STUDY SESSION: 2/8/10

CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: HONORABLE MAYOR AND CITY COUNCIL

FROM: Paul Krutko

SUBJECT: SEE BELOW

DATE: January 27, 2010

Approved

Date 1/28/10

COUNCIL DISTRICT: City-Wide

SUBJECT: Business Attraction/Retention and Development Initiatives

MEMO PURPOSE

The purpose of this memo is to identify potential incentives to spur near-term permanent jobs and City revenues. The incentives are intended to further the Economic Development Strategy's objectives and strengthen the position of the City in a highly competitive, slow-growth market. These are preliminary ideas which will benefit from Council and public input.

BACKGROUND

Reuters reported on Sept 8 that "Commercial mortgage defaults of loans made by banks are projected to peak in 2011." Bloomberg on Sept. 11 stated "Commercial-property sales in the U.S. this year are forecast to fall to the lowest ... since ... the early 1990s." Jon Haveman of Beacon Economics, a leading forecasting company, said in June "...we're still talking 2013 before things really start to turn around again for the state. We have a long row yet to hoe." Unemployment in San Jose has risen to 13%, significantly higher than the national average of 10%. Economies globally have been similarly impacted.

ANALYSIS

The recession has negatively impacted the global, national and regional economy. Yet, even in times of great challenge there are companies that are poised to take advantage of lower costs of land, rent and construction. The potential incentives outlined in this memorandum are intended to gain the interest of key decision makers and focus their attention on San Jose as a preferred location in Silicon Valley. The majority of incentives proposed are based on City revenue reimbursements derived from the projects themselves, requiring no cash outlay from the City.

INCENTIVES OVERVIEW

The proposed incentives focus on spurring business growth in the office, research and development, manufacturing and retail sectors. The goal is to kick-start revenue generation and permanent jobs as early as possible in the economic recovery and provide a competitive advantage to San Jose as companies seek to locate or expand in the area.

Staff is proposing both short-term and on-going incentives. The short-term incentives are designed to provide a meaningful stimulus to companies for a qualifying period of up to two years. After this time it is hoped that the overall economy will have improved substantially and incentives will no longer be required. The short-term incentives are based on a sharing of revenues generated from the projects themselves, provision of Downtown parking while garages under City control have significant excess capacity, or holding steady the short-term valuation of the Park Land Dedication In-Lieu fee. The proposed on-going incentive include the reinstatement of an incentive provided to large retailers and the possible decrease of the North San Jose Traffic Impact Fee for industrial users.

SHORT-TERM PROPOSALS

Project Reimbursement

In order to stimulate new revenue to be generated sooner by encouraging developers, retailers and businesses to make investments during the downturn a portion of new revenue from the project would be returned to developers or businesses to offset the up-front costs associated with development fees and taxes, equipment purchases and infrastructure improvements. The City or Agency would reimburse the developer based on the revenues derived from the project. Potential new revenues may include sales tax, utility tax or property tax. The Redevelopment Agency would enter into separate reimbursement agreements for development in Project Areas. Under this proposal:

- Participants pay all costs up front (equipment, fees, taxes and public improvements).
- Staff and improvements normally paid for by development activity, would continue to be paid for by new development.
- City and Agency would recognize increased revenues, only a portion of which would be used to reimburse companies.

The reimbursements would be negotiated based on the following general guidelines:

- The amount of the reimbursement would not exceed 50% of the revenues generated by the project over a three to five year period.
- With regard to office, R&D, and manufacturing projects, the program would be available to the first 1 million square feet of new development initiated within a two years period. The goal is to direct significant benefits to projects that move forward in a narrow window of time.

- After the three to five year reimbursement period no further reimbursements would be made even if the total eligible costs have not yet been paid.
- With regard to retail projects, participation requires a minimum amount of new revenue. Staff is evaluating appropriate levels for specific uses.

Each agreement would be brought to the City Council and/or the Agency Board for review and approval. The Redevelopment Agency would enter into separate agreements for projects within Project Area boundaries.

Downtown Parking Incentives
The City currently offers a number of parking incentives to encourage leasing activity and business development Downtown. Specific incentives have been aimed at the business incubator program, the software and environmental business clusters and new business relocations to Downtown, resulting in parking for over 400 employees Downtown. To enhance the attractiveness for new businesses and add an important retention tool, new incentives are being proposed to send a strong message that Downtown San Jose has the space and parking rates for businesses to sign new leases. Targeting incentives at companies signing or renewing leases will keep jobs and purchasing power in the Downtown.

The framework for the significant incentive expansion includes:

FREE parking at City owned lots for the first two years of a minimum four-year lease (or longer) for new businesses in the Downtown.
50% discount every month for the first two years of a three-year lease (or longer) for existing businesses that sign new leases to stay Downtown.
Businesses seeking to take advantage of these incentives must sign or renew a lease within one year from Council approval of the incentives.

The rationale for temporarily offering aggressive new incentives is to attract new businesses and retain existing businesses Downtown, with the goal of achieving the ancillary economic benefits increased employment Downtown should generate. In the short-term, the city's Parking Fund is seeing declining revenues and may be taking on short-term debt payments for the Redevelopment Agency that would eliminate discretionary reserves over the next few years. As this new package of incentives is refined, a more detailed look at balancing the fund and cash flow needs to occur. The General Fund is the funding backstop to the Parking Fund, should the Parking Fund become deficient.

One-Year Hold on Parkland In-Lieu Fees

This proposal sets the schedule of Parkland Fees for all MLS Zones in the city based on the 2008 Residential Land Value Study with a freeze on any increase in fees through February 2011 to provide an incentive to development activity.

Since there are only two areas, the North San Jose (MLS Zone 7) and Downtown (MLS Zone 9) that would increase from last year, these areas will continue to pay Parkland Fees based on the

2007 Residential Land Value Study. In the absence of the hold, values would rise from $70/sq.ft. to $80/sq.ft. and $70/sq.ft. to $120/sq.ft., respectively.

The proposal also benefits Six (6) of the fourteen (14) multi-Listing zones in San Jose that have gone down from last year: Evergreen (Zone 3), Alum Rock (Zone 4) Berryessa (Zone 5), Alviso (Zone 7), Willow Glen (Zone 10) and Cambrian (Zone 14). Parkland Fees for these areas will be based on the 2008 residential Land Value Study. Land values in the remaining six (6) zones are unchanged from 2007: Santa Teresa (Zone 2), Santa Clara (Zone 8), South San Jose (Zone 11), Blossom Valley (Zone 12), Almaden Valley (Zone 13) and West San Jose (Zone 15/18).

The Department of Parks, Recreation and Neighborhood Services proposes to return to Council to adjust the fees based upon the 2009 land value study in February 2011.

ONGOING PROPOSALS

Potential to Decrease Traffic Impact Fees in North San Jose

In order to incent new development in conjunction with the North San Jose Area Development Policy, staff is assessing the potential for reducing the associated Traffic Impact Fee. In creating new capacity for the additional 27 million square feet of industrial development approved under the Policy, the North San Jose EIR assumes a mitigation fee for associated traffic improvements that is equally distributed between the different types of development included in the Policy. Staff is investigating the potential for reducing the fee for industrial users by allocating a percentage of the cost for these improvements to unidentified funding opportunities such as State and Federal sources.

Staff is seeking Council and public input on the item, and, if this option has merit, Staff would conduct a feasibility and legal analysis and return to Council to provide an update and request further direction. This analysis is substantial and would require several months to complete.

The following are details for the proposed program:

- Identify those infrastructure projects most likely to get funding from Federal, State, and Regional sources (101/Oakland, 101/Capitol etc.).
- Use these outside sources to offset the traffic impact fees charged to developers.
- Reduction of traffic impact fees related to industrial and commercial users.

Reinstatement of Construction-related Tax Suspension for Large Retailers

Since 2004, large retailers (100,000 gross square feet or more) have been defined as an industrial use for the purposes of construction related tax collection. This results in lower Building & Structures (B&S) tax and a suspended Commercial Residential and Mobile home Park (CRMP) taxes. Encouraging this type of development through the continued suspension of construction-related taxes would allow the City to leverage the fact that these retailers generate significant sales tax. When originally established in 2004, this incentive was intended to be renewed every five years to maintain the City's legal right to reinstitute the taxes without returning to the voters.

These suspensions expired in June, 2009 prior to staff having the opportunity to review and initiate renewal. This suspension was critical for attracting major new retail developments since 2004.

The B&S taxes are used for transportation projects by ordinance; the CRMP Tax is applied to roadway and public improvements by convention.

The following are details for the proposed program:

- Single retail entities occupying a site with more than 100,000 gross square feet would be taxed at the lower B&S tax rate of 1% of building valuation rather than 1.5%.
- These projects would also benefit by not paying 3% valuation under the CRMP tax
- The suspension would be in place for a period of five years.

Providing incentives now to facilitate new development, revenues, and jobs is a high priority in the current economic climate. It's also important to note that foregoing construction taxes further erodes the City's ability to pay for roadway infrastructure. As discussed at other times, the City's current method of requiring new development to pay for the City's unfunded infrastructure backlog is insufficient and merits an alternate more reliable method of funding.

COORDINATION

The concepts discussed in this memorandum have been reviewed with the Redevelopment Agency, the Department of Transportation, the Department of Planning Building Code Enforcement, the Department of Parks and Recreation, the Finance Department, Budget Office and the City Attorney's Office. Further review is required by all departments. A final proposal will be brought forward for Council review based on Council direction provided at the February 8, 2010 study session on the Updated Economic Development Strategy and additional input by the required City Departments.

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For questions please contact Nanci Klein, Division Manager, at 535-8184.