

Memorandum

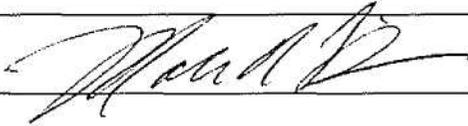
TO: HONORABLE MAYOR AND
CITY COUNCIL

FROM: Stephen Haase, Paul Krutko

SUBJECT: See Below

DATE: April 29, 2005

Approved



Date

May 3, 2005

**SUBJECT: EXTENSION AND EXPANSION OF THE SPECIAL TENANT
IMPROVEMENT PROGRAM**

RECOMMENDATION

- 1) Approval of an Ordinance amending Section 4.46.039.8 of Chapter 4.46 of Title 4 of the San Jose Municipal Code (SJMC) to extend the period during which the City suspends the collection of Building and Structure Construction Taxes imposed for the construction of special industrial use Research and Development and Office tenant improvements.
- 2) Approval of an Ordinance amending Section 4.46.039.9 of 4.46 of Chapter 4.46 of Title 4 of the San Jose Municipal Code (SJMC) to extend the period during which the City suspends the collection of Building and Structure Construction Taxes imposed for the construction of office use tenant improvements in the Downtown Core.
- 3) Direct staff to extend the Coordinated Plan Check Review process allowing for plan check fee collection deferral until permit issuance for tenant improvements in vacant office buildings within the Downtown Core and in vacant industrial and research throughout San Jose.

BACKGROUND

On April 30, 2002 the City Council approved initiation of the Special Tenant Improvement (STI) Program for an initial 18-month period. On October 28, 2003, the City Council approved an 18-month extension of the program and amended the program to include vacant office buildings in the Downtown Core. The STI program includes the suspension of the Building and Structures tax, the Coordinated Plan Check Review process, and the deferral of plan check fees. The STI program was designed to expedite tenant improvements on vacant buildings to make the space ready earlier for more cost effective occupancy.

The Program provides San Jose with a competitive edge in a real estate market characterized by historic levels of vacancy. Since its initiation approximately three years ago, the program has been highly successful and visible. The STI program has been a tool to allow the City to implement an effective method of providing services to the business community. From October 2003 to April 2005, forty-seven development projects, totaling approximately 2.6 million square feet of space have been permitted. A total of 4.1 million square feet of space has been permitted since the inception of the STI program. This represents a 57% increase in permitted space. Staff estimates that approximately 3,900 employees will occupy the space renovated in the second phase of the program, a 139% increase over the first STI period (2,800 jobs). A projected total of 6,700 jobs have been added or retained in the local economy since the STI program's inception. The developers and businesses that have used the process have been very complimentary about the speed, efficiency, and cost effectiveness of the program. The current end date for the STI program is April 30, 2005.

The success of the program indicates that businesses are responding to the incentive program and that it makes a difference in choosing San Jose as a place to do business. The elimination of the program would be detrimental to the City's retention and attraction efforts. Staff strongly recommends a second extension to the current program for an additional 18-month period to October 31, 2007.

ANALYSIS

The Special Tenant Improvement Program is working well. As mentioned above, the STI program grew in permitted space and increased the number of jobs added or retained in San Jose significantly. The construction valuation of the tenant improvements permitted in the second period rose to \$44 million from \$33 million during the previous timeframe. Program statistics show that approximately 810,000 square feet or roughly 31% of the overall 2.6 million square feet of space processed in the second STI authorization period came from companies new to San Jose. The estimated number of jobs generated by new companies is 1,187. Exhibit A provides a breakdown of the costs and performance of the program beginning April of 2002.

The first extension of the STI program included an extension of incentives to Downtown Core office space and resulted in 70,600 square feet of space generating approximately 211 jobs in the Downtown. 2004 was a challenging year for the Downtown. Several large tenants including Agile, Earthlink, and Classic Custom Vacations moved out of the Downtown to take advantage of lower lease rates and to obtain free parking. Use of the Special Tenant Improvement program has been and will be a critical element of the City's efforts to attract jobs to the Downtown. Adding jobs Downtown is essential to drive activity at restaurants, retail businesses, and entertainment and cultural venues.

The STI program continues to help San Jose capture a significant amount of new leased space at a time when the regional industrial and office marketplace continues to struggle. It is also important to note that the STI program is a very effective tool in San Jose's retention efforts.

Newspaper articles have noted many companies moving to other cities in the County with lower costs or out of the Bay Area to take advantage of lower lease rates in other areas. The City must remain aggressive in its bid to keep companies in San Jose. The Special Tenant Improvement Program is a powerful tool to retain and attract jobs to San Jose.

The current sunset date for the STI program is April 30, 2005. Economic indicators show that the San Jose area is not yet demonstrating sustained job growth and vacancy rates remain high. According to Colliers International, Silicon Valley has over 58 million square feet of vacant space. The STI program has a proven track record of expediting job location and capital investment in San Jose. Given the success of the program and the continued economic downturn, staff recommends extending the STI program an additional 18 months to October 31, 2007.

The cost of implementing the initial phase of the STI program was \$330,000, equivalent to the 1% of valuation charged through the Buildings and Structures Tax. OED reviewed the property tax, utility tax and sales tax generated by only a handful of the companies that used the STI program in its initial phase. Approximately \$200,000 in revenue was generated from new companies in the first phase of the STI program. The addition of revenue from only a few of the relocating companies in the first phase has provided the City with revenues well in excess of the \$330,000 of foregone revenue. During the First Phase the STI program accrued revenue for the City in excess of the cost of the construction tax suspension.

The proposed 18-month continuation of the existing tax suspension is expected to reduce Building and Structures Tax revenues by an additional \$440,000. The estimate assumes that participation in the Program overall will remain at the same level as experienced during the current extension of the program. Staff anticipates that an additional 100,000 square feet of space will be occupied in the Downtown and roughly 2.5 million in San Jose's industrial properties. This investment is expected to generate similar results in terms of \$44 million in capital investment and an additional 3,900 jobs. Revenue raised through Building and Structure Construction Taxes is restricted to traffic capital uses.

In order to further evaluate the STI program staff reviewed the gross absorption figures from other cities within Santa Clara County and from Silicon Valley over all.

Difference in Gross Absorption Between 2003 and 2004 (Sqft)

| City | 2003 | 2004 | % Increase |
|----------------|------|-------|------------|
| San Jose | 2.2M | 3.2M | 49% |
| Silicon Valley | 10M | 11.5M | 15% |

The data indicates that San Jose has experienced a greater rate of absorption than the other cities in terms of both square footage and percentage of overall space. In 2004 Silicon Valley experienced a 15% increase in R&D absorption. Approximately 11.5 million square feet of R&D was absorbed in the Valley last year. Of this, a total of 3.2 million square feet or 30% was

absorbed in San Jose. This is an increase of 49% or one million square feet from 2003. San Jose's R&D absorption is the highest performing in the Valley for 2004. It should be noted that the amount of space available in each city varies widely as does the asking price for space in each city. Staff is recommending that if the vacancy rate in any one market area within the City decreases by 5 percentage points staff will review the data and determine if that sub-market area should be eliminated from STI program participation.

The deferral of plan check fees will continue to be provided to projects that meet the eligibility requirements for the tax suspension. The program will continue to allow plan check fees to be deferred until the time of building permit issuance. If a permit is not taken out by a customer benefiting from this program, plan check fees will be due no later than 12 months from the application for the express plan check service. The Coordinated Plan Check Review Fees to be charged under the Special Integrated Review for implementation of the STI program are in accordance with the fee schedule approved by Council in June of 2004. The City achieves full cost recovery for staff review associated with the STI program.

OUTCOMES

Extension of the STI program will assist the City with business retention and attraction efforts and enhancing the revenue base. The STI program is highly regarded by businesses and the brokerage community. Extension of the STI program supports the direction given by the Economic Development Strategy. In particular the activities of the STI program align with Strategic Initiative #5 "Support the Start-Up and Growth of Local Businesses, in Tech as well as Non-Tech Fields" and Initiative #6 "Improve Speed and Predictability of Development Review Process, and Reduce Costs of Operating in San Jose" to support the vision of an Entrepreneurial Environment.

PUBLIC OUTREACH

The Special Tenant Improvement Program proposed extension and expansion were items within the Mayor's Getting Families Back to Work program. San Jose's corporate clients and the brokerage community frequently praise the program. Requests to extend and expand the program were included in the testimony given by corporate representatives and developers to the City Council during the most recent Getting Families Back to Work Study Session. Similar suggestions were made to staff during the outreach phase of the Economic Development Strategy through interviews and focus groups.

COORDINATION

This memorandum has been coordinated with the City Attorney's Office, the City Manager's Budget Office, and the Redevelopment Agency.

Honorable Mayor and City Council

April 29, 2005

Subject: Extension and Expansion of the Special Tenant Improvement Program

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CEQA

Not a Project.



STEPHEN HAASE
Director, Planning Building
Code Enforcement



PAUL KRUTKO
Director, Office of Economic Development

Exhibit A

STI Program Performance

| Area | Time Frame | Projects | Sqft Generated | Jobs Created | Construction Value | Tax Suspension | Additional Revenue |
|------------|------------|----------|----------------|--------------|--------------------|----------------|--------------------|
| Industrial | 4/02-10/03 | 30 | 1,500,000 | 2,800 | \$33,000,000 | \$330,000 | \$376,090 |
| Industrial | 10/03-4/05 | 44 | 2,529,400 | 3,689 | \$42,700,000 | \$427,000 | * |
| Downtown | 10/03-4/05 | 3 | 70,600 | 211 | \$ 1,300,000 | \$ 13,000 | * |
| Total | 36 months | 77 | 4,100,000 | 6,911 | \$77,000,000 | \$770,000 | *\$376,090 |

*Tax revenue derived from projects completed from October 2003 through April 2005 is not yet fully realized. Complete data for that timeframe will be available in the first half of FY 2005-06.