



Memorandum

TO: HONORABLE MAYOR
AND CITY COUNCIL

FROM: Nanci Klein
Jacky Morales-Ferrand

SUBJECT: SEE BELOW

DATE: September 20, 2021

Approved

Date

9/20/21

COUNCIL DISTRICT: 3

SUBJECT: APPROVAL OF DOWNTOWN HIGH-RISE RESIDENTIAL INCENTIVE FOR 27 WEST AT 27 S. 1ST STREET

RECOMMENDATION

Conduct a public hearing to approve an economic development subsidy in connection with a reduction in construction taxes and the Affordable Housing Impact Fee (AHIF) for a downtown residential high-rise at 27 S. 1st Street in the amount of \$6,393,994 pursuant to California Government Code Section 53083 and Open Government Resolution No. 77135 Section 2.3.2.6 C.

OUTCOME

Approval of an economic development subsidy in the amount of \$6,393,994 in conjunction with the Downtown High-Rise Residential Incentive and AHIF Downtown High-Rise Transition Programs, including the reduction to a zero fee for qualifying downtown high-rise projects (“exemption”), approved by City Council in November 2019, for the project at 27 S. 1st Street in Downtown San José.

BACKGROUND

The number of residents in the downtown has long been viewed as critical to support increased transit investment, diversification of retail, and the generation of more jobs in the City’s core. With this objective, the City Council has approved incentives for high-rise residential development in 2007, in 2012, and again in 2016. These programs resulted in the construction of 2,412 units.

On June 12, 2018, the City Council approved the Housing Crisis Workplan that included direction for staff to extend the Downtown High-Rise Incentive program including a 50%

reduction in construction taxes and to align this reduction with the end date for the Affordable Housing Impact Fee (AHIF) Transition Program exemption.

On November 5, 2019, the City Council accepted a Downtown High-Rise Feasibility Assessment that demonstrated a typical high-rise residential development in Downtown San José was not financially feasible. The City Council adopted a resolution to extend the deadline of the AHIF transition period for downtown residential high-rise development in the Downtown Core to June 30, 2025, and approved an ordinance creating a temporary fifty percent (50%) reduction of the construction taxes for residential high-rise development in Downtown.

Previous iterations of the Downtown High-Rise Incentive Program included a reduction in park impact in-lieu fees. However, on December 19, 2017, the City Council adopted a new Downtown Core High-Rise Fee Category reflecting the lower observed occupancy of existing high-rises in Downtown San José. Previously, high-rise developments paid the same rate as any project with five or more residential units in a multi-family structure. With this new fee category, a reduction in parks fees is no longer included as part of the Downtown High-Rise Incentive program.

On August 24, 2014 the San José City Council adopted Resolution No. 77135 which required that a public hearing be conducted for any public subsidy over \$1,000,000 and that notice of such public hearing be in the form of a memorandum addressed to the City Council posted on the City's web site 28 calendar days in advance of the City Council meeting at which a public subsidy is to be considered. The Resolution required that the staff memorandum contain the information found in first table in the Fiscal/Policy Alignment section of this memorandum. California Code Section 53083 (Assembly Bill 562) was also enacted in 2014 and requires local agencies to provide specified information to the public before approving an economic development subsidy over \$100,000. The state-required information is found in the second table in the Fiscal/Policy Alignment section of this memorandum.

ANALYSIS

27 West is a 509,135 square foot, 24 story, type IA construction, mixed-use tower on a 0.57-acre site at 27 S 1st Street. The tower contains 374 rental units and 35,264 sq. ft. of retail with private balconies from floors 5-24; indoor resident amenity space on floor 4, and outdoor resident amenity spaces on levels 5 and 20. Parking is included in an underground garage, and leasable commercial retail spaces are located the first three levels.

To be eligible for the fifty percent (50%) reduction in the Building and Structure Construction Tax (B&S) and the Commercial-Residential-Mobile Home-Park Building Tax (CRMP), a project must:

- Be in the Downtown Planned Growth Area as defined by the 2040 General Plan
- Be at least 12 stories in height
- Complete final inspection of 80% of the units by June 30, 2025

- Pay deferred fees and taxes prior to the scheduling of final inspection of 80% of the units
- Retain contractors licensed by the State of California for the construction of the project
- Employ only construction workers who possess necessary licenses and certifications required by the State of California

Additionally, project developers should make a good faith effort to 1) comply with the State of California's apprenticeship program requirement and 2) ensure that 25% of those apprentices are identified as having an employment barrier.

To be eligible for this AHIF exemption a project must:

- Be a rental development located in the Downtown Core Area (as described in Resolution No. 73587)
- Meet minimum height requirements where the highest occupied floor must have an elevation of at least 150 feet above street-level
- Provide evidence that the development is not a for-sale development
- Records an AHIF Agreement, prior to issuance of a Building Permit and prior to May 30, 2025, specifying which fee shall apply in the event the development fails to satisfy all transition waiver requirements
- Provides evidence of Certificate of Occupancy on or prior to June 30, 2025

The City Council approved the current Downtown High-Rise Incentive Program in 2019 after receiving a feasibility study conducted by an economic consultant, Strategic Economics. The study demonstrated the difficult development conditions in the downtown for high-rise residential development at that time. The report can be found [here](#).¹ Construction costs have remained high in our region and while rents in San Jose have been on the rise since January 2021, they remain below pre-pandemic levels. Given these factors, there is no reason to believe that feasibility has significantly improved since this study was conducted. Staff will complete an updated feasibility analysis for high-rise residential development as a component of the update to the Report the Cost of Residential Development that is part of the Housing Crisis Workplan. Staff intends to initiate this work before the end of the year and report to the City Council in 2022.

The Downtown High-Rise Residential Incentive Program includes affordable housing fees (AHIF or Inclusionary Housing Ordinance depending on date of approval), and the City's two construction taxes applied to residential development.

Construction Taxes

The City's construction taxes include the Building and Structure Construction Tax (B&S) and the Commercial-Residential-Mobile Home-Park Building Tax (CRMP), both of which are based on the valuation of construction derived from the most current building valuation data table published by the International Code Council (ICC) or the developer's stated construction

¹ <https://sanjose.legistar.com/View.ashx?M=F&ID=7709216&GUID=FD432D68-4153-46A9-BFE7-60EAF887660F>

valuation, whichever is higher. The B&S tax rate on residential building construction valuation is 1.54%, and the CRMP tax rate on residential building construction valuation is 2.42%, for a combined tax of 3.96%. Proceeds are used to fund city-wide capital improvement projects such as repairs and redevelopment of existing recreational facilities and transportation-related projects and improvements, such as pavement maintenance, complete streets, pedestrian safety, and traffic calming projects. The total amount of the B&S and CRMP construction taxes for this project is \$2,139,784.

Affordable Housing Impact Fee (AHIF)

The AHIF Program was established to address the increased need for affordable housing connected with the development of new market-rate residential rental units. Under the AHIF program, new market-rate rental housing development are charged a per square foot fee on net rental space. The current per square foot fee is \$19.15. The total AHIF fee for this project is \$5,324,102.

Proposed Economic Subsidy

The proposed economic subsidy for this project is \$1,069,892 from the suspension of 50% of construction taxes and \$5,324,102 from the exemption of the Affordable Housing Impact Fee.

CONCLUSION

A public hearing for the project 27 West, located at 27 S. 1st Street, will be conducted, as is required under City and state law, for the approval of an economic development subsidy in the amount of \$6,393,994 in conjunction with the Downtown High-Rise Residential Incentive and AHIF Downtown High-Rise Transition Programs.

EVALUATION AND FOLLOW-UP

City staff will execute a Project Completion Agreement with Alterra Worldwide Holdings, LLC, as required under City code (SJMC 4.46.039.11 & SJMC 4.47.089) and will monitor project construction to ensure requirements of the Downtown High-Rise Residential Incentive Program are completed prior to the sunset date of June 30, 2025. The project must still comply with affordable housing compliance plan, and record against the site an agreement memorializing the requirements under the AHIF downtown high-rise transition program prior to both building permit issuance and May 30, 2025.

CLIMATE SMART SAN JOSE

The recommendation has no effect on Climate Smart San José energy, water, or mobility goals.

PUBLIC OUTREACH

The memorandum will be posted on the City's website for the October 19, 2021 City Council agenda.

COORDINATION

This memorandum has been coordinated with the Departments of Parks, Recreation and Neighborhood Services, Planning, Building and Code Enforcement, Transportation, the City Attorney's Office, and the City Manager's Budget Office.

COMMISSION RECOMMENDATION

No Commission recommendation is associated with this action.

FISCAL/POLICY ALIGNMENT

The project aligns with the City's Economic Development Strategy to position Downtown as Silicon Valley's City Center to attract a diverse range of residents.

Benefits

- Estimated one-time revenue to the City: \$6,594,893
 - Construction Taxes: \$1,134,493
 - Parkland In-Lieu Fees: \$5,460,400
- Estimated recurring annual revenue to the City: \$136,590
 - Property Tax: \$91,636
 - Business Tax: \$9,668
 - Sales and Transaction Tax: \$35,286

The City of San José receives 14% of one percent of assessed property value as property tax. The County of Santa Clara receives 18% of the property tax distribution. The corresponding school district (San Jose Unified School District) receives 44% of the property tax distribution. In addition, the corresponding school district will collect a fee of \$0.56/square foot for the commercial/retail space and \$3.48/square foot for residential.

The City of San José also receives ongoing revenue from the collection of a 5% Utility User Tax that applies to electricity, gas, telecommunications, and water usage. An estimate is not provided as it varies depending on the specific uses within a building.

The table below addresses the requirements set forth in the City of San José’s Resolution 77135 for publication of information related to an economic development subsidy of more than \$1,000,000.

i. Accountability	The Downtown High-Rise Incentive program suspends 50% of construction taxes for eligible developments and allows for payment of the taxes to be delayed until the scheduling of final inspection for the Certificate of Occupancy. The program also provides an exemption to the Affordable Housing Impact Fee for projects meeting certain conditions.
ii. Net fiscal impact	The project is estimated to generate one-time revenue of \$6,594,893 (Construction Taxes: \$1,134,493, and Parkland In-Lieu Fees: \$5,460,400) and recurring annual revenue of \$136,590 (Property Tax: \$91,636, Business Tax: \$9,668, Sales and Transaction Tax: \$35,286) to the City of San Jose. The construction tax revenue gained on this project is \$1,134,493 and the construction tax revenue forgone is \$1,069,892. The park impact fee gained on this project is \$5,460,400.
iii. Net job impact	This project is estimated to create approximately 590 full-time and 123 part-time construction jobs. 58% of these jobs will generate an annual salary above \$80,000. Post construction, the project is estimated to create 140 on-site FTE positions in the commercial space and 25 FTE positions for the residential space.
iv. Housing impact	This project will deliver 374 new market-rate (above 120% of Area Median Income) housing units (823 estimated residents) to Downtown. All construction jobs will generate an annual salary above \$44,750, which is the annual income for a household of three categorized as extremely low income. No new demand for Extremely Low-Income housing units is anticipated to be generated by employees of this project.
v. Source of funds	The incentive does not provide funds directly to the project. It is a suspension of 50% of construction taxes, and an exemption for the Affordable Housing Impact Fee. The project is estimated to generate one-time revenue of \$6,594,893 and recurring annual revenue of \$136,590 to the City of San Jose.
vi. Neighborhood impacts	No significant impacts are anticipated on traffic or public infrastructure.

The table below addresses the requirements set forth in the State of California AB 562 (Government Code 53083) for publication of information related to an economic development subsidy and a public hearing.

i. Name/address of benefiting business entity	Alterra Worldwide Holdings, LLC 500 South Ervay #516 Dallas, TX 75201
ii. Start and end dates for the subsidy	Projects will become eligible for the subsidy per the current Downtown High-Rise Residential Incentive Program. The subsidy will become finalized upon payment of fees prior to the sunset date of the Downtown High-Rise Residential Incentive Program, subject to conditions therein.
iii. Description of the subsidy, estimated total amount of expenditure of public funds or revenue lost	The City shall suspend 50% of construction taxes on the high-rise constructed at 27 S. 1 st Street and shall allow payment of the taxes to be delayed until prior to scheduling of the final inspection for the Certificate of Occupancy. The City shall also provide an exemption for the Affordable Housing Impact Fee. The estimated economic development subsidy is \$6,393,994.
iv. Statement of public purpose	To encourage the development of high-rise residential in the Downtown Area, spurring increased retail amenities, attracting more employers, increasing transit use, and improving public life in San Jose. The aggregation of these factors will increase the economic vitality of the City's urban core and will translate to increased property tax and sales tax revenue to the City of San Jose.
v. Projected tax revenue	Estimated recurring tax revenue to the City of San José is \$136,590, of which \$91,636 is derived from property tax.
vi. Estimated number of jobs created, broken down by full time, part-time and temporary positions	This project is estimated to create approximately 590 full-time and 123 part-time construction jobs. 58% of these jobs will generate an annual salary above \$80,000. Post construction, the project is estimated to create 140 on-site FTE positions in the commercial space and 25 FTE positions for the residential space.

HONORABLE MAYOR AND CITY COUNCIL

September 20, 2021

Subject: Downtown High Rise Residential Incentive for 27 S. 1st Street

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CEQA

Addendum to the Downtown Strategy 2040 Final Environmental Impact Report and addenda thereto, Planning File Nos. SP18-016.

/s/

JACKY MORALES-FERRAND

Director, Housing

/s/

NANCI KLEIN

Director of Economic Development and
Cultural Affairs

For questions, please contact Jerad Ferguson, Housing Catalyst at (408) 535-8176, or jerad.ferguson@sanjoseca.gov.

Appendix A: Project Renderings

Figure 1 – Aerial View



Figure 2 – Aerial View



Appendix B: Project Renderings (Cont'd)

Figure 1 – View on 1st Street



Figure 2 – View on 1st Street

