

Memorandum

TO: HONORABLE MAYOR
AND CITY COUNCIL

FROM: Rosalynn Hughey
Christopher Burton
Nanci Klein

**SUBJECT: COMMERCIAL LINKAGE
FEE PROGRAM UPDATE**

DATE: January 9, 2024

Approved



Date

1/10/24

INFORMATION

The purpose of this information memorandum is to provide an update to the City Council on the Commercial Linkage Fee program.

BACKGROUND

A commercial linkage fee is an impact fee that applies to new and existing non-residential development projects to fund new affordable housing developments. At City Council direction, staff facilitated nexus and feasibility studies to determine a feasible commercial linkage fee. The analysis led to the City Council establishing the Commercial Linkage Fee (CLF) program in September 2020. The CLF applies to non-residential projects that have a development permit approval or an application for a change in use with the City. The CLF program applies to a variety of commercial/industrial development types, including office, retail, hotels, industrial buildings, research and development facilities, warehouses, and residential care facilities. The CLF program fees can be paid before building permit issuance at a 20% reduced rate or must be paid before the final building inspection is scheduled at the full fee rate.

On March 29, 2022¹, the City Council adopted amendments to the CLF Ordinance. The CLF Ordinance amendments modified the timing of the payment options and went into effect on May 13, 2022. To date, the City has collected \$925,000 through the CLF program, of which \$250,000 has been collected in the last 12 months. The fees have been generated by one hotel development and one residential care facility.

As part of its action on March 29, 2022, the City Council directed staff to re-evaluate the appropriate fee levels for the CLF program:

¹ <https://sanjose.legistar.com/LegislationDetail.aspx?ID=5526160&GUID=40BBA460-CD18-45DF-8F19-664309F6E941&Options=ID%7cText%7c&Search=commercial+linkage+fee>

“Start the process to revisit the feasibility study related to the CLF amendments under either of the following conditions:

- (i) 18 months elapsing from March 29, 2022, or
- (ii) One million square feet in executed leases of new construction over 100,000 square feet in the downtown area for more than one building. The updated feasibility study would include, but not be limited to:
 1. Expanded stakeholder outreach to include commercial/industrial real estate brokers, prospective commercial space tenants, and others;
 2. An analysis of the credit for constructing affordable housing units or restricting market-rate units as affordable (review how many affordable units the City received in lieu of the CLF);
 3. An analysis of the effectiveness of the 20% discount in incentivizing payment at or prior to building permit issuance;
 4. An analysis of the efficacy of the deferred secured payment option as it relates to incentivizing earlier collection of the CLF;
 5. Identifying specific event milestones that would trigger the timing of the next feasibility study;
 6. Exploring a different fee model, such as an index model.”

Although the 18-month mark that the City Council discussed has been reached, the condition of one million square feet in executed leases of new construction over 100,000 square feet in the downtown area for more than one building has not been met. Additionally, development conditions remain extremely strained, interest rates continue to rise, and the costs of construction are high. At this time, staff cannot effectively analyze the criteria listed above because so few projects have moved forward. Staff has provided a status report based on available information.

ANALYSIS

Over the last 18 months, there have been no new leases of commercial/industrial space over 100,000 square feet and only one (hotel) development has started construction in the downtown area. Given these conditions, staff does not recommend proceeding with a new feasibility study at this time. The current economic conditions are unfavorable for commercial/industrial construction due to high development costs and interest rates and persistently low return-to-work rates.

Staff is collecting data on pending development projects that will be subject to the CLF, in the event that these development projects move forward. Staff is in communication with representatives of the pending development projects to gather information about the projected fiscal year in which the projects will move forward. Staff wants to ensure that all relevant information is considered before any CLF program guidelines are altered. Staff has collected the following information (listed in tables 1-5 below) on the status of the CLF program to date.

Table 1: Commercial Linkage Fee Applications Since March 2022

CLF Applications by Status	Total
Closed (all items submitted/reviewed)	35
Active (still have pending items)	37
Active projects that have submitted CLF application	13
Active projects that have NOT submitted CLF application	24
Total	109

Table 2: Total Commercial Linkage Fees Collected

Type of Development	Amount
Residential Care Development	\$679,852
Hotel Development	\$218,853
CLF Application Fees	\$25,014
Total	\$923,719

Table 3: Pending Commercial Linkage Fees Invoiced from Submitted Applications

Pending Fees	Amount
Commercial Linkage Fees*	\$55,149,338
Application Fees	\$9,181
Total	\$55,158,519

*The approximate \$55 million is for all projects moving through the entitlement process; however, there is no guarantee of projects moving to construction.

Table 4: Projection of Payments from Pending Commercial Linkage Fees Only

Projected Payment by Fiscal Year	Amount
Projected to pay Fiscal Year 2023-2024	\$2,176,490
Projected to pay Fiscal Year 2024-2025	\$7,309,853
Projected to pay Fiscal Year 2025-2026	\$2,666,013
Projected to pay Fiscal Year 2026-2027	\$16,958,656
Projected to pay Fiscal Year 2027-2028	\$9,697,691
Deferred payment option NOT projected yet	\$16,340,634
Total	\$55,149,337

Table 5: Projects by Sub-Areas

Projects By Sub-Areas	Total	Percentages
North San José and nearby	13	18%
Downtown and nearby	20	28%
South and East growth areas	17	24%
West San José Urban Villages	14	19%
Edenvale	5	7%
Monterey Corridor	3	4%

Project Type	Total	Percentages
Mixed Use	28	39%
Non-residential/commercial only	44	61%

EVALUATION AND FOLLOW-UP

Since the implementation of the CLF program 18 months ago, only two projects have been constructed and paid their CLF fee. Staff will closely monitor the construction and development markets. Staff will provide an update to the City Council via an information memorandum when the condition of a million square feet in executed leases of new construction over 100,000 square feet in the downtown area is met.

/s/
ROSALYNN HUGHEY
Deputy City Manager
and Acting Housing Director

/s/
CHRISTOPHER BURTON
Director, Planning, Building,
and Code Enforcement

/s/
NANCI KLEIN
Director, Office of Economic Development
and Cultural Affairs

For questions, please contact Darius Brown, Senior Development Officer in the Residential Development Division, Department of Housing, at darius.brown@sanjoseca.gov or (669) 250-8851.