



Memorandum

TO: HONORABLE MAYOR
AND CITY COUNCIL

FROM: Kim Walesh
Jacky Morales-Ferrand

SUBJECT: SEE BELOW

DATE: October 24, 2019

Approved

Date

10-25-19

**SUBJECT: DOWNTOWN RESIDENTIAL HIGH-RISE INCENTIVE AND AHIF
DOWNTOWN HIGH-RISE EXEMPTION PROGRAMS**

RECOMMENDATION

- (a) Adopt a resolution extending the certificate of occupancy deadline for the Affordable Housing Impact Fee exemption to December 31, 2023.
- (b) Approve an ordinance creating a temporary fifty percent (50%) reduction of the Building and Structure Construction Tax and a fifty percent (50%) reduction of the Commercial-Residential-Mobilehome Park Building Tax for qualified residential high rise projects located within the Downtown Planned Growth Area that obtain a City certificate of occupancy on, or prior to, December 31, 2023.

OUTCOME

Approval of the recommendation will result in a 50% reduction of the Building and Structure Construction Tax and the Commercial-Residential-Mobilehome Park Building Tax, and an extension of the certificate of occupancy deadline for the Affordable Housing Impact Fee exemption, for qualified residential high rise projects located in the Downtown.

BACKGROUND

On November 18, 2014, the City Council adopted the Affordable Housing Impact Fee (AHIF) Resolution establishing the AHIF program to address the increased need for affordable housing connected with the development of new market rate residential rental units. Under the AHIF program, new market-rate rental housing developments will be charged \$17.00 per square foot of net rentable space (the "Fee") to address the impact of that type of development on the need for affordable housing. The resolution included a time-limited exemption for Downtown High-Rise

rental projects. The Downtown High-Rise Exemption allows a development to be exempted from paying the Fee, if the following criteria are met:

- The rental development is located in the Downtown Core Area (as described in Resolution No. 73587 – adopted January 9, 2007);
- The rental development meets minimum height requirements where the highest occupied floor within the project must have a floor level elevation of at least 150 feet above the street level (as verified by plans submitted to the Building Division);
- The developer provides evidence that the development is not a for-sale development;
- The developer, prior to issuance of a Building Permit, records an AHIF Agreement, specifying which fee shall apply in the event the developer fails to satisfy all waiver requirements; and
- The developer provides evidence that its final Certificates of Occupancy are ready to issue, except for the fee waiver, on or prior to June 30, 2021.

On December 19, 2017, the City Council adopted a new Downtown Core High-Rise Fee Category for Parks, Recreation, and Neighborhood Services, reflecting lower observed occupancy of existing high-rises in Downtown San Jose. Prior to this new category, high-rise developments paid the same rate as any project with 5 or more residential units. With this new permanent fee category in place, a reduction in Parks Fees is no longer included in the Downtown High-Rise Incentive.

On June 12, 2018, the City Council approved the Housing Crisis Workplan which included direction for staff to extend the 50% reduction on construction taxes to align it with the end date of the AHIF exemption.

On June 25, 2019, the City Council approved amendments to the municipal code to require workforce standards for private development projects receiving a subsidy and directed staff to move forward with a unique services agreement for a consultant to perform the required financial feasibility assessment of Downtown high-rise residential development, with the intent of staff returning to City Council with an extension and amendments to the Downtown Residential High-Rise Incentive.

On September 24, 2019, the City Council considered a report titled Financial Feasibility of Downtown High-Rise Projects and Potential Impact of Incentives and Workforce Standards completed by Strategic Economics, dated September 12, 2019, and directed staff to return to Council with the appropriate ordinance and resolution to enact the AHIF exemption and construction tax reduction for Downtown High-Rise residential development.

ANALYSIS

The adopted Workforce Standards Ordinance (SJMC 14.10) includes provisions that require private construction projects receiving a City subsidy to pay all workers employed on the construction the prevailing wage rate, as well as provisions for requiring apprenticeships, local hire, and use of unrepresented workers. The ordinance contains some exceptions to the definition of subsidy, including when the fee or tax reduction is applied uniformly across all private construction projects within a specific subcategory of use (such as 'High-Rise Residential'), and Council determines, based on the following criteria, that construction of the projects is not financially feasible absent the reduction:

1. Council's determination, supported by findings, must occur following a public hearing,
2. Council's findings must be supported by evidence presented at the public hearing, including a financial feasibility study analyzing whether construction of the projects within the specified subcategory of use is reasonably unlikely absent the fee or tax reduction,
3. The financial feasibility study must be performed by a consultant qualified to provide real-estate analytic services and procured through the City's usual procurement process, and
4. The Council must use reasonable efforts to conduct the hearing within 90 calendar days following completion of the financial feasibility study.

Findings that the Fee and Tax Reduction is Not a Subsidy

On September 24, 2019, the City Council held a public hearing in accordance with Chapter 14.10 of the San Jose Municipal Code to determine whether, the proposed temporary tax reduction for projects within the Subcategory of Use defined as Downtown Residential High-Rise buildings is not a subsidy because the construction of such projects is financially infeasible.

The City Council, after considering evidence presented at the public hearing including but not limited to a financial feasibility study prepared by Strategic Economics that met all requirements of San Joe Municipal Code Section 14.10.310(c), determined that the proposed temporary tax reduction for the defined Subcategory of Use is not a subsidy because the construction of such projects is financially infeasible and that the workforce standards otherwise required by Chapter 14.10 would therefore not apply to any downtown residential high rise project(s) receiving the proposed temporary tax reduction.

Strategic Economics, Inc. is a nationally recognized urban economics consulting firm which provides governmental entities, developers, community groups, and non-profit organizations with the economic analyses and strategic recommendations. Strategic Economics was selected to prepare the analysis following direction from the City Council on June 25, 2019, to select an appropriate consultant from the list of consultants submitted by the South Bay Labor Council on June 20, 2019, consisting of Economic and Planning Systems, Strategic Economics, AECOM, Grounded Solutions, and Economic Roundtable, in accordance with the negotiated settlement

approved by City Council on April 3, 2018. Strategic Economics provided the final report to staff on September 12, 2019.

EVALUATION AND FOLLOW-UP

Following approval of this program and the enacting ordinance, staff will develop completion agreements with high-rise project developers intending to benefit from the incentive program. Pursuant to California Government Code Section 53083, the City must conduct a public hearing upon providing a subsidy to these developments and as such staff will bring back each of the proposed agreements for Council consideration in a timely fashion.

Consistent with the requirements of the Mitigation Fee Act, the City will provide an annual report on actual AHIF revenues, future revenue projections, and expenditures of those revenues once revenues have been received. This report will not include any revenues that would otherwise have been generated by Downtown High-Rise rentals projects that have been exempted from the AHIF and these revenues were not included in the current Affordable Housing Investment Plan.

COST IMPLICATION SUMMARY

Due to the incentive being based on time rather than a specific development limit, the potential fiscal impacts of the program will not be fully understood until development applications are received. The financial feasibility analysis presented to Council on September 24, 2019, assumed that loss of revenue attributable to the proposed incentive would be approximately \$3,250 from the combination of the Building and Structures Construction Tax (SJMC 4.46), and the Commercial-Residential-Mobilehome Park Building Tax (SJMC 4.47), and approximately \$14,608 from the AHIF, per residential unit. The Building and Structures Construction Tax (SJMC 4.46), and the Commercial-Residential-Mobilehome Park Building Tax (SJMC 4.47), also known as the Construction Excise Tax, fund a significant portion of the Traffic Capital Improvement Program. Revenues from these taxes are dependent on the level and nature of construction activity moving through the building permit process.

The AHIF is currently \$18.26 per square foot (Fiscal Year 2019-2020). The AHIF increased by 2.4% each fiscal year since it was adopted in 2014. Under the extended deadline, the AHIF would need to be amended annually until fiscal year 2022-2023 in the Schedule of Fees and Charges. There are no revenue or expense impacts in Fiscal Year 2019-2020. Although this change would result in less impact fees collected on the Downtown High-Rise rental developments that do not reach the original deadline, these fees are already considered foregone and are not included in budget projections or in the Five-Year Affordable Housing Investment Plan.

Pursuant to California Government Code Section 53083, the City must disclose information related to any economic development subsidy over \$100,000 through a public hearing. These

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disclosures are required to include information on the estimated total amount of expenditure of public funds or revenue lost, and projected tax revenue. Staff will bring back these disclosures for individual projects in conjunction with the required project completion agreement.

PUBLIC OUTREACH

This report will be made available to the public on October 25, 2019 on the City of San José website and in hard copy in the City Clerk's office, prior to the City Council meeting scheduled for November 5, 2019.

COORDINATION

This report has been coordinated with memorandum was coordinated with the City Attorney's Office and the City Manager's Budget Office.

COMMISSION RECOMMENDATION/INPUT

This item was not brought before a Commission.

CEQA

Statutorily Exempt, File No. PP17-005, CEQA Guidelines Section 15273, Rates, Tolls, Fares, and Charges, Adjustment to Fees, Rates & Fares without changes to or expansion of services.

/s/
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Director of Economic Development

/s/
JACKY MORALES-FERRAND
Director,
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For questions, please contact Chris Burton, Deputy Director, at (408) 535-8114.