COUNCIL AGENDA: 03/08/22
FILE: 22-269
ITEM: 8.3

CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: HONORABLE MAYOR AND CITY COUNCIL

FROM: Jacky Morales-Ferrand
Nanci Klein
Christopher Burton

SUBJECT: SEE BELOW

DATE: February 15, 2022

Approved Jennifer A. Maguire Date 02/24/22

SUBJECT: ACTIONS RELATED TO IMPLEMENTATION AND AMENDMENT OF THE COMMERCIAL LINKAGE FEE ORDINANCE

RECOMMENDATION

(a) Approve an ordinance amending Chapter 5.11 of Title 5 of the San José Municipal Code, Commercial Linkage Fee to:
   (1) Modify the payment timing to building permit issuance or the scheduling of final building inspection, and
   (b) Add credits for constructing new affordable housing units or restricting market rate units as affordable housing and associated definitions.

(b) Adopt a resolution amending the 2021-2022 Schedule of Fees and Charges (Resolution No. 72737, as amended) to add the Commercial Linkage Fee and make certain changes thereto superseding Resolution No. 79705 to:
   (1) Modify options for payment to provide a deferred payment option for Office and Industrial / Research and Development projects of 100,000 square feet or more including installments after the scheduling of the final building inspection;
   (2) Provide a 20% discount to the fee amount when the fee is paid full at or prior to building permit issuance;
   (3) Add the credit for constructing or restricting new affordable housing units; and
   (4) Increase the maximum square footage for exemption of non-residential office buildings to 50,000 square feet.

(c) Direct staff to return in the fall of 2027 with a comprehensive review of the program including the amount of fees collected and an analysis of the effectiveness of the deferred payment option.

OUTCOME

Accepting staff's recommendation and adopting the amended Commercial Linkage Fee (CLF) Ordinance and the 2021-2022 Schedule of Fees and Charges will support the continued implementation of the CLF program. The City continues to develop strategies to produce more affordable homes, and the CLF amendments will help staff more efficiently deploy the resources to achieve those goals. The fees provide a funding source for affordable housing development, and the City should not delay the collection of fees to fund the production of affordable housing developments. These amendments aim to improve the efficiency of the CLF ordinance and the administration of the policy. No CLF fee amounts will be increased by the recommended actions.

EXECUTIVE SUMMARY

For the past year, staff has faced challenges in implementing the CLF's delayed/phased fee payment procedure. City Council directed staff to further research and explore credits and incentives to bolster the CLF program. After careful review of the CLF and coordination across departments, staff recommends the following amendments to the CLF and Fee Resolution to enable efficient and effective implementation:

1. Change the payment options for all types of projects to require the CLF be paid at building permit issuance or the scheduling of the final building inspection and allow projects that choose to pay at building permit issuance to pay 80% of their CLF. Include the deferred payment option for Office and Industrial / Research and Development (R&D) projects over 100,000 square feet:
    - Allow these projects to pay five equal installments;
    - First payment collected at building permit, second at scheduling of the final building permit inspection, and the three remaining payments annually with accrued interest at 3% simple on the anniversary of the second payment; and
    - The deferred payment must be secured by a payment bond or irrevocable letter of credit.
2. Establish a credit for the construction of or recordation of covenants to provide affordable units.
3. Exempt the first 50,000 square feet of a development from the CLF, an increase from the current 40,000 square feet threshold, for office projects less than or equal to 100,000 square feet of gross floor area.

BACKGROUND

The CLF was established in accordance with the requirements of the Mitigation Fee Act (Government Code section 66000 et seq.). The nexus, or link, between new non-residential development and the need for affordable housing generated by that new development was established by a nexus study that also established the maximum fee amounts per square foot of new non-residential development that could be charged by the City. A Feasibility Study was also performed in connection with the CLF adoption to inform the City Council where in the City the fee would be viable and at what amounts.

How is the fee calculated?

The CLF is an impact fee that applies to new non-residential developments in San José. The charge is based on new commercial businesses that hire employees at various wages, driving the demand for affordable housing for a range of income levels. This fee is transferred to the City's CLF Fund, administered by the Housing Department. The City must expend the monies solely on the production or refurbishment of affordable housing. The CLF applies to most commercial development types[1], including:

- Office
- Retail
- Hotel
- Industrial
- Research and Development
- Warehouse
- Residential Care

For each non-residential development, the CLF is calculated by the Housing Department as follows:

a) Developments adding 5,000 square feet or more of new or additional Gross Floor Area in one of the defined building uses in Resolution 79705 are subject to the fee;
b) Development's Gross Floor Area square feet are multiplied by the fee rate for the specific geographic subarea[2] the project is located in;
c) Any applicable deductions and/or credits are subtracted resulting in the fee amount due; and
d) The invoice for the fee amount due is sent to the developer when the developer requests the issuance of a building permit. The fee increases annually by the amount of the Engineering News Record Construction Cost Index adjustment until paid.

In order for the CLF to be viable, the City must have a sufficient enforcement mechanism to ensure the CLF is paid and that the payment structure can be implemented by existing staff without a major overhaul of existing City systems. Staff has highlighted a conflict with the timing of the delayed/phased payment provision of the CLF that makes it impractical for the City to track and presents challenges regarding collection of the CLF fee.

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[1] Current CLF schedule: https://www.sanjoseca.gov/your-government/departments-offices/housing/developers/developer-fees-charges/commercial-linkage-fee
[2] CLF Geographic Subarea Map: https://bit.ly/3GTSoHP

ANALYSIS

Implementation Challenges

A. Evaluation of Timing of Payment

The City uses the AMANDA system to track phases of development (including permitting and inspection milestones). The CLF assumes that the initial applicant for the commercial development will be responsible for paying the fee to the City. Collecting fees at later stages of development (such as certificate of occupancy for tenant improvements as allowed by the delayed/phased payment option) is increasingly complex. Without the ability to create a trigger that alerts staff of a development progression milestone, it is possible that a developer can complete construction and not pay the CLF. The City would be challenged in collecting the fee without the ability to withhold the temporary certificate of occupancy.

1) Prolonged Time Period

It is possible that some buildings will take several years to lease. This would require staff to track payments and responsible parties over an extended period, potentially across multiple property owners if the building sells prior to lease up. Once commercial building shells are complete, ownership transfers are more likely, and any further improvement permits are likely to be tenants' responsibility. Tracking ownership changes is difficult as this information is maintained by the County Assessor and not easily accessible to City staff. In the event the property is sold after final inspection, the purchaser is unlikely to be aware of any outstanding fee obligations. This change in the responsible party makes it nearly impossible for the City to track and collect the fee. While there are effective short-term ways to secure an applicant’s outstanding obligation, such as a letter of credit or bonding requirement, these requirements are not part of the ordinance, nor is there any time limit on CLF collection that would facilitate limited term security.

2) Certificate of Occupancy

The most difficult issue is with respect to the delayed/phased payment option. The current CLF allows larger office developments over 100,000 square feet to use this option to pay a partial fee at final inspection of the building shell and pay the remainder at completion of tenant improvements. These larger developments are generally multi-tenant buildings that result in occupancy of different portions of the building at varying times. Tenant improvements may or may not require the City to issue a certificate of occupancy; therefore, staff would not necessarily have an opportunity to intervene and enforce payment before certificate of occupancy issuance. Unlike residential development, commercial development may have multiple certificates of occupancy spaced out over a period of years.

3) Lack of Monitoring System

The Housing Department's existing Salesforce database does not contain any information about commercial developments. Creating a new component of the Department's database is possible but would require substantial staff time and technology investment. A manual tracking process on Excel spreadsheets is also difficult and cumbersome, this is an inefficient process, prone to user errors and file corruption over time. Staff presented this technology issue to the Development Services Transformation Executive Team. It was clear that developing a plan to integrate the CLF into the existing permitting AMANDA database is necessary to the CLF program's overall efficiency. The City previously set the Transformation team's established priorities and objectives for the year, but they will look to add the CLF integration to priorities for the next fiscal year. This technology integration challenge is time-sensitive and staff-intensive. This work will require coordination across departments for the configuration, and the more we delay action on this process, the less likely we will be able to collect the fees.

B. <u>Enforceability</u>

Following the City Council's adoption of the Ordinance and Fee Resolution in fall 2020, staff pursued the initial implementation of the CLF program. As staff worked to implement the program, difficulties have emerged related to the process of collecting the CLF due to the timing of payment provisions, specifically, the delayed payment option for Office and Industrial / R&D projects with at least 100,000 square feet.

Staff identified specific challenges with collecting the fee at each individual tenancy:

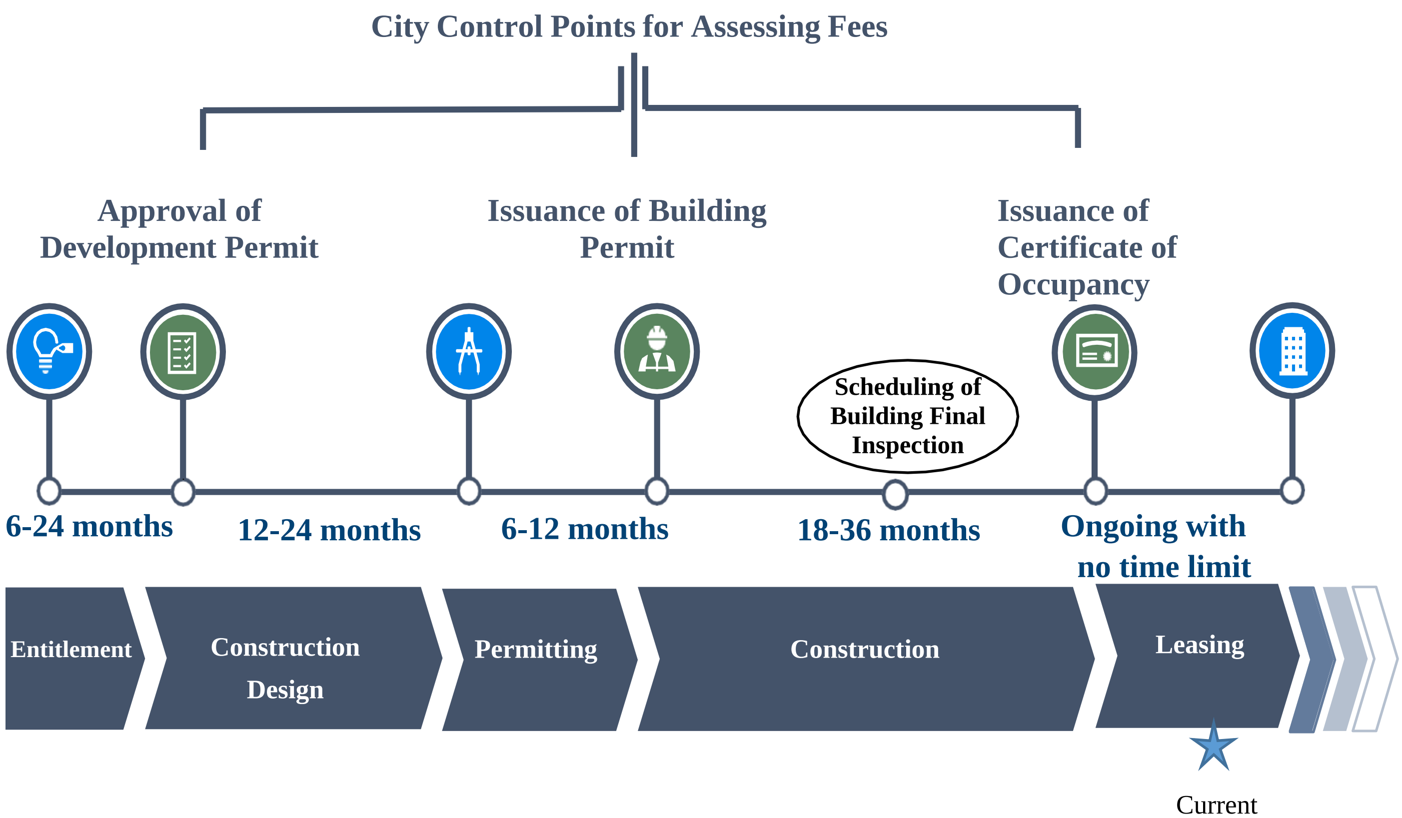
1) **Collectability** – The City's ability to collect and enforce the payment of the fee is strongest at the issuance of permits. For example, if fees are not paid, the building permit is not issued. After these permits are issued, the ability to enforce the payment of the fee by withholding something that the City releases is lost. The scheduling of the final building inspection is one of the last points of leverage the City has over the project.

2) **Responsible Party** – Collection at completion of tenant improvements creates the potential that the fee obligation would be passed on to and paid by the tenant rather than paid directly by the developer, potentially surprising initial tenants with an unexpected buildout cost. If a developer builds a commercial shell, there is no way for the City to know when the developer will come in for their tenant improvements. This could potentially be years before tenant improvement permits are requested and the fee obligation may be passed to the tenant instead of the developer or owner, such that the person seeking permit is unaware of the obligation.

3) **Security for Payment** – While there are effective short-term ways to secure an applicant's outstanding obligation, such as a letter of credit or bonding requirement, these

requirements are not part of the ordinance, nor is there any time limit on CLF collection that would facilitate limited term security. The delayed/phased payment option will only work if payments are secured by a payment bond, irrevocable letter of credit and by a senior deed of trust.

The development process and control points for assessing fees are illustrated below, the blue star shows the current CLF collection point, which extends beyond the primary gating points in the development process.



One milestone that is trackable in AMANDA and allows the City to enforce the payment of the fee is the scheduling of the final building inspection. At this point in the process, the City can withhold the final inspection or temporary certificate of occupancy until the CLF fee is paid in full. **Table 1** shows the implementation challenges for the current and proposed timing of payment options.

Table 1: Difficulty of Payment Options

Option	A. Building Permit or Scheduling of Building Final Inspection with an Option to Defer Payment for Projects Over 100,000 sq.ft	B. Final Inspection of Shell	C. Building Permit	D. Final Building Shell or Temporary Certificate of Occupancy Tenant Improvements
	Recommended			**Current Ordinance**
Difficulty Level	**Moderate** Same benefits and drawbacks as inspection of shell and building permit options. In addition, a new tracking and notification process would need to be added that holds back the final inspection for temporary certificate of occupancy or temporary certificate of occupancy issuance if the payment is not received at the time of scheduling the final building inspection.	**Low** Currently, permit issuance is held up if fees are not paid. To implement this option, a new process would have to be implemented to allow the permit to be issued before the fee is paid. In addition, a process would be required to track the completion of the inspection and hold back temporary certificate of occupancy issuance until the fee is paid.	**Lowest** This option would be the easiest to implement. Almost all existing building permit fees are paid prior to issuance, and this would only require an additional fee to be added to the existing process.	**High** Because the fee can be paid at many different stages, it will be difficult to track whether the payment has been collected at various points in the process. temporary certicuate of occupancy and building permits are different permit types which means the tracking would have to carry over to multiple permit types that are tracked separately in the AMANDA system. Delayed phased payments add an additional requirement for tracking and notifications
Implementation Timeline	**Four Months**	**Three Months**	**One Month**	**One Year**

Green = Easiest
Red= Hardest

C. <u>Department Timelines</u>

Option A

The Development Services Information Technology team with the Information Technology Department estimates four months to configure the AMANDA permitting system for the recommended Option A (Table 1). Currently, all permit inspections (including final inspection) are held back if all outstanding fees are not paid. To allow payment at either building permit issuance or the scheduling of the final building inspection, the team will need to create a new code/process to allow building permits subject to CLF to be issued before all the fees are paid. This code should be able to require all fees to be paid except the CLF before permit issuance. Similar to the existing process for building permit issuance, a new code/process will also need to be created to hold back issuance of the temporary certificate of occupancy for permits subject to CLF until all fees are paid. In addition, since the payment can be received prior to building permit issuance or prior to scheduling of final building inspection, the team will need to create a new notification and tracking process to ensure that the CLF were paid either at building permit issuance or scheduling of final building inspection. Scheduling of final building inspection will be held back. Office and Industrial / R&D projects over 100,000 square feet will have an additional option to elect a deferral payment plan. This option will require developers to provide payment security through bonds or letters of credit.

Option B

Allowing payment up until the final shell inspection (Option B, Table 1) would require a new code/process to allow building permits to be issued even if all the fees have not been paid. This code should be able to require all fees to be paid except the CLF before permit issuance. A new code/process will need to be implemented that will hold back the scheduling of the final building inspection and therefore, temporary certificate of occupancy issuance if CLF are not paid. The Information Technology team estimates that this option would take about 3 months to implement.

Option C

Requiring CLF fee payment before the building permit is issued (Option C, Table 1) is the easiest process to implement technically because it is the closest to the existing process (Table 1). The Information Technology team estimates that implementing this option would take less than a month.

Option D

The current ordinance (Option D, Table 1) which includes a delayed/phased option that allows payment at final building shell or temporary certificate of occupancy tenant improvements is the most complicated to incorporate into the AMANDA permitting system. Allowing payments at a wide range of points in the process is challenging because projects go through multiple permit types in the AMANDA system which are all tracked separately. A new feature would have to be developed to link all the permit types for a project to ensure the CLF were paid at one of the points. The Information Technology team estimates that implementation of this option may require involvement with a contractor and a significant timeline (a year or more) to create the new features.

D. Local CLF programs

In order to address these challenges, staff requested that consultant Keyser Marston consider policy implications, implementation plans, and other administrative issues surrounding the timing of payment. In **Attachment A,** Keyser Marston analyzed 54 CLF programs to explore alternative payment requirements and compared our current timing payment option. **Table 2** provides a snapshot of how other jurisdictions enforce the fee collection. Over 70% of the jurisdictions implementing a CLF program collect the fee at building permit issuance. Only three jurisdictions waited to collect the fee at certificate of occupancy and just Livermore and Oakland provided a phased or installment payment option that extended beyond certificate of occupancy.

Table 2: Survey of CLF programs

Total Number of Cities Reviewed	Fee collected at Building Permit	Fee Collected at Building Permit or Special Approval for Deferral	Fee Collected Prior to a Certificate of Occupancy or Final Inspection	Phased Payment Option
54	40	9	3	2 (with time limits and security requirements)

Solutions to Address Implementation and Enforceability Challenges

A. Modified Fee Amounts

The current recommended option would allow all projects that choose to pay at building permit issuance to pay 80% of their CLF. This recommendation will provide a two-tiered fee structure for all CLF projects. Staff proposes using 80% of the fee because this ratio is consistent with the original direction of City Council to provide a lower fee amount in the delayed payment option. The same incentive amount will be spread to all building types under the CLF. The goal of the incentive is to collect a higher percentage of fees at the time of building permit. Collecting fees earlier in the development process provides relief to staff for tracking the fee and will deposit funds potentially two to three years earlier than if the developer selects paying at certificate of occupancy.

B. <u>Deferred Payment Option</u>

As developers look to initiate construction of large-scale commercial development, typically the funds used during this initial period are more costly than funds secured after construction is complete and closer to when the property will generate income. This increased cost of funds has led to a desire to defer payments beyond the construction of the building shell. Staff proposes to add a deferred payment agreement option for Office and Industrial / R&D projects over 100,000 square feet. This payment option will be five equal payment installments structured with the first payment at building permit, the second at the scheduling of final building inspection, and the three remaining payments with accrued 3% simple interest made annually. Developers must secure the deferred payment by a payment bond or irrevocable letter of credit.

Exploration of Potential Fee Credits

A. <u>Affordable Housing Credit</u>

A developer seeking this credit would build a commercial building, accruing an obligation under the CLF, but build a residential building including affordable housing units to reduce or eliminate their CLF payment. This credit will allow developers to build affordable units on-site, within a mixed-use project, or on a different site from a 100% commercial project by complying with the City's Affordable Housing Siting Policy. The affordable units serving as a credit for the CLF will be in addition to any required affordable units under the Inclusionary Housing Ordinance (IHO). Under the proposal, for each affordable unit provided, the project would receive credit for satisfying the CLF for a given square footage of floor area.

Developers will also have an option to place covenants on existing market rate units for credits. Covenants are eligible for half the amount of credit provided for a newly constructed affordable unit. This is similar to the existing IHO option for acquisition and rehabilitation of existing units, which requires two rehabilitated existing units for every one inclusionary unit owed. Existing units must have an expected remaining life of 55 years and be vacant or occupied by income qualified tenants, and tenants may not be evicted to create a vacancy. The amount of credit varies according to the income level of the affordable unit, as shown in the example of Downtown Office over 100,000 square feet in **Table 3**, below. Credits reflect a similar relationship between affordable units and fee dollars as the City’s existing in-lieu fees under the Inclusionary Housing Ordinance.

Attachment B details the full methodology for calculating the affordable housing fee credit. Staff recommends amending the CLF and fee resolution to include a fee credit for affordable housing as detailed in Table 3.

Table 3: Proposed Affordable Unit Credits

<table>
<tr><th colspan="6">Schedule of Credits toward CLF Payment
for Projects Providing Affordable Units</th></tr>
<tr><td rowspan="3">Affordability Level of Provided Unit</td><td rowspan="3">Income Level Applicable to Affordable Rents</td><td colspan="4">Square Feet of Floor Area (1) Credited for CLF Payment for Each Affordable Unit Provided</td></tr>
<tr><td colspan="2">Per Credit Unit
(Newly built affordable units)</td><td colspan="2">Per Covenant Credit Unit
(Affordability restrictions placed on existing units)</td></tr>
<tr><td>Office in Downtown and Nearby Subarea (≥100,000 sq. ft.)</td><td>Other Non-Residential</td><td>Office in Downtown and Nearby Subarea (≥100,000 sq. ft.)</td><td>Other Non-Residential</td></tr>
<tr><td>Extremely Low</td><td>30% of AMI</td><td>20,323 SF</td><td>60,971 SF</td><td>10,162 SF</td><td>30,486 SF</td></tr>
<tr><td>Very Low</td><td>50% of AMI</td><td>15,605 SF</td><td>46,817 SF</td><td>7,803 SF</td><td>23,409 SF</td></tr>
<tr><td>Low</td><td>60% of AMI</td><td>12,097 SF</td><td>36,292 SF</td><td>6,049 SF</td><td>18,146 SF</td></tr>
<tr><td>Moderate</td><td>100% of AMI</td><td>2,903 SF</td><td>8,710 SF</td><td>1,452 SF</td><td>4,355 SF</td></tr>
</table>

B. <u>Historic Preservation Credit</u>

Staff is recommending not to amend the CLF Ordinance and Fee Resolution to include a fee credit for historic preservation. It is not related to affordable housing, and not consistent with the purpose of the CLF. However, staff prepared a summary of potential terms for a historic preservation credit for consideration in the policy alternatives section; this credit would need to be brought back to City Council as a future amendment to the CLF with additional supporting findings if the City Council supports moving forward with the historic preservation credit.

C. <u>Environmental Sustainability Credit</u>

City Council directed staff to explore a credit for sustainability at the Net Zero standard, not to exceed 20% of the CLF fee for any one development. Staff found that a credit specific to Net Zero, as it is currently defined, would be impractical as Net Zero certification requires post-occupancy performance data which would be unknown at the time of the calculation of the CLF payment. There is, however, interest from the development community for receiving credit for projects that contain environmentally sustainable building practices.

Staff is recommending not to amend the CLF Ordinance and Fee Resolution to include a fee credit for sustainability at the Net Zero standard, at this time. Staff is recommending that a credit for environmentally sustainable developments be considered, along with other development incentive options, when City staff returns to City Council in June 2022 with a Carbon Neutral by 2030 Implementation Plan. Staff prepared a summary of potential terms for the environmental sustainability credit for consideration in the policy alternatives section; this credit would need to be brought back to City Council as a future amendment to the CLF with additional supporting findings if the City Council supports moving forward with the environmental sustainability credit.

Increase Square Footage Threshold to 50,000 Square Feet

A. <u>Effects of Increasing</u>

Currently, the CLF for office space is reduced to $0 for the first 40,000 square feet of office space in projects less than 100,000 square feet of gross floor area. City Council directed staff to explore modifying the $0 fee to apply to the first 50,000 square feet of office space in projects less than 100,000 square feet of gross floor area. Staff reviewed the 294 projects that are currently obligated to satisfy the CLF and identified 103 office projects under 50,000 square feet. Given this very large number of projects that would be exempt, staff recommends amending the CLF Ordinance and Fee Resolution to increase the amount of square footage eligible for a $0 fee from 40,000 to 50,000 square feet. There are only two current office projects from 40,000 to 50,000 square feet. Therefore, there will be little impact on the CLF program management and revenues. However, this change would reduce the total number of CLF projects to 191 from 193. The City will lose $27,066 if the $0 fee threshold increase from 40,000 to 50,000 square feet for office projects under 100,000 square feet is approved based on the two current projects that meet these criteria.

Status of CLF Fee Collections

A. <u>CLF Developments Under Review</u>

Table 4 outlines the number of projects and building use types subject to the CLF. As of December 2021, staff has sent out 66 CLF satisfaction plans to developers out of 294 projects. In addition, five Satisfaction Plans have been submitted for City approval. Out of the five completed agreements, two are exempt from paying the fee, and three have outstanding invoices totaling $2,433,709. There are currently 27 exceptions in SJMC 5.11.050 that allow non-residential developments to claim exemption status, ultimately waiving the fee. The completed list of exceptions is in **Attachment C**. The current process is impractical, and staff is undertaking system improvements and recommending modifications to the Ordinance that would improve collection.

Table 4: CLF Projects Under Review for Applicability of CLF (Listed by Type of Work)

Work Description	Total # of Projects
Additions/Alterations	**9**
Finish Interior	**24**
New Construction	**23**
Tenant Improvement	**238**
Total	**294**

B. <u>CLF Fee Invoicing and Collection Process</u>

The Housing Department's process of reviewing CLF developments and assessing whether the project is subject to the Ordinance is currently being managed offline without a database to monitor the projects. This procedure consists of Housing staff reviewing an excel spreadsheet and cross-referencing the AMANDA database to find the contact info for the developer or Applicant. After the appropriate contact is identified, staff sends an email correspondence to the developer introducing the CLF process of submitting documentation to the Housing Department for review. Once the developer confirms and submits a signed CLF Satisfaction Plan, staff create an offline folder for the development and send an invoice directly to the developer. Housing staff cannot upload the invoice to AMANDA, which further complicates the City's ability to enforce and collect the fees. There is one full-time Housing Department staffer dedicated to this elaborate time-consuming process.

CONCLUSION

The current Ordinance does not help streamline the administration of the program. Therefore, the Administration must address the challenges of integrating the CLF into existing technology processes and modifying the timing of payment so the City can enforce the Ordinance. In summary, the CLF needs to be updated to move away from processes that can cause the City to have issues tracking, monitoring, and collecting the CLF. As a result of this analysis, staff identified solutions to these challenges including:

- Incentivizing developers to pay at building permit and maintaining payment flexibility after the issuance of building permits;
- Allowing a five-installment payment option for large office developments; and
- Aligning the CLF policy with the City's AMANDA permitting system.

EVALUATION AND FOLLOW-UP

The Ordinance Amending the CLF will have a second reading anticipated to be held on March 22, 2022. The changes will be effective 30 days following the second reading of the Ordinance. Stall will return in the fall of 2027 with a comprehensive review of the program including the amount of fees collected and an analysis of the effectiveness of the deferred payment option.

CLIMATE SMART SAN JOSE

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

POLICY ALTERNATIVES

Policy alternatives have been developed based on City Council direction and research that Keyser Marston has conducted on how other communities are implementing their CLF. **Attachment D** calculates the net loss of CLF revenue and affordable units if the City Council determines to move forward with these alternative policies. Please note that the alternative policies for additional credits require findings that must be presented to the City Council for consideration prior to their adoption.

Alternative #1: **Historic Preservation Credit**

Incorporate a Historic Preservation Credit that states, project sites that include a designated City Landmark, individually listed property in the National Register of Historic Places or Contributing Building within a designated City Landmark District or listed National Register Historic District are eligible to receive a reduction of the CLF when the project involves restoration, rehabilitation, and/or relocation of the designated or listed structure. Restoration and/or rehabilitation work must be consistent with the rules and regulations of the California Office of Historic Preservation, the United States Secretary of the Interior Standards for the Treatment of Historic Properties, and the Requirements of the City. If a property is listed in the National Register and not a City Landmark or a Contributing Building in a City Landmark District, the building must be designated under Part 2 of Chapter 13.48 (Historic Preservation Ordinance). Work must be approved through the issuance of a Historic Preservation Permit prior to issuance of a building permit. Upon completion of the work and receipt of the cost of the restoration, rehabilitation, and/or relocation work identified in the Historic Preservation Permit, the CLF for the project will be reduced by the amount spent on restoration and/or rehabilitation of the designated property, for up to 20% of the total CLF.

Pros: Supports SJMC 13.48.010.

Cons: Not related to the production or refurbishment of Affordable Housing.

Reason for Not Recommending: Historic preservation is not related to affordable housing and is not consistent with the purpose of the CLF.

Alternative #2: **Environmental Sustainability Credit**

Projects that are all-electric and have a 100% carbon-free energy supply are eligible to receive a 20% reduction of the CLF. Projects must receive 100% of their energy supply from carbon-free renewable sources, such as by enrolling in San José Clean Energy's Total Green or successor program, or on-site carbon-free renewable generation. If projects are purchasing renewable energy, they must demonstrate a contractual obligation to maintain this purchase through 2040. This credit is available to projects that receive building permits and pay the CLF on or before December 31, 2025, unless extended by ordinance of the City Council.

Pros: City Council approved the Climate Smart San Jose plan in 2018 which includes a goal to achieve 70 million square feet of zero net energy commercial buildings by 2030. City Council adopted Resolution No. 80284 in 2021 which sets a goal for San José to be carbon neutral by 2030 thereby accelerating Climate Smart goals. City Council also adopted a Natural Gas Infrastructure Prohibition Ordinance which applies to most new construction building types, with limited exemptions for some commercial uses. With an estimated application up to approximately 890,000 square feet of commercial development annually, the adoption of an Environmental Sustainability Credit could help the City to achieve its Climate Smart goals by: 1) incentivizing new construction projects which may qualify for an exemption to become all-electric, net zero emission buildings, 2) incentivizing existing buildings to retrofit to become all-electric, net zero emission buildings, and 3) ensuring that any all-electric buildings constructed under the City’s existing Natural Gas Infrastructure Ordinance utilize carbon-free power (thereby resulting in net zero emissions buildings).

Cons: If 25-100% of projects used this credit, it would result in an estimated 7-26 affordable units foregone over a four-year period due to the loss of the CLF revenue.

Reason for Not Recommending: Staff is recommending not to amend the CLF Ordinance and Resolution to include a fee credit for NetZero until further analysis is completed as part of the development of a Carbon Neutral by 2030 Implementation Plan being brought to Council in June 2022.

PUBLIC OUTREACH

Staff conducted four community outreach meetings to solicit comments and questions on the amendments to the CLF. The meetings included various developers, property owners, and community stakeholders. The Housing Department provided an overview of the CLF Ordinance and the Fee Resolution and discussed potential options to satisfy the requirements and the credits. In addition, staff outlined developers' obligations under the ordinance and presented possible changes to the process for meeting the program’s obligation.

Table 5: Summary of Public Outreach Meetings

Meeting Date and Audience	Attendees
Wednesday, October 27, 2021 – Developers	9
Thursday, October 28, 2021 – Advocates	12
Wednesday, December 1, 2021 – Stakeholders/Developers	19
Thursday, December 2, 2021 – Stakeholders/Developers	18
February 10 – 15, 2022 – Stakeholders/Developers	4
TOTAL	62

COORDINATION

Preparation of this memorandum was coordinated with the City Attorney's Office, City Manager's Budget Office, Information Technology Department, and Environmental Services Department.

COMMISSION RECOMMENDATION/INPUT

The Housing and Community Development Commission reviewed the proposed policy changes to the CLF program on January 13, 2022. The report was reviewed and discussed by the Commission. The following is a summary of the Commission's comments:

- The staff recommendation to incentivize payment of the fees at building permit set at 80% should be carefully considered; this is a steep discount. Instead, staff may consider a more limited incentive such as 95% of the fee.
- Concern that staff should recommend the fee be collected at building permit, the simplest and most effective point in the development process to collect the fee.
- Concern that moving the threshold from 40,000 to 50,000 square feet will further erode the CLF.
- Support for the staff recommendation to provide an affordable housing credit and not moving forward with a credit for historic preservation or environmental sustainability.

1. Commissioner Shoor made the motion to receive the staff report and amend the recommendation on payment option to 95% of the fee at building permit issuance, with a second by Commissioner Dawson. The motion passed 8-2.
   Yes: O'Connell, Dawson, Shoor, Del Buono, Vong, Navarro, Wheeler, Partida (8)
   No: Jasinsky, Sellarole (2)
   Absent: Tran, Moore (2)

2. Commissioner Wheeler made the motion to support staff recommendation to remove credits for historic preservation and sustainable development and recommend that the credits come from a different source than the CLF, which is directed to providing affordable housing, with a second by Commissioner Shoor. The motion passed 10-0.
    Yes: O'Connell, Jasinsky, Dawson, Shoor, Del Buono, Vong, Navarro, Wheeler, Partida, Sellarole (10)
    No: (0)
    Absent: Tran, Moore (2)

3. Commissioner Wheeler made the motion to recommend that the exemption level be left at 40,000 square feet., with a second by Commissioner Vong. The motion passed 8-2.
    Yes: O'Connell, Dawson, Shoor, Del Buono, Vong, Navarro, Wheeler, Partida (8)
    No: Jasinsky, Sellarole (2)
    Absent: Tran, Moore (2)

FISCAL/POLICY ALIGNMENT

The policy changes included in this memorandum are aligned with many City priorities, aimed to increase funding available to finance the future development of affordable housing. These include the Housing Crisis Work Plan, the Affordable Housing Investment Plan, the City's General Plan 2040 and its Housing Element, and the *2020-25 Community Plan to End Homelessness*.

BUDGET IMPLICATIONS

At the time of approval of the CLF, one Analyst I/II position was added to the Housing Department as part of the 2020-2021 Adopted Budget, to begin implementation of the new fee program. Staff anticipates bringing forward additional budget actions to continue supporting the CLF Program as part of the City's 2022-2023 budget development process. The additional staffing under consideration will be recommended to be funded by the CLF and is not anticipated to impact the General Fund.

CEQA

Not a Project, File Nos. PP17-009, Staff Reports, Assessments, Annual Reports, and Informational Memos that involve no approvals of any City action; and PP17-008, General Procedure and Policy Making resulting in no changes to the physical environment.

/s/	/s/	/s/
JACKY MORALES-FERRAND	NANCI KLEIN	CHRISTOPHER BURTON
Director, Housing Department	Director, Economic Development	Director, Planning, Building and Code Enforcement

The principal author of this memorandum is Darius Brown, Senior Development Officer. For questions, please contact Rachel VanderVeen, Deputy Director at (408) 535-8231.

Attachment A: Commercial Linkage Fee Timing of Payment Survey
Attachment B: Commercial Linkage Fee Credit for Providing Affordable Units
Attachment C: SJMC 5.11.050 Commercial Linkage Fee Exceptions
Attachment D: Potential Forgone Commercial Linkage Fee Revenue and Affordable Unit Production

Attachment A

Commercial Linkage Fee Timing of Payment Survey

The following table summarizes the timing of payment provisions for 54 CLF programs. Of these 54 programs, 40 require payment at building permit, nine require payment at building permit but allow deferral of payment with special approval, three allow payment prior to a certificate of occupancy or final inspection, and two programs (besides San José) provide a phased payment option.

A. Fee Paid at Building Permit		
	Jurisdiction	**Note**
1	Los Angeles	
2	Seattle, WA	
3	Portland, OR	
4	San Francisco	Partial deferral of payment to occupancy was allowed for a three-year period during the great recession.
5	Sacramento	
6	West Hollywood	
7	Culver City	
8	Glendale	
9	San Luis Obispo Co.	
10	Santa Monica	
11	Sacramento County	
12	Elk Grove	
13	Citrus Heights	
14	Rancho Cordova	
15	Placer County	
16	Santa Clara County	
17	Palo Alto	
18	Menlo Park	
19	Sunnyvale	
20	San Mateo	
21	Foster City	
22	East Palo Alto	
23	San Bruno	
24	Redwood City	
25	Mountain View	
26	Cupertino	
27	Los Altos	
28	Milpitas	
29	Emeryville	
30	Alameda	
31	Newark	
32	San Rafael	
33	Corte Madera	
34	Petaluma	
35	Sonoma County	
36	Cotati	
37	Napa County	
38	South San Francisco	
39	San Mateo County	Prior to first grading or building permit
40	Marin County	Prior to recordation of map or issuance of building permit

BP = Building Permit; CO = Certificate of Occupancy

B. Fee Paid at Building Permit, with Potential to Defer with Approval		
	Jurisdiction	**Note**
1	Pleasanton	Due at BP unless otherwise determined by the City
2	Dublin	Due at BP unless a fee deferral agreement is entered into
3	Fremont	Due at BP unless approved by the Com. Dev. Director
4	Richmond	Due at BP unless conditions of approval allow payment at occupancy
5	Folsom	Due at BP unless director allows deferral to final inspection
6	Napa	Due at BP, payment at final inspection or CO allowed with secured agreement.
7	San Diego	Due at BP, deferral for two years or until first inspection with an agreement.
8	St. Helena	Due at BP, unless otherwise approved by City Council
9	Walnut Creek	Due at BP, Option to delay to CO with Planning Director approval
C. Due Prior To Certificate of Occupancy or Final Inspection		
1	City of Santa Clara	
2	Santa Cruz County	
3	City of San Luis Obispo	
D. Phased Payment Option Available		
	Jurisdiction	**Note**
1	Livermore	Due at CO. Option to pay over five years if post a letter of credit.
2	Oakland	25% due at building permit, 50% due at temporary certificate of occupancy, 25% due eighteen months following temporary certificate of occupancy. City may record a lien to secure payment.

BP = Building Permit; CO = Certificate of Occupancy

Attachment B

Commercial Linkage Fee Credit for Providing Affordable Units

A credit toward the City's CLF is proposed for commercial projects that provide affordable units. Under the proposal, commercial projects would receive a credit for satisfying the CLF for an identified amount of floor area for each affordable unit provided. This summary shows how the proposed credit is derived. The relationship between fee dollars and affordable units reflected in the City's adopted inclusionary in-lieu fee is used as the basis for determining the credit, using the following steps.

Step 1: Identify Cost Per Affordable Unit to Calculate Credit

Identify a cost per affordable unit to translate from fee dollars to units. The in-lieu fee for the inclusionary program is used as the most relevant policy precedent for relating fee dollars and affordable units.

A. Adopted in-lieu fee for rentals in strong market areas [1]		**$43 /SF**
B. Average market rate unit size for in-lieu fee calculation [2]		844 SF
C. Inclusionary percentage applicable to in-lieu fee (off-site percentage applies)		20%
D. In-lieu fee, effective rate per required affordable unit	= A. X B. / C.	**$181,460**

[1] In-lieu fee without adjustments for on-site units or moderate market areas is applied as the purpose is to reflect the full gap.
[2] From Step 1 of the calculation used to determine the rental in-lieu fee.

Step 2: Determine Credit for Low Income Units

Credits are expressed as the amount of floor area for which the CLF is satisfied for each affordable unit provided. Credits are calculated based on representative fee levels for office, rather than create a more complex schedule of credits for each use and geographic area. The effective in-lieu fee rate per affordable unit of $181,460 is used to determine the credit for each Low Income unit because inclusionary units have an average AMI level that falls within the Low Income category.

		Downtown Office	*All Other Uses*
A. CLF rate for credit calculation		$15 /SF	$5 /SF
B. Effective in-lieu fee rate per affordable unit (Step 1)		$181,460	$181,460
C. Floor Area credited for each Low Income unit	= B. / A.	**12,097 SF**	**36,292 SF**

Step 3: Identify Credits for Other Income Levels

A set of ratios are applied to translate the credit for Low Income units from Step 2 into credits for Extremely Low, Very Low and Moderate. Ratios represent the relative cost of providing units by income category based on factors used in the determination of the City's in-lieu fees.

	A.	**B.**	**C.**	**D.**
	Affordability Percentages from In-Lieu Fee Calculation	Ratios based on gap by Income Category	**Floor Area Credited for CLF Payment for each Affordable Unit Provided**	
			Downtown Office	*All Other Uses*
	(% of gap by income level) [1]	=A. / A. for Low	= B X Credit for Low Income from Step 2	
Extremely Low	N/A [2]	1.68[2]	**25,323 SF**	**60,971 SF**
Very Low	51.16%	1.29	**15,605 SF**	**46,817 SF**
Low	39.53%	1.00	**12,097 SF**	**36,292 SF**
Moderate	9.30%	0.24	**2,903 SF**	**8,710 SF**

(1) Figures are from Step 5 of the in-lieu fee calculation used to identify Adjusted In-Lieu Fees for projects providing at least 5% inclusionary units on-site. Percentages reflect the estimated share of the affordability gap applicable to each income category.
(2) For Extremely Low, no comparable affordability percentage was determined in calculating in-lieu fees. Instead, factors from Appendix Table H-1 of the CLF Feasibility Study are used. The ratio of 1.68 is calculated by dividing the office 2,781 SF credit per unit for Extremely Low by the 1,656 SF office credit per unit for Low Income

Attachment C

SJMC 5.11.050 Commercial Linkage Fee Exceptions

A. The following projects or portions of projects shall not be subject to the requirements of this Chapter because the City has determined that such uses do not create a need or create a minimal need for Affordable Housing:

1. Shelter/hotel supportive housing;
2. Agriculture;
3. Aquaculture; aquaponics, and hydroponics;
4. Stadiums, arenas, performing arts venues, and rehearsal space;
5. Cemetery;
6. Certified farmer's market and neighborhood agriculture;
7. Assembly uses;
8. Commercial vehicle storage;
9. Data center;
10. Day Care;
11. Education and training;
12. Energy generation facility;
13. Mineral extraction;
14. Museums, libraries, parks, playgrounds, community centers public or private;
15. Outdoor vending;
16. Parking;
17. Peaking power plant;
18. Public and quasi-public;
19. Stand-by/backup facilities;
20. Public storage/mini-storage;
21. Utilities/electric power generation;
22. Utilities/power generation;
23. Utility facilities;
24. Wireless communication antenna;
25. A project or the portion of a project that is required to comply with the Inclusionary Housing Ordinance (Chapter 5.08) or the Housing Impact Fee Resolution (Resolution No. 77218 as amended);
26. Any resident-serving non-residential portion of a multi-family rental housing project (including child care, employment, social, and counselling services, and the like) developed by a nonprofit housing provider if the Applicant is receiving financial assistance through a public agency, so long as the multi-family rental housing project is an Affordable Housing project meeting the requirements of state or local law and the project's Affordable Housing obligations are secured by a recorded regulatory agreement, recorded memorandum of agreement, or recorded covenant with a public agency for a minimum period of fifty-five (55) years; and
27. Re-occupancy of square footage in an existing building or structure if there is no change of use

Attachment D

Potential Forgone Commercial Linkage Fee Revenue and Affordable Unit Production from Proposed NetZero and Historic Preservation Credits Commercial Linkage Fee

1. Estimate of CLF Revenue Prior to Credits

Annual Estimate	$6,000,000	Based on historic development over a 15-year period (see D. below)
Four-Year Estimate	$24,000,000	Estimate through proposed 12/31/25 expiration of sustainability credit

B. Estimate of Potential Impact of a 20% NetZero Sustainability Credit

	Estimate of Foregone CLF Revenue (Over Four Years)	Estimate of Foregone Affordable Unit Production (Over Four Years) (1)
If 25% of Projects Use Credit	$1,200,000	7 Units
If 50% of Projects Use Credit	$2,400,000	13 Units
If 75% of Projects Use Credit	$3,600,000	20 Units
If 100% of Projects Use Credit	$4,800,000	26 Units

C. Potential Impact of a 20% Credit for Historic Preservation

Only historic preservation projects that reflect a change of use to a higher CLF fee category or that also addnew commercial would be subject to the CLF and eligible for this potential credit. Since the number of projects of this type is likely limited, the impact of this potential credit on CLF revenue and affordable unit production is likely minor and would depend on the nature of the specific projects that propose to utilize this potential credit (if any).

(1) Estimate uses a cost of $181,460 per affordable unit, consistent with the effective per affordable unit amount used to determine the proposed credits for providing affordable units. It is recognized that the actual per unit contribution will vary and will typically be combined with a variety of other funding sources.

D. Fee Revenue Estimate Based on Historic Development Over 15 Years

Project Type	15-Year Annual Average of Commercial Square Feet Developed (1)	Blended CLF Rate Per Square Foot for Estimate	Revenue Estimate before Credits (Rounded)	CLF Blended Rate Assumption
Office >100,000 SF	*512,190*	$10	$5,100,000	Estimate based on 50/50 weighting of Downtown vs. outside of Downtown CLF rates.
Office 5,000 - 100,000SF	*55,968*	$0	$0	Given $0 fee for initial 50,000 square feet, and annual average of 55,968 square feet, assume mostsquare footage not subject to CLF.
Industrial / R&D >100,000 SF	*62,335*	$2.5	$160,000	Adjusted down from $3 rate assuming some development occurs in areas with $0 fee.
Warehouse	*147,276*	$5	$740,000	$5 rate applies in all areas.
Hotel	*113,488*	$4	$400,000	Adjusted from $5 due to application to net square feet.
Annual Total	891,257		$6,400,000	**Approximately $6 Million/Year on Average**

(1) Per City of San José Staff Report Dated August 21, 2020 Regarding CLF Recommendation. Residential Care was not included in this data and so is excluded for purposes of the revenue estimate. Future development will likely vary from these averages, so figures are considered illustrative only.