COUNCIL AGENDA: 09/01/20
ITEM: 8.1

CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: HONORABLE MAYOR AND CITY COUNCIL

FROM: Councilmember Raul Peralez

SUBJECT: Commercial Linkage Fee

DATE: August 28, 2020

Approved by:

Date: 8/28/2020

RECOMMENDATION

Accept staff recommendation with the following modifications:

1. Implement the following phased fee schedule

	Downtown Office		**Office Outside of Downtown**	
	> 100,000 SF	**< 100,000 SF**	**> 100,000 SF**	**< 100,000 SF**
Year 1	$10 / SF	$3 / SF	$5 / SF	$3 / SF
Year 2	$15 / SF	$4.5 / SF	$7.5 / SF	$4.5 / SF
Year 3	$20 / SF	$6 / SF	$10 / SF	$6 / SF

2. Beginning in Year 3, conduct immediately another Commercial Linkage Fee (CLF) feasibility study and provide recommendations for updated fees.
3. Further clarify which Research & Development projects will be included in the same fee structure as Office classification.
4. Modify the collection of impact fees to the issuance of a project’s building permits.
5. Return annually prior to the automatic fee increase with a report on the fee program.
6. Direct staff to explore:
    a. Potentially allowing incentives in the form of fee reductions for
        i. Projects that build affordable housing in parallel with its commercial development, and,
        ii. Projects that implement quantifiable and comparable sustainability measures
    b. The creation of an additional fee structure for projects above one million square feet.

BACKGROUND

In the past several years, the City Council has deliberated at length on whether to explore the implementation of a Commercial Linkage Fee. Finally in 2019, the City Council directed the administration to commence a nexus analysis to determine if there is a linkage between non-residential development in the City and the need for additional affordable housing. Per staff's memorandum, "during the first six years of the 8.8-year RHNA projection period – approximately 68% of the way through the current RHNA cycle – the City has met 94% of its market-rate housing goal but only 18% of its affordable housing goal." These staggering numbers reinforce that we are building in San José but just simply not enough affordable housing, citing funding demand as a driver. Based on the nexus analysis, and the anecdotal evidence, on the question of whether there is a linkage between job growth and housing needs: the answer is a resounding yes!

When approving the nexus analysis in March 2019, we expected a tough discussion as the notion of instituting a commercial development fee to create more affordable housing would likely garner great community interest. Unfortunately, what we did not expect is that both the analysis and this discussion would be occurring in the midst of a global pandemic, let alone an economic recession. This somber reality of changed market conditions is one we must accept for the time being. However, while this may be the "new normal", it is not the permanent normal since the future remains untold with the real possibility of economic recovery. After all, we are fortunate to still see an appetite for development as we continue to entitle commercial projects such as the 3.4 million square foot City View Project and the game changing Google Downtown West project on the horizon. This is an opportunity for us to implement a policy that holds any future job growth in our city accountable for the housing need that comes with it.

ANALYSIS

Phased Approach

It is expected that the pandemic will last well into 2021 and until a vaccine for COVID-19 is discovered and made readily available. We will likely continue to see a trend of business closures and high unemployment rates. The recession that we are currently in has certainly raised many concerns on the future of development. However, despite the unstable situation we are in, within the next three years the City is anticipated to see an estimated 4.8 million square feet of development in Downtown alone.

The impacts of the pandemic will have a lasting effect on our community, most disproportionately on the City's most vulnerable populations: Black and Latinx households, women-led households, and seniors. Many of whom are already strained by the lack of affordable housing. Whether or not development is moving at the same pace prior to the pandemic, the creation of any new jobs generates the demand for more affordable housing. In a recent study reported by the Mercury News, the South Bay is seeing a faster economic recovery and "remains one of the Nation's top performers for job recovery" despite being one of the later regions to relax the Shelter in Place orders.[1]

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[1] https://www.mercurynews.com/2020/08/17/coronavirus-economy-south-bay-job-market-recovers-faster-than-bay-area-state-usa/

As shown in Figure 1, applying the phased in approach to the staff's analysis that estimated originally $14 million in fees generated, the City could see $30 million in three years collected for affordable housing, a more significant amount to tackle the housing crisis.

While jobs are nowhere near the numbers they were at the beginning of the year, this recovery is indicative of San José returning to the market it once was. The phased in approach will ensure that we are accurately capturing the recovery that starts to pick up. It is estimated that it will be a full two to three years for our economy to restabilize, an updated nexus and feasibility study should be done to accurately capture the new circumstances.

Additional Changes

Staff noted that today's R&D developments are more likely to include the use of computers, and have departments such as sales and human resources in an office space setting compared to traditional R&D that is strictly a laboratory type environment. In addition, in 2016 the City of San José's Employment Lands Analysis by Strategic Economics noted the increase in demand for Office/R&D space in North San José with a number of industrial uses being converted to uses that would be considered R&D or office.

While staff does state that the R&D being developed today in Downtown, North San José, and West San José fall under and will be classified as "Office," there should be a clearer identification of tying that classification of R&D to Office. Under SJMC 20.200.818 Office, research and development: "Office, research and development" is an establishment engaged in industrial or scientific research and product design that involves the use of computers and other related office equipment in an office setting. The facility may also include administrative services related to product design or sales, but does not include laboratories, manufacturing or assembly. (Ord. 28460.) However, what if there is a development that includes both a laboratory and a traditional office setting? There should be further clarification between Office/R&D and R&D and close any potential loopholes to capture the appropriate fees.

Currently all cities, with the exception of Santa Clara, in the County collect the linkage fees at the time when building permits are pulled. As a development goes online, the goal is to ensure that there is a proportionate amount of affordable housing developed at that same time. Collecting the fees at the time of the building permits will give the City more time to distribute those funds to begin the construction of affordable housing.

As market conditions and the overall economy continue to be in flux due to the pandemic, we should allow for an annual report back on the progress of the fee program including the number of projects going vertical, the amount of fees collected, and future projections. If needed, minor administrative changes such as streamlining processes that need council authorization could be recommended. I would like to stress that this annual report does not entail an adjustment to the fees themselves but should serve as a progress report for future deliberations.

Further Exploration

I am conscious that what the Council approves on Tuesday is only the beginning. There will continue to be much needed work on increasing both our affordable housing stock and job creating developments. In our discussion with various stakeholders, we have heard creative ideas that should be explored.

I have always been a staunch believer that if the City provides incentives for developers, there should always be substantial benefits for the community and the City. It is safe to say that there is a general consensus that our priority should be to create more housing - and if a commercial developer opts to fund and build affordable housing units comparable to their commercial development in parallel path - that is a win-win. Like our Inclusionary Housing Ordinance that is structured to incentivize building on-site units (15% obligation) rather than paying the in-lieu fee (20% obligation), this fee program should explore a similar model.

Furthermore, I have long encouraged our developments to go beyond our sustainability and green standards. One example is the Reach Code that the City approved in September 2019 adopting the California Green Building Standards Code and California Building Energy Efficiency Standards. What if a developer chooses to go beyond those minimum requirements? Builders may be willing to exceed requirements if they are pursuing third-party certifications like LEED Gold or Platinum, which includes the building envelope, and other measures, too, outside of building code. That would be worth exploring fee incentives for if it results in long term sustainability benefits.

To be clear, it would be our belief and desire that any future incentive applied to CLF would be subject to a Private Workforce Standard feasibility analysis.

Finally, I appreciate that the analysis opted to use a 100,000 square foot building size assumption. However, it would also be in our best interest to better understand the dynamics at projects exceeding 1 million square feet and whether projects above that threshold should be considered for a separate fee level. After all, projects at that magnitude may have different financing capacities and yield expectations compared to smaller commercial developments.

CONCLUSION

We have reached the conclusion of the studies, however the conversations have only just begun in developing the appropriate fee for commercial development and its relation to affordable housing in the City of San José. While we adapt to these unprecedented times, it is important that we are also properly capturing the rebound in the near future. The long awaited commercial linkage fee is a vital and necessary tool that will serve to mitigate displacement and contribute to the sorely needed affordable housing.

FIGURE 1: Projected Fees Collected On All Uses Citywide on Office Phased Approach
Source: **Source**: *City Staff's Analysis - Memorandum from August 21, 2020, Pgs. 3, 15 & 16*

Size	*15 Year Avg (SF)*	*Staff/2021*	*Est. Fees*	*2022*	*Est. Fees*	*2023*	*Est. Fees*
OFFICE							
>100,000	*512,190*	$10	$5,121,900	$15	$7,682,850	$20	$10,243,800
5,000 - 100,000	*55,968*	$3	$167,904	$4.50	$251,856	$7.50	$419,760
<5,000	*3,865*	$3	$11,595	$4.50	$17,393	$7.50	$28,988
Total	*572,022*		**$5,301,399**		**$7,952,099**		**$10,692,548**
RETAIL							
>100,000	*172,390*	$3	$517,170	$3	$517,170	$3	$517,170
5,000 - 100,000	*248,061*	$0	$0	$0	$0	$0	$0
<5,000	*28,828*	$0	$0	$0	$0	$0	$0
Total	*449,279*		**$517,170**		**$517,170**		**$517,170**
INDUSTRIAL							
>100,000	*62,335*	$3	$187,005	$3	$187,005	$3	$187,005
5,000 - 100,000	*13,344*	$0	$0	$0	$0	$0	$0
<5,000	*496*	$0	$0	$0	$0	$0	$0
Total	*76,175*		**$187,005**		**$187,005**		**$187,005**
WAREHOUSE							
>100,000	*101,290*	$5	$506,450	$5	$506,450	$5	$506,450
5,000 - 100,000	*45,986*	$5	$229,930	$5	$229,930	$5	$229,930
<5,000	*2,539*	$5	$12,695	$5	$12,695	$5	$12,695
Total	*149,815*		**$749,075**		**$749,075**		**$749,075**
HOTEL							
>100,000	*56,044*	$5	$280,220	$5	$280,220	$5	$280,220
5,000 - 100,000	*57,444*	$5	$287,220	$5	$287,220	$5	$287,220
<5,000	-	-	-	-	-	-	-
Total			**$567,440**		**$567,440**		**$567,440**
TOTAL			$7,322,089		$9,972,789		$12,713,238
x 3 Years			$21,966,267				
Sans 1 Year = Staff's Estimate			**$14,644,178**				
TOTAL (With Phased Approach)							**$30,008,115**