

Memorandum

TO: HONORABLE MAYOR
AND CITY COUNCIL

FROM: Kim Walesh
Matt Cano

**SUBJECT: DOWNTOWN HIGH-RISE
RESIDENTIAL INCENTIVE**

DATE: July 25, 2019

Approved

D. D. S. L.

Date

7/25/19

INFORMATION

BACKGROUND

On August 6, 2019, the City Council will consider an ordinance amending the San José Municipal Code to add the remaining workforce standards to the ordinance approved on June 25, 2019, which amended the San José Municipal Code to add a new Chapter 14.10 to Title 14 to set forth additional prevailing wage requirements for certain private construction projects.

On June 25, 2019, City Council directed staff to move forward with a unique services agreement for a consultant to perform the required financial feasibility assessment for actions related to potential fee reductions for housing development, with the intent of staff returning on, or as near as reasonably possible to, August 6, 2019 with amendments to the Downtown High-Rise Residential Incentive program.

At the June 25 meeting, the City Council also provided direction to select an appropriate consultant from the list of consultants submitted by Working Partnerships USA 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 the City Council on April 3, 2018.

ANALYSIS

Following the June 25 Council meeting, staff completed outreach with the two consultants included on the list, Strategic Economics and EPS. Staff focused on those consultants who had most recently completed work on Downtown development and/or development feasibility in San José to attempt to expedite the project schedule. Following these discussions, EPS declined to participate, so staff has selected Strategic Economics to complete the required analysis. Staff has agreed with the consultant on the necessary tasks included in the study and are currently in process on executing the contract for the work. The estimated cost for completion of the consultant study is \$60,000. Staff has provided the consultant with all available background

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materials and information, and their initial data review and model development is underway. Staff anticipates that the consultant will provide an initial memo summarizing the results of their background review by July 31.

Staff has also been coordinating closely with representatives from Working Partnerships USA to coordinate on the intent and proposed scope of the study (attached), and is currently coordinating a meeting with the consultant and Working Partnerships to discuss the work underway in more detail. While both parties generally agree that the scope appears in line with the goals of the study, Working Partnerships USA representatives do not agree completely with the proposal to base the analysis on a baseline (or averaged) conceptual prototype.

Staff, in consultation with Strategic Economics and other economic consultants, believes that to sufficiently study an entire subclass of projects, the consultant must first create a conceptual pro forma based on a typical development scenario in the downtown. This would be derived from the applications currently on file and those which are anticipated to move forward in the near future. Once an initial feasibility model is developed, the consultant can perform a sensitivity analysis based on additional criteria or development scenarios provided staff or stakeholders to further explore how different factors might affect feasibility. The alternative proposed by Working Partnerships would require development of a dynamic development model that accounts for interactions between multiple variables over time. Staff believes that this approach is better suited to the analysis of a particular site or specific development project, but continues to work with Working Partnerships and other stakeholders to ensure that the study adequately addresses any further concerns.

Next Steps

Staff is coordinating closely with the consultant and meeting on a weekly basis to monitor progress and the project schedule. Upon completing the review of the available information, the consult will be coordinating with staff, stakeholders and the development community to begin vetting the development model. Staff continues to refine the schedule and is driving hard towards a City Council hearing as close to August 6, 2019 as possible. Staff will be keeping City Council and key stakeholders apprised of the schedule as work progresses.

/s/
Kim Welsh
Deputy City Manager

/s/
Matt Cano
Director of Public Works

For questions, please contact Chris Burton, Deputy Director, Office of Economic Development, at (408) 535-8114.

Attachment: Downtown High-Rise Incentive Financial Feasibility Project Scope

Downtown High-Rise Incentive Financial Feasibility Project Scope

Purpose: Staff is exploring an extension to two aspects of the City's fee considerations for Downtown high-rise residential projects. The current construction tax reduction (SJM: 4.46 & 4.47) requires that projects secure a foundation permit by July 2018, and complete final inspection of 80% of the units by December 2020. Approved on November 18, 2014, the City's Affordable Housing Impact Fee exempted Downtown high-rise rental projects from paying the fee on condition that 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. Staff is proposing removing the deadline for securing a foundation permit, and extending the Certificate of Occupancy deadline across both programs to June 30, 2023. The goal is to move projects with new residential units approved into actual construction.

City Council recently approved the first part of an ordinance outlining workforce standards for private development receiving a public subsidy. The ordinance includes provisions for a fee or tax reduction applied uniformly to all private construction projects within a specified subcategory of use, if the Council determines, in accordance with a qualified consultant study, that construction of the projects in the subcategory is financially infeasible absent the reduction.

Tasks:

1. **Pro Forma Model Development** - Develop a pro forma analysis that utilizes a financial model to evaluate the development economics of a prototypical high-rise apartment projects in the downtown, including data on the following criteria:
 - a. Project Costs:
 - i. The range of high-rise rental housing development projects in the downtown including height (in stories), density, average unit size, parking ratio, land area, building type, program efficiency, etc.
 - ii. Direct project costs, divided by labor and materials, and broken down by residential construction, site work, parking, retail, etc. Labor cost analysis shall present the cost of blue-collar (non-management) construction employee payroll separately from other contractor/subcontractor costs.
 - iii. Indirect project costs, including architecture and engineering, fees, taxes, insurance, financing, and overhead.
 - iv. Land costs.
 - v. City fees, broken down by individual impact fees, service fees, and taxes.
 - b. Project Value:
 - i. Average rents.
 - ii. Vacancy, operating expenses, and miscellaneous revenues.
 - iii. Capitalization rate used to determine project value.
 - iv. Minimum developer profit targets, including consideration for different types of financing or other development characteristics such as speculative development, large multi-family development, co-living, real estate investment trust, closely-held real estate development, international real estate developers, etc.
 - c. A sensitivity analysis estimating the impact of potential variances in the prototype, cost or revenue of the development project based on stakeholder input, including but not limited to:
 - i. Land cost.
 - ii. Financing cost and or structure.
 - iii. Developer threshold (expected returns).
 - iv. Alternate leasing scenarios (including co-living).

Deliverable: Draft memo summarizing peer review results and pro forma inputs.

- 2. Conceptual Pro Forma Analysis** - Complete analysis of whether construction of development projects in the specified Subcategory are financially feasible or not. The analysis will address the following issues:
- a. Whether all projects in the specific Subcategory are financially infeasible absent the proposed fee or tax reduction.
 - b. The reason(s) for any conclusion that construction of projects in the subcategory is financially infeasible.
 - c. The anticipated duration of any condition(s) making construction of projects in the subcategory financially infeasible.
 - d. The minimum fee or tax reduction needed, if any, to make projects financially feasible.
 - e. Any additional options, other than the proposed fee or tax reduction, that would make construction of projects within the subcategory financially feasible, provided that any such options must comply with all applicable laws and regulations, including the City's current general plan.

Deliverable: Draft memo summarizing results of conceptual pro forma analysis.

- 3. Workforce Standards Analysis** - Complete analysis of the impact of the provisions of the City's workforce standards which include prevailing wage, local hire (meaning good faith effort for 30% local hire), apprenticeships (good faith effort for 1:5 apprentice ratio), and targeted hiring of disadvantaged workers (good faith effort to hire disadvantaged workers for 25% of apprentice hours). The analysis must include the following considerations:
- a. The impact on the pro forma of providing the proposed fee or tax reduction without requiring the payment of prevailing wages.
 - b. The impact on the pro forma of providing the proposed fee or tax reduction along with requiring the payment of prevailing wages.
 - c. Details of construction trades workers' wages and benefits as a percentage of total project costs.
 - d. An assessment of the impact of productivity increases versus hourly labor costs.
 - e. The rationale for any costs imposed by the workforce standards.

Deliverable: Draft and final memo summarizing results of workforce standards analysis, as well as finalized results from previous tasks.

- 4. Stakeholder Engagement** - Consultant will work with City staff to gather input from staff, the development community and other stakeholders as needed. It is anticipated that this will include:
- a. An initial kick-off meeting with City staff and weekly coordination calls (as required).
 - b. Interviews with members of the development community and/or a focus group to vet pro forma inputs.
 - c. A meeting with key stakeholders to discuss inputs related to workforce standards.
 - d. Meeting(s) to vet the results with City staff and other key stakeholders.
 - e. Presentations of the results, including attendance at a City Council meeting.

Deliverables: presentation materials for meetings and City Council.