



Memorandum

TO: HONORABLE MAYOR AND
CITY COUNCIL

FROM: Kim Walesh

SUBJECT: SEE BELOW

DATE: December 3, 2019

Approved

D. D. S. L.

Date

12/6/19

**SUBJECT: CITY COUNCIL DIRECTION ON COST OF DEVELOPMENT REPORT
WORKLOAD ASSESSMENT**

RECOMMENDATION

Accept the staff-conducted workload assessment of the Council direction on the Report on the Cost of Residential Development.

OUTCOME

This report is intended to provide the Rules and Open Government Committee with an understanding of the workload and resource impacts of Council direction related to the Cost of Development Report, and provides recommendations consistent with the Council policy prioritization process.

BACKGROUND

On November 6, 2019, City Council directed staff to return to the Rules and Open Government Committee with a workload and resource assessment, and recommendations for prioritization of the items included in Councilmember Jimenez's memorandum dated November 1, 2019. The memorandum requested that staff study the following:

- 1) The impact of development standards and zoning restrictions on the cost of residential development in San José. Staff should study the following:
 - a. Parking requirements, including savings on development costs from reduced or eliminated parking requirements.
 - b. Height maximums, including profit potential with each additional story added to prototype developments (across all construction types).
 - c. Density limitations, including profit potential and impact on feasibility with density bonuses or elimination of density restrictions altogether.

- d. Commercial/retail requirements, including impact on financial feasibility with reduction or elimination of such requirements.
 - e. Any other development standard or zoning restriction within the control of the City that has a material impact on the cost of residential development.
- 2) The impact of development review, including the length of time taken to entitle and construct residential projects, on the cost of development. Include within this analysis:
- a. Cost comparisons between discretionary projects and by-right developments.
 - b. Cost savings by reducing discretionary review. (For example, allowing approval at a Planning Director Hearing instead of Council approval.)
- 3) An analysis of land values, measured in dollars per acre, in other cities in Santa Clara County, and compare with land values in sub-areas within San José.

The first Cost of Residential Development Report was initially brought to Council on April 26, 2018 and May 1, 2018, to provide City Council with a high-level overview of the local real estate market and the potential impact of direct City costs on housing feasibility. The information contained in the report provided important context for a number of development-related policy items that were scheduled in and around the same period. The need to continue to refine and update cost of development models and associated analysis was identified in the Housing Crisis Workplan approved by Council on June 12, 2018. Staff intends to update the report annually, with the next report planned for release in fall of 2020.

ANALYSIS

Council directed staff to return to the Rules and Open Government Committee with a workload and resource assessment on the additional analysis of the impact of development standards, zoning restrictions, and process amendments on the cost of residential development. Many of the items included in the Council direction relate to policy or process issues that are currently under review through the Housing Crisis Work Plan, General Plan 4-Year Review, or other processes. The descriptions below provide a brief outline of work that staff is currently undertaking and some of the major factors affecting them with relation to impacts on cost of development.

Parking requirements: The Zoning Ordinance currently offers provisions for significantly reducing parking below the current requirement and some developers have explored this opportunity. To further the goals of Climate Smart San Jose, staff is currently developing citywide parking reductions strategies which includes consideration of eliminating or reducing parking requirements for residential development. Based on applications submitted and feedback from the developers, the ability to reduce parking is highly situational in that it requires convenient access to other transit options. Furthermore, the financing market and consumer preference drives the amount of parking that is provided. Projects that propose to provide less parking than typically provided often have difficulty receiving project financing.

Height maximums: Outside of the specific height limitations in the Downtown and Diridon areas, the current height limits throughout the City have not represented a barrier to development. San José's multifamily market remains focused on five- to seven-story

construction which falls within the allowable height limits throughout the major growth areas. The few instances where developers have been interested in pursuing high-rise residential outside of the Downtown have been limited to North San Jose--where the market economics can support that type of development and the Zoning Ordinance and General Plan already allow for higher buildings.

Density limitations: San José's General Plan encourages growth at significantly higher densities than the development community is currently pursuing. The economics of most areas in the City and the nature and configuration of available redevelopment sites are often unable to support taller or denser projects, which generally require a more expensive construction type.

Commercial/retail requirements: Ensuring that residential communities have access to employment, amenities, and basic retail offerings is an important land use principal to ensure balanced and livable communities. When forced to compete in a mixed-use environment, residential development performs much stronger financially than retail or other employment uses throughout the majority of the City, and so the General Plan had focused on strategies that preserve or enhance opportunities for commercial development. The significant majority of development projects that have a specific commercial requirement are limited to select sites in the Downtown and development within Urban Villages. The General Plan's Urban Village major growth strategy is based on the redevelopment of existing commercial corridors and centers by allowing higher-density housing to be introduced with the Urban Village boundary. To maintain the opportunity for balanced growth throughout the City, and minimize the displacement of commercial businesses and job opportunities, the policies included in the General Plan require the replacement, and in many cases an increase in the amount of commercial development (including retail, service and office type uses), within the Urban Village. Outright removal of this requirement would have significant implications on the goals and outcomes embedded in the General Plan; however, through the Four-Year Review process, staff is presenting policy alternatives that would allow for more flexibility on how this can be addressed within Urban Village areas, and opportunities to reduce these requirements for affordable housing development.

Any other development standard or zoning restriction: Other standards that could be considered as part of this analysis would be impacts related to local requirements that go beyond typical development standards in surrounding cities. An example would be changes to the Fire or Building Code requirements, or the implementation of the San José Reach Code.

Discretionary projects versus by-right developments: Through the implementation of the Housing Crisis Workplan and the Development Services Transformation process, staff is continuing to identify areas that can provide increased efficiency and reduced review times. Given the transformational nature of most of the high-density residential development envisioned by the General Plan, community engagement continues to be an important priority. Removing requirements for discretionary review and the associated public hearing process would limit the community's opportunity for engagement on new development projects. Due to recent changes in State law, some residential development projects may move forward without the need to rezone the property, and in the case of SB35 eligible projects, without the need for

discretionary review. This will present the opportunity for staff to analyze the impacts of this requirement and provide additional information to Council on the time saved.

Reducing discretionary review: As noted above, recent changes in State law will limit the City's ability to require a rezoning to allow residential development, which is the primary reason a development project would require Council approval. Projects that conform to the existing Zoning District can typically receive project approval through development permit that is heard at Director's Hearing. Staff will continue to monitor the impact of these changes through the broader work included in the Housing Crisis Workplan but believes that due to the changes at the State level that additional financial analysis is not warranted at this time.

Conceptual Pro Forma Model

The Cost of Development Report is based on a pro forma analysis which considers "average" projects for the various development typologies and geographies identified by staff. The pro forma model represents a set of calculations that project the financial return (or potential feasibility) of a type or sub-type of development based on a set of reasonable assumptions. These assumptions include average lot size, average unit size, project density, and parking ratios, and are based on projects that have either been constructed, applied for through the development review process, or are being considered by prospective developers. The consultant completes similar analysis on cost factors such as land, construction costs, and prospective revenues or rents based on available industry information and cited data sources, as well as interviews with recent or prospective developers and contractors. Similarly, staff provides additional information on relevant fees and taxes applicable to the type or sub-type of development.

A pro forma of this basic nature is used by the commercial real estate industry to establish a basic "go/no-go" analysis which can be used to decide whether to invest further in the entitlement process or attract investment or financing to the project. In the context of the Cost of Development Report, the information represents the relative financial performance of development within each typology and geography. The model provides insight into the impacts of different cost and revenue changes to the overall viability of the project. The model does not provide a direct feasibility assessment of individual projects and doesn't account for the individual nature of development sites and projects. (That type of project-specific analysis would be appropriate and feasible if Council was considering targeted encouragement of a specific project, rather than a general type of housing.) Because the analysis is of an average or typical project, this means that individual projects may perform better or worse than the pro forma model based on site, financing, or developer factors that deviate from the average or typical assumptions included in the model.

Staff has discussed the areas of analysis included in the Council direction with the consultant who completed the two previous Cost of Development studies to understand how these might be included. The feedback received from the consultant is that additional information on how these different items would affect a pro forma can be provided in a narrative form; however, to understand the specific impact of these types of policy changes in a pro forma model (for example as individual cost or revenue line items) would require a very different type of analysis.

To complete this new analysis, the consultant would need to consider a specific site and building program and engage an architect to develop a conceptual design and a cost estimator to evaluate the cost of construction and the impact of building program changes resulting from these policy levers. Due to the site- and design- specific nature of this analysis, it would provide a very narrow understanding of this factors on a specific type of development within a specific geography. In the sections below staff provides a workload and resource assessment of these two alternatives.

1. **Additional Narrative in 2020 Cost of Development Report** - Include a high-level narrative that provides context on how policy changes included in the Housing Crisis Work Plan, General Plan Four-Year Review, or other processes, impact the cost of development.

GREEN LIGHT: Staff believes that the scope for the next Cost of Development Report could be expanded to provide additional information on how these factors are impacting developers' decisions to proceed with projects and how they are being factored into pro forma-based decisions. This would result in less than 40 hours of additional staff work, but may increase the cost of completing the report. Staff believes this can be accommodated within existing budget resources and would return to Council in the fall of 2020.

2. **Develop a Site-Specific Building Program Analysis** – Include a technical analysis of the direct and indirect cost implications of the policy s and ordinance amendments included in Council's direction.

YELLOW LIGHT: Due to the increased scope and the need to procure additional consultant services, staff recommends that Council send this recommendation to the Priority Setting Process to understand how in the relative importance of investing time and funding in this compared to other priorities identified in the Housing Crisis Workplan and directed by Council. Due to the detailed nature of the assignment, the report would require a significant amount of staff time and would require reassigning staff resources from other current policy priorities or workplan items. Additionally, the consultant contract for the Cost of Development report is paid for out of one-time Business and Economic Development non-personal funds. Staff estimates the additional cost to hire new consultant support to prepare the report and manage the process is up to \$200,000.

COORDINATION

Preparation of this memorandum has been coordinated with the Department of Planning, Building and Code Enforcement and the Housing Department.

HONORABLE MAYOR AND CITY COUNCIL

December 3, 2019

Subject: Cost of Residential Development Follow Up

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CEQA

Not a Project, File No. PP17-009, Staff Reports, Assessments, Annual Reports, and Informational Memos that involve no approvals of any City action.

/s/

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Director of Economic Development

For questions, please contact Chris Burton, Deputy Director, Economic Development at (408) 535-8114.