

# Memorandum

**TO:** HONORABLE MAYOR  
AND CITY COUNCIL

**FROM:** Erik L. Soliván

**SUBJECT:** Lupina Cost of  
Development Update

**DATE:** September 24, 2024

Approved



Date:

9/25/24

## INFORMATION

The purpose of this memorandum is to provide updated information regarding the Lupina affordable housing development.

Staff conducted further assessment of the financing structure of the 99-unit affordable housing development, Lupina, formerly known as 797 Almaden, and determined that the estimate disclosed in the March 14, 2023 City Council meeting, projecting a per-unit cost exceeding \$1,100,000, was inaccurate because the financing for the development was incorrectly calculated. After further discussions with the Lupina affordable housing project developer, Resources for Community Development, to revise the development's projected pro forma, the development cost is now well below \$1,100,000 per unit.

## BACKGROUND

On March 14, 2023, City Council approved a total City loan commitment of up to \$21,350,000 in construction-permanent funding and up to \$3,590,000 in acquisition funding from Measure E Real Property Transfer Tax for the Lupina affordable housing development.

The financing miscalculation for the Lupina affordable housing development's total development cost had reinforced an inaccurate narrative that typical affordable housing development per unit costs exceeded \$1,000,000. The Lupina affordable housing development financing numbers have been corrected and revised, and the analysis is detailed below. It is correct that current per-unit costs are the highest in the nation, and the industry is beginning to shift towards strategies that bring down the per-unit cost, such as innovations in financing sources used to fund affordable housing as well as utilizing different products for construction.

## **ANALYSIS**

Staff recently conducted an updated comprehensive review of the Lupina affordable housing development's financing structure, and several line-item adjustments were identified as problematic. The following major line items were corrected, the adjustments made, and the resulting impacts on the total development cost and per-unit cost are stated.

- **Standardized the interest rate quote for the tax-exempt construction loan from 8.07% to 6.60%:** The previously projected financing interest rate of 8.07% for the construction senior lender loan has been reduced to 6.60%, which is more accurately aligned with capital markets, industry practices, and other comparable developments. The total construction period interest was lowered from \$8,255,999 to \$6,873,651, which saved \$1,382,348 in construction period interest costs.
  - **Previous Interest Rate Assumption:**  
4.43% (30 Day Average Term Secured Overnight Financing Rate) +  
1.50% Spread + 2.14% Bank Underwriting Cushion = 8.07%
  - **Current Interest Rate Assumption:**  
4.40% (30 Day Average Term Secured Overnight Financing Rate) +  
1.45% Spread + 0.75% Bank Underwriting Cushion = 6.60%
  - **Total Construction Period Interest Savings = \$1,382,348**
- **Standardized hard and soft cost contingencies:** Industry-standard contingencies of 3% per hard and soft cost total were compounded with additional contingencies, which have now been reduced by \$10,519,726 to a total of \$7,414,733.
  - **Previous Contingencies = \$17,934,459**
  - **Current Contingencies = \$7,414,733**
  - **Savings = \$10,519,726**
- **Value-engineered inefficiencies in design and construction:** With a more efficient project, hard costs were reduced, and \$759,103 in additional savings were produced.

The revised financial projection, incorporating all cost-saving changes, results in a total cost reduction of \$12,661,177 from the previous total development cost, which was represented at the City Council meeting on March 14, 2023.

- \$110,380,539 (Previous Total Development Cost) - \$1,382,348 (Reduction in Interest Rate) - \$10,519,726 (Reduction in Contingencies) - \$759,103 (Reduction in Other Hard and Soft Costs) = **\$97,719,362** (Revised Total Development Cost)
- Projected cost per unit after interest rate, contingency, and other cost reductions = **\$987,064**.

The revised budget now reflects a more accurate and reasonable total development cost of approximately \$97,719,362, or approximately \$987,000 per unit. The Lupina developer, Resources for Community Development, provided a revised pro forma confirming the updated figures cited above. As the Lupina affordable housing development project moves toward closing in 2025, the Housing Department will actively monitor the financing as further revisions occur.

Staff also compared the revised Lupina development budget to other comparable affordable housing developments in San José currently in progress, which had a portion set aside for housing homeless/special needs residents. Three of the comparable affordable housing developments are listed below.

- **Hawthorn Senior Apartments**, a 103-unit development with a total development cost of \$88,649,402 at \$861,000 per unit.
  - 20% of units are reserved for homeless/special needs residents.
- **525 North Capitol**, a 160-unit development with a total development cost of \$126,218,436 at \$789,000 per unit.
  - 25% of units are reserved for homeless/special needs residents.
- **Kooser Apartments**, a 191-unit development with a total development cost of \$158,246,366 at \$829,000 per unit.
  - 45% of units are reserved for homeless/special needs residents.

It is important to note that labor costs in San José have been rising and typically account for approximately 40-50% of the total construction contract or approximately \$35,000,000 of the Lupina affordable housing development's \$70,000,000 construction contract costs.

As Federal Open Market Committee rates begin a downward trajectory later this calendar year, by the time the Lupina affordable housing development closes construction financing, there could be a further interest rate reduction of at least 50 basis points. This would lead to a 6.10% construction loan interest rate, resulting in another \$500,000 in total development cost savings, and \$5,000 per unit cost savings, further aligning the Lupina affordable housing development to comparable developments.

HONORABLE MAYOR AND CITY COUNCIL  
September 24, 2024  
**Subject: Lupina Cost of Development Update**  
Page 4

**COORDINATION**

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

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