



Memorandum

TO: HONORABLE MAYOR
AND CITY COUNCIL

FROM: Nanci Klein
John Ristow
Drew Corbett

SUBJECT: Downtown San José
Office Incentives

DATE: September 9, 2024

Approved

Date

9/19/24

COUNCIL DISTRICTS: 3, 6

RECOMMENDATION

- a) Approve an ordinance amending Chapter 4.76 of Title 4 of the San José Municipal Code to add a new Section 4.76.749 to temporarily exempt from the City's Business Tax new tenants executing leases for office space or new property owners engaging in owner-occupied office uses in the Downtown Business Improvement District when certain requirements are satisfied.
- b) Adopt a resolution amending the Master Parking Rate Schedule to establish a Downtown Office Lease Incentive Parking Program at City-owned and operated facilities and update various parking programs and rates.

SUMMARY AND OUTCOME

This memorandum proposes a Business Tax and Parking Incentive Program to boost Downtown San José's office market. The recommendation includes a two-year Business Tax exemption and free parking for two years for office tenants new to Downtown. These incentives aim to attract new businesses, reduce vacancy rates, and stimulate economic growth.

BACKGROUND

At roughly 11 million square feet, Downtown San José's office market is a key regional job center with a diverse mix of professional services, government agencies, and technology firms anchored by major companies such as Adobe and Zoom. The

presence of these office workers has traditionally stimulated ancillary sectors, including retail, dining, entertainment, hospitality, and meeting spaces. However, Downtown's office market has faced significant challenges in recent years based on a combination of hybrid work policies, shrinking corporate real estate appetites, and increased competition from other office submarkets. As a result, Downtown's office vacancy rate rose from around 12% in early 2019 to 31% in midyear 2024. While this partially reflects additional new office space becoming available, overall office-leasing activity has slowed significantly, deal sizes have shrunk, and sublease availabilities are rising.

While Downtown has made post-pandemic progress in nightlife, housing, and restaurants, its daytime economy remains weak, partly due to fewer office workers. Fewer and smaller office tenants mean fewer workers at desks and, by extension, fewer people walking the streets at lunchtime, running errands, or meeting friends after work. Cell phone data and studies indicate that nighttime and weekend activity Downtown has exceeded 2019 levels; however, weekday activity is still 15% below pre-pandemic numbers.

The Mayor's June Budget Message for Fiscal Year (FY) 2024-2025 as approved by the City Council directed staff to explore strategies to reinvigorate the office sector, including considering targeted incentives. This memorandum proposes a Business Tax and Parking Incentive Program designed to address these challenges by encouraging new office tenants to lease Downtown office space to increase foot traffic, support additional jobs, and generate tax revenue.

ANALYSIS

How Cities Support Office Leasing

Cities have limited ability to directly impact office leasing decisions, but municipal policies and initiatives can create more favorable environments for overall business activity. Over the last six months, staff met with office brokers and major office tenants to better understand needs and concerns about Downtown. These interviews underscored three strategies to support Downtown leasing: make Downtown consistently safer and cleaner, enhance the "cool factor", and improve the business climate. Of these, a positive perception of safety and cleanliness is the most crucial first step in enabling further leasing or renewal discussions. Without addressing these fundamental issues, attracting and retaining business, regardless of other factors, including incentives, becomes challenging.

To address these needs, City Council designated Downtown Vibrancy as a key part of the Attracting investment in Jobs and Housing City Focus Area¹, supporting enhanced

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<https://www.sanjoseca.gov/home/showpublisheddocument/98918/638212376484130000>

interdepartmental coordination, data tracking, and collaboration along with providing additional resources for this area. The FY 2024-2025 Downtown Action Plan, presented to the Community and Economic Development Committee on June 24, 2024,² focuses multi-departmental resources within four functional domains outlined below.

- **Clean, Safe, and Housed:** Ensure Downtown San José is clean and safe for residents, visitors, and employees while supporting the most vulnerable populations.
- **Public Realm and Activation:** Enhance and activate shared public spaces to support a more consistently positive visitor and resident experience.
- **Arts, Entertainment, and Culture:** Support and grow our cultural anchors in arts, entertainment, and events along with San José State University.
- **Business Development and Investment:** Enhance broker, tenant, and investor engagement through proactive marketing, communications, and strategic incentives.

The FY 2024-2025 Adopted Budget³ contains additional investments in several of these areas, including beautifying Santa Clara Street, enhancing San Pedro Square, cleaning downtown freeway offramps, new marketing initiatives and partnerships, and continuing Downtown events, such as block parties and the holiday ice rink. These initiatives build upon recent investments, including the San José Police Department's Downtown foot patrol, the addition of a new Community Service Officer detail for Downtown, and the San José Downtown Association's Social Impact Team focused on outreach to the unhoused. Staff is engaged in communicating these investments to the commercial real estate community to highlight City leaders' commitment to improving both the perception and reality of Downtown.

Incentives

While safety and cleanliness are essential prerequisites for leasing discussions, financial incentives can play an important supporting role. Incentives can also send a clear message that the agency offering the incentives is committed to fostering a thriving business environment. At the local level⁴, there are two primary types of incentives to consider when it comes to attracting new business: 1) direct financial support and 2) elimination of taxes or fees.

Direct financial support provides immediate funding to businesses to help with expenses, such as capital equipment or other operational or startup needs. The City's Storefronts Grant program is one such example. For several years, the City has funded

² <https://sanjose.legistar.com/gateway.aspx?M=F&ID=8140ab1d-e675-4f3c-a4f1-57ffcf55a54e.pdf>

³ <https://www.sanjoseca.gov/home/showpublisheddocument/111497/638525773679170000>

⁴ The State of California offers several statewide incentive programs for businesses creating jobs in California, including the California Competes Tax Credit program, sales and use tax rebates for manufacturing equipment, and a research and development tax credit program. Economic Development staff regularly communicates such programs to the business community.

grants of \$10,000 and \$15,000 to help small, ground-floor retail businesses citywide improve interior and exterior spaces and fill empty storefronts. This program has resulted in dozens of businesses filling difficult to lease spaces. The FY 2024-2025 Adopted Budget includes⁵ \$650,000 for the Storefronts Grants program, which is enough funding to support roughly 40 grants.

On the other end of the spectrum, eliminating local taxes or fees reduces costs that a business would otherwise pay to the City. This may temporarily result in foregone revenue for the City, but can be offset by the long-term economic benefit of new businesses.

As part of a Downtown office incentive initiative, staff recommends a targeted program to attract new business to Downtown focused on reducing costs in two areas: 1) Business Tax and 2) monthly parking in City-owned lots and garages. Staff recommends the following considerations and criteria for both programs.

Geography: Follow the existing Business Improvement District boundaries for this incentive program. A map of the Business Improvement District boundaries is included in the **Attachment**.

New Business: Focus on attracting new businesses. The programs would be available to office tenants and owner-occupiers new to Downtown. The incentive would not be available for existing businesses in the Downtown that are expanding or relocating to another building within it. Since these incentives target businesses that are not currently contributing to Downtown's tax base, any revenue generated is additional and does not require backfilling through the City's budget.

Program Duration: Set a two-year application window for both programs, from January 1, 2025 to December 31, 2026. This window is long enough to generate interest and participation, but short enough to create a sense of urgency.

Qualifying Uses: Target the following enumerated uses in the Downtown Commercial zoning district (Chapter 20.70, Title 20 of the San José Municipal Code⁶) to define eligible office-using businesses: research and development, business and administrative offices, and financial services. These uses capture the vast majority of Downtown's office tenants.

Threshold Size: Set a minimum threshold lease size of 2,500 square feet to balance the administrative burden of running these programs while ensuring economic impact and still attracting startups. The same threshold will apply to owner-occupiers.

⁵ <https://www.sanjoseca.gov/home/showpublisheddocument/111497/638525773679170000>

⁶ https://library.municode.com/ca/san_jose/codes/code_of_ordinances?nodeId=TIT20ZO_CH20.70DOZO_RE_PT2USAL_20.70.100ALUSPERE

Lessees or Owner-Occupiers: Include both new tenants and new owner-occupiers, ensuring that companies investing in Downtown real estate for office use are eligible, whether they lease or own their spaces.

Additional considerations specific to each incentive type are described below.

Business Tax

As required under Chapter 4.76 of the San José Municipal Code⁷, all companies conducting business in San José must register and obtain a Business Tax Certificate, which is evidence of having paid the City's Business Tax or having qualified for an exemption. Administered by the Finance Department, the tax is calculated on a per-employee basis for operating businesses, with rates varying based on the size of the business⁸. A 90-person office, for instance, pays about \$4,000 per year, while a 500-person operation would pay roughly \$30,000. Exemptions exist for financial hardship and certain business types, such as residential daycare facilities.

Staff recommends a two-year, 100% Business Tax exemption for qualified new office tenants or owner-occupiers in the Downtown. This would make the district more competitive relative to other areas and encourage qualifying businesses to lease office space.

City-Owned Parking

The availability and usage of City-owned parking garages play a key role in supporting Downtown's office market. The City owns garages and parking lots in Downtown San José and offers monthly parking permits at many of them, currently ranging from \$100 to \$125 per permit per month. Office buildings Downtown may offer a limited number of on-site parking spaces for tenants, who often look to supplement their parking needs at nearby City-owned garages and lots and private parking facilities. Some office buildings in Downtown do not have any on-site parking, meaning tenants must satisfy 100% of their parking needs off-site.

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https://library.municode.com/ca/san_jose/codes/code_of_ordinances?nodeId=TIT4REFIBUTA_CH4.76BUTA

⁸ <https://www.sanjoseca.gov/your-government/departments-offices/finance/business-tax-registration/business-tax-rates>

Regarding the four parking garages included in the Downtown incentive program (Market Street, Second and San Carlos Street, Third Street, and Fourth San Fernando Streets), the average daily peak parking occupancy was around 40% during FY 2023-2024. Based on current parking demand trends, the Department of Transportation does not anticipate a significant increase in Downtown parking occupancy in the foreseeable future.

In response to periods of high office vacancy, the City Council has implemented parking incentives to support leasing activity, most recently in 2010. The new parking incentive program would offer free parking for up to two years. After the two years free, tenants could continue to pay for parking at the then-current market rate. The major recommended provisions are outlined below.

- **Discount:** Free parking for two years with a minimum four-year lease or, in the case of owner-occupiers, a minimum four-year occupancy commitment.
- **Parking Permits per Tenant:** No more than two parking permits per 1,000 square feet of gross leasable area of office space occupied.
- **Garages:** “Global” parking permit access to Market Street, Second and San Carlos Streets, Third Street, and Fourth and San Fernando Streets garages. This provides flexibility for permit holders and simplifies City implementation.
- **Available Passes in Program:** A maximum of 500 passes available under the program, better setting parameters for revenue management, and supporting a sense of urgency within the commercial real estate market.

By offering up to two years of free parking, the City directly lowers significant overhead costs for qualifying new office tenants, making Downtown a more financially viable option for tenants in a competitive office market. Providing additional, flexible parking options also solves a “pain point” for prospective tenants in Downtown, supporting employee recruitment efforts. At the same time, the program develops a pipeline of future paying customers for the City-owned garages once the free period ends, as businesses may sign up for monthly passes at the full cost.

Modeling Impact

The table below summarizes the potential value of eliminating Business Tax and parking costs over two years for three businesses of different size points.

Example A – small	Example B – medium	Example C – large
<ul style="list-style-type: none"> 6,500 sq. ft. tenant, estimated 43 employees, four-year lease, 13 parking permits. Business Tax exemption for first two years of lease. Free parking for two years. 	<ul style="list-style-type: none"> 20,000 sq. ft. tenant, estimated 130 employees, four-year lease, 40 parking permits. Business Tax exemption for first two years of lease. Free parking for two years. 	<ul style="list-style-type: none"> 100,000 sq. ft. tenant, estimated 667 employees, four-year lease, 200 parking permits. Business Tax exemption for first two years of lease. Free parking for two years.
<ul style="list-style-type: none"> Business Tax Incentive to business: \$3,600 Parking Incentive to business: \$31,200 	<ul style="list-style-type: none"> Business Tax Incentive to Business: \$12,634 Parking Incentive to business: \$96,000 	<ul style="list-style-type: none"> Business Tax Incentive to business: \$81,300 Parking Incentive to Business: \$480,000

The table shows how the Downtown Office Leasing Incentive Program offers substantial benefits across different business sizes. For smaller tenants, the Business Tax exemptions and parking incentives can significantly reduce operating costs, making Downtown a more appealing choice. As the size of the tenant increases, so do the savings. A larger tenant, for example, could benefit from over \$81,000 in Business Tax exemptions and nearly \$500,000 in parking incentives over the lease term. This demonstrates that the program is designed to be flexible and supportive for companies of varying sizes.

Implementing the proposed Business Tax and parking incentives for Downtown San José would result in some foregone revenue for the City. Still, the exact amount is difficult to estimate and depends on the market's utilization of the program. Based on recent leasing data, the potential uptake of both programs in Downtown San José could be moderate, with room for growth as market conditions improve and as City staff and brokers partner to market the incentive to prospective tenants. Roughly 22 new Downtown office leases of 2,500 square feet or larger were recorded by Cushman & Wakefield since July 1, 2023, with no lease larger than 36,000 square feet.

Given current leasing trends, it is reasonable to expect 20 to 30 qualifying leases per year. Conservatively, 20 leases per year averaging 10,000 square feet would cover 400,000 square feet and add 2,600 employees, resulting in approximately \$120,000 in foregone Business Tax over the two years. Optimistically, 30 leases averaging 12,500 square feet would cover 750,000 square feet, add 5,000 employees, and result in \$220,000 in foregone Business Tax over the two years. Both scenarios would fully utilize the available parking passes, valued at \$1.2 million over the two years.

Exempting a taxpayer from the Business Tax will also exempt them from paying into the Downtown Business Improvement District. This is expected to result in foregone revenue for the Downtown Business Improvement District in the range of approximately \$26,000 to \$48,000 per year, until those businesses convert into paying Downtown Business Improvement District members at the conclusion of the free period.

While these projections represent an attempt to model based on recent activity levels, it is important to consider the potential impact of securing a new, large-scale tenant. Downtown that has several move-in-ready options for a major headquarters relocation, including 488 Almaden Boulevard (390,000 square feet) and 200 Park Avenue (one million square feet). Leases fully occupying these opportunities would likely result in foregone Business Tax that reaches the cap (currently approximately \$181,000) and quicker exhaustion of the available parking permits.

While the incentive program would result in some foregone revenue, the presence of additional office workers would generate economic activity that supports ancillary businesses, which in turn drives City revenues. An exact accounting is difficult, but professional and technology workers have a high job-creation impact, with each job attracted within these sectors creating an additional job in the region. Office workers also spend money – historically, an average of \$195 per week on goods and services within the vicinity of their office building, according to a 2012 study from the International Council of Shopping Centers. Even just two-thirds of that level of spending would result in more than \$17 million in new spending in Downtown, using the conservative estimate of job creation cited above. Also, once the free period ends, businesses staying through the end of their lease term would begin paying the Business Tax and are likely to convert into paid-parking customers.

Existing Office Tenants and Renewals

While this program primarily focuses on attracting new businesses, it is crucial to recognize the significant turnover risk Downtown faces with existing office tenants over the next 12 to 18 months. Securing these tenants' continued presence is just as important as bringing in new ones. The FY 2024-2025 Downtown Action Plan referenced earlier is designed to improve the overall quality of life in the area, making it a more appealing place for employees to commute to, spend time in after work, and ultimately stay for the long term. Enhancements like these not only support employee attraction and retention, but also make Downtown a more vibrant and desirable business district.

It is important to note that attracting new businesses goes beyond filling vacant office space. The influx of new office workers would create a positive feedback loop, stimulating the local economy and benefiting all Downtown occupants – office workers, retail businesses, residents, and visitors. To support this, staff actively engage with Downtown's top 20 existing employers to highlight the City's current and upcoming

investments and improvements, reinforcing the commitment to making Downtown an attractive place to do business.

Next Steps

To maximize the impact of the Downtown Office Leasing Incentive Program, the City Manager's Office of Economic Development and Cultural Affairs staff will implement a targeted marketing and outreach strategy. This will involve actively engaging with commercial real estate brokers, developers, and potential tenants through a series of presentations and direct outreach efforts. Staff will collaborate closely with industry associations and local business groups to ensure that the incentives are well-publicized and understood by key decision makers. Additionally, staff will develop tailored marketing materials, including brochures and digital content, to highlight the benefits of relocating to Downtown San José.

To implement the Business Tax exemption for new tenants, the Finance Department staff would create a new Business Tax registration form and a new exemption form that eligible businesses would complete and submit for review and approval. Once the applicant is approved for the Business Tax incentive and requests parking, as outlined in the Downtown Office Lease Incentive Parking Program, the Department of Transportation would execute a parking agreement as authorized in the Master Parking Rate Schedule.

It is important to note that the eventual beneficiaries of the incentive program would need to go through a formal approval process under state law if the value of the incentive meets or exceeds \$100,000. The City Council would review the proposed specific incentive(s) for the business, assess the economic impact, and provide an opportunity for public input before granting approval. Any proposed incentive for a specific business meeting this criteria must be disclosed at least 28 days prior to the public hearing date. An outline of the incentive as well as the estimated economic impact, including jobs created, for all approved incentives would be posted on the City's website.

Policy Alternatives

Alternative #1: Business Tax Incentive Only

Pros: Reduces the impact on the City's revenue compared to offering both Business Tax and parking incentives. It would be easier to implement the Business Tax Incentive compared to a dual-incentive program.

Cons: Less attractive to businesses that also need parking solutions, potentially limiting the overall effectiveness.

Reason for not recommending: While less costly in terms of foregone revenue, this alternative may not be sufficient to reduce vacancy rates or drive tenant interest.

Alternative #2: Parking Incentive Only

Pros: Focuses on reducing costs associated with parking, a significant expense for many businesses; easier to implement than a dual-incentive program.

Cons: Limited in scope, potentially attracting fewer businesses overall, including those who do not need a parking solution.

Reason for not recommending: Lacks the comprehensive appeal of addressing both Business Tax and parking costs.

EVALUATION AND FOLLOW-UP

An update on the program will be brought to Community and Economic Development Committee as part of the annual Downtown Progress Report in June 2025.

COST SUMMARY/IMPLICATIONS

As described above, the potential foregone revenue impact from the Business Tax Incentive Program could range from approximately \$120,000 to \$220,000 in the General Fund and from the Parking Incentive Program up to \$1.2 million in the General Purpose Parking Fund if all 500 permits available under the program were allocated. However, because these potential revenues would be from new businesses in the Downtown area that are not currently paying taxes or fees, they have not been assumed in the development of the annual budget and program implementation would not have any immediate budgetary impact.

COORDINATION

This memorandum was coordinated with the City Attorney's Office and City Manager's Budget Office.

PUBLIC OUTREACH

This memorandum will be posted on the City's Council Agenda website for the October 1, 2024 City Council meeting. In addition to the agenda posting, staff has briefed members of the commercial real estate community who are active in Downtown, the San José Chamber of Commerce, and the San José Downtown Association.

COMMISSION RECOMMENDATION AND INPUT

No commission recommendation or input is associated with this action.

CEQA

Not a Project, File No. PP17-008, General Procedure and Policy Making resulting in no changes to the physical environment.

PUBLIC SUBSIDY REPORTING

This item itself does not include a public subsidy as defined in section 53083 or 53083.1 of the California Government Code, nor the City's Open Government Resolution.

/s/
Nanci Klein
Director of Economic Development
and Cultural Affairs

/s/
John Ristow
Director of Transportation

/s/
Drew Corbett
Acting Director of Finance

For questions, please contact Nathan Donato-Weinstein, Assistant to the City Manager, at Nathan.Donato-Weinstein@sanjoseca.gov or (408) 535-8178.

ATTACHMENT

Attachment: Map of the BID Boundaries 2024

[illegible]

 Business Improvement District

BID Boundaries 2024

