitled Downtown high-rise developments on June 3, 2024. This memorandum will be posted on the City's Council Agenda website for the June 11, 2024 City Council meeting.
An update on this policy recommendation will be shared with the Housing and Community Development Commission and the Parks and Recreation Commission, as a part of the Directors' Reports.

COORDINATION

This memorandum has been coordinated with the City Attorney's Office and the City Manager's Budget Office.

COMMISSION RECOMMENDATION AND INPUT

No commission recommendation or input is associated with this action. An update on this policy recommendation will be shared with the Housing and Community Development Commission and the Parks and Recreation Commission, as a part of the Directors' Reports.

CEQA

Not a Project, File No. PP17-008, General Procedure and Policy Making, resulting in no changes to the physical environment.

PUBLIC SUBSIDY REPORTING

This item does not include a public subsidy as defined in section 53083 or 53083.1 of the California Government Code or the City's Open Government Resolution, however staff in the City Manager's Office of Economic Development and Cultural Affairs will bring forward each eligible high-rise project for their required individual public hearing in accordance with City Council Resolution 77135 and California Government Code Section 53083.

/s/
NANCI KLEIN
Director, Office of Economic Development and Cultural Affairs

/s/
JON CICIRELLI
Director, Parks, Recreation, and Neighborhood Services Department

/s/
CHRIS BURTON
Director, Planning, Building, and Code Enforcement Department

/s/
JOHN RISTOW
Director, Department of Transportation

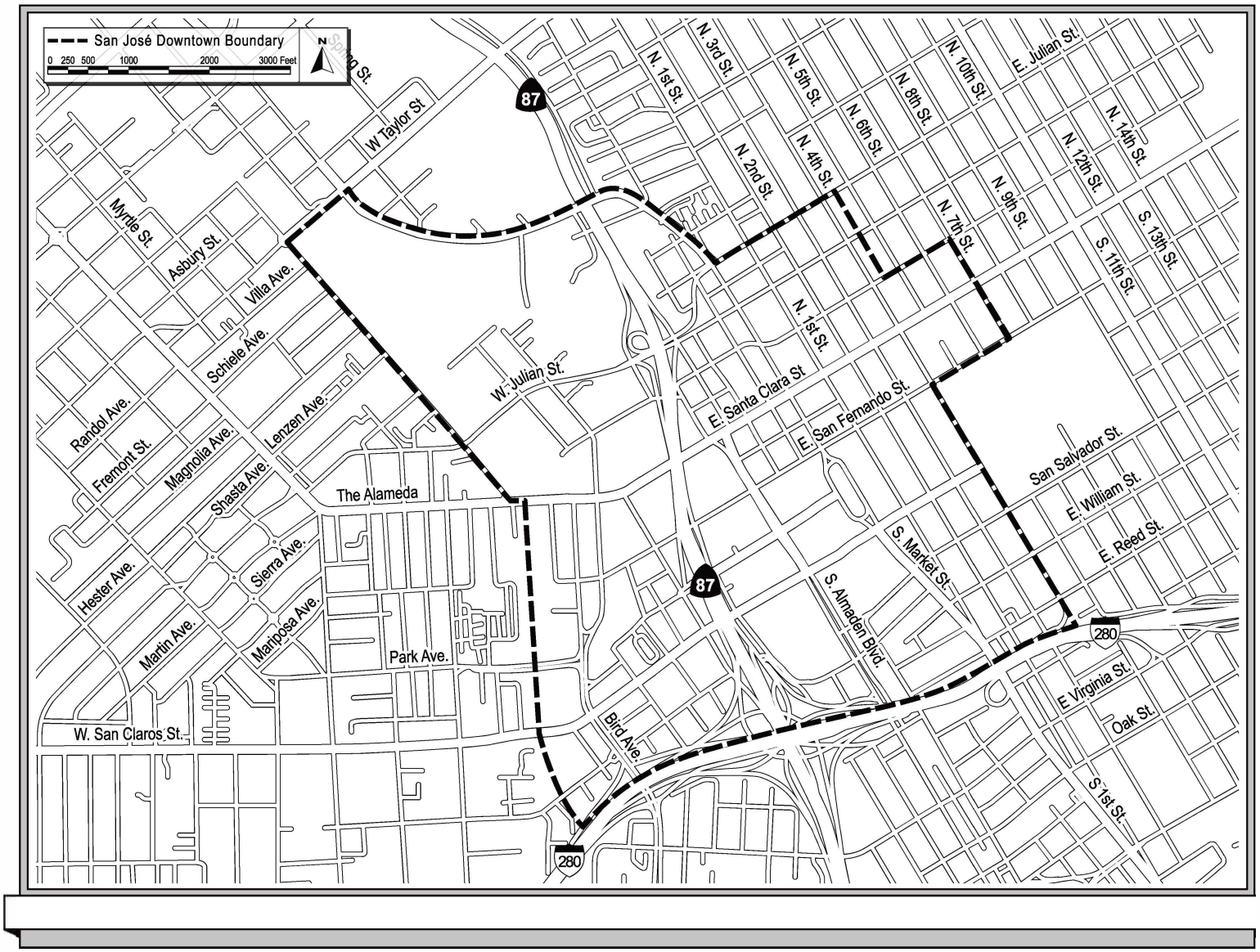
/s/
ERIK L. SOLIVAN
Director, Housing Department

For questions, please contact Blage Zelalich, Deputy Director, or Joe Sordi, Development Facilitation Officer, City Manager's Office of Economic Development and Cultural Affairs at blage.zelalich@sanjoseca.gov or (408) 535-8172 or joe.sordi@sanjoseca.gov or (408) 535-7903.

Attachments:

Attachment A: Downtown Planned Growth Area Boundary and Downtown Core Area Boundary
Attachment B: Council Memorandum on Cost of Residential Development from City Council Study Session October 26, 2023
Attachment C: Cost of Development by Century | Urban

Attachment A: Downtown Planned Growth Area Boundary and Downtown Core Area Boundary



CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: HONORABLE MAYOR AND CITY COUNCIL

FROM: Christopher Burton
Rosalynn Hughey
Nanci Klein

SUBJECT: SEE BELOW

DATE: October 19, 2023

Approved Jennifer A. Maguire

Date **10/20/2023**

SUBJECT: COST OF RESIDENTIAL DEVELOPMENT IN SAN JOSE STUDY SESSION

PURPOSE

The annual Cost of Residential Development Report (Report) and the Study Session are intended to provide City Council with insight into the economics of residential development, one of the primary challenges impeding the construction of new housing in San José. The Study Session will provide City Council with an update to the Report presented at the November 1, 2022 Study Session. The Report is comprised of two sets of analyses produced with the assistance of a consultant that evaluates the total cost of residential development in San José for market-rate and affordable housing.

OUTCOME

The Report provides an analysis of the impact of market and economic conditions on the cost to construct new market-rate and affordable housing in San José. City Council will hear a presentation from consultant Century | Urban on the findings of the updated Report, as well as insights from local industry experts in the fields of construction, real estate, financing, and affordable housing development.

BACKGROUND

In 2017, City Council directed staff to convene a City Council Study Session to discuss the aggregate impact of the fees and policies the City imposes on housing development and construction. The goal of the Study Session was to provide context and background for upcoming development-related items to be considered by City Council.

In 2018, City Council held two Study Sessions on April 26 and May 1 on the cost of residential development in San José that provided an overview of the local real estate market and residential development. Members of the Urban Land Institute provided a detailed summary of development financing and the impact of various City costs and policies on the viability of projects. Keyser Marston and Associates provided a detailed report, including a conceptual pro forma analysis for market-rate residential development based on the current market conditions in San José. The analysis in 2018 showed that new residential development was unlikely in many parts of San José based on economic conditions. The most likely area for new residential development was in West San José and development in Downtown and North San José had some potential.

In 2019, staff presented an update on the cost of residential development to City Council. This update found similar results as the 2018 study, suggesting that development remained feasible in West San José. Development in Downtown and North San José was again marginal and did not obtain a sufficient return to attract investment. Other areas of the City returned a negative value and were not possible. The 2019 update also included an additional analysis prepared by Keyser Marston and Associates on affordable housing.

In 2021, staff conducted a Request for Proposal and selected a new consultant to perform the work required to update the annual analysis. Century | Urban was selected as the consultant and the work to update the analysis with the consultant was initiated in early 2022. Century | Urban prepared a conceptual feasibility analysis for five residential rental and sale development prototypes most regularly seen in San José. The updated analysis revealed that none of the examined prototypes were feasible largely due to a 17% increase in Bay Area construction costs since the last analysis was completed, as well as a rise in interest rates and borrowing costs.

In 2023, the Report continues to show numerous challenges in developing both market-rate and affordable housing in the City. According to Century | Urban, average total development costs per unit, including the cost of materials and labor, increased 12% to 13% over the past 18 months and continue to be the most significant barrier to new housing construction. The recent experience in the City aligns with the Report findings in that 2023 new construction multifamily projects reported higher than anticipated funding gaps due to notable increases in their total development costs. Residential development in the City continues to face significant barriers related to increased costs of construction and financing.

ANALYSIS

The continued updates to the Report are an important tool for understanding the barriers to new housing construction. In particular, the updates provide a more detailed understanding of the factors both outside and within the City's control that impact the feasibility of residential development. These factors can contribute to the City's ability to deliver on its housing goals. As was the case in previous iterations, the analysis from the most recent Report continues to paint a bleak picture for future residential development in San José. Construction costs, despite a brief pause early in the pandemic, have continued to rise significantly and remain the biggest barrier to housing development in the City. This is a factor that the City has limited control over. On the other hand, City fees and the approval process for new developments are areas within the City's control to change.

New housing development for both market-rate and affordable housing is dependent upon private capital investment. From the start of the process, a developer will compile data based on estimated costs balanced against the estimated income that a new project will generate once completed. This model is referred to as a development "pro forma." It is created individually by a developer early in the development process and is refined as the project moves along in the process. The pro forma is an important part of the decision-making process as the model will show whether the proposed project is both financially feasible and a worthwhile investment for private capital. The data and assumptions included in a specific pro forma for market-rate development are typically treated as proprietary to that developer or investor and are not shared with the City or the public.

Cost of Residential Development Report: Market-Rate Housing

The Report is intended to provide insight into the current economic conditions impacting residential development. Each individual project or deal is unique, complex and often spans many years. To provide a measure of the feasibility of residential development at any given time, the Report uses conceptual prototypes. These prototypes do not represent specific projects but rather reflect the typical characteristics of development that have occurred in the City in recent years and that are considered in each of the sub-areas by the *Envision San José 2040 General Plan* (General Plan). The prototypes used in this update are unchanged from the previous Reports. In general, they remain reflective of the types of development the City has seen for new multifamily housing. In addition, keeping the prototypes consistent allows for an easier comparison of the results of this study to those of the previous studies.

The Report looks at market-rate for-sale and rental multifamily housing development in three different prototypes: a five-story low-rise building, a seven-story mid-rise building, and a 22-story high-rise building. It is important to distinguish these types of development as each requires a different type of construction, which means different materials are used in the construction of the buildings. These material types affect the cost of construction. In general, the types of construction become more expensive the higher the building height. These prototypes are analyzed in several different submarket areas.

The majority of new residential development considered in the General Plan is planned for densities higher than are currently found throughout the City. While much of the housing throughout San José is at lower densities (primarily single-family homes), the long-term strategy outlined in the General Plan is to provide opportunities for high-density housing to maximize the number of new units constructed and to meet the City's housing goals. The Report is intended to highlight current market conditions that present challenges to delivering the housing envisioned in the General Plan and, therefore, uses high-density housing prototypes as a basis for the analysis.

Through these conceptual prototypes, the consultant, Century | Urban, created a development pro forma that analyzes each prototype's feasibility based on the current market conditions. The prototypes and the associated assumptions are detailed in the Report and included in **Attachment A**.

Defining Residual Land Value

The Report uses standard assumptions and developer insights to create the underlying feasibility model. In this analysis, the measure of feasibility is Residual Land Value, which is the amount of value remaining to purchase land once projected revenues and all other costs associated with planning, constructing, and leasing/selling the project have been accounted for. These costs also include an expected return on investment for the developer and other investors consistent with industry standards that are used by both the development and investment communities to make decisions on where to focus projects and investments. When comparing relative development activity between San José and other cities around the state or even nationally, the level of feasibility or return is ultimately the measure by which decisions on which projects to pursue and move forward are made. A positive residual value indicates the development could pay up to a specific price for land and still be considered feasible. A residual value that is zero or negative indicates a development that is infeasible as there is no remaining value to purchase land.

The results in the Report are based on conceptual prototypes and not on specific projects. The Report provides a macro view of development feasibility in the City. This does not necessarily mean that individual projects will not start. Specific projects may have unique circumstances that enable them to move forward in the current conditions.

Market-Rate Housing Development Remains Infeasible in Any Area

The results from the Report are included in **Table A and Table B** below. To summarize, all prototypes show significant negative residual land values. This means that even before accounting for the purchase of land, the cost to construct the building is infeasible. The residual values shown are on a per unit basis. The locations are based on the Development Fee Framework/Inclusionary Housing Ordinance submarket areas. Downtown is a subsection of the Central area, and the south and east are composed of multiple areas in the southeast part of the City. Not all prototypes were tested in all locations, and cells on the table with *NA* (not applicable) indicate locations that were not tested.

Table A: Residual Land Values for Market-Rate Rental Housing by Size and Location (per unit)

Rental Prototypes /Location	**Low-Rise (5 stories)**		**Mid-Rise (7 stories)**		**High-Rise (22 stories)**	
Year	***2022***	**2023**	***2022***	**2023**	***2022***	**2023**
Central	*($257,000)*	($343,000)	*($338,000)*	($435,000)	*($498,000)*	($614,000)
West	*NA*	*NA*	*($216,000)*	($363,000)	*($376,000)*	($542,000)
Downtown	*NA*	*NA*	*NA*	*NA*	*($432,000)*	($568,000)
North	*NA*	*NA*	*($317,000)*	($429,000)	*($476,000)*	($607,000)
South and East	*($261,000)*	($323,000)	*NA*	*NA*	*NA*	*NA*

Table B: Residual Land Values for Market-Rate For-Sale Housing by Size and Location (per unit)

For Sale Prototypes/ Location	Low-Rise (5 stories)		High-Rise (22 stories)	
Year	***2022***	**2023**	***2022***	**2023**
Central and West	*($307,000)*	($394,000)	*NA*	NA
Downtown	*NA*	NA	*($518,000)*	($611,000)
North	*($369,000)*	($419,000)	*NA*	*NA*
South and East	*($394,000)*	($342,000)	*NA*	*NA*

**The sales comparable data for the south and east submarkets showed a marked improvement in the sales price per square foot as compared to the sales comparable data for the 2022 study.*

Estimated Land Costs

Century | Urban also provided a land cost estimate based on location to provide context to the residual land values. Land prices estimated by the consultant (**Table C**) range from $25,000 to $85,000 per unit, depending on the geographic area. Due to limited land sale transactions for multifamily residential developments since the 2022 analysis, land values are estimated to be the same as the prior year's analysis.

Table C: Land Cost Estimates by Geographic Area

Land Prices Per Unit	South and East	Central	West	North	Downtown
Low	$40,000	$40,000	$65,000	$25,000	$25,000
High	$65,000	$65,000	$75,000	$85,000	$85,000

Construction Costs Remain a Barrier to New Development

The consultant also conducted a sensitivity analysis as part of the Report (**Exhibit C** in **Attachment A** to this memorandum) that looked at the impacts of various changes to multiple feasibility factors. For example, the sensitivity analysis included a 5% increase or decrease in rental rates, or a 5% increase or decrease in construction costs, etc. In all scenarios analyzed, the residual values did not shift to positive values that indicate feasibility. In all cases, the per unit residual values remained at significant negative levels. The largest improvement in feasibility was with a 5% reduction in construction costs. This analysis further shows the significant challenges faced in the current economic conditions for new market-rate construction and reinforces the major hurdle of construction costs.

In addition, two versions of Type I (high-rise) rental and sale prototypes are included –one version, which reflects standard City requirements for payment of an inclusionary in-lieu fee and construction taxes, and a "waiver" version, which reflects a waiver of payment of the inclusionary in-lieu fee and 50% reduction of select construction taxes.

Challenges to Provide Much-Needed Housing

The findings of this updated Report continue to point to an extremely unfavorable development climate throughout San José and, to some extent, the wider Bay Area. Development feasibility has decreased significantly for almost all of the proformas analyzed in the report and throughout all sub-areas.

Commercial real estate requires a balance between the costs associated with entitling, financing, and constructing a project and the total supportable cost realized in revenues from the lease or sale of units upon completion. A considerable number of variables go into each side of this equation but ultimately, if the balance is tipped towards infeasibility the project will be unable to obtain the financial resources necessary to proceed with the project. Several factors continue to impact this balance for residential development throughout San José but the primary amongst them continues to be construction costs, including the cost of materials and labor, which have continued to increase significantly since the start of the pandemic. The Report cites the Engineering News Record and TBD Consultants, both of which publish indices that track construction costs quarterly in the Bay Area. Both indices reflect major increases in cost since 2014 (over 200%) and even more significant increases since the first quarter of 2020 (up to 27%). While San José has experienced some rental rate and sale price growth over the same periods, construction cost growth has significantly outpaced both.

In addition to these "hard cost" increases, financial conditions for borrowing as well as services and City fees (soft costs) have significantly impacted development proformas. Increases in interest rates and borrowing costs driven in part by inflation and corresponding policy reactions have caused a decrease in market transaction volume and the availability of capital for construction projects. In addition to the cost of financing projects, the risk profile for new development has changed significantly. In addition to representing the required return developers expect from a potential project, the Return on Cost metric is often also used in assessing the viability of new projects by financial institutions considering construction loans. The Report assumed a Return on Cost of 5.75%, which already reflects an increase over the assumed Return on Cost in the 2022 Report, but subsequent discussions with members of the development community suggested that financial partners and lenders are targeting an even higher Return on Cost of 6.5%. The volatility of the current market and increased uncertainty of the economic outlook moving forward also create additional challenges.

Beyond the soft costs associated with entitlement and construction, multiple developers raised concerns about ongoing operating costs such as increasing insurance rates that have had a significant impact on baseline assumptions. Diminished net operating income would further impact supportable development costs, which in turn further diminishes feasibility.

City Fees and Taxes

There are a variety of City fees associated with processing development applications. Due to the "cost recovery model' of development services operations, applicants pay fees to several departments, including Fire, Planning, Building, and Code Enforcement, and Public Works. These fees pay directly for staff and the cost to the City to process and review the project. These fees represent less than 1% of the total cost per unit. There are also fees associated with public improvements such as sanitary sewer connection fees or street frontage improvements, among others. The largest component of City costs comes from inclusionary (affordable) housing in-lieu fees, parkland impact in-lieu fees, and construction taxes. Construction taxes, in general, fund transportation infrastructure, among other things, and are assessed based on the valuation of the new building. Parkland obligations for residential development can be satisfied through the dedication of improved or unimproved land, payment of an in-lieu fee, or a combination of both. The Report assumes a 25% reduction in parks fees for on-site recreational amenities. The fees and taxes included in the Report include a reduction based on average levels of credit for market-rate housing projects. Most qualifying affordable housing projects receive between 50% and 75% in park fee payment reductions. The City's inclusionary housing requirements can be fulfilled in a variety of ways including building new affordable housing units or through payment of an in-lieu fee.

Based on the data in the Report, these costs represent 5% to 10% of the total costs to build a unit (**Table D**). These numbers are marginal compared to the overall cost of the unit; however, they still add costs and contribute to the level of infeasibility. Reduction of these taxes and fees to zero would improve feasibility slightly, but would not fundamentally change the outcome of the analysis; more importantly, such elimination would also significantly reduce City resources necessary to support transportation infrastructure renovate and create new park infrastructure and support affordable housing and related grant-matching requirements that support all these programs.

It is important for staff and City Council to continue to understand the cost implications of all policy decisions in the near term that could add additional costs to new housing development or decrease potential future revenues that would otherwise support day-to-day City infrastructure. Any added costs would further contribute to the infeasibility of new market-rate construction.

Table D: City Taxes and Fees on a per Unit Basis

City Impact Fees and Taxes (rental)	Range per Unit	
Year	2022	2023
Planning/Building fees	$2,800 to $7,000	$3,100 to $7,700
Construction taxes	$6,400 to $6,800	$7,900 to $9,900
Parkland in-lieu fees	$9,800 to $20,800	$9,800 to $20,800
Inclusionary housing in-lieu fees	$21,000 to $49,600	$24,500 to $57,700
Total City Impact Fees and Taxes	**$40,000 to $84,200**	**$45,300 to $96,100**

Cost of Residential Development Report: Affordable Housing

Century | Urban also prepared a Report for the City regarding the recent impact of market conditions on the cost and feasibility of constructing affordable housing included in **Attachment B –** *Affordable Housing Development Cost Study*. The purpose of this study was to understand the changes in the cost of developing affordable housing within the City, the funding sources used to pay for such costs, and the unique attributes of affordable housing that contribute to its higher construction costs.

The study compared the cost of developing affordable housing in San José to similar costs in other large California cities. This study evaluated the period from March 2022 to February 2023 for eight projects in San José and 21 projects in other cities that received tax credit allocations during this period. These projects ranged in height from five to seven stories and proposed a large family, "Non-Targeted" or "Special Needs" housing type. Non-Targeted projects are projects with a geographic set aside rather than a target population set aside. Special Needs developments target individuals and families who are homeless or at risk of homelessness and need permanent affordable housing and supportive services. These types of developments provide supportive services to assist an individual or family retain their housing, improve their health status, maximize their ability to live, and, when possible, work in the community.

The study showed that the average cost per unit for all San José projects was 23% higher than the average cost per unit for other City projects, and notably, the average cost per unit for Special Needs projects in San José were 43% higher than the average cost per unit for Special Needs projects in other cities. Acquisition costs per unit were 33% higher for all San José projects than in other cities. **Table E** provides the total development cost, average per unit.

Table E: Total Development Costs, Average per Unit

	San Jose Projects	Other City Projects	San Jose Cost Difference
All Projects	$811,700	$658,800	23%
Large Family	$875,700	$727,000	20%
Special Needs	$925,600	$683,600	35%
Non-Targeted	$588,600	$553,700	6%

* This refers to the 21 projects in other cities studied in the report.

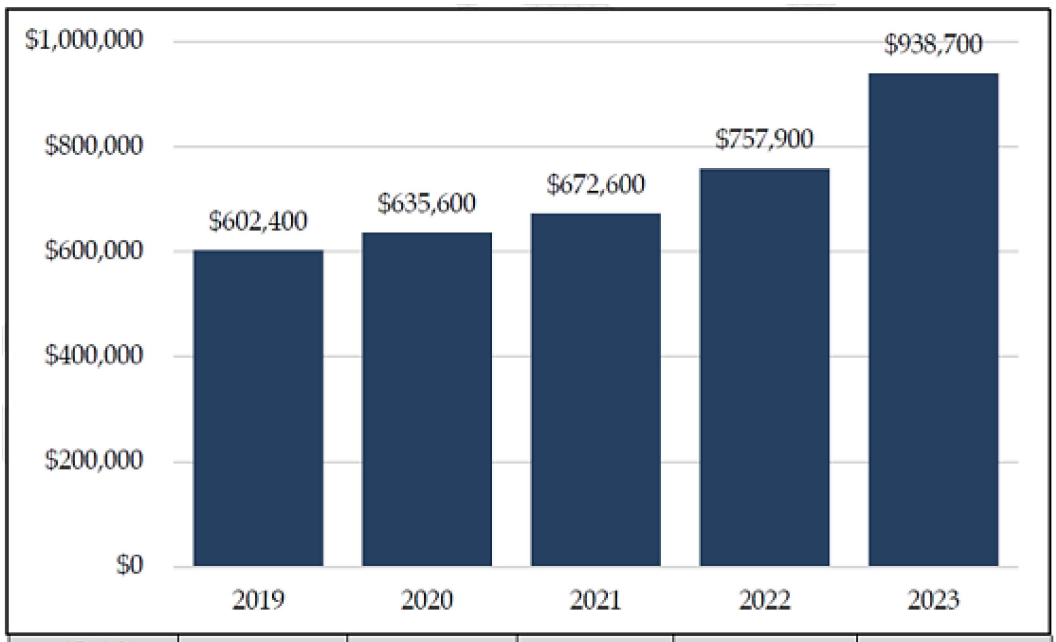
The findings summarized below outline the challenges and major cost factors that impact affordable housing developments in light of recent economic and market fluctuations, and demonstrate why the cost of affordable housing is more expensive in San José than in other cities.

General Trends

Escalation of Construction Cost

Similar to the findings from the market-rate study, construction costs have been a significant challenge for affordable housing development. Annual construction cost escalation averaged between approximately 8% from 2010 to 2020. While the increase was only 1% during the pandemic, 2021 showed a significant increase of 15% followed by an 8% increase in 2022 with major contributors being material and labor costs. This double-digit increase over an 18-month period led to per-unit costs for both large families and special needs units averaging around $900,000 per unit, which were 20%-35% higher than other cities. **Chart 1** provides the total development costs per unit by year.

Chart 1: San José Projects Total Development Costs per Unit by Year



YOY % Change	NA	6%	6%	13%	24%

Increase in Cost of Financing

Financing for affordable housing developments is more complicated in that it requires multiple sources of funding, not just equity and debt. Projects have to apply to at least five to six sources of funding, which on average can take two to three years to acquire as some federal and state sources offer only a single application round a year. In addition, obtaining tax credit allocations is a highly competitive process and demand is often double what is available. Due to inflation, the recent increase in interest rates from around 4% to 8% has had a significant impact on the cost of obtaining financing to cover affordable housing development costs. The length of time it takes to acquire multiple funding sources exposes the borrower to interest rate fluctuations and other variable costs before the close of financing following a tax credit allocation. Multiple funding sources also bring additional compliance, regulatory, and legal costs. More than 60% of

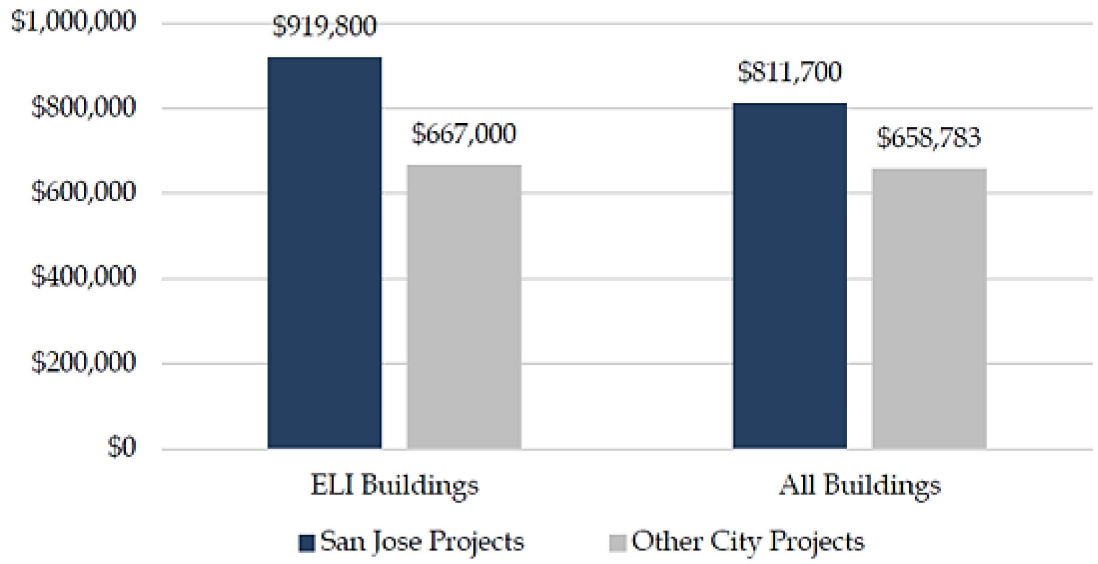
the construction financing is funded through a senior lender construction loan. Increases in interest rates drive up the cost of loans from banks. Affordable housing developments offer deeper affordability and generate lower rental income, making it difficult to meet the senior lender's debt service requirements. As a result, the developer obtains a smaller senior loan and, to cover the gap, seeks larger commitments from lenders willing to provide debt with lower interest rates, typically government lenders including the state, county, and the City.

The City of San José Versus Other Cities

Deeper Affordability Levels

San José developments provide deeper affordability, with approximately 75% of San José projects setting aside 50% or more units for extremely low-income households, in comparison to approximately 43% of other cities' projects. Development costs for extremely low-income buildings are higher, as shown in **Chart 2** below, due to the larger average unit size in these projects. Special Needs units in the City are 33% larger in square feet on average than in other cities. The larger average unit size accommodates the larger household size for extremely low-income units and Special Needs units.

Chart 2: Average Development Cost Extremely Low Income (ELI) Buildings Compared to All Buildings



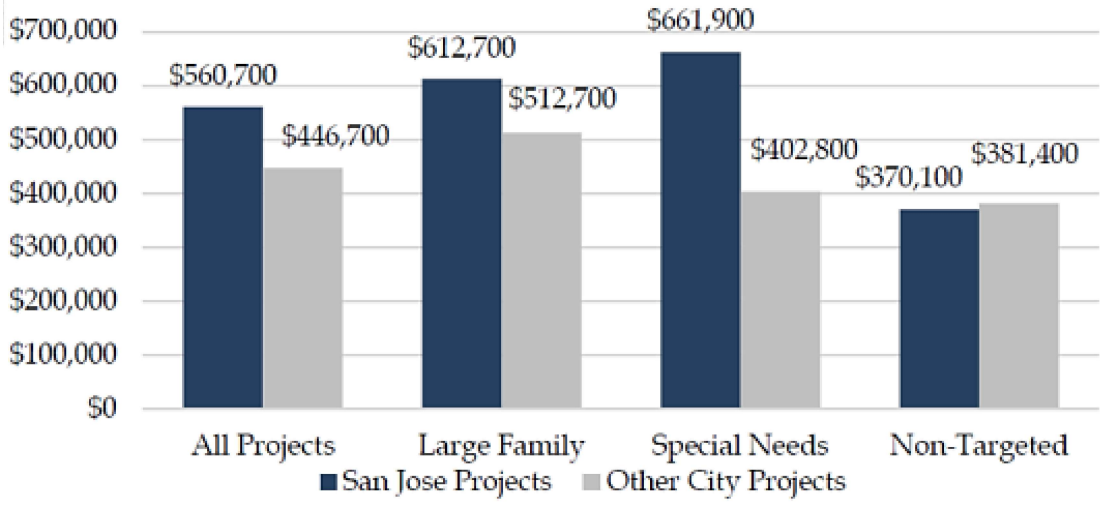
Higher Direct Construction Costs

Direct construction costs represent approximately 69% of total construction costs and have been increasing by 12% annually. The cost of labor and materials to construct buildings, site improvements and parking are higher in San José when compared to other cities. There is also a significant cost difference for Special Needs projects in San José compared to other cities. A shortage in the construction labor market and prevailing wage requirements applicable to San José projects result in higher direct construction costs for these projects. Many cities like San

José require that projects that receive City subsidies pay the prevailing wages set for by the state. However, not all cities have this requirement.

Table F: Total Direct/Hard Development Costs, Average/Unit

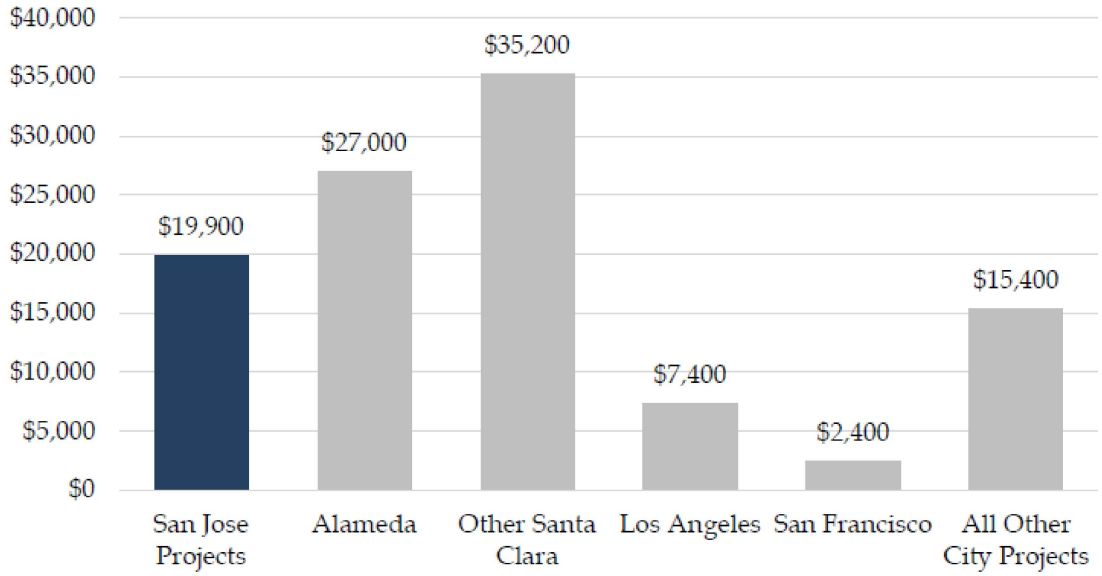
	San Jose Projects	Other City Projects	San Jose Cost Difference
All Projects	$560,700	$446,700	26%
Large Family	$612,700	$512,700	20%
Special Needs	$661,900	$402,800	64%
Non-Targeted	$370,100	$381,400	-3%



Higher Impact Fees

Cities impose impact fees and taxes, such as traffic impact, construction taxes, and parkland in-lieu fees, on new development to fund the infrastructure needed to support new housing. These charges can support important local services, such as schools, parks, and transportation. San José's impact taxes and fees averaged $20,000/unit versus $15,000/unit in other cities. As outlined in **Chart 3** below, projects in the City and County of San Francisco and the City of Los Angeles receive impact fee waivers that are proportionally higher than San José.

Chart 3: Impact Fees/Unit



A current work item in the Housing Crisis Work Plan is to assess reducing the construction taxes charged to affordable housing developments. Staff initiated internal discussions around this item, but due to staffing changes in the Housing Catalyst role, this work has been put on hold. As part of this work effort, staff will seek to understand how San José construction taxes compare to other jurisdictions.

Higher Financing Costs

Affordable housing projects are financed through multiple financing sources. Financing costs represent approximately 9% of San José projects and other City project's total development costs. It should be noted that financing costs have doubled in the past 12 months.

San José projects averaged approximately six funding sources per project. Each additional funding source potentially adds costs due to extended timelines and/or operational requirements. This layering of capital is causing long delays, which can add significantly to hard costs in a rapidly rising construction cost environment.

As projects become more complex, affordable housing developments also experience higher soft costs such as increased legal and consultant fees as well as syndication costs associated with financial consultants needed to manage multiple funding streams and partners. In addition, public funding in California can be highly fragmented creating a need to coordinate between state, county, and local funding sources. **Table G** provides the average financing cost per unit.

Table G: Average Financing Cost per Unit

Application Year	San Jose Projects	Other City Projects
2019	$30,700	$39,500
2020	$40,900	$34,800
2021	$43,600	$37,600
2022	$69,000	$53,000
2023	$103,800	$65,400

Lower Federal Equity Pricing

Affordable housing projects raise capital to fund development costs through investor equity, referred to as tax credit equity. An investor receives credits over a 10-year tax credit period. As the amount of tax credits available for allocation is fixed each year, the pricing of tax credits directly affects the number of units that can be financed through public funding sources. A lower tax credit price requires more state and local subsidies to fill financing gaps.

Some City of San José projects received equity pricing as low as 0.90 cents to the dollar in 2022-2023. Equity investments are a significant source of funding at the conversion phase when the construction is complete, and equity capital is injected into the project to take out the senior lender construction loan balance. When equity pricing and investment equity are lower, the development must procure additional subsidies to bridge the funding gap.

CONCLUSION

The updated Report shows that the current economic conditions remain a significant barrier to the construction of new market-rate and affordable housing. Similar to last year's Report, none of the prototypes assessed were shown to be feasible under current market conditions, and in fact, conditions have worsened. This is apparent in the current decline in permitting and construction activity throughout the City.

The affordable housing cost study identifies additional significant barriers to financing and building affordable housing developments. Total development costs for affordable housing continue to have material consequences for the supply of new affordable housing at a time when San José lacks enough affordable housing to meet residents' needs, with a severe shortage of adequate, affordable housing for extremely-low-, very-low-, low-, and moderate-income households.

EVALUATION AND FOLLOW-UP

Staff plans to update the report annually as part of its ongoing work on housing policy. The next update is anticipated in the fall of 2024. Staff will also continue to bring forward further analysis and recommendations regarding the impacts on development costs through the Housing Catalyst Work Plan and continued work on the Development Fee Framework.

PUBLIC OUTREACH

Meetings with development community members were held on September 28 and October 12, 2023. A draft version of the Report was shared with participants at these meetings. A meeting with affordable housing developers was held on October 4, 2023, to review the findings of the Cost of Affordable report and seek input. This memorandum will be posted on the City's Council Agenda website for the October 26, 2023, City Council Study Session.

/s/	/s/	/s/
CHRISTOPHER BURTON Director, Department of Planning Building and Code Enforcement	ROSALYNN HUGHEY Deputy City Manager and Acting Housing Director	NANCI KLEIN Director of Economic Development and Cultural Affairs

The principal authors of this memorandum are Banu San, Housing Planning and Policy Administrator, Housing Department; and Blage Zelalich, Deputy Director, Office of Economic Development and Cultural Affairs. For questions, please contact Banu San at banu.san@sanjoseca.gov or (408) 975-4489 and Blage Zelalich at blage.zelalich@sanjoseca.gov or (408) 535-8172.

ATTACHMENTS:

Attachment A – Cost of Development by Century | Urban
Attachment B – Affordable Housing Development Cost Study by Century | Urban

Attachment C – Cost of Development by Century | Urban

Century | Urban

Strategic Real Estate Advisory Services

Conceptual Feasibility Analysis

Presented to:

City of San Jose

October 18, 2023

235 Montgomery Street, Suite 629 | San Francisco, CA 94104 | www.centuryurban.com

CONCEPTUAL FEASIBILITY ANALYSIS

TO: City of San Jose, Office of Economic Development

FROM: Century Urban, LLC

SUBJECT: Conceptual Feasibility Analysis

DATE: October 18, 2023

CONFIDENTIAL AND PRIVILEDGED

Summary

The City of San Jose, Office of Economic Development (the "City") has engaged Century Urban, LLC ("Century | Urban") to prepare a conceptual feasibility analysis for five residential rental and sale development prototypes. The analysis is intended to update conceptual prototype feasibility analyses prepared in 2018, 2019, and 2022 to provide a perspective on the general development economics of high-density residential development in the current market and to fulfill the requirements of 14.10.310 of the San Jose Municipal Code (see Legislative Background below for additional detail). The prototypes are analyzed across a range of City submarkets, projects sizes, and construction types, among other factors.

The conceptual analyses' findings indicate that similar to the findings in 2022, residential development economics are challenging under current market conditions. Since the last analysis was prepared, the cost of construction has continued to increase, while rising interest rates have increased capital costs, along with target returns for achieving feasibility. Rental rates and condominium sale prices have increased since the last analysis, but the magnitude of these increases is insufficient to offset the effect of higher development costs.

The analyses conclusions are not intended to imply that every residential development is equally challenged in San Jose. Actual projects may differ from the prototype assumptions and may be less or more challenged.

Analysis Qualifications

The analysis referenced in this memorandum utilizes prototypical projects representing high-level average or median project types and high-level project assumptions prevalent at the time the analysis was prepared. Though there may be similarities, prototype projects do not correspond to any actual specific project or the actual economics of any particular development.

While prototypes were designed to represent actual or median projects, any given actual project may reflect different costs, rental rates, sale prices, or other details driven by the circumstances of that project such as its developer, history, site conditions, contractor, business plan, and/or other factors. Moreover, the criteria and assumptions utilized in selecting and analyzing the prototypes may be specific to the time during which the analysis was prepared and the research was conducted. Research was conducted and data was gathered for this report during the third quarter of 2023. Appropriate assumptions for the prototypes will likely evolve over time as market conditions change.

In 2023, residential real estate markets experienced a significant drop in transaction volume. CBRE projected in its mid-year 2023 that commercial real estate investment volume will drop 37% year over year in 2023, and Green Street Advisors estimated that transaction volume during the second quarter of 2023 was down approximately 50% compared with the same time last year. In some respects, this trend is mirrored in San Jose residential real estate; the City has seen limited new project starts, completions, and sales, as well as limited land sales for new development projects. As a result, certain analysis assumptions such as land prices and target returns are estimated based on the limited available data and incorporate qualitative feedback from market participants.

Legislative Background

This conceptual feasibility analysis has been prepared to analyze whether construction of Private Construction Projects within the residential Subcategory of Use is Financially Infeasible as specified in Section 14.10.310 of the San Jose Municipal Code, which specifies that A) the City Council must make a determination whether a fee or tax reduction is not a Subsidy, supported by findings, following a public hearing; B) the Council's findings must be based on evidence presented at the public hearing including a study on whether relevant Private Construction Projects are Financially Infeasible; and C) the financial feasibility study must be performed by a qualified consultant retained through the City's normal procurement process. The study must address a specific set of issues (see Exhibit E), and preparation of the study will include the opportunity for stakeholder input. The Council is also directed to use reasonable efforts to conduct the required public hearing within 90 calendar days following completion of the study. Capitalized terms used in this paragraph are defined in Chapter 14.10 of the San Jose Municipal Code.

Construction Types

The residential development prototypes to be analyzed fall into three common residential construction types: Type V, Type III, and Type I. Each of these construction types has multiple

subtypes and requirements specified by building code, but in general, the lower the construction type number, the greater the fire-life-safety requirements.

- Type V construction refers to a building type in which the interior and exterior structural materials of the building are permitted to be "combustible". This means that wood may be used as a core structural material in the building's design including for framing, walls, floors and roofs. Wood-framed construction is often used for single-family homes, as well as smaller apartment and retail buildings. Wood frame construction is often lower cost than other construction methods.
- Type III construction refers to a building in which exterior walls are "non-combustible" but other elements (framing, floors, ceilings) may be designed with combustible materials such as wood. Walls are typically constructed from concrete block, precast panels, or other non-combustible materials. This type of construction is generally used in larger apartment buildings, schools and other medium-sized commercial buildings.
- Type I construction refers to a building in which all structural materials are non-combustible. In a Type I building, walls, floors, and roofs are constructed with materials such as concrete and steel. This construction type is generally utilized with high-rise residential and commercial buildings and tends to be the most expensive of the three construction types.

In addition to limiting construction materials for each building type, the International Building Code and most local building codes also limit the maximum height and building stories for a project depending on its construction type.

The three construction types utilized in the prototype analysis are intended to reflect a range of building types and sizes developed by residential developers in the City.

Prototypes

The prototypes reviewed in this conceptual analysis are based on prototypes previously analyzed in 2018, 2019, and 2022 to allow comparison to these prior analyses and are intended to represent a range of residential development projects.

Building Heights/Density

For rental prototypes, the analysis includes a Type V project of five stories with a density of 65 units per acre, a Type III project of seven stories with a density of 90 units per acre, and a Type I project of 22 stories with a density of 350 units per acre. The for-sale prototypes include a Type V project of five stories with a density of 50 units per acre and a Type I project of 22 stories with a density of 350 units per acre.

Prototype Building Height and Density					
Prototype Size	Low-Rise	Mid-Rise	High-Rise	Low-Rise	High-Rise
Rental/Sale	Rental	Rental	Rental	Sale	Sale
Construction Type	Type V	Type III	Type I	Type V	Type I
Height/Stories	5	7	22	5	22
Density/Acre	65	90	350	50	350

Two versions of the Type I rental and sale prototypes were analyzed – one version, which reflects standard City requirements for payment of an inclusionary in-lieu fee and construction taxes, and a "waiver" version, which reflects a waiver of payment of the inclusionary in-lieu fee and 50% reduction of select construction taxes.

Submarkets

The prototypes were reviewed and applied in submarkets including "South & East", "Central", "West", "North" and "Downtown." The City provided boundaries based on its Inclusionary Housing Ordinance Areas (see Exhibit G) to guide the geographical definition of each submarket. Century | Urban researched each prototype and submarket to estimate the property income, expenses, sales prices, costs, fees, and land cost assumptions appropriate for the prototype or submarket.

Prototype Submarkets					
Prototype Size	Low-Rise	Mid-Rise	High-Rise	Low-Rise	High-Rise
Rental/Sale	Rental	Rental	Rental	Sale	Sale
Construction Type	Type V	Type III	Type I	Type V	Type I
Submarkets	South & East, Central	Central, West, North	Central, West, North, Downtown	South & East, Central & West, North	Downtown

Average Unit Sizes

The prototypes assume an average unit size of 900 net square feet for all rental prototypes, 1,150 net square feet for the Type V sale prototype, and 950 net square feet for the Type I sale prototype. Assumed building efficiencies (i.e., net square feet as a percentage of gross square feet) ranged from 78% to 80% resulting in average gross square feet per unit of 1,125 to 1,438.

Prototype Unit Sizes and Efficiencies					
Prototype Size	Low-Rise	Mid-Rise	High-Rise	Low-Rise	High-Rise
Rental/Sale	Rental	Rental	Rental	Sale	Sale
Construction Type	Type V	Type III	Type I	Type V	Type I
Avg Unit Size Net SF	900	900	900	1,150	950
Efficiency	80%	80%	78%	80%	78%
Avg Unit Size Gross SF	1,125	1,125	1,154	1,438	1,218

Parking Ratios

Assumed parking ratios are 1 per unit for the Type V and Type III rental prototypes, 0.8 per unit for the Type I rental prototypes, and 1.1 per unit for the Type V and Type I sale prototypes.

Prototype Parking Ratios					
Prototype Size	Low-Rise	Mid-Rise	High-Rise	Low-Rise	High-Rise
Rental/Sale	Rental	Rental	Rental	Sale	Sale
Construction Type	Type V	Type III	Type I	Type V	Type I
Parking Ratio	1.0	1.0	0.8	1.1	1.1

The prototypes described above are summarized in Exhibit A. To allow comparison to prior analysis, the prototype assumptions are consistent with prototype assumptions used in the 2022 analysis.

Assumptions

Assumptions for the conceptual analysis, which are detailed in Exhibit D, include the following:

- All prototypes except Type I rental and sale prototypes assume above-grade structured parking. Type I prototypes assume below-grade structured parking.
- Project construction timelines are estimated to range from 20 to 30 months.
- Inclusionary requirements are assumed to be fulfilled through the payment of the in-lieu fee, which in the case of "waiver" scenarios is assumed to be waived as discussed below.
- Construction is assumed to be open shop.

Development Costs

Development costs include "hard costs", which represent the labor and materials associated with building construction, and "soft costs", which represent costs related to items such as architecture and engineering, financing, City fees, insurance, property taxes, overhead, legal, accounting and marketing.

As noted above, development costs for a given project may vary by project design, size, location, construction type, site specific conditions, and other factors. For this analysis, an average project with a flat or relatively flat site and no unusual environmental, soils, infrastructure, or off-site conditions is assumed.

Although this analysis reflects a specific point-in-time, construction costs in the Bay Area have increased significantly over time and will likely continue to change. The sensitivity analysis described below reflects the effect on feasibility of changes in development costs.

Hard Costs

Building hard costs were estimated separately from parking hard costs, which varied based on the type of parking assumed in each prototype.

Building Hard Costs Per GSF (excluding parking)			
Size	Construction Type	Rental	Sale
Low-Rise	Type V	$438	$468
Mid-Rise	Type III	$498	NA
High-Rise	Type I	$558	$594

Parking Hard Costs Per GSF				
Size	Type	Parking Type	Rental	Sale
Low-Rise	Type V	Above-grade	$108	$112
Mid-Rise	Type III	Above-grade	$112	NA
High-Rise	Type I	Below-grade	$267	$272

The assumptions utilized for prototype hard costs were generated by a cost estimating consultant. Total hard costs also include a 5% hard cost contingency.

Soft Costs

Soft costs are estimated by soft cost category for each prototype as further detailed in Exhibit D. In total, soft costs equated to 32% to 40% of hard costs and ranged from approximately $133 to $185 per gross square foot depending on the prototype[1]. Variations in soft costs among the prototypes of the same construction type are driven primarily by the range of City fees, particularly parkland and inclusionary in-lieu fees, which vary by submarket.

Soft Costs as a % of Hard Costs - Rental Prototypes						
Size	Type	South & East	Central	West	North	Downtown
Low-Rise	Type V	32%	40%	NA	NA	NA
Mid-Rise	Type III	NA	39%	38%	33%	NA
High-Rise	Type I	NA	37%	37%	32%	36%

[1] Excluding "waiver" scenarios.

Soft Costs as % of Hard Costs - Sale Prototypes					
Size	Type	South & East	Central & West	North	Downtown
Low-Rise	Type V	32%	33%	34%	NA
High-Rise	Type I	NA	NA	NA	31%

Average Soft Costs Per GSF			
Size	Type	Rental	Sale
Low-Rise	Type V	$133	$134
Mid-Rise	Type III	$153	NA
High-Rise	Type I	$185	$168

The tables above do not include the Type I "waiver" scenarios in which 50% of Building and Structure ("B&S") and Commercial, Residential, Mobile Home Park ("CRMP") construction taxes and 100% of inclusionary in-lieu fees are waived.

Further detail regarding development cost assumptions is provided in Exhibit D.

City Fees

City fees for each prototype are estimated based on the prototype's location and size, among other factors. City fees include the following:

- Construction taxes, which include the following six categories: B&S; CRMP; Construction Taxes; Residential Construction Tax; Strong Motion Instrumentation Program Assessment ("SMIPA"); and Building Standards Administration Special Revolving Fund ("BSARSF"). The latter two categories are collected on behalf of the State. The amounts of these taxes are calculated based on a percentage of building construction valuation or on a per unit basis. The "waiver" scenarios for certain Type I prototypes analyze the potential effect of waiving 50% of the B&S and CRMP taxes in addition to the inclusionary in-lieu fee described below.
- Parkland In-Lieu Fees, which are assessed for each prototype project based on its location. All prototypes are assumed to receive a 25% parkland fee credit based on the provision of onsite open space.
- School Fees (ranging from $4.55 to $4.79 per square foot) are assessed per residential gross square foot based on the applicable submarket location and school district.
- The City is continuing to re-examine its traffic fees. As a result, estimated traffic fees have not been included in the analysis. As part of the traffic fee revisions, the City is defining centrally located "growth areas" where new development may not be assessed traffic fees based on vehicle mile traveled ("VMT").

- Inclusionary In-Lieu Fees are assessed per square foot depending on the project size and submarket location. The "waiver" scenarios for certain Type I prototypes analyze the potential effect of waiving this fee in addition to a portion of the construction taxes described above.
- Other City planning and building permit fees are assessed based on project size, number of units, and other factors. These fees include the costs of the City's land use and site plan approvals, planning review, and building department fees, among other fees.

The total City Fees per unit for each prototype are estimated to be in the ranges shown in the table below. Further detail is provided in Exhibit D.

Total City Permits & Fees Per Unit	Approximate Range
Construction Taxes	$7,900 to $9,900
Parkland In-Lieu Fees	$9,800 to $20,800
School Fees	$5,100 to $6,900
Planning/Building Fees	$3,100 to $7,700
Inclusionary In-Lieu Fees	$24,500 to $57,700
Total Fees	**$53,600 to $92,800**

Rental Rates

For the rental prototypes, Century | Urban conducted research regarding the effective rental rates at properties similar to each prototype in each applicable submarket. Effective rental rates reflect actual in-place rental revenue taking into account concessions or other deductions. As an example, at the time of this writing, many Class A projects were offering four weeks of free rent in association with a twelve-month lease. As a result, effective rents are generally lower than asking rents.

Based on this research, the following effective monthly rental rate assumptions for each prototype and applicable submarket, shown on both a per rentable square foot and per unit basis, are utilized in the conceptual feasibility analysis. Monthly rental rates are rounded to the nearest $10.

Rent Per SF/Month	South & East	Central	West	North	Downtown
Type V	$3.42	$3.60	NA	NA	NA
Type III	NA	$3.60	$4.10	$3.40	NA
Type I	NA	$3.60	$4.10	$3.40	$3.87

Rent Per Unit/Month	South & East	Central	West	North	Downtown
Type V	$3,080	$3,240	NA	NA	NA
Type III	NA	$3,240	$3,690	$3,060	NA
Type I	NA	$3,240	$3,690	$3,060	$3,480

The City also requested analysis of the effect on Type I "waiver" scenarios of requiring that 5% of total onsite units be affordable to households earning no more than 100% of Area Median Income for Santa Clara County ("AMI") as determined by the U.S. Department of Housing and Urban Development ("HUD") with adjustments by the California Department of Health and Community Development ("HCD"). AMI is often used to determine the affordability level of below-market rate housing. For example, very low-income households earn no more than 50% of AMI, and low-income households earn no more than 80% of AMI. Housing affordable to households earning 100% of AMI would generally be considered as targeting moderate-income households. Based on an assumed unit mix, the estimated average affordable rent at this AMI tier was $4.15 per square foot or $3,734 per unit per month. This rental rate is higher than the estimated market rate rental rates for all Type I prototype submarkets in the analysis. Accordingly, inclusion of a 5% onsite affordability requirement at 100% AMI would not affect projected revenues and the results of the analysis.

Sales Prices

Estimated sale prices for the for-sale prototypes are based on research regarding sales comparables with adjustments for building age in the prototype submarkets. For preceding period from October 2022 to September 2023, over 900 sales comparables were reviewed. The average sales prices per square foot reflected in these sales comparables are summarized by submarkets in the table below. Similar to rental rates, sales prices vary across submarkets and product types.

Condominium Sales Comparables Prior 12 Months	South & East	Central & West	North	Downtown
Average Sale Price PSF	$620	$690	$690	$730

The tables below summarize the assumed average sales prices on a per-square-foot and per-unit basis based on the research conducted with adjustments for building age.

Average Sales Price PSF	South & East	Central & West	North	Downtown
Type V	$775	$725	$700	NA
Type I	NA	NA	NA	$775

Average Sales Price Per Unit	South & East	Central & West	North	Downtown
Type V	$891,250	$833,750	$805,000	NA
Type I	NA	NA	NA	$736,250

Brokerage commissions, warranty reserves, and sales costs are subtracted from gross sale proceeds to estimate net sale proceeds for each prototype.

Developer Return

Developers require a return on their investment to undertake the risks involved with a development project. The required return for a specific project may vary based on the project's specific characteristics, as well as market/economic conditions including specifically capital market conditions. The prototype feasibility analyses include an estimate of the return that developers would require to proceed with project development.

For the rental prototypes analysis, the required return is estimated using a Return-on-Cost ("ROC") metric. This return metric is commonly used for rental projects. The appropriate target ROC is established based on a project's perceived risks, which include the uncertainty of project costs, schedule, revenues, and economic conditions upon completion. The target ROC assumed for the rental prototypes is 5.75%.

For the sale prototypes analysis, the required return is estimated based on a Profit Margin metric. Like the ROC for rental projects, the Profit Margin metric is commonly used for for-sale projects, and the appropriate target Profit Margin is based on the project's perceived risks. The target Profit Margin used for the sale prototypes is 20%.

Land Costs

Land costs are estimated based on research of comparable land sale transactions in each submarket. Land sale prices vary substantially even within each submarket and are affected by location, topography, site and soil conditions, parcel configuration, neighboring uses, access, noise, entitlement and permit status, among other factors. The

estimated land costs per unit for each submarket are summarized in the table below. There have been limited land sale transactions for multifamily residential developments since the 2022 analysis; as a result, land values are estimated to be the same as the estimated land values in the 2022 analysis.

Land Prices Per Unit	South & East	Central	West	North	Downtown
Low	$40,000	$40,000	$65,000	$25,000	$25,000
High	$65,000	$65,000	$75,000	$85,000	$85,000

The land costs per unit shown in the table above are compared to the estimated residual land values for the applicable prototypes in each submarket, as further discussed below.

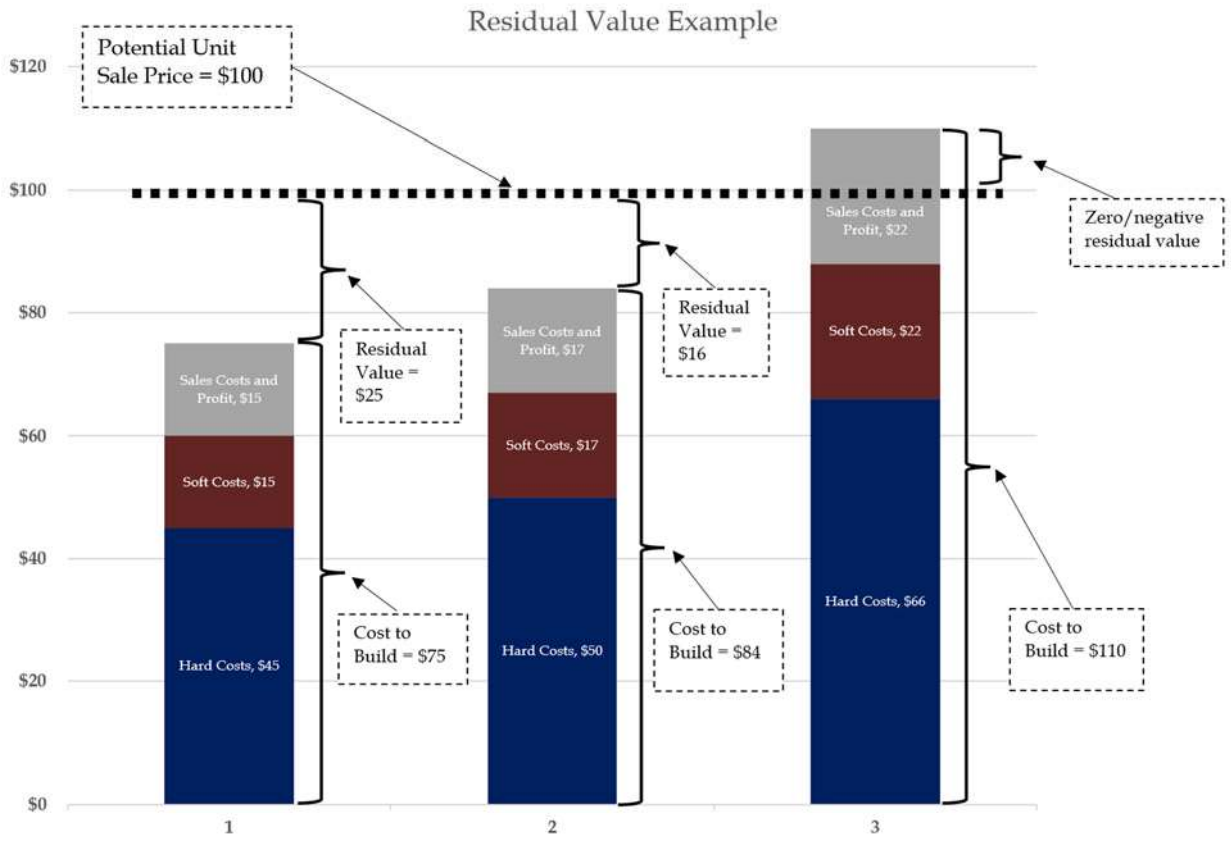
Feasibility Analysis

To evaluate the potential feasibility of each prototype, Century | Urban prepared an analysis to estimate each prototype's residual land value and then compared that residual land value to the estimated market price of land in each submarket based on comparable land sale transactions.

The residual land value represents the amount that a developer estimates that it can pay for a development site and still achieve its target return. If the residual land value is greater than the market price of land, then this is an indication that new development projects are feasible, land for development is more likely to transact, and new projects are more likely to be developed. If residual land value is less than the market price of land, then this is an indication that new development projects are not feasible, land for development is less likely to transact, and new projects are less likely to be developed.

The example shown in the chart below demonstrates the concept of residual value for three individual units in three hypothetical projects. In this example, a unit can be sold for $100. In example 1 (on the left), the hard costs, soft costs and target developer return required to build the unit total $75. In this case, the remaining "residual land value" is $100 (sales price) minus $75 (total development cost, developer return, and sales costs) = $25 per unit. If the developer were to pay more than $25 a unit for land, then the total cost to build would exceed $100 and the developer would not recover its costs or receive its target return. Therefore, in example 1, new development is likely to occur in a market where land can be purchased for $25 per unit or less. In example 2, shown in the middle, total development cost, developer return, and sales costs are $84 and residual land value is $100 (sales price) minus $84 = $16 per unit. This example reflects that as development costs increase, the price a developer can pay for land decreases (from $25 per unit in example 1 to $16 per unit in example 2) assuming that sales prices remain constant. In example 3 on the right, the total development cost, developer return, and sales costs of $110

exceed the sale price per unit, which results in zero or "negative" residual land value. In this scenario, development is unlikely to occur.



Feasibility Results

The conceptual feasibility analysis indicates that none of the prototypes support positive estimated residual land value in any of the submarkets. These results suggest a challenging environment for ground-up residential development projects similar to the prototype projects in the selected submarkets. The conceptual feasibility assumptions and resulting residual land values for each prototype are shown in Exhibit B.

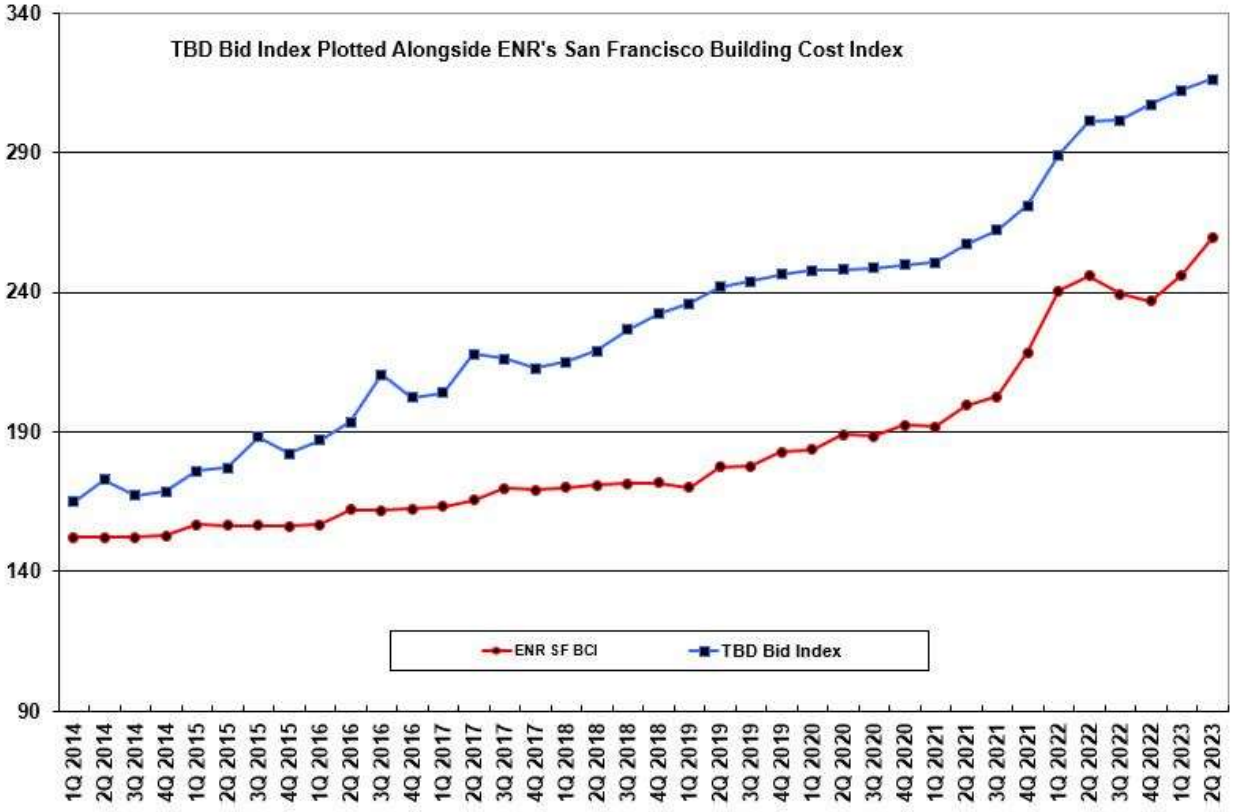
As noted above, the "Waiver" scenarios in the tables below reflect a waiver of 50% of certain construction taxes and 100% of inclusionary in-lieu fees for Type I prototypes.

Residual Values Per Unit - For Rent					
Submarket	South & East	Central	West	North	Downtown
Type V	($323,000)	($343,000)	NA	NA	NA
Type III	NA	($435,000)	($363,000)	($429,000)	NA
Type I	NA	($614,000)	($542,000)	($607,000)	($568,000)
Type I - Waiver	NA	($540,000)	($469,000)	($572,000)	($495,000)

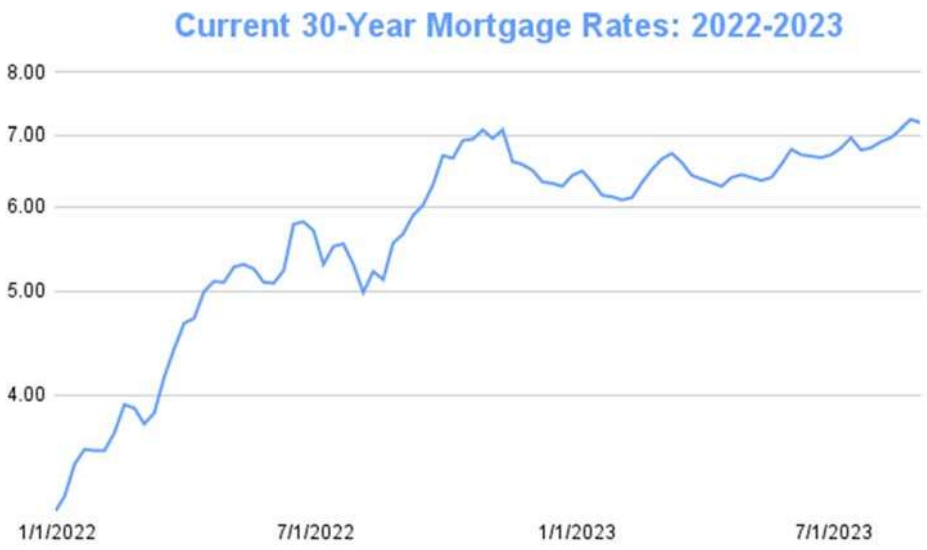
Residual Values Per Unit - For Sale				
Submarket	South & East	Central & West	North	Downtown
Type V	($342,000)	($394,000)	($419,000)	NA
Type I	NA	NA	NA	($611,000)
Type I - Waiver	NA	NA	NA	($570,000)

Macroeconomic Context

In general, the Bay Area features a diverse economy with low unemployment, a large and diverse range of employers, and significant demand for housing by prospective renters and homebuyers at a variety of income levels. However, even though demand is strong, housing development remains challenging. One of the primary challenges is the high cost of construction. The Engineering News Record ("ENR") and TBD Consultants publish indices which track construction costs quarterly in the Bay Area. The chart below shows the change in these indices since 2014. Both indices reflect major increases in cost since 2014 and even more significant increases since 2020. Since 2014, the total increase has been over 200%. Between the first quarter of 2020, when the COVID-19 pandemic began, and the second quarter of 2023, the latest available data, TBD Consultants estimates an increase of 27%. To a limited extent, these hard cost increases have been offset by rental rate and sale price growth, but construction cost growth has outpaced rental rate and sale price growth.



Other macro-economic factors have also impacted residential feasibility. Increases in interest rates and borrowing costs driven in part by inflation and corresponding policy reactions have caused a decrease in market transaction volume. In July 2019, Polaris Pacific tracked listings for over 2,200 condominiums in the active sale inventory in Silicon Valley. In August 2023, there were under 1,500 such listings. During the period from 2015 to 2023, there was an average of 63 new construction sales month. In comparison, new construction sales averaged 35 units per month over the 18-month period from March 2022 to August 2023 and 31 units per month over the 12-month period from September 2022 to August 2023. To a certain extent, these changes can be attributed to the rise in interest rates. Since the writing of last year's report, interest rates for 30 year fixed-rate mortgages have more than doubled, as shown in the following chart from Freddie MAC:



Given continued demand for housing, the market for leasing and sales remains active, but the increased cost of debt, affecting both residential condominium buyers and commercial apartment investors, has, compared with 2022 and previous years, increased debt service payments, putting downward pressure on property prices. In addition, the Federal Reserve has indicated that further rate increases are still likely, adding speculation that further negative asset price movement is possible. These trends, plus increased development costs have negatively affected project feasibility, and made it more difficult for developers to attract lenders and investors to their projects.

Sensitivity Analysis

As previously noted, the assumptions used in the prototype analysis are based on research regarding current development costs, rents, sale prices and underwriting inputs. However, these assumptions are intended to reflect average projects and may shift over time as market conditions change.

To provide additional context, sensitivities were prepared to analyze the potential effect of 5% variations in hard costs, soft costs, rental rates, and sale prices by construction type. The results of these sensitivity analyses, which are summarized in Exhibit C, indicate that 5% improvements in hard costs, soft costs, rental rates, and sale prices do not bridge the feasibility gap (see below for explanation of how the feasibility gap is calculated) for any of the prototypes.

The feasibility gap amounts shown in the Exhibit C charts represent the sum of the absolute amount of the estimated negative residual land value per unit for each prototype plus the estimated market cost of land per unit for such prototype. For example, the average projected

residual land value for the Type V rental prototypes is approximately negative $332,000 per unit and the estimated market land cost per unit is approximately $52,500 per unit, so the estimated feasibility gap is approximately $384,500 per unit for this prototype (rounded to $390,000 in Exhibit C). In other words, the residual land value for this prototype would have to increase by $384,500 to yield a residual land value of positive $52,500 per unit that corresponds to estimated market land costs, thereby indicating a potentially feasible project.

The leftmost column in each chart in Exhibit C shows the average feasibility gap per unit for each rental or sale prototype across all relevant submarkets analyzed for such prototype. The columns to the right of this column show the effect on the average feasibility gap of varying hard costs, soft costs, rental rates or sale prices by 5%. For example, for the first Type V rental prototype chart shown in Exhibit C, a 5% reduction in hard costs would decrease the feasibility gap by $30,000 from $390,000 to $360,000.

As noted above, City Permits and Fees including construction taxes, parkland in-lieu fees, schools fees, planning and building fees and inclusionary in-lieu fees are estimated to total approximately $30,000 to $90,000 per unit depending on the prototype, with the lowest totals being associated with the waiver scenarios. Given feasibility gaps which range from approximately $370,000 to approximately $670,000 per unit, a reduction or even waiver of all such fees would not eliminate the estimated feasibility gap.

The estimated feasibility gaps will likely be bridged by improvements in the relationship between development costs and project revenues. In addition, there may be proposed development projects that are closer to feasibility than the prototypes studied for purposes of this analysis, whereby smaller reductions in development costs or improvements in revenues may render such projects feasible.

An additional sensitivity analysis was prepared to estimate the potential effect of deferring the payment of development impact fees from the commencement of project construction (i.e., upon building permit issuance) to the completion of construction (i.e., upon certificate of occupancy issuance). The effect of this change in payment timing is projected to range from approximately $2,200 to $5,500 per unit depending on the prototype, which does not appear to materially affect feasibility.

Community Review

In connection with the preparation of this analysis, the City held virtual meetings on September 28th and October 12th to review the underwriting assumptions and findings for the feasibility prototypes with stakeholders such as local developers, brokers, and other industry professionals. High-level feedback was provided during the September 28th meeting, and more specific

feedback was provided during the October 12th meeting. A summary of the feedback provided during the October 12th meeting is provided in Exhibit F. With the exception of a few comments regarding estimated development costs being potentially higher than development costs observed by some participants in the meeting, the effect of the feedback provided would be to further increase the estimated feasibility gaps in this analysis.

Conclusion

This conceptual analysis reviewed a set of residential development prototypes to assess the potential feasibility of new rental and sale development projects in San Jose.

The analysis indicates negative estimated residual land values across the reviewed prototypes and suggests that, similar to the conclusions in 2022, development of residential projects is challenging in the current market. As noted at the beginning of this report, since the time when the 2022 study was prepared, the cost of construction has continued to increase, while rising interest rates have increased capital costs and target returns for achieving feasibility. Rental rates and condominium sale prices have increased since the 2022 analysis, but the amount of these increases is insufficient to offset the effect of higher development costs and target returns.

The conclusion that development of residential projects is challenging in the current market is not intended to suggest that no residential development in the City will occur, as projects may have cost structures or target rental rates or sale prices that vary from the prototypes. However, the results do suggest a difficult development environment for projects similar to the prototypes. Even with 5% variations in development costs or rental rates and sales prices, the prototype projects still appear to be challenged.

Exhibit A

Prototype	1	2	3	4	5
Rental/Sale	Rental	Rental	Rental	Sale	Sale
Construction Type	Type V	Type III	Type I	Type V	Type I
Height/Stories	5	7	22	5	22
Avg Unit Size Net SF	900	900	900	1,150	950
Efficiency	80%	80%	78%	80%	78%
Avg Unit Size Gross SF	1,125	1,125	1,154	1,438	1,218
Density/Acre	65	90	350	50	350
Parking Ratio	1.0	1.0	0.8	1.1	1.1
Parking SF Per Stall	400	400	400	400	400
Parking Type	Above-grade	Above-grade	Below-grade	Above-grade	Below-grade
Submarkets	South & East, Central	Central, West, North	Central, West, North, Downtown	South & East, Central & West, North	Downtown

Exhibit B

San Jose Residential Feasibility Analysis - Exhibit B

Per unit costs rounded to nearest '00; per unit residual values rounded to nearest '000, monthly pro-forma values rounded to nearest '0

Submarket:	South & East
Prototype:	Type V
Tenure	Rental

Item	**Amount**
Average Unit Size (Net Rentable SF)	900
Stories	5.00
Density (du/ac)	65
Efficiency	80%
Parking Ratio	1
Construction Months	20
Construction Costs	*Per Unit*
Hard Costs	
Building Hard Costs	$492,800
Parking Hard Costs	$43,200
Contingency/Other Hard Costs	$26,800
Total Hard Costs	$562,700
Soft Costs	
Architectural and Engineering	$33,800
Financing Costs	$31,600
City Fees and Permits	$53,600
Other Soft Costs	$52,300
Soft Cost Contingency	$8,600
Total Soft Costs	$179,800
Total Hard and Soft Costs	$742,600
Pro-Forma	*Per Unit*
Revenue	
Average Rent Per Square Foot Per Month	$3.42
Average Rent Per Month	$3,080
Other Income Per Month	$180
Vacancy / Credit Loss at 5% Per Month	$160
Total Revenue Per Month	$3,100
Operating Expenses	
General Operating Expenses Per Month	$590
Taxes Per Month	$490
Total Annual Operating Expenses Per Month	$1,080
Net Operating Income Per Month	$2,010
Net Operating Income Per Year	$24,200
Residual Analysis	*Per Unit*
Residual Value	
Total Supportable Cost	$420,000
Total Hard and Soft Costs	$743,000
Residual Value	($323,000)
Feasibility Gap	($375,000)
Market Land Cost	
2019-2021 Indicative Land Cost - Low	$40,000
2019-2021 Indicative Land Cost - High	$65,000

San Jose Residential Feasibility Analysis - Exhibit B

Per unit costs rounded to nearest '00; per unit residual values rounded to nearest '000, monthly pro-forma values rounded to nearest '0

Submarket:	Central
Prototype:	Type V
Tenure	Rental

Item	**Amount**
Average Unit Size (Net Rentable SF)	900
Stories	5.00
Density (du/ac)	65
Efficiency	80%
Parking Ratio	1
Construction Months	20
Construction Costs	*Per Unit*
Hard Costs	
Building Hard Costs	$492,800
Parking Hard Costs	$43,200
Contingency/Other Hard Costs	$26,800
Total Hard Costs	$562,700
Soft Costs	
Architectural and Engineering	$33,800
Financing Costs	$33,600
City Fees and Permits	$92,800
Other Soft Costs	$54,400
Soft Cost Contingency	$10,700
Total Soft Costs	$225,200
Total Hard and Soft Costs	$787,900
Pro-Forma	*Per Unit*
Revenue	
Average Rent Per Square Foot Per Month	$3.60
Average Rent Per Month	$3,240
Other Income Per Month	$180
Vacancy / Credit Loss at 5% Per Month	$170
Total Revenue Per Month	$3,250
Operating Expenses	
General Operating Expenses Per Month	$590
Taxes Per Month	$520
Total Annual Operating Expenses Per Month	$1,120
Net Operating Income Per Month	$2,130
Net Operating Income Per Year	$25,600
Residual Analysis	*Per Unit*
Residual Value	
Total Supportable Cost	$445,000
Total Hard and Soft Costs	$788,000
Residual Value	($343,000)
Feasibility Gap	($395,000)
Market Land Cost	
2019-2021 Indicative Land Cost - Low	$40,000
2019-2021 Indicative Land Cost - High	$65,000

San Jose Residential Feasibility Analysis - Exhibit B

Per unit costs rounded to nearest '00; per unit residual values rounded to nearest '000, monthly pro-forma values rounded to nearest '0

Submarket:	Central
Prototype:	Type III
Tenure	Rental

Item	**Amount**
Average Unit Size (Net Rentable SF)	900
Stories	7.00
Density (du/ac)	90
Efficiency	80%
Parking Ratio	1
Construction Months	24
Construction Costs	*Per Unit*
Hard Costs	
Building Hard Costs	$560,300
Parking Hard Costs	$44,800
Contingency/Other Hard Costs	$30,300
Total Hard Costs	$635,300
Soft Costs	
Architectural and Engineering	$38,100
Financing Costs	$44,200
City Fees and Permits	$92,000
Other Soft Costs	$58,800
Soft Cost Contingency	$11,700
Total Soft Costs	$244,800
Total Hard and Soft Costs	$880,100
Pro-Forma	*Per Unit*
Revenue	
Average Rent Per Square Foot Per Month	$3.60
Average Rent Per Month	$3,240
Other Income Per Month	$180
Vacancy / Credit Loss at 5% Per Month	$170
Total Revenue Per Month	$3,250
Operating Expenses	
General Operating Expenses Per Month	$590
Taxes Per Month	$520
Total Annual Operating Expenses Per Month	$1,120
Net Operating Income Per Month	$2,130
Net Operating Income Per Year	$25,600
Residual Analysis	*Per Unit*
Residual Value	
Total Supportable Cost	$445,000
Total Hard and Soft Costs	$880,000
Residual Value	($435,000)
Feasibility Gap	($487,000)
Market Land Cost	
2019-2021 Indicative Land Cost - Low	$40,000
2019-2021 Indicative Land Cost - High	$65,000

San Jose Residential Feasibility Analysis - Exhibit B

Per unit costs rounded to nearest '00; per unit residual values rounded to nearest '000, monthly pro-forma values rounded to nearest '0

Submarket:	West
Prototype:	Type III
Tenure	Rental

Item	**Amount**
Average Unit Size (Net Rentable SF)	900
Stories	7.00
Density (du/ac)	90
Efficiency	80%
Parking Ratio	1
Construction Months	24
Construction Costs	*Per Unit*
Hard Costs	
Building Hard Costs	$560,300
Parking Hard Costs	$44,800
Contingency/Other Hard Costs	$30,300
Total Hard Costs	$635,300
Soft Costs	
Architectural and Engineering	$38,100
Financing Costs	$44,100
City Fees and Permits	$90,700
Other Soft Costs	$58,700
Soft Cost Contingency	$11,600
Total Soft Costs	$243,200
Total Hard and Soft Costs	$878,500
Pro-Forma	*Per Unit*
Revenue	
Average Rent Per Square Foot Per Month	$4.10
Average Rent Per Month	$3,690
Other Income Per Month	$180
Vacancy / Credit Loss at 5% Per Month	$190
Total Revenue Per Month	$3,680
Operating Expenses	
General Operating Expenses Per Month	$610
Taxes Per Month	$600
Total Annual Operating Expenses Per Month	$1,210
Net Operating Income Per Month	$2,470
Net Operating Income Per Year	$29,600
Residual Analysis	*Per Unit*
Residual Value	
Total Supportable Cost	$515,000
Total Hard and Soft Costs	$878,000
Residual Value	($363,000)
Feasibility Gap	($434,000)
Market Land Cost	
2019-2021 Indicative Land Cost - Low	$65,000
2019-2021 Indicative Land Cost - High	$75,000

San Jose Residential Feasibility Analysis - Exhibit B

Per unit costs rounded to nearest '00; per unit residual values rounded to nearest '000, monthly pro-forma values rounded to nearest '0

Submarket:	North
Prototype:	Type III
Tenure	Rental

Item	**Amount**
Average Unit Size (Net Rentable SF)	900
Stories	7.00
Density (du/ac)	90
Efficiency	80%
Parking Ratio	1
Construction Months	24
Construction Costs	*Per Unit*
Hard Costs	
Building Hard Costs	$560,300
Parking Hard Costs	$44,800
Contingency/Other Hard Costs	$30,300
Total Hard Costs	$635,300
Soft Costs	
Architectural and Engineering	$38,100
Financing Costs	$42,500
City Fees and Permits	$64,100
Other Soft Costs	$57,200
Soft Cost Contingency	$10,100
Total Soft Costs	$212,100
Total Hard and Soft Costs	$847,400
Pro-Forma	*Per Unit*
Revenue	
Average Rent Per Square Foot Per Month	$3.40
Average Rent Per Month	$3,060
Other Income Per Month	$180
Vacancy / Credit Loss at 5% Per Month	$160
Total Revenue Per Month	$3,080
Operating Expenses	
General Operating Expenses Per Month	$590
Taxes Per Month	$490
Total Annual Operating Expenses Per Month	$1,080
Net Operating Income Per Month	$2,000
Net Operating Income Per Year	$24,000
Residual Analysis	*Per Unit*
Residual Value	
Total Supportable Cost	$418,000
Total Hard and Soft Costs	$847,000
Residual Value	($429,000)
Feasibility Gap	($485,000)
Market Land Cost	
2019-2021 Indicative Land Cost - Low	$25,000
2019-2021 Indicative Land Cost - High	$85,000

San Jose Residential Feasibility Analysis - Exhibit B

Per unit costs rounded to nearest '00; per unit residual values rounded to nearest '000, monthly pro-forma values rounded to nearest '0

Submarket:	Central
Prototype:	Type I
Tenure	Rental

Item	**Amount**
Average Unit Size (Net Rentable SF)	900
Stories	22.00
Density (du/ac)	350
Efficiency	78%
Parking Ratio	1
Construction Months	30
Construction Costs	*Per Unit*
Hard Costs	
Building Hard Costs	$643,800
Parking Hard Costs	$85,400
Contingency/Other Hard Costs	$36,500
Total Hard Costs	$765,800
Soft Costs	
Architectural and Engineering	$45,900
Financing Costs	$63,600
City Fees and Permits	$91,700
Other Soft Costs	$68,300
Soft Cost Contingency	$13,500
Total Soft Costs	$283,000
Total Hard and Soft Costs	$1,048,800
Pro-Forma	*Per Unit*
Revenue	
Average Rent Per Square Foot Per Month	$3.60
Average Rent Per Month	$3,240
Other Income Per Month	$200
Vacancy / Credit Loss at 5% Per Month	$170
Total Revenue Per Month	$3,270
Operating Expenses	
General Operating Expenses Per Month	$670
Taxes Per Month	$510
Total Annual Operating Expenses Per Month	$1,180
Net Operating Income Per Month	$2,080
Net Operating Income Per Year	$25,000
Residual Analysis	*Per Unit*
Residual Value	
Total Supportable Cost	$435,000
Total Hard and Soft Costs	$1,049,000
Residual Value	($614,000)
Feasibility Gap	($666,000)
Market Land Cost	
2019-2021 Indicative Land Cost - Low	$40,000
2019-2021 Indicative Land Cost - High	$65,000

San Jose Residential Feasibility Analysis - Exhibit B

Per unit costs rounded to nearest '00; per unit residual values rounded to nearest '000, monthly pro-forma values rounded to nearest '0

Submarket:	Central - Waiver
Prototype:	Type I
Tenure	Rental

Item	**Amount**
Average Unit Size (Net Rentable SF)	900
Stories	22.00
Density (du/ac)	350
Efficiency	78%
Parking Ratio	1
Construction Months	30
Construction Costs	*Per Unit*
Hard Costs	
Building Hard Costs	$643,800
Parking Hard Costs	$85,400
Contingency/Other Hard Costs	$36,500
Total Hard Costs	$765,800
Soft Costs	
Architectural and Engineering	$45,900
Financing Costs	$59,200
City Fees and Permits	$29,900
Other Soft Costs	$64,700
Soft Cost Contingency	$10,000
Total Soft Costs	$209,600
Total Hard and Soft Costs	$975,400
Pro-Forma	*Per Unit*
Revenue	
Average Rent Per Square Foot Per Month	$3.60
Average Rent Per Month	$3,240
Other Income Per Month	$200
Vacancy / Credit Loss at 5% Per Month	$170
Total Revenue Per Month	$3,270
Operating Expenses	
General Operating Expenses Per Month	$670
Taxes Per Month	$510
Total Annual Operating Expenses Per Month	$1,180
Net Operating Income Per Month	$2,080
Net Operating Income Per Year	$25,000
Residual Analysis	*Per Unit*
Residual Value	
Total Supportable Cost	$435,000
Total Hard and Soft Costs	$975,000
Residual Value	($540,000)
Feasibility Gap	($666,000)
Market Land Cost	
2019-2021 Indicative Land Cost - Low	$40,000
2019-2021 Indicative Land Cost - High	$65,000

*Waiver scenarios assume a waiver of inclusionary fees and a 50% reduction in CRMP and B&S Construction Taxes

San Jose Residential Feasibility Analysis - Exhibit B

Per unit costs rounded to nearest '00; per unit residual values rounded to nearest '000, monthly pro-forma values rounded to nearest '0

Submarket:	West
Prototype:	Type I
Tenure	Rental

Item	**Amount**
Average Unit Size (Net Rentable SF)	900
Stories	22.00
Density (du/ac)	350
Efficiency	78%
Parking Ratio	1
Construction Months	30
Construction Costs	*Per Unit*
Hard Costs	
Building Hard Costs	$643,800
Parking Hard Costs	$85,400
Contingency/Other Hard Costs	$36,500
Total Hard Costs	$765,800
Soft Costs	
Architectural and Engineering	$45,900
Financing Costs	$63,500
City Fees and Permits	$90,100
Other Soft Costs	$68,200
Soft Cost Contingency	$13,400
Total Soft Costs	$281,100
Total Hard and Soft Costs	$1,046,800
Pro-Forma	*Per Unit*
Revenue	
Average Rent Per Square Foot Per Month	$4.10
Average Rent Per Month	$3,690
Other Income Per Month	$200
Vacancy / Credit Loss at 5% Per Month	$190
Total Revenue Per Month	$3,700
Operating Expenses	
General Operating Expenses Per Month	$690
Taxes Per Month	$590
Total Annual Operating Expenses Per Month	$1,280
Net Operating Income Per Month	$2,420
Net Operating Income Per Year	$29,000
Residual Analysis	*Per Unit*
Residual Value	
Total Supportable Cost	$505,000
Total Hard and Soft Costs	$1,047,000
Residual Value	($542,000)
Feasibility Gap	($612,000)
Market Land Cost	
2019-2021 Indicative Land Cost - Low	$65,000
2019-2021 Indicative Land Cost - High	$75,000

San Jose Residential Feasibility Analysis - Exhibit B

Per unit costs rounded to nearest '00; per unit residual values rounded to nearest '000, monthly pro-forma values rounded to nearest '0

Submarket:	West - Waiver
Prototype:	Type I
Tenure	Rental

Item	**Amount**
Average Unit Size (Net Rentable SF)	900
Stories	22.00
Density (du/ac)	350
Efficiency	78%
Parking Ratio	1
Construction Months	30
Construction Costs	*Per Unit*
Hard Costs	
Building Hard Costs	$643,800
Parking Hard Costs	$85,400
Contingency/Other Hard Costs	$36,500
Total Hard Costs	$765,800
Soft Costs	
Architectural and Engineering	$45,900
Financing Costs	$59,100
City Fees and Permits	$28,400
Other Soft Costs	$64,600
Soft Cost Contingency	$9,900
Total Soft Costs	$207,900
Total Hard and Soft Costs	$973,600
Pro-Forma	*Per Unit*
Revenue	
Average Rent Per Square Foot Per Month	$4.10
Average Rent Per Month	$3,690
Other Income Per Month	$200
Vacancy / Credit Loss at 5% Per Month	$190
Total Revenue Per Month	$3,700
Operating Expenses	
General Operating Expenses Per Month	$690
Taxes Per Month	$590
Total Annual Operating Expenses Per Month	$1,280
Net Operating Income Per Month	$2,420
Net Operating Income Per Year	$29,000
Residual Analysis	*Per Unit*
Residual Value	
Total Supportable Cost	$505,000
Total Hard and Soft Costs	$974,000
Residual Value	($469,000)
Feasibility Gap	($612,000)
Market Land Cost	
2019-2021 Indicative Land Cost - Low	$65,000
2019-2021 Indicative Land Cost - High	$75,000

*Waiver scenarios assume a waiver of inclusionary fees and a 50% reduction in CRMP and B&S Construction Taxes

San Jose Residential Feasibility Analysis - Exhibit B

Per unit costs rounded to nearest '00; per unit residual values rounded to nearest '000, monthly pro-forma values rounded to nearest '0

Submarket:	North
Prototype:	Type I
Tenure	Rental

Item	**Amount**
Average Unit Size (Net Rentable SF)	900
Stories	22.00
Density (du/ac)	350
Efficiency	78%
Parking Ratio	1
Construction Months	30
Construction Costs	*Per Unit*
Hard Costs	
Building Hard Costs	$643,800
Parking Hard Costs	$85,400
Contingency/Other Hard Costs	$36,500
Total Hard Costs	$765,800
Soft Costs	
Architectural and Engineering	$45,900
Financing Costs	$61,500
City Fees and Permits	$62,600
Other Soft Costs	$66,600
Soft Cost Contingency	$11,800
Total Soft Costs	$248,500
Total Hard and Soft Costs	$1,014,300
Pro-Forma	*Per Unit*
Revenue	
Average Rent Per Square Foot Per Month	$3.40
Average Rent Per Month	$3,060
Other Income Per Month	$200
Vacancy / Credit Loss at 5% Per Month	$160
Total Revenue Per Month	$3,100
Operating Expenses	
General Operating Expenses Per Month	$670
Taxes Per Month	$480
Total Annual Operating Expenses Per Month	$1,150
Net Operating Income Per Month	$1,950
Net Operating Income Per Year	$23,400
Residual Analysis	*Per Unit*
Residual Value	
Total Supportable Cost	$407,000
Total Hard and Soft Costs	$1,014,000
Residual Value	($607,000)
Feasibility Gap	($662,000)
Market Land Cost	
2019-2021 Indicative Land Cost - Low	$25,000
2019-2021 Indicative Land Cost - High	$85,000

San Jose Residential Feasibility Analysis - Exhibit B

Per unit costs rounded to nearest '00; per unit residual values rounded to nearest '000, monthly pro-forma values rounded to nearest '0

Submarket:	North - Waiver
Prototype:	Type I
Tenure	Rental

Item	**Amount**
Average Unit Size (Net Rentable SF)	900
Stories	22.00
Density (du/ac)	350
Efficiency	78%
Parking Ratio	1
Construction Months	30
Construction Costs	*Per Unit*
Hard Costs	
Building Hard Costs	$643,800
Parking Hard Costs	$85,400
Contingency/Other Hard Costs	$36,500
Total Hard Costs	$765,800
Soft Costs	
Architectural and Engineering	$45,900
Financing Costs	$59,400
City Fees and Permits	$33,600
Other Soft Costs	$64,900
Soft Cost Contingency	$10,200
Total Soft Costs	$214,000
Total Hard and Soft Costs	$979,800
Pro-Forma	*Per Unit*
Revenue	
Average Rent Per Square Foot Per Month	$3.40
Average Rent Per Month	$3,060
Other Income Per Month	$200
Vacancy / Credit Loss at 5% Per Month	$160
Total Revenue Per Month	$3,100
Operating Expenses	
General Operating Expenses Per Month	$670
Taxes Per Month	$480
Total Annual Operating Expenses Per Month	$1,150
Net Operating Income Per Month	$1,950
Net Operating Income Per Year	$23,400
Residual Analysis	*Per Unit*
Residual Value	
Total Supportable Cost	$408,000
Total Hard and Soft Costs	$980,000
Residual Value	($572,000)
Feasibility Gap	($662,000)
Market Land Cost	
2019-2021 Indicative Land Cost - Low	$25,000
2019-2021 Indicative Land Cost - High	$85,000

*Waiver scenarios assume a waiver of inclusionary fees and a 50% reduction in CRMP and B&S Construction Taxes

San Jose Residential Feasibility Analysis - Exhibit B

Per unit costs rounded to nearest '00; per unit residual values rounded to nearest '000, monthly pro-forma values rounded to nearest '0

Submarket:	Downtown
Prototype:	Type I
Tenure	Rental

Item	**Amount**
Average Unit Size (Net Rentable SF)	900
Stories	22.00
Density (du/ac)	350
Efficiency	78%
Parking Ratio	1
Construction Months	30
Construction Costs	*Per Unit*
Hard Costs	
Building Hard Costs	$643,800
Parking Hard Costs	$85,400
Contingency/Other Hard Costs	$36,500
Total Hard Costs	$765,800
Soft Costs	
Architectural and Engineering	$45,900
Financing Costs	$63,200
City Fees and Permits	$85,400
Other Soft Costs	$67,900
Soft Cost Contingency	$13,100
Total Soft Costs	$275,600
Total Hard and Soft Costs	$1,041,300
Pro-Forma	*Per Unit*
Revenue	
Average Rent Per Square Foot Per Month	$3.87
Average Rent Per Month	$3,480
Other Income Per Month	$200
Vacancy / Credit Loss at 5% Per Month	$180
Total Revenue Per Month	$3,500
Operating Expenses	
General Operating Expenses Per Month	$680
Taxes Per Month	$550
Total Annual Operating Expenses Per Month	$1,230
Net Operating Income Per Month	$2,260
Net Operating Income Per Year	$27,200
Residual Analysis	*Per Unit*
Residual Value	
Total Supportable Cost	$473,000
Total Hard and Soft Costs	$1,041,000
Residual Value	($568,000)
Feasibility Gap	($624,000)
Market Land Cost	
2019-2021 Indicative Land Cost - Low	$25,000
2019-2021 Indicative Land Cost - High	$85,000

San Jose Residential Feasibility Analysis - Exhibit B

Per unit costs rounded to nearest '00; per unit residual values rounded to nearest '000, monthly pro-forma values rounded to nearest '0

Submarket:	Downtown - Waiver
Prototype:	Type I
Tenure	Rental

Item	**Amount**
Average Unit Size (Net Rentable SF)	900
Stories	22.00
Density (du/ac)	350
Efficiency	78%
Parking Ratio	1
Construction Months	30
Construction Costs	*Per Unit*
Hard Costs	
Building Hard Costs	$643,800
Parking Hard Costs	$85,400
Contingency/Other Hard Costs	$36,500
Total Hard Costs	$765,800
Soft Costs	
Architectural and Engineering	$45,900
Financing Costs	$58,700
City Fees and Permits	$23,700
Other Soft Costs	$64,300
Soft Cost Contingency	$9,600
Total Soft Costs	$202,300
Total Hard and Soft Costs	$968,100
Pro-Forma	*Per Unit*
Revenue	
Average Rent Per Square Foot Per Month	$3.87
Average Rent Per Month	$3,480
Other Income Per Month	$200
Vacancy / Credit Loss at 5% Per Month	$180
Total Revenue Per Month	$3,500
Operating Expenses	
General Operating Expenses Per Month	$680
Taxes Per Month	$550
Total Annual Operating Expenses Per Month	$1,230
Net Operating Income Per Month	$2,260
Net Operating Income Per Year	$27,200
Residual Analysis	*Per Unit*
Residual Value	
Total Supportable Cost	$473,000
Total Hard and Soft Costs	$968,000
Residual Value	($495,000)
Feasibility Gap	($551,000)
Market Land Cost	
2019-2021 Indicative Land Cost - Low	$25,000
2019-2021 Indicative Land Cost - High	$85,000

*Waiver scenarios assume a waiver of inclusionary fees and a 50% reduction in CRMP and B&S Construction Taxes

San Jose Residential Feasibility Analysis - Exhibit B

Per unit cost and pro-forma values rounded to nearest '00, per unit residual values rounded to nearest '000

Submarket:	South & East
Prototype:	Type V
Tenure	Sale

Item	**Amount**
Average Unit Size (Net Saleable SF)	1,150
Stories	5
Density (du/ac)	50
Efficiency	80%
Parking Ratio	1.1
Construction Months	20
Construction Costs	*Per Unit*
Hard Costs	
Building Hard Costs	$672,800
Parking Hard Costs	$49,300
Contingency/Other Hard Costs	$36,100
Total Hard Costs	$758,100
Soft Costs	
Architectural and Engineering	$45,500
Financing Costs	$42,700
City Fees and Permits	$69,900
Other Soft Costs	$74,200
Soft Cost Contingency	$11,600
Total Soft Costs	$243,900
Total Hard and Soft Costs	$1,002,000
Pro-Forma	*Per Unit*
Revenue	
Average Price Per Net Saleable Square Foot	$775
Average Price	$891,300
Sales Costs Including Warranty Reserve	$53,500
Profit	$178,300
Total Net Supportable Cost	$659,500
Residual Analysis	*Per Unit*
Residual Value	
Supportable Cost	$660,000
Total Hard and Soft Costs	$1,002,000
Residual Value	($342,000)
Feasibility Gap	($395,000)
Market Land Cost	
2019-2021 Indicative Land Cost - Low	$40,000
2019-2021 Indicative Land Cost - High	$65,000

San Jose Residential Feasibility Analysis - Exhibit B

Per unit cost and pro-forma values rounded to nearest '00, per unit residual values rounded to nearest '000

Submarket:	Central & West
Prototype:	Type V
Tenure	Sale

Item	**Amount**
Average Unit Size (Net Saleable SF)	1,150
Stories	5
Density (du/ac)	50
Efficiency	80%
Parking Ratio	1.1
Construction Months	20
Construction Costs	*Per Unit*
Hard Costs	
Building Hard Costs	$672,800
Parking Hard Costs	$49,300
Contingency/Other Hard Costs	$36,100
Total Hard Costs	$758,100
Soft Costs	
Architectural and Engineering	$45,500
Financing Costs	$43,000
City Fees and Permits	$77,400
Other Soft Costs	$74,600
Soft Cost Contingency	$12,000
Total Soft Costs	$252,500
Total Hard and Soft Costs	$1,010,700
Pro-Forma	*Per Unit*
Revenue	
Average Price Per Net Saleable Square Foot	$725
Average Price	$833,800
Sales Costs Including Warranty Reserve	$50,000
Profit	$166,800
Total Net Supportable Cost	$617,000
Residual Analysis	*Per Unit*
Residual Value	
Supportable Cost	$617,000
Total Hard and Soft Costs	$1,011,000
Residual Value	($394,000)
Feasibility Gap	($446,000)
Market Land Cost	
2019-2021 Indicative Land Cost - Low	$40,000
2019-2021 Indicative Land Cost - High	$65,000

San Jose Residential Feasibility Analysis - Exhibit B

Per unit cost and pro-forma values rounded to nearest '00, per unit residual values rounded to nearest '000

Submarket:	North
Prototype:	Type V
Tenure	Sale

Item	**Amount**
Average Unit Size (Net Saleable SF)	1,150
Stories	5
Density (du/ac)	50
Efficiency	80%
Parking Ratio	1.1
Construction Months	20
Construction Costs	*Per Unit*
Hard Costs	
Building Hard Costs	$672,800
Parking Hard Costs	$49,300
Contingency/Other Hard Costs	$36,100
Total Hard Costs	$758,100
Soft Costs	
Architectural and Engineering	$45,500
Financing Costs	$43,200
City Fees and Permits	$81,200
Other Soft Costs	$74,800
Soft Cost Contingency	$12,200
Total Soft Costs	$257,000
Total Hard and Soft Costs	$1,015,100
Pro-Forma	*Per Unit*
Revenue	
Average Price Per Net Saleable Square Foot	$700
Average Price	$805,000
Sales Costs Including Warranty Reserve	$48,300
Profit	$161,000
Total Net Supportable Cost	$595,700
Residual Analysis	*Per Unit*
Residual Value	
Supportable Cost	$596,000
Total Hard and Soft Costs	$1,015,000
Residual Value	($419,000)
Feasibility Gap	($474,000)
Market Land Cost	
2019-2021 Indicative Land Cost - Low	$25,000
2019-2021 Indicative Land Cost - High	$85,000

San Jose Residential Feasibility Analysis - Exhibit B

Per unit cost and pro-forma values rounded to nearest '00, per unit residual values rounded to nearest '000

Submarket:	Downtown
Prototype:	Type I
Tenure	Sale

Item	**Amount**
Average Unit Size (Net Saleable SF)	950
Stories	22
Density (du/ac)	330
Efficiency	78%
Parking Ratio	1.1
Construction Months	30
Construction Costs	*Per Unit*
Hard Costs	
Building Hard Costs	$723,500
Parking Hard Costs	$119,700
Contingency/Other Hard Costs	$42,200
Total Hard Costs	$885,300
Soft Costs	
Architectural and Engineering	$53,100
Financing Costs	$70,500
City Fees and Permits	$59,800
Other Soft Costs	$81,200
Soft Cost Contingency	$13,200
Total Soft Costs	$277,900
Total Hard and Soft Costs	$1,163,200
Pro-Forma	*Per Unit*
Revenue	
Average Price Per Net Saleable Square Foot	$775
Average Price	$736,300
Sales Costs Including Warranty Reserve	$50,000
Profit	$134,000
Total Net Supportable Cost	$552,200
Residual Analysis	*Per Unit*
Residual Value	
Supportable Cost	$552,000
Total Hard and Soft Costs	$1,163,000
Residual Value	($611,000)
Feasibility Gap	($666,000)
Market Land Cost	
2019-2021 Indicative Land Cost - Low	$25,000
2019-2021 Indicative Land Cost - High	$25,000

San Jose Residential Feasibility Analysis - Exhibit B

Per unit cost and pro-forma values rounded to nearest '00, per unit residual values rounded to nearest '000

Submarket:	Downtown - Waiver
Prototype:	Type I
Tenure	Sale

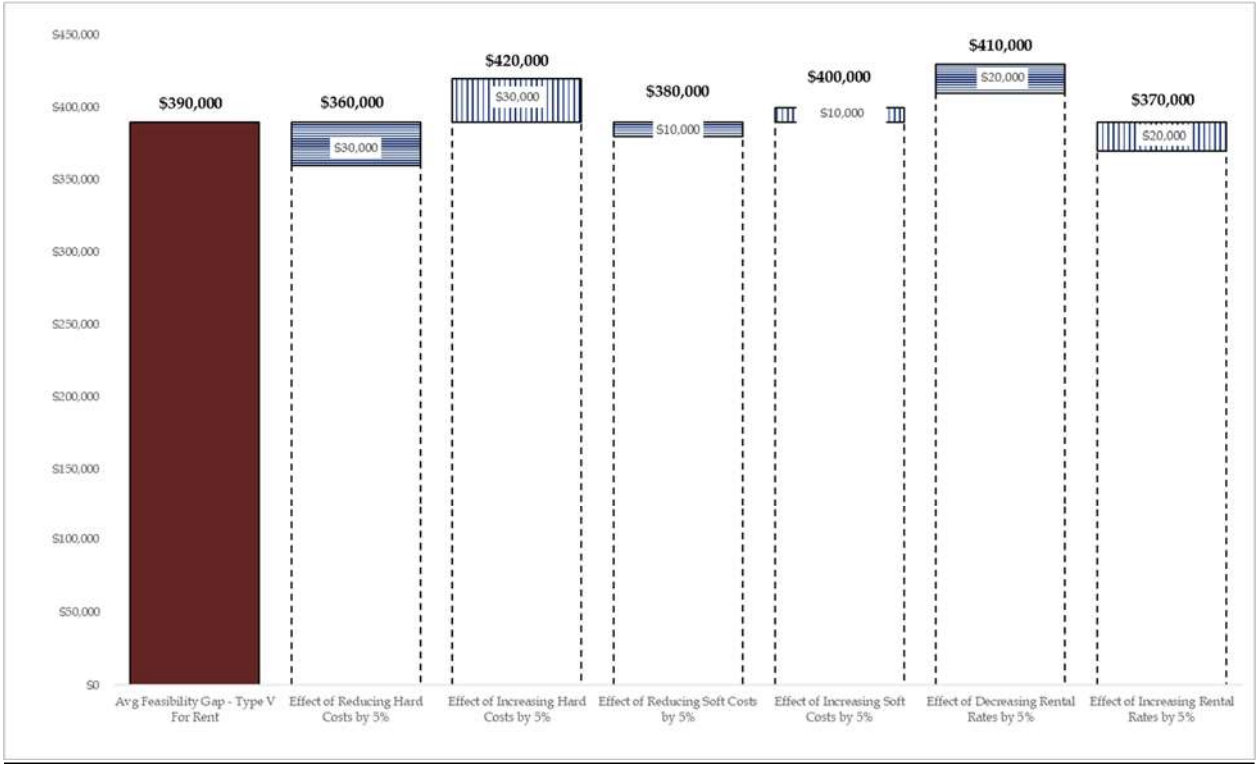
Item	**Amount**
Average Unit Size (Net Saleable SF)	950
Stories	22
Density (du/ac)	330
Efficiency	78%
Parking Ratio	1.1
Construction Months	30
Construction Costs	*Per Unit*
Hard Costs	
Building Hard Costs	$723,500
Parking Hard Costs	$119,700
Contingency/Other Hard Costs	$42,200
Total Hard Costs	$885,300
Soft Costs	
Architectural and Engineering	$53,100
Financing Costs	$68,000
City Fees and Permits	$24,800
Other Soft Costs	$79,100
Soft Cost Contingency	$11,300
Total Soft Costs	$236,300
Total Hard and Soft Costs	$1,121,600
Pro-Forma	*Per Unit*
Revenue	
Average Price Per Net Saleable Square Foot	$775
Average Price	$736,300
Sales Costs Including Warranty Reserve	$50,000
Profit	$134,000
Total Net Supportable Cost	$552,200
Residual Analysis	*Per Unit*
Residual Value	
Supportable Cost	$552,000
Total Hard and Soft Costs	$1,122,000
Residual Value	($570,000)
Feasibility Gap	($666,000)
Market Land Cost	
2019-2021 Indicative Land Cost - Low	$25,000
2019-2021 Indicative Land Cost - High	$25,000

*Waiver scenarios assume a waiver of inclusionary fees and a 50% reduction in CRMP and B&S Construction Taxes

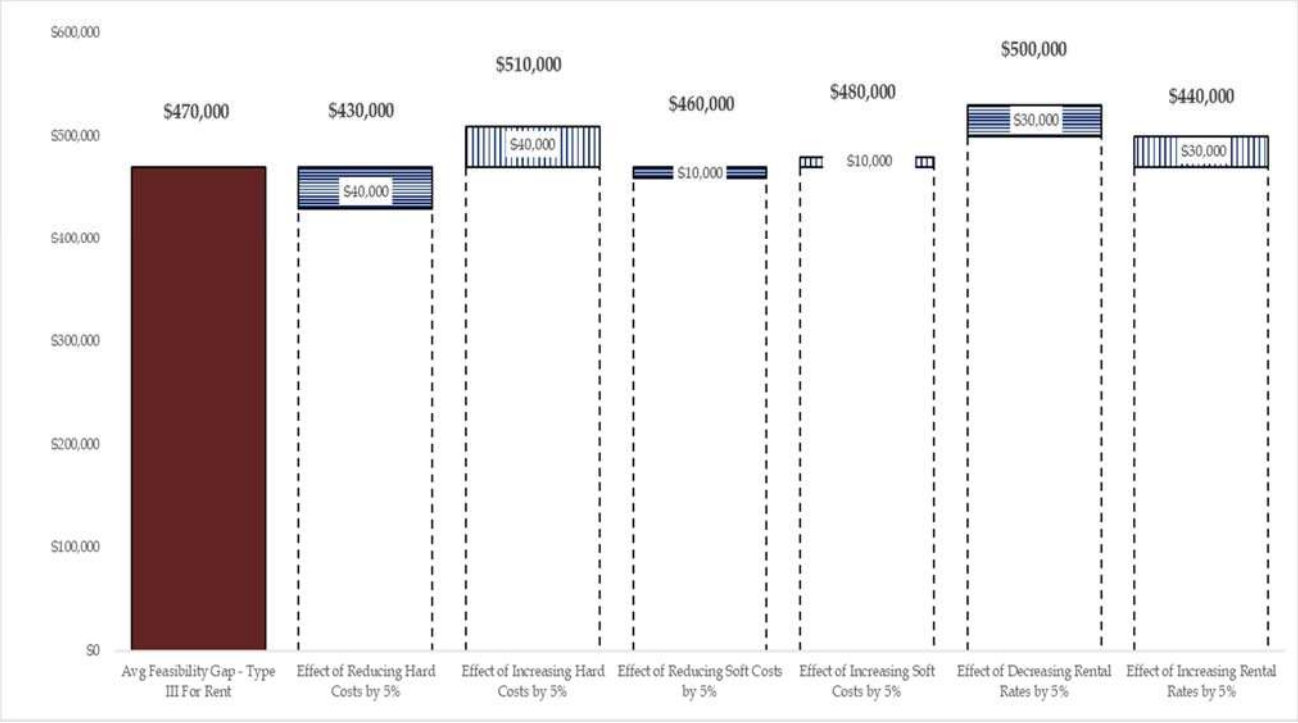
Exhibit C

Effect Per Unit on Feasibility Gap of Varying Hard Costs, Soft Costs, and Rental Rates by 5%

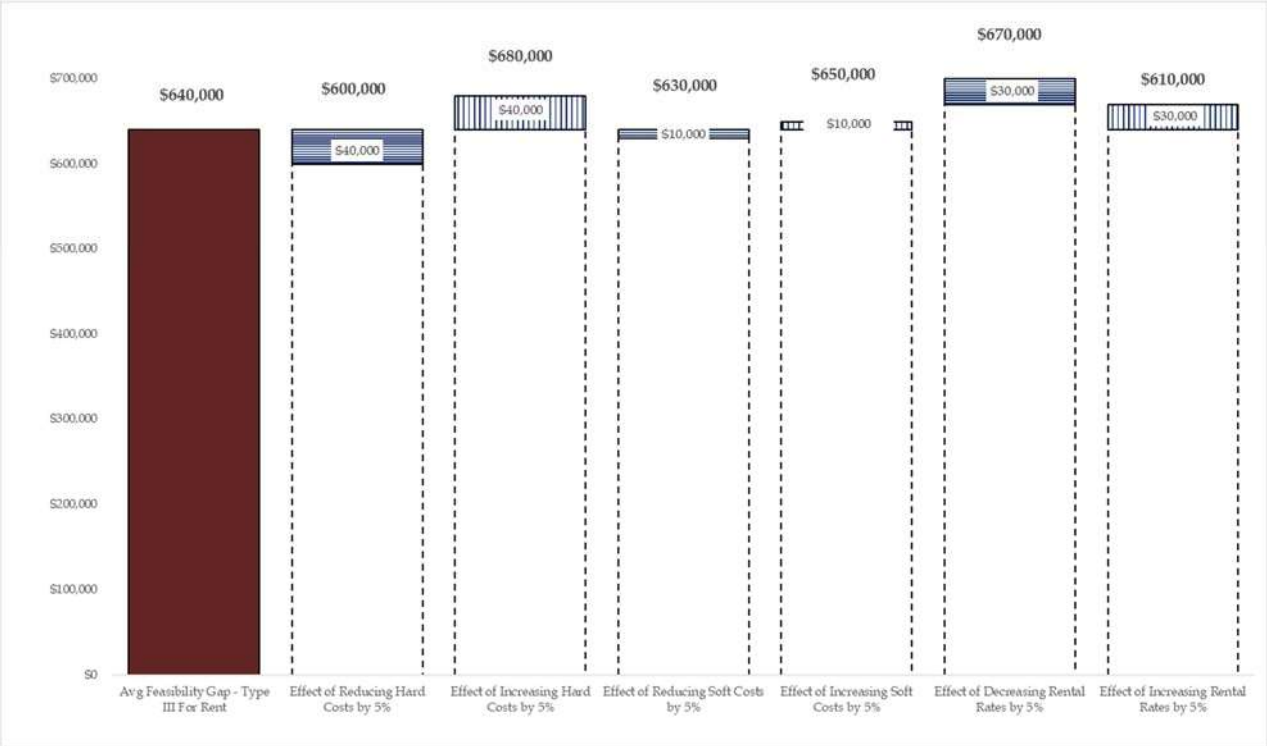
Type V Rental Prototype



Type III Rental Prototype

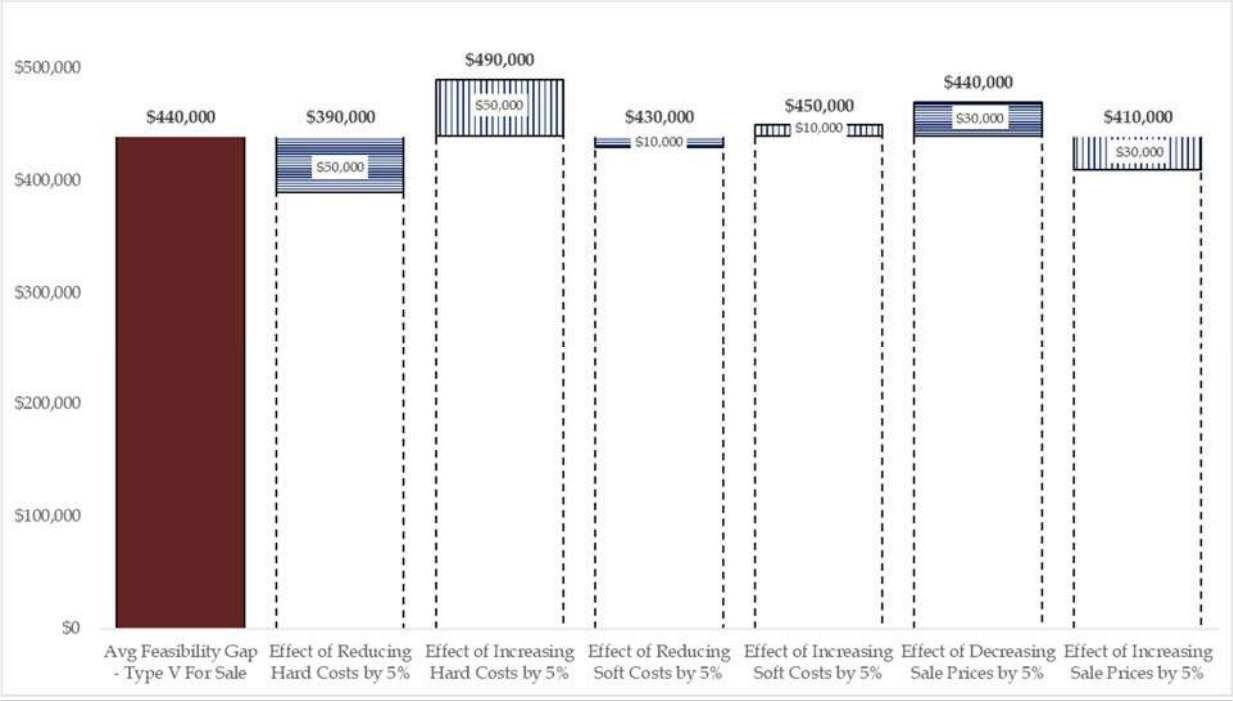


Type I Rental Prototype



Effect Per Unit on Feasibility Gap of Varying Hard Costs, Soft Costs, and Sale Prices by 5%

Type V Sale Prototype



Type I Sale Prototype

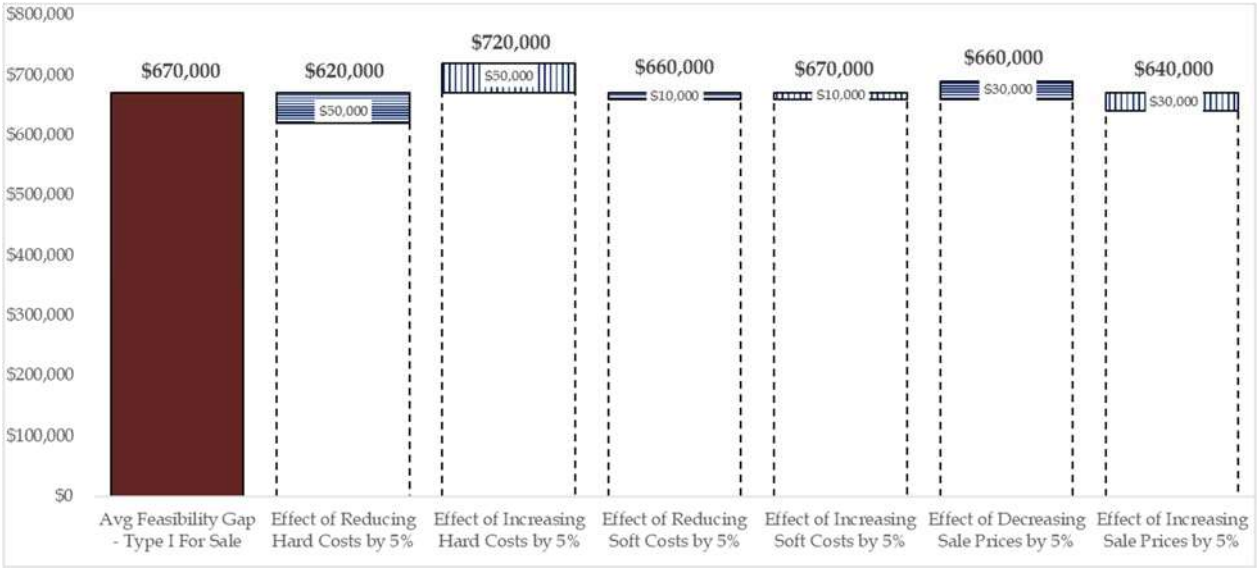


Exhibit D

Development Costs

Building Hard Costs Per GSF		Rental	Sale
	Type V	$438	$468
	Type III	$498	NA
	Type I	$558	$594

Parking Hard Costs Per GSF		Rental	Sale
Above grade pricing for Type V and Type III, below grade pricing for Type I.	Type V	$108	$112
	Type III	$112	NA
	Type I	$267	$272

Hard Cost Contingency	Rental	Sale
	5.00%	5.00%

Entitlement Professional Fees		Rental	Sale
e.g., CEQA-related and pre-entitlement professional fees	Type V	$531,000	$531,000
City Fees calculated separately	Type III	$531,000	
	Type I	$1,062,000	$1,062,000

Post Entitlement A&E / Prof Fees	Rental	Sale
of Hard Costs	6.00%	6.00%

Insurance	Rental	Sale
of Hard Costs	1.00%	1.50%

Developer Fee	Rental	Sale
	4.00%	4.00%

Financing	Rental	Sale
Interest Rate	8.00%	8.00%
Loan to Cost	55.00%	55.00%
Fees	1.00%	1.00%

Soft Cost Contingency	Rental	Sale
	5.00%	5.00%

Rental Prototype Assumptions

Market Rent Per Unit / Month	South & East	Central	West	North	Downtown
Type V	$3,080	$3,240			
Type III		$3,240	$3,690	$3,060	
Type I		$3,240	$3,690	$3,060	$3,480

Market Rent Per SF / Month	South & East	Central	West	North	Downtown
Type V	$3.42	$3.60			
Type III		$3.60	$4.10	$3.40	
Type I		$3.60	$4.10	$3.40	$3.87

Other Income Per Unit / Month *(Incl parking)*	
Type V	$180
Type III	$180
Type I	$200

Vacancy/Credit Loss 5.00%

Operating Expenses Per Unit / Year (not including property taxes)

Type V	$7,080
Type III	$7,080
Type I	$8,040

Target Return on Cost

Type V	5.75%
Type III	5.75%
Type I	5.75%

Sale Prototype Assumptions

Market Sale Price PSF	South & East	C, W, N	Downtown
Type V	$775	$725	
Type I			$775

Sales Costs Including Warranty Reserve 5%-6%

Target Profit Margin	South & East	C, W, N	Downtown
Type V	20%	20%	
Type I			20%

Note 1 Monthly unit rents and annual unit operating expenses are rounded to the nearest $10.

City Permits and Fees - Rental Prototypes *Total fees and per unit fees rounded to nearest '00*

Prototype		Type V South & East	Type V Central	Type III Central	Type III West	Type III North
Residential Value Per GSF		$149.80	$149.80	$149.80	$149.80	$149.80
Residential Value Per Unit		$168,500	$168,500	$168,500	$168,500	$168,500
Parking Value Per GSF		$68.12	$68.12	$85.19	$85.19	$85.19
Parking Value Per Unit		$27,200	$27,200	$34,100	$34,100	$34,100
Total Valuation Per Unit		$195,800	$195,800	$202,600	$202,600	$202,600
Construction Tax Assumptions						
Building and Structure		1.54% of value				
CRMP		2.42% of value				
Construction Tax		$75.00 per unit				
Residential Construction Tax		$90.00 per unit				
SMIPA		0.01% of value				
BSARSF		0.004% of value				
Total Construction Tax Per Unit		$7,900	$7,900	$8,200	$8,200	$8,200
Parkland In-Lieu Fees		$13,100	$22,600	$22,600	$20,800	$27,700
Parkland Credit	*Note 1*	25%	25%	25%	25%	25%
Total Parkland In Lieu Fees Per Unit		$9,800	$17,000	$17,000	$15,600	$20,800
School Fees Per Residential GSF		$4.55	$4.79	$4.79	$4.79	$4.79
School Fees Per Unit		$5,100	$5,400	$5,400	$5,400	$5,400
Planning and Building Fees Per Unit		$6,200	$6,200	$5,300	$5,300	$5,300
Inclusionary In-Lieu PSF		$21.74	$49.99	$49.99	$49.99	$21.74
Inclusionary Fee Per Unit		$24,500	$56,200	$56,200	$56,200	$24,500
Total Permits and Fees Per Unit		**$53,600**	**$92,800**	**$92,000**	**$90,700**	**$64,100**

Note 1 Adjustment to reflect assumed amount of parkland provided within project.

Note 2 Traffic fees currently being revised

City Permits and Fees - Rental Prototypes *Total fees and per unit fees rounded to nearest '00*

Prototype	Type I Central	Type I West	Type I North	Type I Downtown
Residential Value Per GSF	$149.80	$149.80	$149.80	$149.80
Residential Value Per Unit	$172,800	$172,800	$172,800	$172,800
Parking Value Per GSF	$112.22	$89.90	$89.90	$89.90
Parking Value Per Unit	$35,900	$28,800	$28,800	$28,800
Total Valuation Per Unit	$208,800	$201,600	$201,600	$201,600
Construction Tax Assumptions				
Building and Structure	1.54% of value			
CRMP	2.42% of value			
Construction Tax	$75.00 per unit			
Residential Construction Tax	$90.00 per unit			
SMIPA	0.01% of value			
BSARSF	0.004% of value			
Waiver Scenario B&S, CRMP Reduction	50% Waiver Scenarios Only			
Total Construction Tax Per Unit	$8,500	$8,200	$8,200	$8,200
Parkland In-Lieu Fees	$22,600	$20,800	$27,700	$14,600
Parkland Credit *Note 1*	25%	25%	25%	25%
Total Parkland In Lieu Fees Per Unit	$17,000	$15,600	$20,800	$11,000
School Fees Per Residential GSF	$4.79	$4.79	$4.79	$4.79
School Fees Per Unit	$5,500	$5,500	$5,500	$5,500
Planning and Building Fees Per Unit	$3,100	$3,100	$3,100	$3,100
Inclusionary In-Lieu PSF	$49.99	$49.99	$21.74	$49.99
Inclusionary Fee Per Unit	$57,700	$57,700	$25,100	$57,700
Note: Inclusionary Fees Waived in Waiver Scenarios				
Total Permits and Fees Per Unit	**$91,700**	**$90,100**	**$62,600**	**$85,400**

Note 1 Adjustment to reflect assumed amount of parkland provided within project.

Note 2 Traffic fees currently being revised

City Permits and Fees - Sale Prototypes *Total fees and per unit fees rounded to nearest '00*

Prototype		Type V South & East	Type V Central & West	Type V North	Type I Downtown
Residential Value Per GSF		$149.80	$149.80	$149.80	$149.80
Residential Value Per Unit		$215,300	$215,300	$215,300	$215,300
Parking Value Per GSF		$68.12	$68.12	$68.12	$112.22
Parking Value Per Unit		$30,000	$30,000	$30,000	$30,000
Total Value Per Unit		$245,300	$245,300	$245,300	$245,300
Construction Taxes					
Building and Structure		1.54% of value			
CRMP		2.42% of value			
Construction Tax		$75.00 per unit			
Residential Construction Tax		$90.00 per unit			
SMIPA		0.01% of value			
BSARSF		0.004% of value			
Waiver Scenario B&S, CRMP Reduction		50% Waiver Scenarios Only			
Total Construction Tax Per Unit		$9,900	$9,900	$9,900	$9,400
Parkland In-Lieu Fees Per Unit		$13,100	$22,600	$27,700	$14,600
Parkland Fees Credit	*Note 1*	25%	25%	25%	25%
Total Parkland In Lieu Fees Per Unit		$9,800	$17,000	$20,800	$11,000
School Fees Per Residential GSF		$4.55	$4.79	$4.79	$4.79
School Fees Per Unit		$6,500	$6,900	$6,900	$5,800
Planning and Building Fees Per Unit		$7,700	$7,700	$7,700	$3,200
Inclusionary In-Lieu Per GSF		$25.00	$25.00	$25.00	$25.00
Inclusionary In-Lieu Per Unit		$35,900	$35,900	$35,900	$30,400
Note: Inclusionary Fees Waived in Waiver Scenarios					
Total Permits and Fees Per Unit		**$69,900**	**$77,400**	**$81,200**	**$59,800**

Note 1 Adjustment to reflect assumed amount of parkland provided within project.

Note 2 Traffic fees currently being revised

Exhibit E

14.10.310 Financially Infeasible.

A fee or tax reduction applied uniformly to all Private Construction Projects within a specified Subcategory of Use is not a Subsidy if the Council determines, in accordance with the requirements of this Section, that construction of the projects is Financially Infeasible.

A. The Council must make its determination that a fee or tax reduction is not a Subsidy, supported by findings, following a public hearing.

B. The Council's findings must be supported by evidence presented at the public hearing, including a study analyzing whether construction of the Private Construction Projects within the specified Subcategory of Use is Financially Infeasible.

C. The financial feasibility study referenced in Subsection B of this Section 14.10.310 must be performed by a consultant qualified to provide real-estate analytic services.

1. The City will select and retain the consultant using its normal procurement process.

2. The required consultant study must address the following issues:

a. Whether construction of the Private Construction Projects in the specified Subcategory of Use is Financially Infeasible;

b. The reason(s) for any conclusion that construction of the Private Construction Projects in the specified Subcategory of Use is Financially Infeasible;

c. The anticipated duration of any condition(s) making construction of the Private Construction Projects in the specified Subcategory of Use Financially Infeasible;

d. The estimated size of the financial gap between the Private Construction Projects in the specified Subcategory of Use being Financially Infeasible and financially feasible;

e. Options for making construction of the Private Construction Projects in the specified Subcategory of Use financially feasible, including the following:

i. Providing the proposed fee or tax reduction without requiring the payment of prevailing wages;

ii. Providing the proposed fee or tax reduction along with requiring the payment of prevailing wages; and

iii. Any additional options, other than the proposed fee or tax reduction, that would make construction of the Private Construction Projects within the specified Subcategory of Use financially feasible, provided that any such options must comply with all applicable laws and regulations, including the City's current general plan.

3. Consultant's preparation of the required study will include the opportunity for stakeholder input.

4. The Council will use reasonable efforts to conduct the required public hearing within ninety (90) calendar days following the completion of the study referred to in Subsections B and C of this Section 14.10.310.

(Ord. 30292)

Exhibit F

Feedback from Developers, Brokers and Other Industry Professionals

From Zoom Meetings held on October 12, 2023

- Agree with conclusion that development is generally infeasible under current market conditions.
- Parking ratio too low – need at least 1.4 spaces per unit.
- Average unit size should be 675-750 SF for rental.
- Type V rental hard costs before contingency should be $485-$490 per net square foot.
- Type I hard costs appear to be in correct range.
- Developers are electing not to pay in-lieu fees.
- Target Return on Cost should be approximately 6.5% with 6.0% at minimum.
- Construction Loans – 50% LTC with 8.5%-9% interest rate
- Waiving impact fees helps, but is insufficient. Waiving annual property taxes would have more substantial beneficial effect.
- Generally, total development costs per unit appear to be approximately 10% high.
- Downtown projects have some of lowest rents in City – low rents are needed to incentivize people to live Downtown – approximately $3.00 per square foot (PSF).
- Rents approximately $0.20 PSF/month too high for South & East submarkets and $0.80 PSF/month too high for Downtown submarket; north rents appear to be in appropriate range.
- Other comment: rents $0.30 PSF/month too high in Center submarket – seeing rent in low $3.00 PSF range
- Operating expenses have increased substantially since last year.
- Insurance costs have gone up 3x since last year, now $2,000-$2,250 per unit excluding earthquake coverage.
- Operating expenses have exceeded $3,900 per unit for Type III excluding RE taxes, insurance and management.
- Estimate low rise total development cost per unit cost to be $750,000 as compared to $869,000.

Exhibit G

City of San Jose Inclusionary Housing Ordinance Areas