STRATEGIC ECONOMICS

COMMUNITY PLANNING COLLABORATIVE

Residential Feasibility Study and Inclusionary Analysis

PUBLIC DRAFT REPORT

Prepared for:

City of Gilroy

November 18, 2025

CITY OF gilroy CALIFORNIA

A community with a spice for life

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I. Introduction

REPORT PURPOSE

This report is part of a collaborative effort by six jurisdictions in Santa Clara County to analyze and potentially implement new or revised affordable housing policy tools. The participants in the study include Gilroy, Los Altos Hills, Los Gatos, Mountain View, the City of Santa Clara, and Sunnyvale. Together, these jurisdictions have commissioned Strategic Economics to perform a **Grand Nexus Study**. The study includes the required analysis and findings for:

- **Residential impact fees** charged on single-family units and "missing middle" developments of fewer than 10 units
- **Inclusionary affordable housing requirements** and associated in-lieu fees
- **Commercial linkage fees** charged on non-residential development

The Grand Nexus Study culminated in three reports to address each of the above policies: The Residential Impact Fee Study; The Residential Feasibility Study and Inclusionary Analysis (this report); and The Commercial Linkage Fee Study. Each jurisdiction has opted into one, two, or all three components of the study.

This report focuses on inclusionary housing policies in the City of Gilroy. The report describes how inclusionary policies work, how policy alternatives could impact the financial feasibility of new housing development, and how Gilroy could leverage a potential inclusionary housing policy to increase affordable housing production within the city. The purpose of this report is to provide context and findings for the City to review when considering a potential inclusionary housing policy.

BACKGROUND ON INCLUSIONARY HOUSING POLICIES

Inclusionary housing policies—also called "inclusionary zoning"—require market rate housing developers to set aside a percentage of units in a residential project and offer them at below market rates as deed-restricted affordable units. California law requires rental inclusionary policies to provide for alternative means of compliance with the policy, such as by paying a fee "in-lieu" of providing on-site units or by supporting the production of affordable units in some other way (such as a land donation). Inclusionary policies capture some of the economic value generated by building market rate housing in order to support the development of affordable units. Inclusionary policies are one strategy local governments can use to create mixed income developments, provided the policy is met with onsite units.

Typically, inclusionary policies designate certain income requirements that developers must meet to fulfill the affordability requirement. These income categories are based on the area median income (AMI) of a region. Rents and sales prices are set at below market rate (BMR) levels so that households pay no more than 30 percent of the targeted income level for their income category. Each year, the California Department of Housing and Community Development (HCD) publishes income limits and standard housing income categories for every county corresponding to its AMI. Figure 1 shows the income limits for Santa Clara County in 2025.

Median incomes for households in Gilroy are lower than the official Area Median Income for Santa Clara County as a whole. Figure 1 also shows U.S. Census Bureau estimates of median income for households of each size in Gilroy and Santa Clara County, as a point of comparison against the California HCD's area median income for Santa Clara County. The Census estimates differ in methodology from the HCD income limits shown in the same figure. Based on comparison of the two Census estimates, Gilroy's median income is approximately 60 to 80 percent of the County's median income for the household sizes shown in Figure 1.

FIGURE 1: INCOME LIMITS FOR SANTA CLARA COUNTY IN 2025 VS. MEDIAN INCOME IN GILROY, BY CATEGORY AND HOUSEHOLD SIZE

	California HCD: Santa Clara County Income Limits					*U.S. Census: Median Income by Household Size*	
	Extremely Low	Very Low	Low	Median	Moderate	*Santa Clara County*	*Gilroy*
Percent of AMI:	30%	50%	80%	**100%**	120%		*N/A*
Household Size							
1	$42,200	$70,350	$111,700	**$136,650**	$164,000	***$79,398***	***$45,781***
2	$48,200	$80,400	$127,650	**$156,150**	$187,400	***$161,425***	***$111,861***
3	$54,250	$90,450	$143,600	**$175,700**	$210,850	***$196,657***	***$137,125***
4	$60,250	$100,450	$159,550	**$195,200**	$234,250	***$225,840***	***$174,450***
5	$65,100	$108,500	$172,350	**$210,800**	$253,000	***$189,196***	***$147,000***

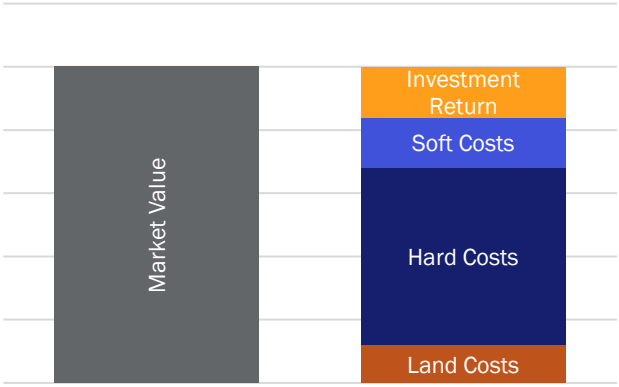
Source: CA HCD, 2025; U.S. Census Bureau, ACS 5-Year Survey, 2023; Strategic Economics, 2025.

INCLUSIONARY POLICIES AND FINANCIAL FEASIBILITY

Because inclusionary policies seek to leverage the activities of the private market to produce affordable housing, they are reliant on the financial feasibility of market rate housing projects. Market rate development projects are only financially feasible when the market value of the project (based on total revenue) exceeds project costs and an investment return required by capital markets. As shown in Figure 2, financial feasibility is determined by the following factors.

- Total **project revenues** are determined by the market value of the project.
    - **For ownership projects, the market value consists of the sales prices the units can obtain.**
    - **For rental projects, the market value of the project depends on the annual revenue it will generate and the current capitalization rate,** which reflects overall project investment risk relative to alternative investments.
- Total **project costs** include hard costs, soft costs, investment return, and land costs.
    - **Hard costs** include materials and labor associated with physical construction of the building.
    - **Soft costs** include indirect expenses such as architecture and engineering, taxes, insurance, financing costs, and municipal fees.
    - **Land costs** refer to the price the developer pays to acquire the land.
- **Investment return** refers to the required financial return on investment that a project must achieve to attract developer and lender investment. For ownership projects, required return is based on the net revenues from the initial sale of units. For rental projects, required return is based on the stabilized annual operating income of the development.

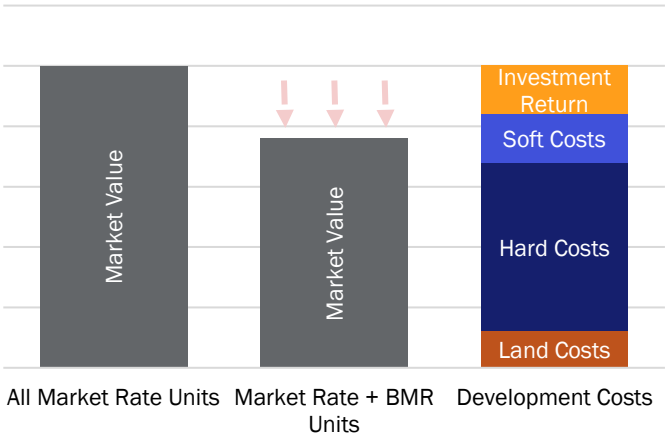
FIGURE 2: COMPONENTS OF FINANCIAL FEASIBILITY: PROJECT VALUE AND PROJECT COST COMPONENTS



Source: Strategic Economics, 2025.

Inclusionary policies have the benefit of potentially producing affordable housing units without using public forms of subsidy, but they may impact financial feasibility by reducing the market value of the project. Because inclusionary units generate less revenue than market rate units, substituting market rate units with inclusionary units will reduce the project's total revenue. Figure 3 visualizes this impact on the project's overall feasibility. In this example, a new project that may be feasible with all market rate units becomes infeasible if its total value is significantly reduced when a percentage of the units are offered at below market rates. However, projects that generate an investment return that is sufficiently high to absorb a reduction in value from the inclusionary policy, while still meeting a minimum market return, will remain financially feasible.

FIGURE 3: POTENTIAL IMPACT OF INCLUSIONARY POLICIES ON FINANCIAL FEASIBILITY



Source: Strategic Economics, 2025.

An effective inclusionary policy will set affordability requirements high enough that they result in substantial additional affordable units, but not so high that they prevent the feasibility of market rate housing projects altogether. Thus, the purpose of conducting a feasibility analysis is to identify an inclusionary level that that allows projects to generate enough revenue to proceed while also providing affordable units.

Financial feasibility in market rate housing projects depends upon a variety of highly dynamic factors. Project costs can fluctuate due to changes in construction labor, materials costs, interest rates, or a variety of other factors. Similarly, a project's revenue can fluctuate significantly based on the availability of housing supply in the local market, changes in the attractiveness of a project's location, or other factors impacting demand in the local market. Finally, the minimum investment return can fluctuate based on external factors such as interest rates in the macro economy or trends in real estate capital markets. The Policy and Market Scenarios discussion in the next section includes an analysis of market scenarios that address these fluctuations. Additionally, updating feasibility analyses periodically can help ensure that inclusionary policies are still able to function optimally as market conditions change.

CITY OF GILROY'S CURRENT INCLUSIONARY HOUSING POLICY

The City of Gilroy does not currently have a citywide inclusionary / in-lieu fee policy. However, the City's Neighborhood District Policy, which applies to five neighborhood districts, requires that fifteen percent of residential units developed in each district include income-restricted affordable housing. According to materials provided by the City, the Neighborhood District Policy has helped produce 204 income-restricted affordable rental units, 52 affordable senior units, and 36 income-restricted ownership units.

REPORT ORGANIZATION

This report summarizes the impact of inclusionary policy options on financial feasibility for housing projects in Gilroy and provides policy context for consideration of inclusionary policy alternatives. The report is organized in two sections:

- Section II, Financial Feasibility Analysis, describes the current market for housing development in Gilroy; the potential for market rate projects to support inclusionary housing; and the sensitivity of financial feasibility to market conditions. This section also discusses the relationship between inclusionary requirements and in-lieu fee levels.

- Section III, Policy Considerations and Findings section discusses inclusionary housing policies used by Gilroy's neighboring jurisdictions and other state and local policy considerations influencing the implementation of inclusionary policies. The Summary of Findings and Conclusions portion of this section summarizes the final conclusions from all prior sections and presents Strategic Economics' overall conclusions for the City of Gilroy.

The report also includes an appendix: Appendix I: Financial Feasibility Assumptions.

II. Financial Feasibility Analysis

Strategic Economics conducted a financial feasibility analysis to test a set of inclusionary policy scenarios under current market conditions and a range of alternative market conditions. This analysis evaluated both ownership and rental housing project types. The results provide context that the City of Gilroy can use to assess the potential for an inclusionary policy to align with the City's affordable housing objectives in an evolving market.

This financial feasibility analysis section includes four parts. It begins with an overview of the methodology used for the feasibility analysis, including details on the modeling approach and the types of housing tested in the analysis. This section then shows the results of the financial feasibility modeling for all housing types in Gilroy—both with the existing inclusionary policy and under a variety of market and inclusionary policy scenarios. The financial feasibility analysis concludes with an overview of in-lieu fees, explaining how they are calculated and how inclusionary requirements impact in-lieu fee levels.

METHODOLOGY

Analysis Approach

Strategic Economics evaluated financial feasibility for housing projects in Gilroy using a static "pro forma" model. A pro forma is a real estate finance model used to aggregate assumptions about development costs, revenue, and financing conditions to evaluate the financial feasibility of new housing projects. A static pro forma—a simplified version of pro forma that does not model developer cash flows over time—is a standard approach for supporting broadly applicable policy and planning decisions.

Applying this static pro forma model to residential projects and inclusionary policies in the City of Gilroy required three steps:

- Develop a set of residential development "prototypes" to evaluate inclusionary policies for multi-unit development across a range of product types typical of recent housing construction in Santa Clara County;
- Develop pro forma assumptions for these prototypes, including hard construction costs, soft costs, and revenue expectations for Gilroy. Strategic Economics based these assumptions on market research, interviews with developers active in Santa Clara County, and other recent experience with pro forma analysis in the San Francisco Bay Area.
- Use the pro forma model to test the financial performance of each prototype under a variety of market and policy scenarios.

EVALUATING FEASIBILITY

Strategic Economics measured the financial performance of each prototype using **residual land value analysis**. In residual land value analysis, the land cost estimate is initially taken out of the equation. Instead, the analysis begins by estimating project market value, hard costs, and soft costs, as well as a minimum acceptable return for a typical developer pursuing the project.

This calculation requires identifying six key metrics for feasibility:

- **Project Revenue** is the primary indicator of market value for the project, based on expected income or sales proceeds.
    - For ownership projects, this is the project's total net sales proceeds.
    - For rental projects, this is the project's annual net operating income (NOI), which is defined as the annual revenue from rent, less vacancy and operating costs.
- **Target Return** is the level of return on investment that a project must achieve for the developer and lenders to determine that it is a worthwhile investment.
    - For ownership projects, this metric used is *return on cost.* Return on cost is the ratio of net project value to total development cost.
    - For rental projects, the primary metric is *yield on cost.* Yield on cost is the ratio of NOI to total development cost.[1]
- **Supportable Development Costs** are the highest development cost for which the project would still be viable given project revenue and the minimum target return.
    - For ownership products, the supportable development cost is each project's projected net sales proceeds, less the required return on cost.
    - For rental projects, the supportable development cost is the project's projected NOI divided by its minimum target yield on cost.
- **Total Development Costs (Excluding Land)** are the sum of hard construction costs, soft costs, municipal fees, financing costs, and contingency.
- **Residual Land Value (RLV)** is calculated by subtracting total development cost (excluding land) from supportable development cost. The residual land value that remains, therefore, represents the maximum a developer could pay for land while still achieving the minimum necessary return.
- Residual land value can be compared to **Typical Land Costs** to evaluate feasibility. Typical land costs are the market average costs (calculated on a per square foot basis) for a vacant property on which the housing project could be built.

A project is financially infeasible when its residual land value is less than zero. If its residual land value is greater than zero but less than the typical market value for land, the project may be feasible because land values tend to vary significantly within a market depending on a range of factors. If the residual land value is at or greater than a typical land value, it is likely to be feasible.

Prototypes

The development prototypes used in the feasibility analysis are generalized examples of new housing, representing a broad range of multi-unit housing projects typical of recent development trends in the Gilroy market area. This study used three residential prototypes to evaluate financial feasibility. The same set of prototypes were used in the residential impact fee study for Gilroy.

The prototypes used in the City of Gilroy's inclusionary analysis range in density from 8 to 36 units per acre. Figure 4 provides a summary of each of the three prototypes. This includes two ownership product types and one rental product type, as described below:

[1] For a development project to obtain financing, its yield on cost must be higher than its capitalization rate—the ratio of NOI to project value. In other words, lenders and developers expect the completed project to be worth more than its total development costs. The relationship between yield on cost and cap rates varies based on financing conditions and perceived market risk.

Ownership Prototypes

- **Single-Family Subdivision:** this prototype represents a typical neighborhood with detached single-family homes at a density of seven units per acre. It includes 30 single-family homes built on 4.5 acres. Individual homes range from three to four bedrooms, and from 2,300 to 2,700 square feet. Each home has a private, two-car garage.

- **Townhomes:** this prototype represents a development with attached, single-family units built at a density of 20 units per acre. These units generally include between two and four-bedrooms, averaging 1,710 square feet, and are built over a private garage.

Rental Prototypes

- **Small Scale Rental Apartments:** this prototype is a three-story multifamily building at a density of 36 units per acre. The prototype contains a mix of studio to three-bedroom units, with an average unit size of 955 square feet. Parking is a combination of surface and tuck-under parking with two spaces per unit.

FIGURE 4: RESIDENTIAL PROTOTYPES USED IN INCLUSIONARY ANALYSIS FOR CITY OF GILROY

	Single-Family Subdivision	Townhomes	Small Scale Rental Apartments
Tenure	**Ownership**	**Ownership**	**Rental**
Parcel Size (acres)	4.5	1.5	1.5
Number of Stories	2	3	3
Total Gross Square Feet	79,000	51,300	60,647
Number of Units	30	30	54
Average Unit Size (net square feet)	2,633	1,710	955
Bedroom Types	3-BD to 4-BD	2-BD to 4-BD	Studio to 3-BD
Units per Acre	7	20	36
Parking Format	Private Garages	Private Garages	Surface + Tuck-Under
Residential Parking Ratio	2.00	2.00	2.00
Residential Parking Spaces	60	60	108

Source: Strategic Economics, 2025; Cities in Santa Clara County, 2025; CoStar, 2025.

Pro Forma Assumptions

COST AND RETURN ASSUMPTIONS

Strategic Economics estimated development costs based on interviews with developers and general contractors experienced with residential development in Santa Clara County, as well as reviews of market data and budgets for other development projects throughout the Bay Area. As noted earlier, the main cost categories for development include hard costs, soft costs, and land costs:

- **Hard costs** refer to the direct construction costs, such as materials and construction labor, used to physically prepare the site for development, construct the building, and perform all site work including site circulation, utilities, and landscaping.

- **Soft costs** include all indirect expenses required to complete a development project, such as architecture, engineering, consulting, legal fees, taxes, municipal fees, and insurance. In addition to these costs, developers must account for the cost of financing a construction loan, and a contingency for unexpected expenses.

- **Land costs** refer to the cost of acquiring land for development. In residual land value analysis, the land cost is calculated last, as the highest land cost the developer could afford to pay and still have the project pencil. Strategic Economics also estimated typical land costs for each prototype to compare against the residual land value and assess feasibility.

Strategic Economics modeled the required **investment return** as follows:

- For ownership projects, required return is based on the net revenues from the initial sale of units (referred to as *return on cost*). For rental projects, required return is based on the stabilized annual operating income of the development (referred to as *yield on cost*).

The Single-Family Subdivision, Townhome, and Small Scale Rental prototypes assume similar wood frame construction methods for the residential portions of their buildings, but the apartments include significant additional costs per square foot of building area due to their stacked construction and higher density of appliances and utility systems. Figure 5 provides a high-level overview of cost assumptions used to evaluate financial feasibility for ownership product types. The townhome and apartment prototypes have higher construction financing costs due to their longer construction time. More detailed cost assumptions can be found in the Appendix, in Figure 27.

FIGURE 5: SUMMARY OF COST ASSUMPTIONS FOR PRO FORMA

	Unit of measure	Single-Family Subdivision	Townhomes	Small Scale Rental Apartments
Typical Land Costs	per square foot	$15	$20	$30
Hard Costs				
Demolition and Site Work	per sq. ft. land	$5	$10	$10
Building Area Construction	per gross sq. ft.	$200	$200	$290
Parking				
Private Garages		N/A – Included in building area		
Surface	per space			$10,000
Tuck-under	per space			$10,000
Soft Costs				
Arch, Eng., Consulting, Taxes, Insurance, Legal, and Other Soft Costs (excluding fees, contingency)	% of hard costs	13.0%	18.0%	13.0%
Municipal Fees	per unit	$96,000	$61,940	$52,911
Contingency	% of hard + soft costs	5.0%	5.0%	5.0%
Financing Costs	% of hard + soft costs	3.0%	4.2%	5.4%
Developer Return				
Target Developer Return-on-cost	% of total dev costs	15.0%	15.0%	
Target Developer Yield-on-cost	% of total dev costs			5.5%

Sources: Strategic Economics, 2025; Developer Interviews, 2025; Redfin, 2025; CoStar, 2025; Federal Reserve Bank of New York, 2025.

MARKET RATE REVENUE ASSUMPTIONS

Strategic Economics analyzed recent property sales data from Redfin alongside current property listings and input from local developers to determine market rate revenue assumptions for ownership products. Ownership revenue assumptions are shown in Figure 6. The average sales value per unit for

each product type accounts for typical sales prices for each unit type in the Single-Family Subdivision and Townhome prototypes. Based on recent home sales, typical townhome sales prices in the city of Gilroy range from $550,000 for a two-bedroom unit to $900,000 for a four-bedroom unit. The typical sales price for single-family home is $1.05 million for a three-bedroom unit and $1.25 million for a four-bedroom unit. Detailed revenue assumptions for ownership projects can be found in the Appendix in Figure 29.

FIGURE 6: OWNERSHIP PRO FORMA MARKET RATE UNIT REVENUE ASSUMPTIONS

	Unit of measure	Single-Family Subdivision	Townhomes
Average Sales Value	**per unit**	**$1,216,667**	**$809,167**
Marketing Expense	% of Sales Price	5%	5%
Net Revenue		$1,155,833	$768,708

Sources: Strategic Economics, 2025; Developer Interviews, 2025; Redfin, 2025.

Market rate rent assumptions were derived from three sources of information. Strategic Economics analyzed current rental listings in comparable apartment projects; collected input from developers; and analyzed market trends from CoStar to identify typical City of Gilroy rents for small scale rental apartments. Figure 7 provides a summary of revenue assumptions including the average monthly rent and assumptions for vacancy rate, operating costs, and capitalization rate. Capitalization rate (cap rate) refers to the ratio of net annual operating income (gross maximum rent, less vacancy and operating costs) to the project's total market value. Detailed revenue assumptions for rental projects can be found in the Appendix in Figure 30.

FIGURE 7: SMALL SCALE RENTAL APARTMENTS MARKET RATE REVENUE ASSUMPTIONS

	Unit of measure	Small Scale Rental Apartments
Rent Assumptions		
Average Unit Size	Square feet	955
Monthly Rent per Square Foot	$/sq. ft.	$2.79
Average Monthly Rent	per unit	$2,659
Other Revenue Assumptions		
Vacancy Rate	% of Units	5%
Operating Expense	% of Market Rate Revenue	30%

Sources: Strategic Economics, 2025; Developer Interviews, 2025; Apartment Websites, 2025; CoStar, 2025.

BELOW MARKET RATE REVENUE ASSUMPTIONS

Strategic Economics also modeled the below market rate (BMR) rents and sales prices associated with inclusionary units as appropriate to each inclusionary policy scenario. These units were priced at a level such that qualifying households pay no more than 30 percent of their monthly income on housing costs. To determine whether households qualify for affordable housing, HCD publishes a table for each county that lists the county's "area median income" and household income categories based on household size. This income table (shown in the Appendix in Figure 31) delineates the maximum income that qualifies as very low-, low-, and moderate-income for each household size. The

inclusionary policy designates what share of units must be provided to households in each income range. The maximum revenue each inclusionary unit could generate is tied to the top of this range, although in practice this amount is somewhat lower than the maximum.

Expected revenues were calculated using the income limits, the assumed share of income that can be spent on housing, and estimates for other monthly costs. For ownership housing, other monthly costs might include utility costs, property taxes and insurance, private mortgage insurance, and homeowners' association (HOA) fees. For rental housing, this generally includes any utility costs not included in the rent. Because household incomes vary for households qualifying in each income category, Strategic Economics assumed that the average AMI level of qualifying households would be below the maximum allowable AMI in the income category. Figure 8 shows the assumed percentage of AMI used as an average in each income category for ownership and rental inclusionary units.

FIGURE 8: MAXIMUM AMI FOR INCOME CATEGORIES AND AVERAGE AMI ASSUMPTION FOR OWNERSHIP AND RENTAL INCLUSIONARY UNITS

Income Category	Maximum % of AMI	Assumed % of AMI for Ownership Units	Assumed % of AMI for Rental Units
Moderate-Income	120%	110%	110%
Median-Income	100%	90%	90%
Low-Income	80%	70%	60%
Very Low-Income	50%	N/A	50%
Extremely Low-Income	30%	N/A	30%

Sources: Strategic Economics, 2025.
Note: The average AMI reflects the likelihood that not all households qualifying in an income category could afford a rent or sales price based on the maximum income level within an income category. The percentages used correspond with California Health and Safety Code guidance on affordable rent and sales price levels for Extremely Low, Very Low, Low, Median, and Moderate-Income categories.

Though market rate rents and sales prices exceed affordable rents and prices for most income categories, households at the countywide median income can afford market rate rents in Gilroy. Figure 9 shows achieved sales prices for BMR units as modeled in the ownership pro forma models. For most income categories and prototypes, BMR units would achieve less than one-half of the market rate sales price in Gilroy. Figure 10 shows achieved monthly rents for BMR units compared to market rate rents. For the small scale rental apartment prototype, households in moderate-income categories could afford rents that are at or above market rate levels in Gilroy. However, as shown in Figure 1, Gilroy's median income is much lower than Santa Clara County's median income; depending on household size, the "median" household in Gilroy may qualify as low-income according to HCD's income limits for Santa Clara County. This helps explain why Gilroy's market rate rent is lower than the maximum allowable rent for median-income or moderate-income households. When modeling feasibility for inclusionary policies, Strategic Economics assumed that BMR rents would be no more than the market rate rent for each unit type.

Figure 32, Figure 33, and Figure 34 in the Appendix show more details on affordable sales prices and rent calculations.

FIGURE 9: MAXIMUM SALES PRICE FOR BELOW MARKET RATE UNITS BY INCOME LEVEL AND PROTOTYPE, 2025

	Single-Family Subdivision	Townhome
Market Rate Sales Price per Unit	$1,216,667	$809,167
Below Market Sales Price per Unit (Income Level)		
Low (70% Achieved AMI)	$309,196	$299,260
Median (90% Achieved AMI)	$445,126	$426,448
Moderate (110% Achieved AMI)	$581,055	$553,635

Sources: Strategic Economics, 2025; Santa Clara County Housing Authority, 2025; CA HCD, 2025; Redfin, 2025; Freddie Mac, 2025; Alta Housing, 2025; Ownwell, 2025.
Notes: Accounts for share of income spent on housing costs (30%), current interest rates, monthly utility costs, taxes, insurance, and HOA costs. Achieved sales price reflects likely average for units in each income category in an inclusionary project.
Medium Single-Family sales prices are higher because it assumes all units are either three-bedroom or four-bedroom units.

FIGURE 10: MARKET RATE RENT IN GILROY VS. ACHIEVED MONTHLY RENT PER UNIT AT REQUIRED INCOME LEVEL, 2025

	Small Scale Rental Apartments
Average Market Rate Rent per Unit	**$2,659**
Below Market Monthly Rent per Unit (Income Level)	
30% AMI (Extremely Low)	$1,163
50% AMI (Very Low)	$2,018
60% AMI (Low)	$2,371
90% AMI (Median)	$3,616*
110% AMI (Moderate)	$4,445*

Sources: Strategic Economics, 2025; Santa Clara County Housing Authority, 2025; CA HCD, 2025.
Note: This table shows achieved monthly rent at each income level based on 30 percent of monthly income at the specified share of AMI, less a utility allowance.
*BMR Rents with asterisk indicate that the maximum affordable rent for that category exceeds market rate rents. In such cases, the market rate rent was used to model revenue obtained from inclusionary units.

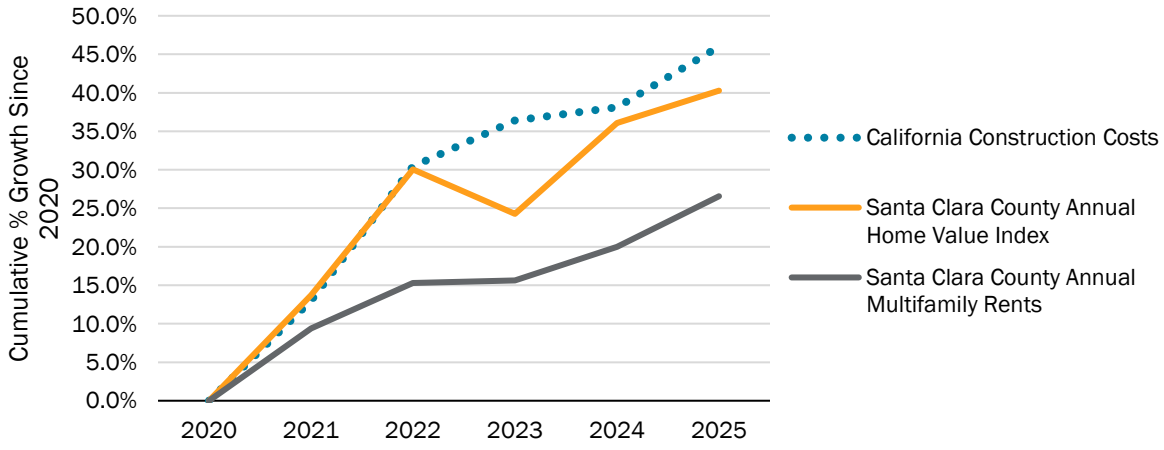
INITIAL FEASIBILITY ANALYSIS RESULTS

The current feasibility outlook in Gilroy is a product of both the strength of the city's housing market and recent trends on a regional or national level that are influencing construction costs and housing demand. This section provides an overview of recent regional trends before presenting findings on ownership and rental project feasibility in Gilroy.

Trends Influencing Feasibility

Home values in Santa Clara County largely kept pace with construction cost inflation over the past five years, while multifamily rent growth fell behind costs. The years 2022 and 2023 were a period of high rates of inflation throughout the national economy. As shown in Figure 11, construction costs across California rose by approximately 46 percent between 2020 and 2025. Home values in Santa Clara County increased by nearly as much (40 percent) over the same period. In comparison, Santa Clara County's multifamily rents grew by only 27 percent over the five-year period—far less than the construction cost increases developers have experienced in the multifamily construction industry.

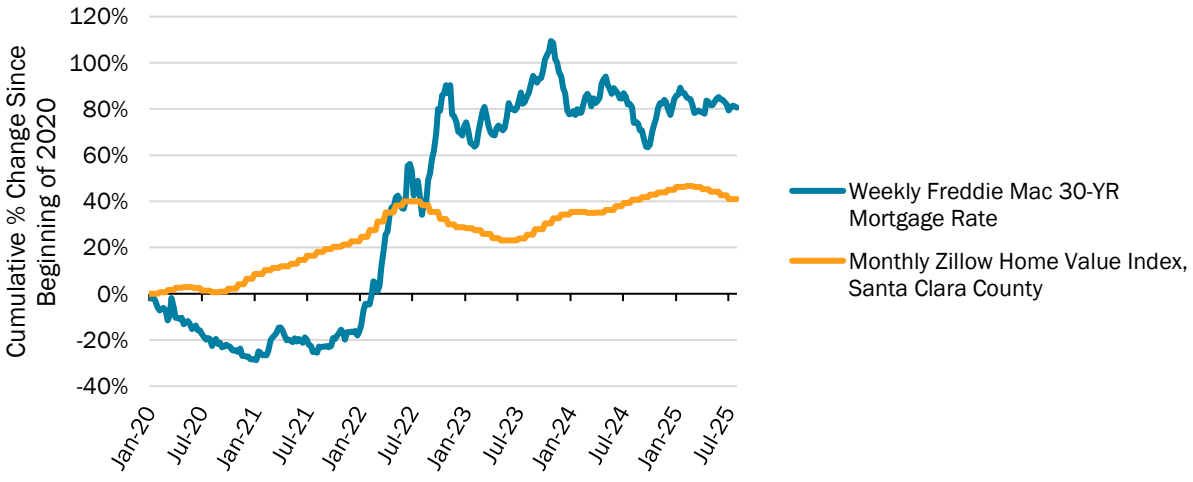
FIGURE 11: SANTA CLARA COUNTY TRENDS IN HOME VALUES, CONSTRUCTION COSTS, AND MULTIFAMILY RENTS, 2020 TO 2025



Sources: CoStar, 2025; CA EDD, 2025; ENR, 2025; Zillow, 2025; Strategic Economics, 2025.
Note: This chart shows the Zillow Home Value Index for Santa Clara County on an annual average basis, but doing so simplifies the monthly fluctuations in home value. For this reason, the trend shown here does not entirely match the trend shown in Figure 12, despite being based on the same data.

Santa Clara County home values increased rapidly from 2020 through mid-2022, but higher interest rates limited home value growth from late 2022 through 2025. Figure 12 shows monthly changes in the same home index for Santa Clara County shown Figure 11, and compares them to weekly fluctuations in the national 30-year mortgage rate over the past five years. This chart shows that mortgage interest rates doubled nationally, from 3.7 percent to 7.8 percent, between 2020 and 2023 and remained above 6.5 percent through mid-2025. Rising interest rates nationally moderated rising home prices in Santa Clara County, which grew by less than one percent between July of 2022 and July of 2025.

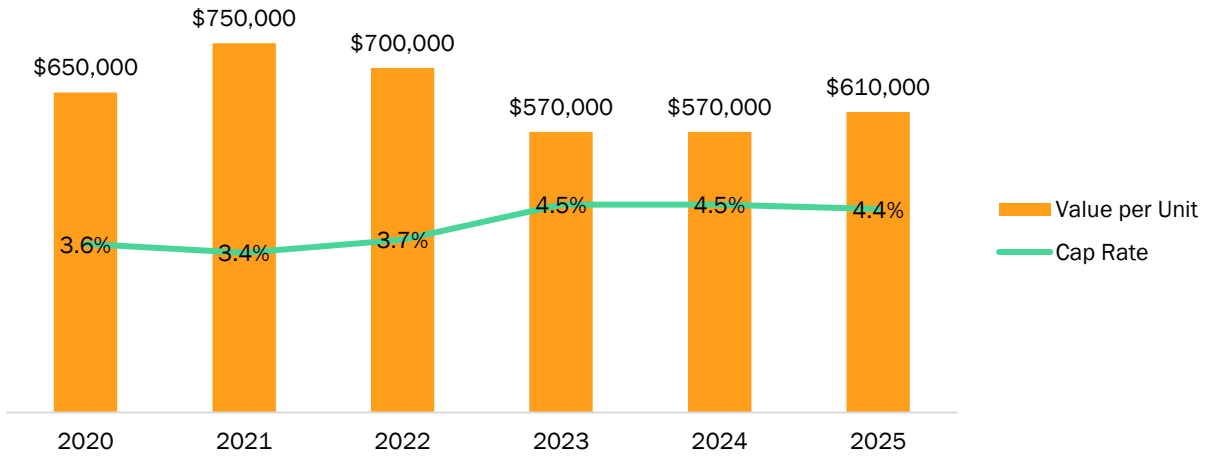
FIGURE 12: MONTHLY SANTA CLARA COUNTY HOME VALUE INDEX VS. NATIONAL WEEKLY 30-YEAR MORTGAGE RATE



Sources: Freddie Mac, 2025; Zillow, 2025; Strategic Economics, 2025.

The value per unit of multifamily properties in Santa Clara County decreased between 2021 and 2025. As shown in Figure 13, the average market value of four and five-star multifamily properties in Santa Clara County fell from a high of $750,000 per unit in 2021 to $570,000 in 2024, with a modest recovery for 2025 to date. Capitalization rates (which describe the ratio between a property's annual income and its market value) increased in 2023, indicating a decline in investor confidence in multifamily investments. This decline was in response to higher interest rates at the national level and a softening of the rental market in Santa Clara County and many other parts of the San Francisco Bay Area.

FIGURE 13: GENERAL MARKET TRENDS IN SANTA CLARA COUNTY FOR 4- AND 5-STAR RENTAL PROPERTIES, CAP RATE VS. VALUE PER UNIT



Sources: CoStar, 2025; Strategic Economics, 2025.

As a result of these recent market trends, multifamily rental projects are much less financially feasible in 2025 than they were in 2020, and ownership projects are slightly less feasible than they were in 2020. Multifamily rental project developers face much higher construction costs in 2025 than they did in 2020, with lower average market values per unit; this makes it much more difficult to develop a viable project in 2025. Ownership projects also face higher interest rates and higher construction costs in 2025 than they did in 2020. However, the market values for ownership units in Santa Clara County have mostly kept pace with construction costs over the past five years.

Feasibility Findings

The feasibility analysis results presented in this section reflect the market trends identified above. This section begins with an explanation of feasibility findings for ownership prototypes, followed by the feasibility results for rental prototypes.

It is important to note that the feasibility analysis of building prototypes, while intended to represent typical examples of the range of residential developments that could occur, does not represent every possible development proposal. Although the analysis may show that a building prototype is infeasible, specific proposals of a similar building type may be feasible for a variety of reasons. These circumstances could include developments with a low land cost basis if the land has been held for a period of time; access to financing sources at a lower cost than market or equity investors with lower return requirements; established relationships with suppliers and contractors that help reduce costs; and other factors.

FEASIBILITY OF OWNERSHIP PROTOTYPES

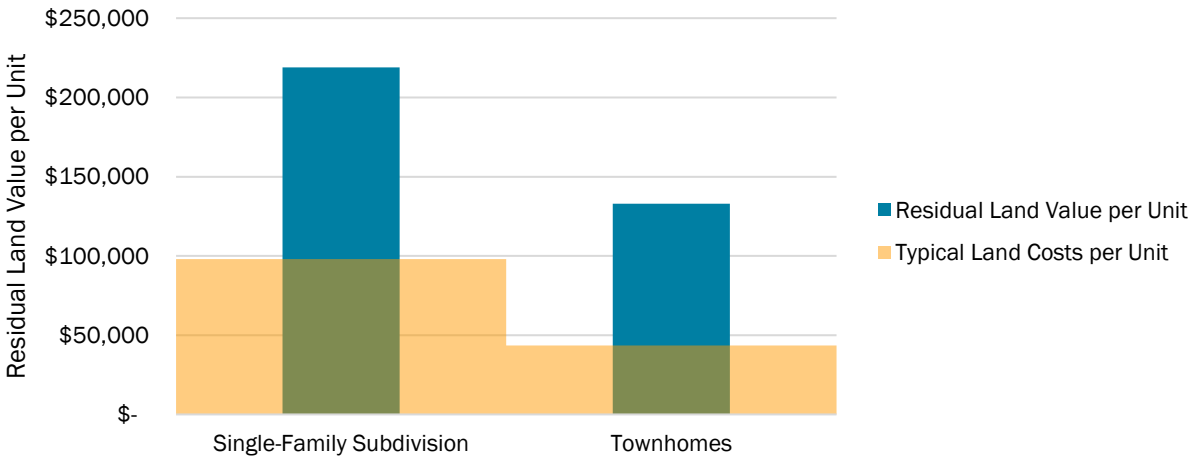
Both ownership prototypes are currently feasible in Gilroy under current market conditions. Figure 14 shows the results of the pro forma analysis for both prototypes given the City's current policy—which does not require inclusionary units. As Figure 14 shows, the Single-Family Subdivision prototype would generate a residual land value per unit of approximately $219,000. This is about $121,000 more per unit than typical land costs for single-family developments in Gilroy. Similarly, the Townhome prototype would generate $133,000 per unit in residual land value, which is nearly $90,000 more than typical land costs per unit for townhome projects in Gilroy. Figure 15 compares the residual land value per unit for each ownership prototype with typical land costs in Gilroy for each prototype.

FIGURE 14: PRO FORMA RESULTS PER UNIT FOR OWNERSHIP HOUSING IN GILROY, WITHOUT INCLUSIONARY POLICY

	Medium Single-Family	Townhomes
Revenue per Unit		
Gross Revenue (Average)	$1,216,667	$809,167
Less Marketing Costs	-$60,833	-$40,458
Total Sales Proceeds	**$1,155,833**	**$768,708**
Development Costs per Unit		
Hard Costs	$559,337	$363,780
Soft Costs (Excluding Fees)	$72,714	$65,480
Other Municipal Fees	$96,000	$61,940
Financing & Contingency	$58,026	$44,317
Total Development Cost	**$786,077**	**$535,518**
Residual Land Value		
Total Sales Proceeds	$1,155,833	$768,708
Target Return on Cost	15%	15%
Supportable Development Cost	$1,005,072	$668,442
Total Development Cost	$786,077	$535,518
Residual Land Value	**$218,996**	**$132,925**
Feasibility		
Residual Land Value	$218,996	$132,925
Typical Land Cost	$98,010	$43,560
Typical Land Cost per S.F.	$15	$20
Feasibility Result	**Feasible; Residual Land Value Exceeds Typical Land Costs**	**Feasible; Residual Land Value Exceeds Typical Land Costs**

Sources: Strategic Economics, 2025; City of Gilroy, 2025; Developer Interviews, 2025; Redfin, 2025.

FIGURE 15: RESIDUAL LAND VALUE VS. LAND COSTS PER UNIT FOR OWNERSHIP HOUSING IN GILROY, WITHOUT INCLUSIONARY REQUIREMENTS



Sources: Strategic Economics, 2025; City of Gilroy, 2025; Developer Interviews, 2025; Redfin, 2025.

FEASIBILITY OF RENTAL PROTOTYPES

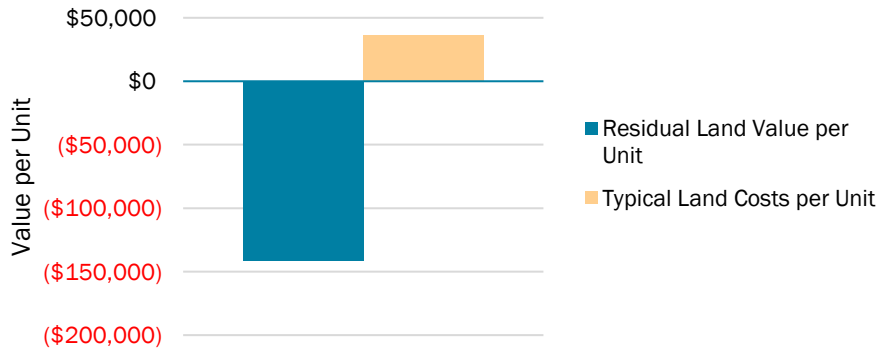
Strategic Economics found that Small Scale Rental Apartments are not feasible in Gilroy under current conditions. Figure 16 provides a summary of pro forma results on a per unit basis, and Figure 17 visualizes the feasibility result. These figures show that Small Scale Rental Apartments would generate a residual land value of negative $142,000, because development costs for this building type are greater than the capitalized value of the completed building. Because development costs grew nearly 20 percent more than multifamily rents over the past five years (as shown in Figure 11) while cap rates increased (as shown in Figure 13), a multifamily project that was viable in 2020 would be challenging to develop in 2025.

FIGURE 16: PRO FORMA RESULTS PER UNIT FOR RENTAL HOUSING IN CITY OF GILROY, WITHOUT INCLUSIONARY

	Small Scale Rental Apartments
Net Operating Income	
Gross Scheduled Income	$31,911
Less Vacancy	-$1,596
Less Operating Expenses	-$9,573
Total Net Operating Income	**$20,742**
Development Costs per Unit	
Hard Costs	$357,797
Soft Costs (Excluding Fees)	$51,233
Other Municipal Fees	$52,911
Financing, Contingency & Developer Overhead	$56,960
Total Development Cost	**$518,901**
Residual Land Value	
Total Net Operating Income	$20,742
Target Yield on Cost	5.5%
Supportable Development Cost	$377,131
Total Development Cost	$518,901
Residual Land Value	**-$141,770**
Feasibility	
Residual Land Value	-$141,770
Typical Land Cost	$36,300
Typical Land Cost per S.F.	$30
Feasibility Result	**Infeasible, Residual Land Value is Negative**

Sources: Strategic Economics, 2025; City of Gilroy, 2025; Developer Interviews, 2025; CoStar, 2025.

FIGURE 17: RESIDUAL LAND VALUE VS. LAND COSTS PER UNIT FOR SMALL SCALE RENTAL APARTMENTS IN GILROY – WITHOUT INCLUSIONARY REQUIREMENT



Sources: Strategic Economics, 2025; City of Gilroy, 2025; Developer Interviews, 2025; CoStar, 2025.

POLICY AND MARKET SCENARIOS

The previous section describes feasibility under current conditions in Gilroy; this section considers alternatives for inclusionary policies that may better align with the City's objectives and optimize the production of affordable units in future years. In addition, Strategic Economics recommends that local governments considering a new or updated affordable housing policy be cognizant of the potential impact of the policy under a range of market conditions, as it is difficult for local inclusionary ordinances to keep current with evolving market cycles.

Strategic Economics performed scenario testing to evaluate how prototypes would perform with different inclusionary requirements and market conditions. Strategic Economics also calculated the in-lieu fees associated with each inclusionary policy option. The purpose of this section is to help the City of Gilroy identify inclusionary and in-lieu fee requirements that could remain relevant as market conditions change.

Inclusionary Policy Scenarios

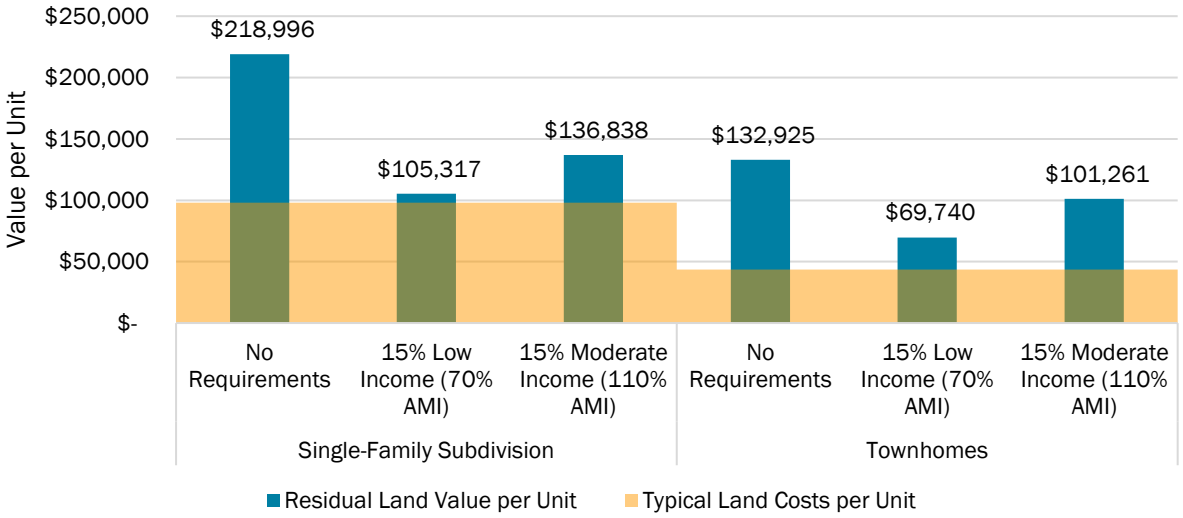
This section describes the impact of an inclusionary policy's income targets on financial feasibility. Inclusionary policies consist of two main components: the percentage of onsite affordable units required, and the income group(s) targeted by the policy. All ownership scenarios presented below assume a 15 percent onsite requirement and all rental scenarios presented below assume a 10 percent onsite requirements. For both tenures, the two scenarios test the sensitivity of the results to different income levels. A discussion of setting the percentage onsite requirement is included in the findings section.

Strategic Economics tested the following inclusionary policy scenarios:

- For ownership projects:
    - Scenario A: 15 percent inclusionary requirement for moderate-income households. This policy assumes a maximum 120% of AMI, leading to an average of 110% AMI.
    - Scenario B: 15 percent inclusionary requirement for low-income households. This policy assumes a maximum 80% of AMI, leading to an average of 70% AMI.
- For rental projects:
    - Scenario A: 10 percent inclusionary requirement for very low-income households. This policy assumes a maximum 50% of AMI, leading to an average of 50% AMI.
    - Scenario B: 10 percent inclusionary requirement for extremely low-income households. This policy assumes a maximum 30% of AMI leading to an average of 30% AMI.

For ownership units, applying a 15 percent inclusionary requirement would substantially reduce per-unit revenue, but both prototypes would remain feasible. Figure 18 shows the residual land value per unit for both ownership prototypes with a 15 percent low-income requirement compared to a 15 percent moderate-income requirement. As discussed in the methodology section (Figure 9), there is a significant gap between new market rate home values and the below market sales prices for moderate- and low-income buyers, leading to a decline in residual land values for the scenarios tested. However, even with a 15 percent low-income requirement, the Townhome prototype would generate $25,000 more per unit than typical land costs and the Single-Family Subdivision prototype would remain marginally feasible, generating $7,000 per unit more than typical land costs.

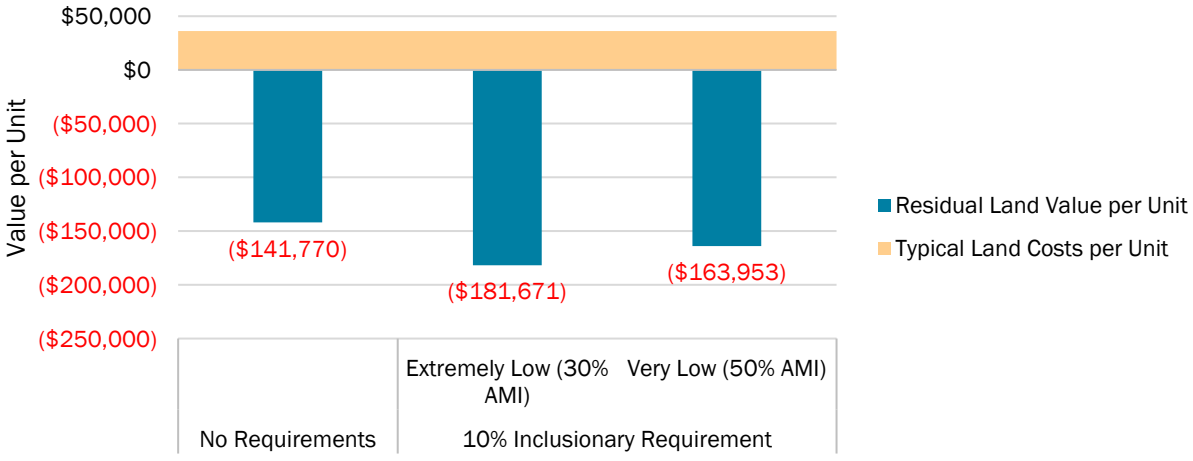
FIGURE 18: RESIDUAL LAND VALUE PER UNIT VS. LAND COSTS PER UNIT IN CITY OF GILROY WITH AND WITHOUT A 15 PERCENT INCLUSIONARY REQUIREMENT, BY INCOME REQUIRED – OWNERSHIP UNITS



Sources: Strategic Economics, 2025; City of Gilroy, 2025; Developer Interviews, 2025; Redfin, 2025.

Because the Small Scale Rental Apartments prototype is infeasible under current market conditions, the tested inclusionary policy scenarios are unlikely to be relevant until conditions improve. Figure 19 summarizes this result. As discussed in the methodology section (Figure 10), Gilroy's market rate rent levels are approximately 75 percent of the AMI in Santa Clara County. (Extremely low-income rents are about 44 percent of Gilroy's market rate rents, while very low-income rents are around 76 percent of market rate rent.) The next subsection includes findings on how changes in market conditions might support an inclusionary policy.

FIGURE 19: RESIDUAL LAND VALUE PER UNIT VS. LAND COSTS PER UNIT IN GILROY WITH 10% INCLUSIONARY POLICY, BY INCOME REQUIRED – RENTAL UNITS



Sources: Strategic Economics, 2025; City of Gilroy, 2025; Developer Interviews, 2025; CoStar, 2025.

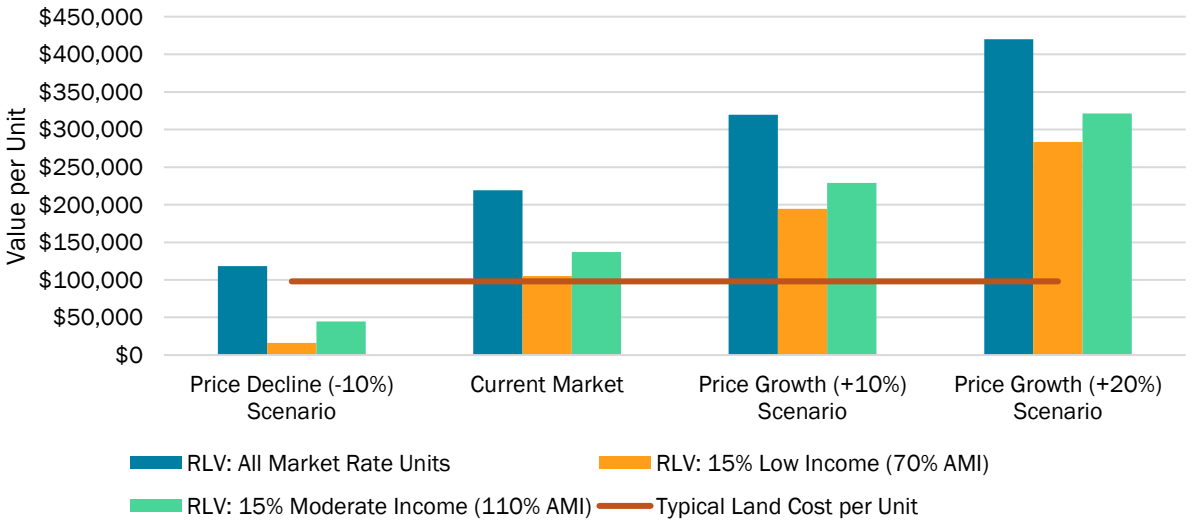
Market Scenarios

This section tests the sensitivity of the feasibility results to changes in market conditions. The current pro forma results rely upon assumptions for development costs, return thresholds, sales prices, rents, and land costs, all of which are subject to change over time. This section describes how some of the most important market factors impact the viability of inclusionary policies.

Strategic Economics tested the sensitivity of the feasibility results by varying market factors that influence revenue, while holding development costs constant. For the ownership prototypes, Strategic Economics tested a range of market prices above and below current prices. For rental prototypes, Strategic Economics evaluated a range of scenarios that includes increases and decreases in market rents combined with variations in the market capitalization rates that determine the value of development.

The inclusionary policy scenarios for the Single-Family Subdivision prototype may not be supported if market values drop by ten percent or more. Under current market conditions, both the moderate- and low-income inclusionary policy scenarios could be supported by the Single-Family Subdivision prototype. However, as shown in Figure 20, the residual land value of the Single-Family Subdivision prototype would fall below typical land prices if a low- or moderate-income inclusionary policy is applied and market values drop by ten percent.

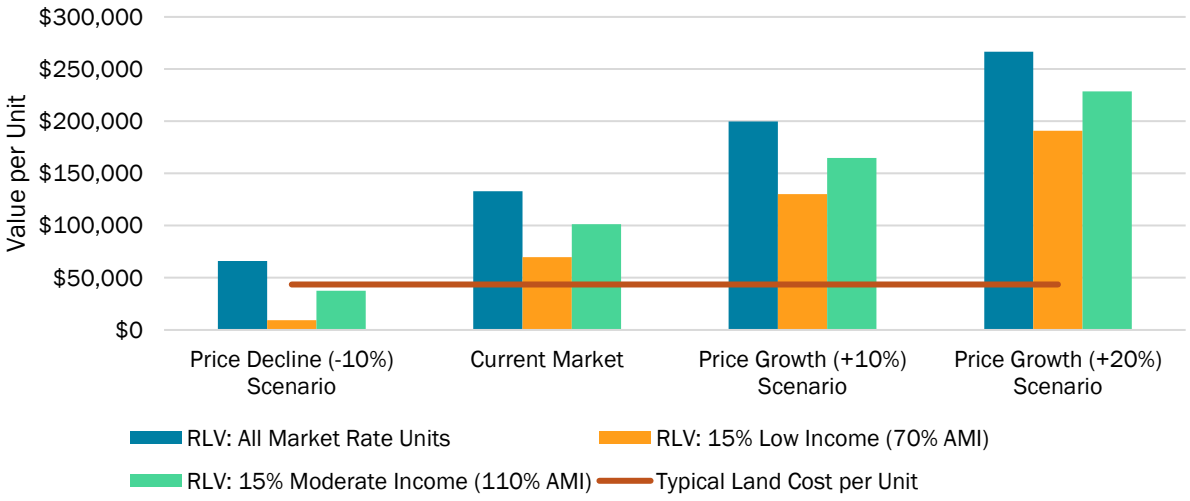
FIGURE 20: SENSITIVITY OF RESIDUAL LAND VALUE TO MARKET PRICE IN GILROY – SINGLE-FAMILY SUBDIVISION



Sources: Strategic Economics, 2025; City of Gilroy, 2025; Developer Interviews, 2025; Redfin, 2025.

The inclusionary policy scenarios for the Townhome prototype may not be supported if market values drop by ten percent or more. As shown in Figure 21, a decline in the market value of townhomes would cause both the moderate-income policy scenario and the low-income scenario to result in a residual land value that drops below the current market value of land.

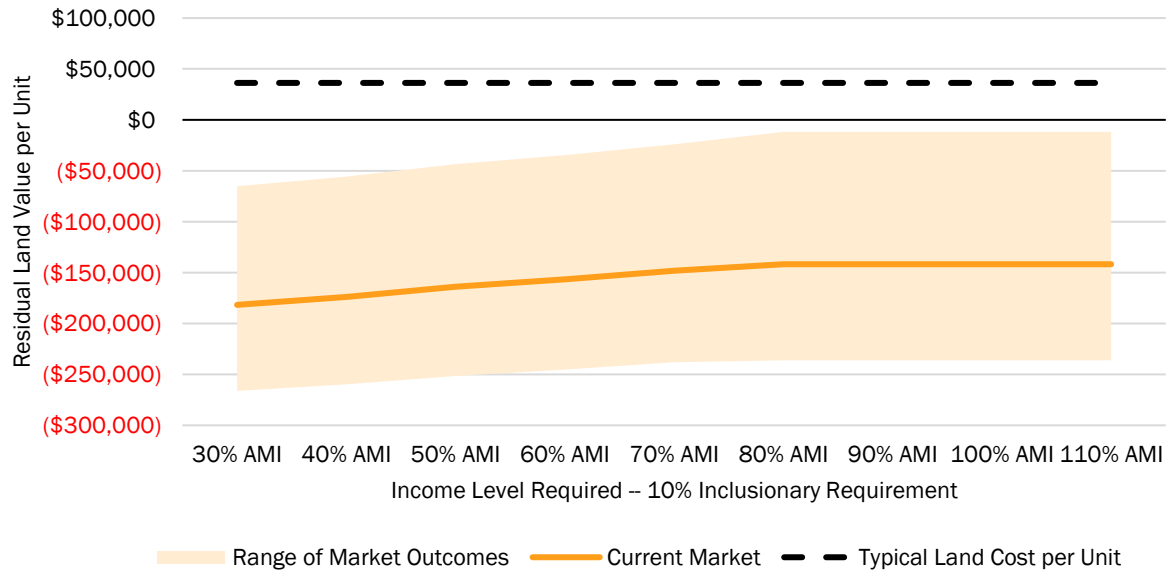
FIGURE 21: SENSITIVITY OF RESIDUAL LAND VALUE TO MARKET PRICE IN GILROY – TOWNHOMES



Sources: Strategic Economics, 2025; City of Gilroy, 2025; Developer Interviews, 2025; Redfin, 2025.

While an inclusionary policy would have only a modest impact on apartment project revenues, it is unlikely that most apartment projects will be feasible in the near future (Figure 22) due to broader challenges. Even under improved conditions, average market rents in Gilroy will struggle to overcome current high development costs of apartment projects.

FIGURE 22: RESIDUAL LAND VALUE VS. LAND COSTS PER UNIT FOR SMALL SCALE RENTAL APARTMENTS IN GILROY, WITH CURRENT MARKET CONDITIONS VS. RANGE OF LIKELY MARKET OUTCOMES



Sources: Strategic Economics, 2025; CoStar, 2025; Developer Interviews, 2025; City of Gilroy, 2025; Santa Clara Housing Authority, 2025.
Note: Range of Market Outcomes refers to a range of "weak market" vs. "strong market" fluctuations from current market conditions, based on a ten percent change in in market rate rents and the typical range of cap rates observed in Santa Clara County over the past ten years. The high end of the range of market outcomes was based on a 3.75 percent cap rate and ten percent rent increase. The low end of the range of market outcomes was based on a 5.5 percent cap rate and a ten percent rent decrease.

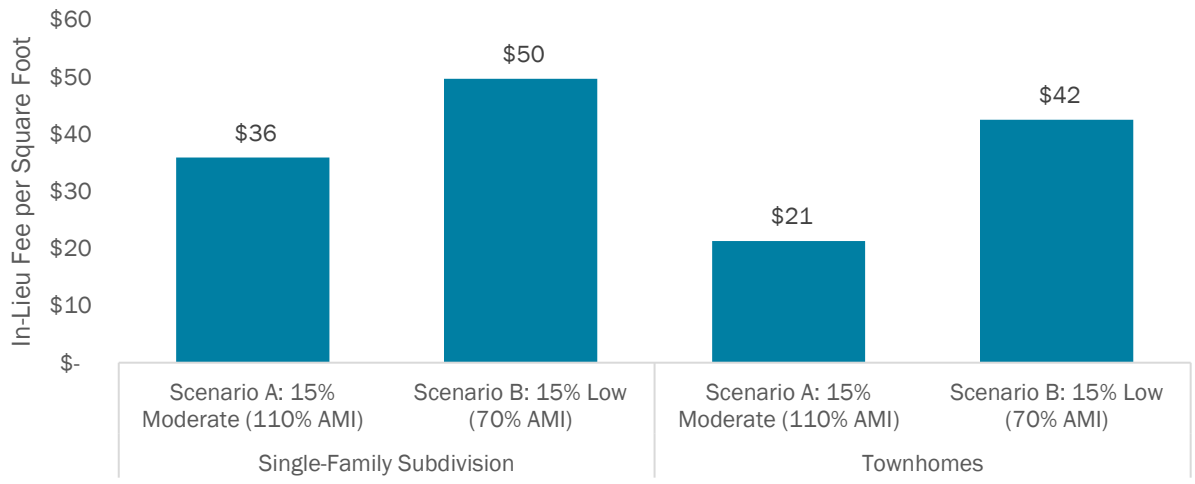
In-Lieu Fee Analysis

For each policy scenario, Strategic Economics calculated the in-lieu fee that would be equivalent to the revenue lost from meeting the onsite requirement for below market rate units. This approach used the *affordability gap,* the difference in revenue per square foot between a project with all market rate units and a project with the required affordable units. To calculate expected revenue from affordable units, Strategic Economics used the same "achieved AMI" assumptions as discussed in Figure 8; this approach avoids creating an in-lieu fee that is less expensive than the likely cost of providing on-site units. Per square foot in-lieu fees were defined using the net residential area of each prototype. The final in-lieu fees recommended for adoption will be closely coordinated with the recommended inclusionary policy (considering the total revenue impact of both the onsite percentage and income targets), with potential adjustments to incentivize the City's preference for either onsite units or the collection of fee revenues.

Detailed in-lieu fee findings are summarized below:

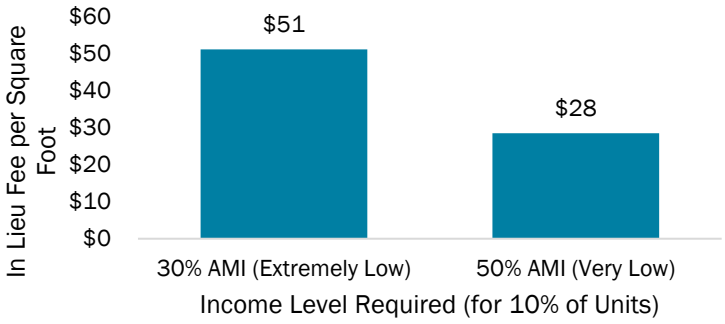
- **The equivalent in-lieu fee for the ownership policy scenarios is:**
  - Scenario A: $36 per square foot for single-family units or $21 per square foot for townhome units for a policy that targets moderate-income households; and
  - Scenario B: $50 per square foot for single-family units or $42 per square foot for townhome units for a policy that targets low-income households.
- **The equivalent in-lieu fee for the rental policy scenarios is:**
  - Scenario A: $28 per square foot for the small-scale rental apartment for a policy that targeted very low-income households; and
  - Scenario B: $51 per square foot for the small-scale rental apartment for a policy that targeted extremely low-income households.

FIGURE 23: EQUIVALENT IN-LIEU FEE PER NET SQUARE FOOT CORRESPONDING TO REVENUE FOREGONE FROM INCLUSIONARY POLICY IN GILROY - WITH 15% AFFORDABLE UNIT REQUIREMENT – OWNERSHIP UNITS



Sources: Strategic Economics, 2025; City of Gilroy, 2025; HCD, 2025; Santa Clara County Housing Authority, 2025.
Note: While individual policies may allow for incomes up to 80% of AMI or 120% of AMI, respectively, the achieved price level is more likely to correspond to lower income households for an individual project. This model reflects an expected "achieved" price level for each income category, which also corresponds with the California Health and Safety Code's income guidelines for affordable for-sale housing.

FIGURE 24: EQUIVALENT IN-LIEU FEE PER NET SQUARE FOOT CORRESPONDING TO REVENUE FOREGONE FROM INCLUSIONARY POLICY IN GILROY - WITH 10% AFFORDABLE UNIT REQUIREMENT – RENTAL UNITS



Sources: Strategic Economics, 2025; City of Gilroy, 2025; HCD, 2025; Santa Clara County Housing Authority, 2025.

III. Policy Considerations and Findings

This section reviews key considerations, in addition to financial feasibility, for developing inclusionary and in-lieu fee policies for the City of Gilroy. First, the section provides a summary of inclusionary policies for other peer jurisdictions in Santa Clara County. The section then outlines other key policy and legal considerations, before concluding with a summary of findings and conclusions.

INCLUSIONARY POLICIES IN NEIGHBORING JURISDICTIONS

Most peer jurisdictions require an onsite inclusionary percentage of 15 percent, with certain modifications tailored to smaller projects, larger projects, and/or ownership projects. Los Gatos, for example, uses a sliding scale that ranges from 10 to 20 percent onsite inclusionary depending on the size of the project. Cupertino has a 15 percent requirement for rental projects, but a higher percentage, 20 percent, for ownership projects. Like the other cities, Mountain View has a fifteen percent across-the-board requirement, except with an additional 10 percent requirement for above moderate households specifically for townhouses and rowhouses. Finally, Palo Alto has a 20 percent requirement for for-sale projects on more than five acres.

In peer cities, the inclusionary requirements for rental projects target a mix of income levels, from very low to moderate-income households. Whereas Santa Clara's inclusionary policy uses a weighted average approach to ensure that affordable units target less than the median income, most other jurisdictions assign percentage requirements to individual income categories. Cupertino targets very low and low-income units; Los Gatos targets moderate-income units; and Sunnyvale targets a mix of very low and low-income units. Mountain View's inclusionary policy uses an average income approach similar to Santa Clara's, but targets a much lower income level, of 65 percent of AMI. Lastly, San Jose provides rental developers with a choice: they can either target extremely low-income households, or provide a mix of very low, low, and moderate-income units.

In their inclusionary requirements for ownership projects, all peer cities except Los Gatos and Mountain View target median income or moderate-income households. Most cities require a mix of median income (targeting up to 100 percent of AMI) and moderate-income (targeting up to 120 percent of AMI) units. However, Los Gatos requires five to ten percent of ownership units to be dedicated to low-income households—half of the Town's total inclusionary requirement. Mountain View's policy also differs from other peer cities, but specifically for townhomes and rowhouses. For these project types, Mountain View requires ten percent of units to be set aside for above moderate-income households, which its policy defines as up to 135 percent of AMI. This brings the City's total inclusionary requirement to 25 percent for these projects, but at a higher average AMI than other jurisdictions.

FIGURE 25: INCLUSIONARY REQUIREMENTS IN SELECT JURISDICTIONS IN SANTA CLARA COUNTY, AS OF 2025

Jurisdiction	Minimum Size for Inclusionary Requirement	Policy Categories	Required Share of Units	
			Rental	For-Sale
Cupertino	5 Units		9% Very Low 6% Low	10% Median 10% Moderate
Los Gatos	5 Units	5-19 Units	10% Moderate	5% Low 5% Moderate
		20-100 Units	10-20% Moderate	5-10% Low 5-10% Moderate
		100+ Units	20% Moderate	10% Low 10% Moderate
Mountain View	No Minimum	Townhouses & Rowhouses	15% (Avg. 65% AMI)	15% Moderate (Avg. 100% AMI) 10% Above Moderate (Avg. 135% AMI)
		All Other Developments	15% (Avg. 65% AMI)	15% (Avg. 100% AMI)
Palo Alto	3+ Units	Project on <5 acres	Impact Fee	10% Median 5% Moderate
		Project on >5 acres		20% (2/3 Median, 1/3 Moderate)
San Jose	10+ Units	Option 1	10% Extremely Low	15% Moderate
		Option 2	5% Very Low 5% Low 5% Moderate	15% Moderate
City of Santa Clara	3+ Units	<10 Units:	1 unit or in-lieu/impact fee	
		10+ Units	15% (Avg. 100% AMI)	15% (Avg. 100% AMI)
Sunnyvale	Rental: 3+ Units For-Sale: 7+ Units		5% Very Low 10% Low	15% Moderate

Sources: City of Cupertino, 2025; Town of Los Gatos, 2025; City of Mountain View, 2025; City of Palo Alto, 2025; City of San Jose, 2025; City of Santa Clara, 2025; City of Sunnyvale, 2025; Strategic Economics, 2025.
Note: some cities apply an impact fee to projects that do not meet the minimum size threshold for the inclusionary requirement.

OTHER POLICY CONSIDERATIONS

This section reviews other policy considerations that may be relevant to Santa Clara County jurisdictions when developing an inclusionary policy. These include conditions for HCD review; Metropolitan Transportation Commission requirements; and State Density Bonus Law, as described below:

- **Any local inclusionary policy may be subject to review by the California Department of Housing and Community Development if it includes a greater than 15 percent inclusionary requirement for households at income levels of 80 percent of AMI or less.** Since 2017, the AB 1505 legislation (also known as the "Palmer fix") provided for a set of conditions that could trigger HCD review, including an elevated inclusionary requirement for very low- and low-income

households and failure to meet 75 percent of above moderate RHNA goals.[2] Inclusionary policies under review may need to perform a feasibility study demonstrating that "the ordinance does not unduly constrain the production of housing."

- **The Metropolitan Transportation Commission (MTC) requires compliance with its Transit Oriented Communities (TOC) policy in transit station areas for jurisdictions to be eligible and/or competitive for certain regional funding sources.** Gilroy's Caltrain station may or may not qualify for this funding source. If Gilroy did qualify, the TOC policy would require adoption of at least two affordable housing production policies; one option for this requirement is to adopt an inclusionary policy that meets MTC's criteria. These criteria are as follows:
    - Rental Policy: must require least 15 percent of units to be affordable, with an average income of 80% of AMI or less.
    - Ownership Policy: must require least 15 percent of units to be affordable, with an average income of 120% of AMI or less.

- **The State Density Bonus law allows multifamily developments to build to a higher density than the maximum density allowed by zoning if affordable units are included in the project.** Recent changes to state law have expanded opportunities for developments to utilize this bonus. With the passage of AB 1287 in 2024, the State created a "stackable" density bonus, allowing for market rate projects to achieve density bonuses of up to 100 percent by providing the maximum percentage of affordable units in multiple categories. By State law, the affordable units provided under the SDBL also count towards local inclusionary requirements, provided the units are targeted at or below the income level required by the local policy. The bonus market rate units allowed in SDBL projects commonly result in an overall project with a lower percentage of affordable units than the percentage in the local inclusionary policy.

FIGURE 26: DENSITY BONUS AMOUNT TRIGGERED BY PROVISION OF AFFORDABLE UNITS, BY INCOME LEVEL AND SHARE OF UNITS IN INCOME CATEGORY

	Amount of Density Bonus Triggered[a]		
	Very Low-Income Units	Low-Income	Moderate-Income
5% of Units	20% Density Bonus	None	None
10% of Units	32.5% Density Bonus	20% Density Bonus	5% Density Bonus[b]
15% of Units	50% Density Bonus	27.5% Density Bonus	10% Density Bonus[b]

Sources: Meyers Nave, 2023; Strategic Economics, 2025.

Notes:

a) Density bonuses are additive, up to a 50 percent density bonus for market rate projects or up to a 100 percent bonus if the maximum share of units is provided in multiple categories of income targets.

b) Applies only to For-Sale Units

[2] From January 31st, 2023 through the end of 2024 (approximately one-quarter of Gilroy's eight-year RHNA Cycle), the City had met around four percent of its very low-income RHNA target; six percent of its low-income RHNA target; 12 percent of its moderate-income RHNA target; and 58 percent of its above moderate-income RHNA target.

SUMMARY OF FINDINGS AND CONCLUSIONS

This section provides a summary of findings from the feasibility and inclusionary analyses along with conclusions that inform modifications to the City's inclusionary policy.

Findings

- **Both of the ownership prototypes are currently feasible in Gilroy under current market conditions.** The Single-Family prototype outperforms the Townhome prototype and therefore has a higher capacity to accommodate affordable housing requirements.
- **Because the Small Scale Rental Apartments prototype is infeasible under current market conditions, the tested inclusionary policy scenarios are unlikely to be relevant until conditions improve.** Although Gilroy has received some recent proposals for apartment projects, a typical rental project in Gilroy will be challenged by market conditions due to low rents in the local market area and unfavorable multifamily development conditions regionwide.
- **For ownership units, applying a 15 percent inclusionary requirement would substantially reduce per-unit revenue, but both ownership prototypes would remain feasible.**
- **While a ten percent inclusionary policy would have only a modest impact on apartment project revenues in the current market, it is unlikely that most apartment projects will be feasible in the near future due to broader challenges.** Market conditions represent the primary barrier to feasibility, both locally and at the regional scale.
- **The inclusionary policy scenarios on the single-family prototype likely would remain feasible even with a ten percent drop in market values.**
- **The inclusionary policy scenarios on the Townhome prototype may not be supported if market values drop by ten percent or more.**

Conclusions

A fifteen percent onsite inclusionary policy targeting moderate- and/or low-income households could be applied to ownership developments in Gilroy without significantly constraining new development. Under the scenarios tested, a fifteen percent requirement targeted to either moderate-income or low-income households is viable for ownership housing products under a range of conditions. The City could also set a fifteen percent requirement for a mix of moderate and low-income households, with similar feasibility results. While a policy that includes low-income households would be financially feasible in the typical case, developers report occasional difficulties in qualifying low-income homebuyers. In addition, other monthly costs such as HOA dues and hazard insurance could represent a significant burden for these households over time. Therefore, the City should monitor the implementation of an ownership policy targeted to households that are below a moderate income level to ensure that this policy is a practical tool for generating housing at lower income levels.

While the City could adopt an inclusionary policy for rental projects, the policy would be unlikely to generate significant affordable units until fundamental changes in the market occur. Based on input from City staff recognizing that current market rents in Gilroy are already in the low- to moderate-

income range, the analysis examined an inclusionary policy targeted to very low- and/or extremely low-income households. However, current market rents are not high enough to spur development even without an inclusionary policy in place. A very large increase in market rents, combined with falling or stabilizing development costs, could generate significant multifamily development activity in Gilroy, but these conditions might occur only when market rents exceed what moderate income households could afford. Under these conditions, the City should consider adjusting the affordability levels in its policy if the goal is to generate units in a broader range of income levels.

In conjunction with the inclusionary policy, the City should adopt an in-lieu fee specific to each product type (single-family, townhome, and rental product types), and allow payment of the in-lieu fee for smaller scale projects and when the policy results in fractional units. Because City staff has expressed an interest in including small-scale and single-unit developments in the policy, it could apply an inclusionary policy to all project sizes, and expect to collect fees on smaller-scale projects for which meeting the policy with onsite units is infeasible. While in-lieu fees charged in conjunction with an inclusionary policy are not legally required to be supported by a nexus study, the City should consider the how any adopted in-lieu fee levels compare with maximum justifiable fee found in the nexus study. Should inclusionary policies or in-lieu fees face a future legal challenge, the nexus analysis may offer additional support for affordable housing fee levels that fall below the nexus-justified maximums, Out of the in-lieu fee scenarios included in this report, the fee associated with policy Scenario A for single-family developments (15 percent inclusionary targeted to low-income households) exceeds the maximum nexus fee (a calculated $54 in-lieu fee compared with the maximum nexus fee of $48 per square foot).

If the multifamily market improves to an extent that significant development activity for rental apartments occurs, the City could consider an onsite requirement for rental projects of 15 percent to meet MTC's transit-oriented communities standards. For an inclusionary policy to qualify as an "Affordable Housing Production Policy" to satisfy MTC's TOC guidelines for station areas, it must require at least a 15 percent of rental units to be inclusionary at 80 percent of AMI. The City could also consider setting a higher requirement in the half-mile Caltrain station area than in other areas of the city.

Monitor the residential market periodically and adjust the inclusionary policy as appropriate. As shown in the Policy and Market Scenarios section, the feasibility of development, and its ability to accommodate and inclusionary policy, may depend on a variety of factors. Indicators of a changing market include changes in the pace of development applications, trends in sales values and rental rates, a significant change in the California Construction Cost index, or changes in interest rates. Jurisdictions should update the inclusionary feasibility study periodically to ensure the policy is well-suited to the current market environment.

Appendix I: Financial Feasibility Assumptions

Cost Assumptions

FIGURE 27: DETAILED COST ASSUMPTIONS FOR PROTOTYPES IN CITY OF GILROY

	Unit of measure	Single-Family Subdivision	Townhomes	Small Scale Rental Apartments
Land Costs	per square foot	$15	$20	$30
Hard Costs				
Demolition and Site Work	per sq. ft. land	$5	$10	$10
Building Area Construction				
Residential - Type V	per gross sq. ft.	$200	$200	$290
Parking	per space			
Surface	per space			$10,000
Tuck-under	per space			$10,000
Soft Costs				
Arch, Eng & Consulting	% of hard costs	5.0%	5.0%	5.0%
Taxes, Insurance, Legal & Accounting	% of hard costs	5.0%	10.0%	5.0%
Other Soft Costs	% of hard costs	3.0%	3.0%	3.0%
Total Soft Costs (Excluding Fees)	**% of hard costs**	**13.0%**	**18.0%**	**13.0%**
Municipal Fees		Shown in Separate Table		
Contingency	% of hard + soft costs	5.0%	5.0%	5.0%
Financing				
Amount Financed (Loan-to-cost)	% of hard + soft costs	55%	55%	55%
Average outstanding balance	% of Amt Financed	55%	55%	55%
Construction Loan Fee	% of Amt Financed	1.0%	1.0%	1.0%
Construction Interest (annual)		8.0%	8.0%	8.0%
Term	Months	12	18	24
Developer Return				
Target Developer Return-on-cost	% of total dev costs	15.0%	15.0%	
Target Developer Yield-on-cost	% of total dev costs			5.5%

Sources: Strategic Economics, 2025; Developer Interviews, 2025; Redfin, 2025; CoStar, 2025; Federal Reserve Bank of New York, 2025.

FIGURE 28: GILROY MUNICIPAL FEE ESTIMATES PER PROTOTYPE - OWNERSHIP AND RENTAL PROTOTYPES

Prototype	Single-Family Subdivision	Townhomes	Small Scale Rental Apartments
Permits & Fees			
Building Permit	$142,606	$3,117	$45,557
Plan Check	$129,395	$168	$748
Sewer & Water	$489,703	$293,278	$626,592
Other	$657,354	$360,374	$181,664
Total	**$1,419,058**	**$656,938**	**$854,562**
Impact Fees			
Traffic	$374,910	$335,700	$604,260
Schools	$426,525	$262,895	$313,545
Other	$659,520	$602,670	$1,084,806
Total	**$1,460,955**	**$1,201,265**	**$2,002,611**

Sources: City of Gilroy, 2025; Strategic Economics, 2025.

Prototype and Revenue Assumptions

FIGURE 29: MARKET RATE OWNERSHIP PRO FORMA PROTOTYPE AND REVENUE ASSUMPTIONS, CITY OF GILROY

	Unit of measure	Single-Family Subdivision		Townhomes	
Unit Size					
1-BD	sq. ft.	-		950	
2-BD	sq. ft.	-		1,400	
3-BD	sq. ft.	2,300		1,700	
4-BD	sq. ft.	2,700		2,000	
Average Unit Size	sq. ft.	2,633		1,710	
Unit Sales Value		Price	Share	Price	Share
1-BD	per unit	-		550,000	0%
2-BD	per unit	-		725,000	23%
3-BD	per unit	1,050,000	17%	800,000	50%
4-BD	per unit	1,250,000	83%	900,000	27%
Average Sales Value					
Per unit	**per unit**	**$1,216,667**		**$809,167**	
Marketing Expense	% of Sales Price	5%		5%	
Net Revenue		$1,155,833		$768,708	

Sources: Strategic Economics, 2025; Developer Interviews, 2025; Redfin, 2025.

FIGURE 30: MARKET RATE RENT PER UNIT ASSUMPTIONS, CITY OF GILROY

	Unit of measure	Small Scale Rental Apartments
Residential		
Unit Size		
Studio	square feet	550
1-BD	square feet	750
2-BD	square feet	1,150
3-BD	square feet	1,400
Average Unit Size	**square feet**	**955**
Unit Rents		
Studio	per unit	$2,000
1-BD	per unit	$2,300
2-BD	per unit	$3,000
3-BD	per unit	$3,400
Average	**per unit**	**$2,659**
Other Revenue Assumptions		
Vacancy (Market Rate Units)	% of Units	5%
Vacancy (Below Market Rate Units)	% of BMR Units	5%
Operating Expense	% of Revenue	30%
Capitalization Rate		4.50%

Sources: CoStar, 2025; Apartment Websites, 2025; Strategic Economics, 2025.

FIGURE 31: AREA MEDIAN INCOME AND INCOME LIMITS FOR SANTA CLARA COUNTY, 2025

People per Household	1	2	3	4	5
Bedroom Count	**Studio**	**1-BD**	**2-BD**	**3-BD**	**4-BD**
Extremely Low	$42,200	$48,200	$54,250	$60,250	$65,100
Very Low-Income	$70,350	$80,400	$90,450	$100,450	$108,500
Low-Income	$111,700	$127,650	$143,600	$159,550	$172,350
Median-Income	**$136,650**	**$156,150**	**$175,700**	**$195,200**	**$210,800**
Moderate-Income	$164,000	$187,400	$210,850	$234,250	$253,000

Sources: California HCD, 2025; Strategic Economics, 2025.
Note: Extremely Low-Income refers to up to 30% of AMI; Very Low-Income refers to up to 50% of AMI; Low-Income refers to up to 80% of AMI, and Moderate-Income refers to up to 120% of AMI.

FIGURE 32: MAXIMUM SALES PRICE PER UNIT AND AVERAGE BMR PRICE FOR MEDIUM SINGLE-FAMILY PROTOTYPE IN SANTA CLARA COUNTY, BY BMR INCOME LEVEL, 2025

	Unit Mix	Low (70% Achieved AMI)	Median (90% Achieved AMI)	Moderate (110% Achieved AMI)
Bedroom Count				
One Bedroom	0%			
Two Bedroom	0%	$282,037	$396,748	$511,459
Three Bedroom	0%	$301,139	$428,581	$556,023
Four Bedroom	100%	$310,808	$448,435	$586,061
Average Price per BMR Unit		**$310,808**	**$448,435**	**$586,061**

Sources: Strategic Economics, 2025; Santa Clara County Housing Authority, 2025; CA HCD, 2025; Redfin, 2025; Freddie Mac, 2025; Alta Housing, 2025; Ownwell, 2025.
Notes: Accounts for share of income spent on housing costs (30%), current interest rates, monthly utility costs, taxes, insurance, and HOA costs. Achieved sales price reflects likely average for units in each income category in an inclusionary project.

FIGURE 33: MAXIMUM SALES PRICE PER UNIT AND AVERAGE BMR PRICE FOR TOWNHOME PROTOTYPE IN SANTA CLARA COUNTY, BY BMR INCOME LEVEL, 2025

	Unit Mix	Low (70% Achieved AMI)	Median (90% Achieved AMI)	Moderate (110% Achieved AMI)
Bedroom Count				
One Bedroom	0%			
Two Bedroom	23%	$282,037	$396,748	$511,459
Three Bedroom	50%	$301,139	$428,581	$556,023
Four Bedroom	27%	$310,808	$448,435	$586,061
Average Price per BMR Unit		**$299,260**	**$426,448**	**$553,635**

Sources: Strategic Economics, 2025; Santa Clara County Housing Authority, 2025; CA HCD, 2025; Redfin, 2025; Freddie Mac, 2025; Alta Housing, 2025; Ownwell, 2025.
Notes: Accounts for share of income spent on housing costs (30%), current interest rates, monthly utility costs, taxes, insurance, and HOA costs. Achieved sales price reflects likely average for units in each income category in an inclusionary project.

FIGURE 34: BELOW MARKET RATE RENTAL REVENUE ASSUMPTIONS IN SANTA CLARA COUNTY, 2025

	Small Scale Rental Apartments
Share of Units by Bedroom Count[1]	
Studio	9%
1-BD	41%
2-BD	41%
3-BD	9%
Achieved Monthly Rent per Unit[2]	
30% AMI (Extremely Low)	$1,163
50% AMI (Very Low)	$2,018
60% AMI (Low)	$2,371
90% AMI (Median)	$3,616
110% AMI (Moderate)	$4,445
Monthly Operating Expenses per Unit[3]	$1,206

Sources: Strategic Economics, 2025; Santa Clara County Housing Authority, 2025; CA HCD, 2025

Notes:

1. Reflects distribution of units in prototype.
2. Based on California HCD's 2025 table of median incomes by household size for Santa Clara County; Santa Clara County Housing Authority's utility allowances for multifamily units; and an assumption of no more than 30 percent of income spent on housing costs. Achieved rent reflects likely average for units in each income category in an inclusionary project.
3. Operating expenses per unit based on the average operating expense per unit of a market rate unit in each prototype, based on 30 percent of average market rate rent for each unit.