



Memorandum

TO: HONORABLE MAYOR
AND CITY COUNCIL

FROM: Paul Krutko

SUBJECT: SEE BELOW

DATE: March 5, 2010

Approved

Date 3/4/10

COUNCIL DISTRICT: City-Wide

SUBJECT: Business Attraction/Retention and Development Initiatives

RECOMMENDATION

- 1) Accept the staff report regarding Business Attraction/Retention and Development Initiatives.
- 2) Discussion and direction to the City Manager regarding the suspension of business taxes for certain small businesses.
- 3) Discussion and direction to the City Manager regarding staff recommendation for a Downtown parking incentive to allow free or discounted parking: and
- 4) Direct the City Manager to include a discussion of an appropriate City investment strategy in development incentives in the context of the overall City budget, including alternative amounts to be invested, potential return on investment and priority areas for investment, in the Community and Economic Development City Service Area presentation during the City Budget Study Sessions in May.

BACKGROUND

At the February 8, 2010 City Council Study Session on the Economic Development Strategy Update, the Council discussed options to provide economic development incentives to spur business attraction and retention efforts during the economic downturn. The incentives would be designed to spur business investment in the next year that will reduce unemployment in San Jose and generate economic activity creating revenue to support City services. Staff presented a set of proposals in a memorandum that were included with the agenda materials provided for the February 8 Study Session. Prior to the Study Session the Mayor and several Council members

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circulated a memorandum (dated January 25, 2010) that also included a set of proposed development incentives.

At the February 8 meeting Council approved the staff's memorandum and another memorandum prepared by the Mayor and directed the staff to return with an analysis of the costs related to two specific incentives contained the Mayor-three Councilmember memorandum; a suspension of the business license fee for some small businesses and a free parking program for businesses signing new leases or renewing leases for downtown office space.

ANALYSIS

The development incentive proposals presented by the Mayor and Council members Liccardo, Pyle and Herrera and those presented by City staff incorporated similar concepts. The Council proposal and staff proposals materially differ in two areas, which include the Council proposal to suspend collection of business (license) taxes for new companies employing up to 8 employees and the proposal to suspend parking fees for companies renewing their leases in the Downtown area. At the February 8 Study Session, Council also discussed additional alternatives for a business license suspension. An analysis of the revenue loss associated with the various proposals is provided below.

In summary, staff is not recommending the business license tax suspension as it would create an immediate revenue loss to the General Fund in the current year. Staff is recommending implementation of the Downtown Parking Incentive as the use of the large inventory of vacant parking spaces would not represent a revenue loss as the spaces are currently unused and not generating any income presently.

Proposed Business Tax Suspension

The Mayor and Council members Liccardo, Pyle and Herrera proposed the following incentive:

- Suspend business (license) tax collection for any new small business, employing up to 8 employees, until the end of Fiscal Year 2010-11;

Finance Department data indicates that there are approximately 42,000 businesses employing 8 or fewer persons out of approximately 75,000 total businesses located in the City. Based on an estimated 9,000 newly registered businesses employing 8 or fewer employees in calendar year 2009, the potential loss of business tax revenue for this proposal is approximately \$1.6 million per fiscal year. For the period of April 2010 through June 2011 the estimated potential loss of revenue is \$2.0 million.

The annual tax revenue generated by the collection of business tax is projected to be \$12 million in FY 2009-10. Business tax revenue from residential and commercial-based businesses employing up to 8 employees generates approximately \$5.8 million per year or 48% of the total business tax revenue generated. The business tax for a business with 8 employees or less is \$150

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per year.¹ The following paragraphs summarize the cost associated with this proposal and two alternatives:

Mayor and Council Proposal

Providing the April 2010 through June 2011 suspension of the payment of the business tax for newly registered businesses with 8 or fewer persons is estimated to result in approximately \$2.0 million of lost revenue for the City.

Alternative I

At the February 8 meeting Councilmember Liccardo also posed a potential alternative incentive to suspend the collection of the business (license) tax for companies with 8 or fewer employees with a more narrow focus on companies providing documentation of a signed new or renewed lease.

Based on calendar year 2009, the City has 22,561 existing small commercial-based businesses. Finance Department staff estimate that 80% (18,049) of existing small commercial-based businesses with 8 or fewer persons will renew their business tax certificate. Of that 80%, Finance estimates that approximately 10% (1,805) may be able to provide renewed leases and take advantage of the proposed incentive. In addition, Finance estimates that 2,300 new small commercial-based businesses will register each fiscal year and may be able to provide new signed leases. Of those 2,300 new small commercial-based businesses, approximately 10% will owe the City for prior year business taxes as well as late charges. By adding the number of accounts together (1,805 + 2,300 + 230) and multiplying by the \$150 business tax fee, this proposal could result in a potential loss of \$650,000 to the General Fund annually. For the period of April 2010 through June 2011, the amount of lost business tax revenue is approximately \$813,000.

It is important to note that the small commercial-based businesses employing 8 or fewer persons generate approximately \$3.4 million in business tax revenue annually. While Finance used the estimate of 10% described above, potentially all 22,561 existing small-commercial based businesses could provide renewed lease agreements, ultimately resulting in an annual General Fund loss of \$3.4 million (\$4.2 million for the period of April 2010 through June 2011).

Alternative II

Suspending collection of the Business Tax for businesses employing 8 or fewer persons entering into new leases (as opposed to renewals) is estimated to reduce the forgone revenue to

¹ For more information regarding calculating business tax, refer to Municipal Code 4.76

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approximately \$380,000 (2,300 + 230 accounts at \$150 business tax) annually (\$475,000 for the period of April 2010 through June 2011).

Summary

The chart below summarizes the three options of business tax incentives outlined in this memo.

| | Proposal from Mayor & Council members | Alternative I | Alternative II |
|--------------------------------------------|----------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------|
| Time Frame | April 2010 through June 2011 | April 2010 through June 2011 | April 2010 through June 2011 |
| Proposal | Suspend Tax for New Businesses with 8 or fewer employees | Suspend Tax for Commercial Based Businesses that enter into New or Renewed Leases ¹ with 8 or fewer employees | Suspend Tax for Commercial Based Businesses that enter into New Leases with 8 or fewer employees |
| Estimated Fiscal Impact² | Loss of Tax Revenue: \$2.0M | Loss of Tax Revenue: \$813K - \$4.2M | Loss of Tax Revenue: \$475K |

¹ Assumed 10% of existing commercial-based businesses are up for renewal.

² Proposals do not include an estimated \$80K in annual personnel cost.

Staff Recommendation

The business incentives proposed by staff at the February 8, 2010 Study Session did not include any recommendations to suspend the collection of the business tax. Incentive proposals presented to Council, generated by staff, were based on the concept of reimbursement to the business for a portion of new revenue generated to the City or expanding projects over the next two year period. Due to the magnitude of the existing estimated budget deficit, staff did not recommend a suspension of the business tax given the negative impact on General Fund revenue.

Proposed Downtown Parking Incentives

At the February 8, 2010 Economic Strategy Study Session, both the Mayor/Councilmember and Staff proposals aimed to create an attractive and simple set of parking incentives designed to attract and retain business in our Downtown. At the Study Session, staff was requested to provide information that described the differences and estimated revenue impacts of each of the proposals. The table below compares the features and estimated lost revenue of each proposal:

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| Features of the Proposals | Mayor/Council members | Staff |
|------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <p><u>NEW</u> Businesses</p> <p>Projected Loss of Current Revenue</p> | <ul style="list-style-type: none"> • Free Parking for 2 years • No required length of lease <p style="text-align: center;">\$0</p> | <ul style="list-style-type: none"> • Free Parking up to 2 years • Length of free parking equal to ½ of length of lease <p style="text-align: center;">\$0</p> |
| <p><u>EXISTING</u> Businesses</p> <p>Projected Loss of Current Revenue</p> | <ul style="list-style-type: none"> • Free Parking for 2 years • No required length of lease <p style="text-align: center;">\$1.5 million</p> | <ul style="list-style-type: none"> • 50% discount up to 2 years • Length of free parking equal to ½ of length of lease <p style="text-align: center;">\$250,000</p> |
| <p>Cap on # of Spaces</p> <p>Expiration of Incentives</p> | <ul style="list-style-type: none"> • 1,000 space maximum system-wide for new/existing businesses • Expiration upon reaching the 1,000 space maximum | <ul style="list-style-type: none"> • No system-wide space cap on new businesses except facility space availability. • Capped at 200 permits system-wide for existing businesses • One year enrollment period. • Authority to increase cap on existing businesses to 400 permits system-wide, and incentive period to two years based upon need, financial feasibility and space availability. |

Rationale for the Staff Proposed Incentive Programs

As indicated in the January 27 staff memorandum, the rationale for offering aggressive incentives, beyond those currently offered by the City, is to attract new businesses and retain existing businesses Downtown. For new businesses, the Mayor/Councilmember and Staff proposals are closely aligned and offer roughly the same incentive – two years of free parking.

The differences include the following:

- The Mayor/Councilmember proposal provides for two years of free parking regardless of the length of the lease, and would provide no parking revenue to the City if the lease is only for a two year period. The Staff proposal provides up to two years of free parking with a lease period of four years. If a business is seeking a shorter lease period, they would still be eligible for free parking, the length of which would be equal to one half of the length of the lease signed. The advantage of this approach is that it ensures some level of parking revenue to the City, and likely extends the length of the leases beyond two years, creating additional economic benefits.

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- The Mayor/Councilmember proposal caps the total number of spaces that can be offered as incentives at 1,000, whereas the Staff proposal provides no limit to new businesses beyond space availability because there is no reduction in current revenues to the City, and the space is currently available. Staff's proposal does cap existing businesses at 200 permits initially system-wide, as a way to limit the revenue loss to \$250,000, as compared to \$1.5 million estimated revenue loss from the Mayor and Councilmember proposal.

The Fourth and San Fernando Parking Garage was financed with tax exempt debt. IRS restrictions limit the amount of private use that may take place at a tax exempt facility. In light these restrictions, staff will need to work with the City Attorney's Office and bond counsel to analyze whether there is sufficient room within the IRS private use tests to make the incentive available at the Fourth and San Fernando Parking Garage.

Staff has had discussions with the Downtown Parking Board and other stakeholders, including office building managers, and the feedback received is that the Staff proposed incentives for new businesses are aggressive, and a good tool to help them attract new tenants. The incentive of a 50% discount for existing Downtown businesses is also an attractive incentive to retain existing tenants with expiring leases. Both the Downtown Parking Board, and office building managers, understand the need to control the level of revenue loss associated with existing business incentives, and from that standpoint are supportive of the 50% discount to existing tenants as a way to protect the revenue stream to the Parking Fund. Staff is prepared to work with the building owners and brokers to combine parking incentives with other incentives offered by the private sector as part of their lease negotiations to create attractive packages for new and existing businesses. Staff will also work closely with the San Jose Downtown Association to market the parking incentives through the parking website www.sjdowntownparking.com and the ample space in our parking facilities and on the City's Downtown Parking Guidance System.

Projected Revenue Loss and Impact to the City's Parking Fund

As described below, the City's Parking Fund is currently being impacted by a variety of factors that are reducing both revenues and reserves. Attraction and retention of businesses Downtown is important and staff believes that providing free parking to attract new businesses that currently do not pay parking fees, and offering existing businesses/parkers a 50% discount provides the right level of incentives to help lease vacant office space, keep leased space occupied, and control further revenue losses to the Parking Fund.

At the February 23, 2010 City Council meeting, staff presented information that described the various factors that were impacting the condition of the City's Parking Fund, including:

- Mid-Year reductions in revenues and balancing actions totaling \$1.5 million
- Extension of an existing \$6.8 million and provision of a new \$6.8 million loan to the Redevelopment Agency from the City's Parking Fund, which reduces available reserves and interest earnings

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- Disposition of parking lots, for future development, reducing Fund revenues.

With the above financial reality, staff's goal is to provide as aggressive as incentives as possible, particularly for new businesses resulting in no revenue loss, while carefully managing our way through the economic downturn and keeping the Parking Fund in balance. An incentive package will assist in creating a future with higher lease and occupancy rates Downtown and increased City revenues. It is also important to note that the Fourth and San Fernando Garage bond covenants require the City to set parking rates and charges for the City's parking system to cover necessary operating and maintenance costs of the parking system. Additionally, the rates must be sufficient to generate revenues that, when combined with surplus Agency revenues, is at least 150% of debt service. To the extent that parking revenues including surplus Agency revenues are insufficient to meet this test, the City would be obligated to raise parking rates. Staff will return to Council to amend the Master Parking Rate Schedule for Municipal On and Off Street parking Facilities based on Council direction.

Other Issues Discussed at Study Session

Proposed Fee Deferral and Staffing

In the January 25, 2010 memorandum, staff was directed to explore the potential of deferring impact fees for housing, commercial and industrial projects. The Chief Development Office and the Director of Planning, Building and Code Enforcement has initiated conversations with key stakeholders on what type of deferrals would actually spur development activity. A key consideration is that certain types of deferrals would reduce resources necessary to move forward with other City priorities. An additional key consideration would be whether the Council would want to specify a maximum amount of investment in fee deferrals in the context of the overall City Budget and whether priorities should be established in regards to the investment. An example of the complicated interrelationship between an impact fee and key city priorities are that fees generated for transportation improvements are used by the City currently as leverage to obtain stimulus dollars. If the City does not collect impact fees, the City may not have sufficient funds to successfully compete for State and Federal dollars.

It is for this reason, that the staff is recommending that the discussion of deferral of development fees be included in the Community and Economic Development City Service Area presentation during the May City Budget Study Session. Staff would be prepared to discuss optional levels of investment in fee deferral, potential return on those alternative levels of investment and priority areas where that type of investment should be considered.

Small Business Services

The memorandum dated January 25, 2010 from the Mayor and Council members Liccardo, Pyle and Herrera also requested staff to provide documentation on how new small businesses are informed of free and low-cost business resources.

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BusinessOwnerSpace (BOS) was created in 2007 by work2future (w2f), within the Office of Economic Development. BOS is a network of over 40 partners providing free or low cost services to entrepreneurs and small businesses. BOS provides a virtual one-stop for small business needs. BOS has responded to 120,000 small business requests throughout Santa Clara County. BOS provides interactive portal designed based on best practices in serving small business needs. BOS also provides a range of experienced staff across the 40 organizations that meet with and assist small companies face to face. BOS services, including the web portal, are available in Spanish and Vietnamese. OED, w2f, the Finance Department and the General Services Department are collaborating now to install dedicated web portal kiosks on the first floor of City Hall so small businesses can take advantage of BOS services while they are in City Hall.

The Finance Department and the Office of Economic Development continue to collaborate to ensure the small business owners are made aware of key services available to them. Information is provided when a business owner makes initial contact with the City. Written material describing key services, such as BOS is available in the City hall lobby and at the service windows on the first floor of City Hall.

COORDINATION

This memorandum has been coordinated with the Department of Transportation and the Finance Department, City Manager's Budget Office and the City Attorney's Office.

CEQA

Not a project.


PAUL KRUTKO
Chief Development Officer

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