CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: HONORABLE MAYOR AND CITY COUNCIL

FROM: Mayor Liccardo

SUBJECT: SEE BELOW

DATE: March 8, 2022

Approved

Date 3/8/22

SUBJECT: ACTIONS RELATED TO IMPLEMENTATION AND AMENDMENT OF THE COMMERCIAL LINKAGE FEE ORDINANCE

RECOMMENDATION

1. Approve the staff recommendation.
2. Adopt Recommendation #2 from the memorandum of Councilmembers Carrasco, Cohen, and Jimenez, but consistent with Council's prior direction, impose a revised commercial linkage fee rates only after Staff has "[c]onduct[ed] a new feasibility study, to be undertaken no more than two years from fee adoption."

BACKGROUND

We all want more resources for affordable housing. Yet how we impose fees and taxes matters. We have two mechanisms that impose costs on commercial and office ownership for affordable housing: the Commercial Linkage Fee (CLF) and Measure E transfer taxes. The CLF is projected to generate some $6.4 million annually, according to Staff. In 2020, voters approved Measure E, which draws the overwhelming majority of its revenue from the transfer of the large commercial, office, and industrial properties. This year, Measure E will generate $90 million.

The vast difference in the revenues generated by these two approaches—$6.4 million to $90 million—tells only part of the story. It's also critical to appreciate how the imposition of fees and taxes affects investment decisions in our city. CLF makes it more difficult for builders to secure financing from lenders or equity investors needed for commercial, office, or industrial development. Those same lenders know that San Jose elicits far lower lease rates than cities to our west and north, and they will not tolerate the same pro formas in San Jose that they see in Palo Alto or Mountain View. Measure E, in contrast, merely taxes the transfer of property, with little direct influence over the decision to build. It's the development that generates and attracts jobs, not the change in title.

In summary, Measure E does not undermine job-creating goals as CLF can--but generates thirteen (13) times more revenue for affordable housing.

The risk-reward tradeoff between these two measures informs why we should tread much more carefully with the CLF, particularly given San Jose's uniquely challenged situation as the major city with the worst jobs-to-employed resident ratio in the United States. The consequences of our severe imbalance include inadequate city services, congested freeways, greater greenhouse gas emissions, and the most thinly staffed City Hall of any large city in the nation. This imbalance hits our low-income communities the hardest, depriving them of access to job opportunities within their city, and depriving them of critical services like childcare, after-school programs, gang prevention services, senior nutrition programs, and emergency medical response. In short, our goal must be to get the golden eggs—the affordable housing *and the jobs*--without killing the goose.

While our colleagues' memorandum points to some 20 million square feet outside of Downtown West that has obtained entitlements, we would have a difficult time finding many experts who will opine that even half of that will get built. Our development history in San Jose provides ample precedent for many beautiful renderings that get presented and approved, but neither financed nor constructed. As the 2020 staff report revealed, over the prior decade, two cities that together have about one-quarter of San Jose's population—namely Sunnyvale and Santa Clara—had seen five times as much commercial space built in their cities over the last decade as had job-poor San Jose. As we saw with high transportation impact fees in North San Jose, we'll simply push jobs to other cities, and stall development. The rich (cities) will get richer. San Jose will merely bear the burden of higher housing costs for employees who work in wealthier suburbs.

We have, and must continue, to take a balanced approach to this work. Staff's recommendation follows City Council's 2020 direction by providing reasonable payment options that correspond to the housing nexus, which occurs as the building secures tenant leases. It also encourages up-front payments through a discounted fee structure. Funds collected under the "pay early" option will become available years before they would materialize under the current ordinance, which calls for payment of the fee prior to final building inspection.

The deferred payment option is important for commercial development that may need the flexibility to align payments with the leasing of the building. This flexibility will be especially critical during tough economic times when tenanting can take multiple years, making the difference between "go or no go" for many projects. The City can better collect the fees owed based on requiring a payment bond or letter of credit. Furthermore, payments that utilize this option will be subject to accrued interest.

A final note: as we consider the best solutions for generating affordable housing funds, it's worth noting that the same large property owners and commercial developers who are subjected to the CLF could have opposed Measure E. They could have spent several million dollars to persuade homeowners that this would be a tax on them—just as business groups successfully accomplished in defeating transfer taxes in San Francisco and several other Bay Area cities in the last decade. They didn't. On several occasions, I urged them not to, assuring them that our Council and I would act judiciously in imposing other fees on job-creating development, and engage in those decisions collaboratively, because we all recognize the tremendous importance of reversing San Jose's historically job-poor status. Hopefully, we still do.