CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: HONORABLE MAYOR AND CITY COUNCIL

FROM: Jeff Ruster

SUBJECT: SEE BELOW

DATE: September 26, 2019

Approved D-DSyL Date 9/26/19

SUBJECT: OVERVIEW OF STRATEGIES AND TOOLS TO MITIGATE SMALL BUSINESS DISPLACEMENT

PURPOSE OF STUDY SESSION

Accept staff report responding to the referral from the December 4, 2018 City Council meeting directing staff to "explore strategies and financial tools to mitigate small business displacement."

BACKGROUND

On December 4, 2018, Council adopted actions associated with the sale of property to Google including direction from a memo authored by Mayor Liccardo and Councilmembers Carrasco, Davis, and Arenas. Among the elements of that memo was direction to return in the fall of 2019 with "strategies and financing tools to mitigate small business displacement."

Staff has developed an initial pilot strategy and a work plan for 2019-20 focusing on the Alum Rock-East Santa Clara Street transit corridors.

Overview of the San José Small Business Community

It is estimated that there are more than 50,000 small businesses in San José with the following breakdown:

- 35,250 are self-employed proprietors, offering services like consulting, bookkeeping, house cleaning, landscaping, and everything in between.
- 15,600 establishments employ between 2-35 employees and of these, 11,400 have 2 – 9 employees including many independent retail, restaurant, and food service businesses.

In total, small business is estimated to employ 156,600 individuals, representing 36% of all jobs in San José.

A work2future-commissioned study shows that in San José, 60% of small business owners are people of color, and almost 51% of small businesses are immigrant-owned. In addition, 30% of immigrant owners self-report that they do not speak English proficiently.

For many San José residents, starting a business is a powerful wealth-building strategy designed to secure economic self-sufficiency and a long-term future in the city. For family-owned businesses in the United States the intergenerational impact can be significant, with an estimated 30% of all family-owned businesses successfully passing to the next generation.

Furthermore, starting a business represents an attractive career pathway to maximize the economic value of acquired experience, skills, and qualifications. Over time, these small businesses continue to provide a regular source of local employment cementing the relationship within residential neighborhoods. Across San José some small businesses are important community anchors that preserve and celebrate the city's cultural identity and social heritage.

Defining Small Business Displacement

Business displacement occurs when external factors contribute to a business involuntarily closing or relocating from its current premises. Business displacement can be categorized into three broad categories:

- Direct Displacement: A business impacted by changes to the lease or building they operate in, including rent increases, property reinvestment, renovation or wholesale redevelopment and sale.

- Indirect Displacement: Changes to the immediate area that impact operations or business viability, including customer preferences and operating environment. This can include the availability of parking or access and changes in surrounding uses (such as anchor tenants). Indirect impacts can also in turn lead to direct displacement.

- Macro-Level: Changes to the broader business, economic or regulatory environment that have detrimental effects on local business viability. This could include unforeseen environmental impacts resulting from natural disasters or major environmental changes. Macro-level impacts may contribute to both direct and indirect displacement.

While displacement can affect business of all sizes, it often has the most pronounced impact on small and locally owned/operated business within a neighborhood. As property owners seek higher rents due to rising asset values and economic improvement in the area, or as developers replace older buildings with new projects, rents can rise significantly. This can result in a sudden price shock for the business as they attempt to absorb the higher cost. To protect the cash flow and profitability of the business either overhead must be reduced or prices increased. If this is not possible, then the owner will need to relocate on a comparable cost basis to mitigate the risk of business failure.

Businesses who are tenants in leased space are reliant on the terms of a signed lease or legal agreement with the property owner. Unlike residential tenants, commercial property tenants have limited rights and protections under California law. Commercial tenants on a month-to-month arrangement are at risk of sudden rent increases or lease termination. There is also no legal requirement for a property owner or private developer to provide financial relocation support to business and commercial tenants/leaseholders, unless otherwise specified in the lease.

Staff has heard anecdotally that in many cases where businesses have planned to relocate, the process of finding, permitting, improving, and ultimately moving into a new space can take six to nine months or more. In cases where an existing property owner chooses not to renew the lease, or the property is sold for redevelopment, the business may have as little as 30 days to vacate the property.

Any agreement reached between the property owner and tenant outside of the terms of the lease is the result of negotiation undertaken between the parties. Many small business tenants are either unaware that they should seek legal advice or cannot afford the cost. This can lead to a highly uncertain outcome for the business tenant. Local government is prohibited in law from representing the property owner, developer, or tenant.

The overall loss of small businesses can result in reduced economic mobility for residents who may own, work at, or frequent these businesses daily. If widespread business displacement takes place within a neighborhood, then over time the composition of the community can be significantly altered.

Context of Growth in San José

In attempting to focus staff's analysis and understanding of the issue, current efforts focus on the potential for small business displacement as related to development consistent with the implementation and build out of the City's residential and commercial goals as defined in the General Plan.

The City has long held smart-growth goals at the core of its major land-use policies, and in 2011 adopted the Envision 2040 General Plan Update which went further than before in limiting the suburban sprawl and focused the growth in key locations served by existing infrastructure, particularly transit infrastructure.

For example, outside of established major employment areas, including Downtown and North San Jose, GP2040 laid out the framework for the Urban Village concept, which protected the City's Urban Growth Boundary and existing single family neighborhoods. As the first horizon of Urban Villages has completed the planning process, the potential for small business displacement becomes more apparent.

Because the opportunity to develop lower density housing types throughout San Jose is disappearing, residential developers are pursuing the redevelopment of older commercial

properties into mixed-use projects as envisioned by the General Plan. These changes to the General Plan (macro-level factor) are shifting the underlying economics in certain areas (indirect factor), and as properties are sold this can trigger increased rents or leases not being continued (direct factor) for local small businesses.

Many indirect and macro-level factors causing displacement are unpredictable, or otherwise only become apparent with hindsight. For example, when the City changed the regulatory framework around cannabis based businesses, the influx of new businesses who could pay higher rents created location challenges for some smaller industrial businesses in those limited areas where cannabis businesses could locate. Similarly, as costs have become increasing prohibitive to new development in employment areas, property owners have repositioned industrial buildings to attract more office like uses, resulting in comparable rent increases across submarkets like North San Jose and pricing out industrial employers.

Publicly Funded Development Projects

In addition to the impacts of private property owners, two public development-related factors can trigger small business displacement.

Transport Infrastructure Projects

Publicly funded major transport infrastructure projects (such as major highway improvements and the planned BART Phase II to Silicon Valley) are high cost, multi-year, complex engineering-led projects with long-term impacts. BART Phase II to Silicon Valley will substantially enhance the value of transit-oriented development in the business corridors and surrounding residential areas closest to the location of the new stations.

Land required for the BART Phase II to Silicon Valley is subject to a legally defined procedure commencing with VTA issuing a notification process and culminating in individual agreements with property owners based on fair-market value prior to construction taking place.

However, there is the potential for significant indirect displacement as each phase of a transport infrastructure project must be carefully managed prior to, during and post construction. Experience from the VTA Bus Rapid Transit program demonstrated that uncertainty and delays arising from road closures and parking restrictions can undermine commercial retail locations. VTA recognizes that timely and effective business mitigation programs must be in place and has begun working with the City to explore policies and strategies to mitigate potential macro-level and indirect displacement.

Affordable Housing Projects

Affordable housing projects financed by public funds are now under active negotiation and approval as a result of the City's Housing Investment Plan and the successful County Bond measure. The City typically publishes a Notice of Funding Availability and then allocates

funding based on the scoring of responding projects. The project seeking City funding then goes to City Council for approval and term sheets are negotiated. After that the City executes the loan and related documents.

In the case of City-funded housing projects that directly cause permanent displacement, the City will require the developer to hire a relocation consultant and prepare a relocation plan with noticing and assistance to be provided consistent with the applicable state and federal laws and guidelines. Under those requirements existing business tenants who are displaced as a result of the publicly funded project are eligible for compensation and relocation support. If the project results in permanent displacements, the City or another funding agency must approve a relocation plan. Relocation of businesses may include negotiations regarding moving expenses and other payments.

The timing of when negotiations take place is important to the business owner. The more time the business owner has to make decisions, the greater the likelihood they can find a suitable alternative location.

Any required relocation cost should be funded through a project budget approved by the City and/or County. There are affordable housing projects where multiple sources of public funds are deployed, and in those circumstances the partners jointly agree on the relocation process.

Small business can be at a heightened risk of direct displacement when the current property owner seeks to maximize the sale value to the new developer in advance of the City or County receiving a request for funding in connection with a proposed project.

ANALYSIS

As City staff developed the pilot components of the small business anti-displacement strategy, they considered the following:

1. Many Variables Impact Small Business Resiliency
   Small business owners close or move their business due to a wide range of economic, financial, and personal reasons. Beyond the obvious scenarios of direct and indirect displacement, business owners may choose to move or close their business due to changing customer demands, higher costs of doing business (supplies, personnel, credit, etc.), and personal decisions (health issues, retirement, lack of succession plan for a family-owned business, etc.).

   Some small businesses are more readily positioned to adapt to changes in their business environment while others are not. Long-standing relationships with their property owner, more established resource networks (legal, accounting, capital, etc.) to tap into, or a more resilient set of business and financial practices can make a fundamental difference to the long-term sustainability of the business. However, for those businesses operating with

limited access to relevant information, low access to professional services, and low capitalization, the shock of involuntary displacement increases the risk of permanent business closure. Addressing these core business resiliency issues has been at the heart of the city's approach to date.

2. Program Design and Assessment to Include a Racial Equity Lens
   The City's strategy to address small business displacement should explicitly address any policies, programs and/or practices that may hinder businesses owned by people of color and immigrants from using available services. Indeed, many business owners of color at risk of displacement have fewer relocation choices due to lower incomes, less wealth, lower credit scores and limited access to loans. Hence, the City's approach should aim to directly address these barriers, and in doing may result in the deployment of new, and in certain cases untested, outreach strategies, services, and partnerships.

   OED has worked with the City's Racial Equity team reviewing the project's problem statement and initial service delivery strategy. In addition, staff have engaged in design-thinking sessions and focus groups with a concentration on immigrant and people of color owned businesses to understand their challenges and related recommendations for overcoming these challenges.

   The City's community, business service and financial partners have also provided critical input into the design of this pilot project. One example is the Federal Deposit Insurance Corporation (FDIC) which held two focus groups on the Alum Rock corridor with banking institutions to identify partnerships and commercial lending opportunities in San Jose. With some 20 to 25 financial institutions in attendance, both sessions were held completely in Spanish. Some of the partnerships described further within this memo resulted from these targeted outreach efforts.

3. Pilot, Assess and Adapt
   The City's small business community is large and diverse. What works well in one business district or neighborhood may need to be tailored in another. Approaches therefore must be piloted, evaluated, and adapted to incorporate changes to those factors impacting small business resiliency, while recognizing that different business districts/corridors may have very different situations and influences related to displacement. Small-scale pilots will help reveal effective approaches but implementation will require flexibility to address the varied needs of small businesses, their locations, and broader economic conditions.

Initial Building Blocks and Progress to Date

Guided by these parameters, staff has analyzed, developed, and prototyped key components of the pilot phase of the proposed small business anti-displacement strategy.
Initially this project will focus on the Alum Rock and East Santa Clara Street corridors since they are likely to witness the most intense development across the city with the BART Phase II to Silicon Valley, five urban villages and numerous affordable housing projects forecast to be constructed over the next eight years. Nonetheless, as this initial strategy is rolled out, City staff and partners will continue to support small businesses city-wide through current efforts such as the San José Public Library Works, Small Business Ally, and the overall umbrella of partnership services offered through the Business Owners Space (BOS) program.

Key building blocks of this initial strategy include the following:

- Review of Other Jurisdictions Strategies
  Through a mid-year General Fund appropriation approved by City Council in February 2019, staff contracted with Keen Independent Research to undertake a review of different U.S. cities' initiatives to mitigate the impact of small business displacement.

  In addition, OED has actively participated with the City's Housing Department through membership of the Policy Link Network to gain an oversight of differing approaches pursued by other cities. Based on this input, it is important to note that much of the evaluation of displacement nationally has been focused primarily around residential displacement.

  As further detailed under "Next Steps," staff has developed a preliminary list of potential policy measures and financing tools that could support the City's small business anti-displacement strategy.

  The key lessons learned from reviewing the experience of other jurisdictions include the following:

  - Early consultation and active community involvement can build awareness and understanding of the potential impact of major projects and assist in defining the need for local mitigation and demand for technical support, in advance of actual displacement.

  - Transportation infrastructure projects with significant funding for business mitigation programs such as those in Los Angeles can be effective in retaining existing businesses both during and after construction. The key design features were the scale of funding available over the lifetime of the project, the broad geography and eligibility criteria, highly localized delivery models and a physical location for technical assistance providers. The design metrics were to identify the number of businesses continuing to trade within the geographic area two years after these interventions.

- Providing direct financial support as well as technical assistance to business districts and individual businesses has been useful in cities such as Portland and Austin in the attempt to retain longstanding local businesses. Key components of the technical assistance offered include development of modified business and marketing plans, and support to enhance financial controls.

- Preserving existing and creating new affordable commercial space enables local businesses to remain in the locality on a long-term basis. Cities such as Washington D.C. are using stipulations in planning agreements to achieve this by negotiation with developers of key sites. The results of the research study indicate that these efforts can be difficult to scale and monitor effectively.

The full report from Dave Keen Associates can be accessed at the following link: http://sjeconomy.com/keen-independent-research-programs-to-assist-economically-displaced-businesses-august-2019

- Build a Rapid Deployment Service Network
  Certain long standing BusinessOwnerSpace.com (BOS) partners have agreed to work with the City in a targeted and responsive manner. These agencies include the Small Business Development Center (SBDC), SCORE, the Minority Business Development Agency (MBDA), AnewAmerica, and work2future.

  At no cost to the small business owner or the City, these agencies stand ready to:

  - Meet with a business owners located in the pilot area within 48 to 72 hours of notification received; and

  - Provide small business consulting services, including business planning, marketing strategies, access to capital, layoff aversion, tax assistance, accounting, and record keeping.

  Of critical note is that these service providers have the linguistic and cultural competencies, and just as importantly the trust of the small business community.

- Secure Critical Lease Negotiation and Real Estate Support Services
  Two new small business anti-displacement services have been added to those mentioned above:

  - The first are the pro bono legal services provided by Start Small Think Big, a non-profit operating in New York and five counties in California. Working with approximately 30 law firms across Silicon Valley, this organization acts as an intermediary and connects lawyers from these firms to small business that earn below a certain income threshold (e.g. less than $128,000/year for a family of four). These

free legal services can include the review of lease agreements, support related to personnel or financial considerations, and matters associated with business formation and transfer of business ownership. However, this nonprofit does not provide litigation support of any kind; and

- Services provided by the Minority Business Development Agency (MBDA), which historically has focused on supporting small business to build their capacity and secure funding to compete for federal procurement opportunities. Recently, the MBDA has expanded its service menu to include direct, no cost assistance for small business in searching for a new location, determining optimal space requirements, scoping tenant improvement budgets, and, when appropriate, assisting the business owner in securing funding to relocate.

- Form Partnerships with Community Intermediaries
  Key to facilitating demand for and confidence in the services offered under this strategy will be partnerships with community and neighborhood business representatives to establish a rapport with the business owners, fluid communication, and trust with the City and the service providers.

  Partnerships formed to date include those with the Alum Rock Business Association, East Santa Clara Business Association, Somos Mayfair, Veggielution, and the Silicon Valley Organization. These partnerships will play a critical role with outreach and securing the confidence and indeed buy-in of the small business community to facilitate feedback to the City on the needs of small business owners and the impact of services. In addition, the strategy will rely as well on the outreach support of City Council offices, the Office of Immigrant Affairs, the City's Housing Department, and the Small Business Ally Program. It should be noted that the Alum Rock Business Association already has begun to provide technical assistance to small businesses along the corridor to assist them in preparing and organizing their financial records in order to expedite funding requests should relocation and/or business interruption funding become available.

- Feedback and Listening Sessions with Small Businesses
  Key to staff's approach to developing the proposed pilot strategy has been a series of focus groups, feedback sessions and one-on-one consultations with the Small Business Advisory Task Force, members of the Business Owners Space (BOS) network, constituents of the Santa Clara Business Association and most recently, and as facilitated by the SBDC with businesses at the Shirakawa Community Center.

  As part of the San Jose Entrepreneurship Summit held on May 8th, a design-thinking session was conducted with more than 40 participants. The purpose of this session was to hear from the businesses directly the challenges and impediments that are impacting their business resiliency, and to solicit their suggestions for overcoming these obstacles. Collective feedback from these sessions served to enhance the components of the strategy, most notably

the technical assistance menu, service delivery approach, and methods of conducting outreach and engaging with the small business community.

- Partnerships and Exploration of Financing Tools with Private Providers of Capital
  City staff has collaborated on three different networking events with the Small Business Administration (SBA) and the Federal Deposit Insurance Corporation. At each event, City partners convened private providers of capital to discuss opportunities, strategies, and partnerships for these financial institutions to engage more actively with small business in San José, and in certain cases specifically with those located along the Alum Rock/East Santa Clara Corridor.

  From these sessions new referral partnerships are under development with a variety of Community Development Finance Institutions (CDFIs) certified by the U.S. Treasury Department. Examples include referral partnerships with national and regional agencies such as the Local Initiatives Support Coalition (LISC), Opportunity Fund, Working Solutions, CDC Micro Finance and Inner City Advisors. These agencies are able to provide a wide range of loan products, often supported by federal funding from the SBA, for working capital, asset acquisition, tenant improvements and/or other real estate investment purposes.

- Alum Rock Storefront Activation Grant Program Pilot Strategy to Address Displacement
  As approved by City Council on June 11, 2019, $75,000 dedicated to the Alum Rock Corridor through Councilmember Carrasco's Office (BD#44) was included in the Mayor's June Budget Message for Fiscal Year 2019-2020. The adopted budget message also directed the Office of Economic Development to develop a pilot strategy to address displacement through the application of the Storefronts Grant Program. Staff, in close coordination with the Alum Rock & East Santa Clara Business Association, has commenced outreach to potential small businesses located on the Alum Rock Business Corridor. The intent will be to target these funds to small businesses that are facing imminent displacement and actively seeking a new location to transfer their business operations either temporarily or long-term on the Alum Rock Business District Corridor.

The Next 6 to 12 Months – Implementing the Pilot and Refining the Strategy

The pilot phase will commence in October 2019, whereby the City and its partners will launch a coordinated information awareness campaign to the businesses in the pilot area through the Alum Rock Business Association, the BOS service providers and community-based partners. Examples of activities include workshops, lender roundtables, community meetings, door-to-door canvassing, SVO Business Walks, and social media and email blasts. City Council offices, the Office of Immigrant Affairs, and the City's Housing Department will also support these outreach efforts.

One initial outreach effort involves a series of workshops provided by Start Small, Think Big that will provide an overview of the key provisions within standard lease agreements, as well as provide small business participants with insight into their legal rights and remedies. The initial set of workshops is tentatively scheduled for October 15, 2019 at the Mexican Heritage Plaza.

Key next steps in building out the pilot program include:

- City Hall Sign Posting/Single Point of Contact
  The Office of Economic Development is actively developing a referral system to streamline enquiries from small businesses impacted by displacement. The aim is to streamline small business inquiries to address their concerns quickly and, where appropriate, connect them with available services provided by the City and its partners. To ensure that appropriate translation and interpretative support is available, staff will also have available a toll-free-translation phone service to assist with business representations who need services in languages other than English.

- Facilitate Additional Small Business Listening Sessions
  Staff will work closely with the pilot project partners to conduct additional focus groups, surveys, executive interviews, and/or design-thinking sessions with small businesses following the launch of the pilot program. From the feedback received, staff expects to gain additional insights to deepen its understanding of the needs of small businesses and further refine the pilot service menu and delivery approach.

- VTA Consultation
  Staff will work closely with VTA to identify all businesses directly and indirectly impacted on the BART Downtown extension to ensure an effective business mitigation program is available and funding fully utilized. VTA is in the process of selecting a consultant to design a mitigation strategy to support small business prior to, during and after BART construction. The consultant is expected to be selected by VTA and start work in the fall of 2019. Staff will also collaborate with VTA on plans for transit-oriented development to ensure that small businesses receive the technical support and financial assistance necessary to mitigate the potential negative consequences of displacement. The current timeline from VTA assumes the VTA Board will approve a business mitigation program by the summer of 2020.

- Financing Tools
  A key focus of these new partnerships is likely to include forging tighter connections with banks, credit unions and other small business lenders to support impacted small businesses with their relocation efforts and working capital needs. Examples of concepts currently under consideration are discussed below:

- Based on the three August networking events with the FDIC and SBA, staff will continue to refine and build upon the early partnerships established with the before-mentioned CDFIs. Collectively, the partners will offer small business referrals to those banks interested in offering small businesses in the pilot area loans featuring competitive terms and interest rates. These loans may serve to support the small business with their working capital, asset acquisition, tenant improvement and other real estate related needs. Where appropriate, BOS partners such as the SBDC will assist the small business with underwriting support related to securing SBA-backed loans.

- As a complementary source of capital, staff will explore the feasibility of grant opportunities and partnerships with philanthropic organizations, corporate foundations and financial institutions (as through the Community Reinvestment Act) to support service providers and intermediaries working in partnership with the City on this strategy.

- Policy and Program Options for City-wide Consideration
  Based on the review of other cities' programs and policies by Keen Independent Research, Staff will review various policy alternatives to bolster the City's small business anti-displacement strategy. The objective is to design a range of policy and program solutions to sustain a long-term strategy that has capable of supporting small business retention across the city. Policy alternatives could include:

  - Evaluate the effectiveness of public notifications as part of the entitlement process for all business tenants on sites/parcels of land impacted by privately and publicly funded development projects, including in the case of the latter those related to affordable housing. The objective is to make visible to businesses at the earliest opportunity the impact of development. In turn this would encourage property owners to provide more advance notification to existing tenants of potential changes to their current lease circumstances.

  - Develop partnerships and funding strategies with trusted community partners to conduct outreach and education efforts in business corridors and neighborhoods that are subject to intense development pressure. The sustained ability of these intermediaries to provide the outreach, follow-up, and feedback of the City's small business displacement strategy is of high importance to the short and long-term success of this strategy.

  - Conduct a legal review of potential policy and financial options that the City may have to facilitate access by displaced small business along the Alum Rock corridor to

existing and/or newly developed commercial space associated with affordable housing projects.

- Collaborate with VTA to design a comprehensive program to address effective mitigation and support for all small business impacted directly or indirectly by the BART extension and transit oriented development.

- Review and Refine the Technical Assistance Service Menu
  City staff and partners will conduct regular check-ins to assess the level of interest, take-up rate of the services offered, and to share feedback from the small business owners themselves as to the impact and ease of access of the services offered. Based on stakeholder feedback, staff will continue to build new partnerships with small business serving agencies to; (i) add services otherwise not already available, (ii) include sector-specific expertise (e.g. restaurant) and/or (iii) expand the level of cultural and linguistic service delivery options for impacted businesses.

EVALUATION AND FOLLOW-UP

The Office of Economic Development will provide an update to City Council following the initial evaluation of the pilot program in the Alum Rock-East Santa Clara business corridor. In the short-run, key metrics will include those related to demand for the services offered and the successful completion of anticipated deliverables (business and marketing plans, access to capital, etc.) and in the longer run, the retention of businesses served through these services. These success metrics will seek to differentiate outcomes by business sector, age of business, type of assistance received and, where available, ownership. Data collection techniques and sources will include surveys, focus groups, as well as City, partner, and other secondary data sources.

COORDINATION

This document was coordinated with the City's Housing Department, Planning, Building and Code Enforcement, Office of Immigrant Affairs, Transportation and the City Attorney's Office.

COMMISSION RECOMMENDATION/INPUT

This report was not coordinated with any board or commission.

FISCAL/POLICY ALIGNMENT

This action supports Initiative 4 of the City's Economic development strategy, "Nurture the Success of Local Small Businesses."

/s/
KIM WALESH
Deputy City Manager
Director of Economic Development

For questions, please contact Victor Farlie, Office of Economic Development, (408) 535-8230.