



Memorandum

TO: HONORABLE MAYOR
AND CITY COUNCIL

FROM: Kim Welsh

SUBJECT: SEE BELOW

DATE: May 29, 2020

Approved

Date

5/29/20

COUNCIL DISTRICT: 3

**SUBJECT: ECONOMIC RECOVERY TEMPORARY CAP ON NEW OR
INCREASED INFRASTRUCTURE FEES FOR DEVELOPMENT**

RECOMMENDATION

Adopt a resolution approving a temporary cap on: (i) any future new fees on new development citywide for public infrastructure (excluding affordable housing); and (ii) future increases to the existing Diridon Basic Infrastructure Impact Fee. The temporary maximum rates in this recommendation would apply to building permits issued before January 1, 2023 as follows:

- (a) Retail/Industrial: \$8.16 per square foot
- (b) Office/R&D: \$12.20 per square foot
- (c) Hotel: \$5,962.00 per room
- (d) Residential: \$5,470.00 per unit

OUTCOME

Providing certainty about development fee levels over the next 2.5 years helps developers and lenders of entitled projects to know project costs and secure financing, so they can start construction of their projects. Driving major construction projects during the health emergency and recession will create needed jobs and tax revenue.

It should be noted that this memorandum identifies the next steps in consideration of a Commercial Linkage Fee for affordable housing, but the recommendation in the memorandum has no impact on the level of the anticipated Commercial Linkage Fee.

BACKGROUND

The City periodically considers levying impact fees or other assessments on new development to fund needed public improvements. In 2018-2019, City Council provided direction to implement a new infrastructure impact fee and to study some potential new fees.

In March of 2019, the City Council directed staff to bring forward consideration of a Commercial Linkage Fee to generate revenue for affordable housing. City staff are completing the required studies and anticipate presenting a fee recommendation to City Council in August.

In late 2018, Council directed staff to continue developing financing plans for any needed public improvements, amenities, and services needed to support the anticipated increased development capacity in the amended Diridon Station Area Plan or to support Downtown development. In 2019, the City Council established the Diridon Basic Infrastructure Impact Fee (“Diridon Impact Fees”), payable by new development in the Diridon Station Area to support needed public infrastructure.

In October of 2019, staff began to provide clear and transparent notice to development applicants in their planning permits about this Council direction to study and potentially implement additional fees. However, since much of this work is on-going, the permit conditions cannot provide exact dollar amounts or additional specificity. The placement of the permit conditions generally ensures that no applicant would be unaware if the Council implemented such fees prior to any project securing a building permit (the point where fees in place must be paid.). The existing permit conditions are attached to this memorandum as Attachment A.

The advent of the COVID-19 pandemic has created great uncertainty in the real estate and financial markets. The advent of economic recession has created great need to encourage development projects to start construction, in order to generate construction and other jobs and boost property tax rolls. The presence of the virus and the economic effects are anticipated to last at least the next two years.

Staff recommends that the City Council provide certainty about the maximum level of new impact fees that could be put in place the next 2.5 years to support public infrastructure—over and above the anticipated Commercial Linkage Fee. By providing certainty, developers who intend to start construction during this difficult and uncertain period will be able to finalize their cost models and secure their financing.

Specifically, staff recommends a temporary fee cap for any new fees for public infrastructure (excluding affordable housing) on new developments citywide and a similar fee cap on any increase to the existing Diridon Impact Fees. The temporary fee cap would be applicable to any building permits issued for construction before January 1, 2023.

ANALYSIS

Fee Certainty Facilitates Financing

Prior to COVID, up to 18 million square feet of Office/R&D, and roughly 7,000 units of housing, were moving through the development approval pipeline in San Jose. Today, staff estimates that amount has fallen to 6.5 million square feet of Office/R&D (roughly 1/3 of the pre-COVID Office/R&D development). Staff is more optimistic about the continued development of housing and estimates and 5,000 units of housing could possibly proceed in the next two to three years under the right conditions.

Developers need certainty to secure project financing for development projects. At the best of times, certainty is required to assure financial partners that potential projects are feasible. Particularly now, financial institutions are hesitant to lend because there is a lack of clarity related to further COVID-19 impacts. If projects are to proceed, lenders must be assured of specific costs to determine project feasibility. Lending partners must also be assured that costs will not rise over a two to three-year period to facilitate development in this higher-risk environment.

Therefore, staff is recommending that caps be placed on potential new fees for public infrastructure (excluding affordable housing) until January 2023 to provide the development and lending community the certainty that is required. Most economists recognize that some segments of the economy will likely take a minimum of two years to stabilize. Some segments of the economy, like the entertainment and leisure sectors, are anticipated to take well beyond two years to recover.

Diridon Infrastructure Fees and Potential Downtown Fees

As referenced above, in 2019, the City Council adopted Ordinance Number 30305 establishing the Diridon Impact Fees. The Diridon Impact Fee was supported by Nexus Study prepared by Strategic Economics in May 2019 and is codified in San José Municipal Code Chapter 14.35. The current Diridon Infrastructure Fee is as follows:

- Retail: \$4.08 per square foot
- Office: \$6.10 per square foot
- Hotel: \$2,931 per hotel room
- Residential: \$2,735 per unit

Infrastructure fees were created for a base level of infrastructure, known as of 2017. Existing development fees in the Diridon Station Area are expected to generate approximately \$76 million dollars at build out to help fund construction of basic streets, sanitary sewer, storm drainage, and a Station plaza space.

At the time when the Diridon Impact Fees were put in place, it was anticipated that additional infrastructure fees would be required as additional infrastructure needs emerged to support intensification of the Diridon Station Area as part of the Diridon Station Area Plan amendment process. Staff anticipates that the current fees may need to double, resulting in approximately \$150 million in infrastructure fees. An expansion of the boundary for the Diridon Impact Fee may be appropriate to accommodate greater density and development needs. Currently, no infrastructure fees exist in the Downtown outside of the Diridon Area. The Department of Transportation has launched a study of downtown mobility, planning for infrastructure improvements that can optimize the major transportation improvements like BART that are happening in downtown San Jose.

Elements of Staff Recommendation

Staff proposes a temporary fee cap applicable to any building permits issued for construction before January 1, 2023, that is double the current Diridon Impact Fees, as follows:

1. Retail/Industrial: \$8.16 per square foot
2. Office/R&D: \$12.20 per square foot
3. Hotel: \$5,862.00 per room
4. Residential: \$5,470.00 per unit

This temporary fee cap level is recommended because it provides sufficient room for potential increase in the Diridon Impact Fees if needed during the period, and provides certainty should any other new infrastructure fees be proposed for implementation during the period over and above the Commercial Linkage Fee—though none are anticipated at this time.

The recommended fee cap would not apply to any existing fee programs, including but not limited to North San Jose Development, 101/Oakland/Mabury, Edenvale, Evergreen East Hills and 280/Winchester, Park Impact Fee, Sanitary Sewer and Sewage Treatment Plant Connection Fee, Storm Drainage Fee and Utility Underground Fee.

It is important to note that by allowing for the potential to raise fees or charges over the next two and a half years in the Downtown or Citywide, the Council is not mandated to raise fees or charges to the levels recommended in this memorandum. Potential new infrastructure fees or fee increases above the temporary cap could be studied during the temporary cap period, but could not be implemented.

The suggested fee caps are not a subsidy as the suggested fee caps are uniform for all uses throughout Diridon and Citywide.

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Commercial Linkage Fee Not Affected By This Action

The staff recommendation for a Commercial Linkage Fee is intended to go to Council in August 2020 with the completed nexus study and feasibility reports. The analysis will include comparable area linkage fees and rents, and San Jose-specific market information to shed light on the ability of different types of development in San Jose to pay a Commercial Linkage Fee. If desired, Council could direct staff to establish Commercial Linkage Fees for Office/R&D, Industrial, Hotel and/or Retail uses.

The Commercial Linkage Fee is not included in the temporary cap recommended by this memo.

EVALUATION AND FOLLOW-UP

Council support of the actions proposed will direct staff to amend permit conditions relevant to the Diridon Specific Area Plan, downtown and City-wide. Development fee increases for Diridon and new fees for Citywide will be capped until January 23, 2023.

CLIMATE SMART SAN JOSE

The recommendation in this memo has no effect on Climate Smart San José energy, water, or mobility goals.

COORDINATION

This memorandum has been coordinated with the City Attorney's Office, the City Manager's Budget Office, the Department of Planning, Building and Code Enforcement, Public Works Department, and the Department of Transportation.

COMMISSION RECOMMENDATION

This item has not been reviewed by any commission. The proposed Council actions are consistent with prior City Council direction on facilitating development, jobs and revenue and evaluation of a Commercial Linkage Fee to support affordable housing.

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COST IMPLICATIONS

It is important to note that the fees referenced in this memorandum are in reference to fees that pay for specific identified uses; these fees are not received into the General Fund. The proposed development fee caps will limit the amount of revenue generated from the City's development fees that would be allocated to infrastructure or other specified purposes, but provides certainty with regard to project costs that is critical to allow project applicants and financial partners the predictability needed to move projects forward in this critical time frame. Over the long term, new development will increase the city's property tax base.

CEQA

Statutory Exemption, File No. PP17-005, Adjustment to Fees, Rates & Fares without changes to or expansion of services.

/s/

KIM WALES

Deputy City Manager

Director Economic Development

For questions, please contact Nanci Klein, Assistant Director, Economic Development/Director of Real Estate, at (408) 535-8184.

Attachment A - Current Standard Permit Conditions

ATTCHMENT A

CURRENT STANDARD PERMIT CONDITIONS

Downtown Financing Plans.

The San José City Council (“City”) approved the (1) Envision San Jose General Plan 2040 (“General Plan”) in 2011, (2) Diridon Station Area Plan (“Diridon Plan”) in 2014, and (3) Downtown Strategy 2040 (“Downtown Strategy”) in 2018. The Diridon Plan and Downtown Strategy, in conjunction with the General Plan, provides the framework for development located in Downtown San Jose.

The City is in the process of developing financing plans for the Diridon Plan and the entire Downtown to fund public improvements, affordable housing, and other amenities and services. The financing plans may include the creation of a (1) Community Facilities District(s); (2) Enhanced Infrastructure Financing District(s); (3) Property Based Improvement District(s); (4) Mitigation Impact Fee program(s); (5) Commercial linkage fee program(s); and/or (6) other financing mechanisms or combination thereof.

The City is in the process of amending the Diridon Plan and updating the Diridon Basic Infrastructure Impact Fee. Updates to the Diridon Basic Infrastructure Impact Fee may include expanding the impact fee to other areas of Downtown. The City Council has also directed City staff to complete studies and make recommendations related to commercial impact fees to help fund affordable housing. Further, the City is developing a Downtown Transportation Plan that may require funding to construct the public improvements identified in the Downtown Transportation Plan. These efforts are on-going and there will continue to be other similar efforts to study various funding mechanisms for public improvements, affordable housing, and other amenities and services in the Downtown.

By accepting this Permit including the conditions of approval set forth in this Permit, permittee acknowledges it has read and understands all the above. Permittee further agrees that prior to the issuance of any building permit, the project shall be subject to, fully participate in, and pay any and all charges, fees, assessments, or taxes included in any City Council approved financing plans applicable to Downtown, as may be amended, which may include one or more of the financing mechanisms identified above.

Affordable Housing Financing Plans.

The San José City Council (“City”) approved the Envision San Jose General Plan 2040 (“General Plan”) in 2011. The General Plan provides the framework for development located in San Jose.

The City is in the process of developing financing plans to help fund affordable housing and related amenities and services. The financing plans may include the creation of a (1) Community Facilities District(s); (2) Enhanced Infrastructure Financing District(s); (3) Property Based Improvement District(s); (4) Mitigation Impact Fee program(s); (5) Commercial linkage fee program(s); and/or (6) other financing mechanisms or combination thereof. For example, the City Council has directed City staff to complete studies and make recommendations related to

commercial impact fees to help fund affordable housing. These efforts are on-going and there will continue to be other similar efforts to study various funding mechanisms for affordable housing.

By accepting this Permit including the conditions of approval set forth in this Permit, permittee acknowledges it has read and understands all of the above. Permittee further agrees that prior to the issuance of any building permit, the project shall be subject to, fully participate in, and pay any and all charges, fees, assessments, or taxes included in any City Council approved financing plans related to affordable housing, as may be amended, which may include one or more of the financing mechanisms identified above.