

Memorandum



# Memorandum

**TO:** HONORABLE MAYOR  
AND CITY COUNCIL

**FROM:** Nanci Klein  
Jacky Morales-Ferrand

**SUBJECT:** SEE BELOW

**DATE:** September 26, 2022

Approved

Date

9/26/22

**COUNCIL DISTRICT: 3**

**SUBJECT: PUBLIC HEARING AND APPROVAL OF A DOWNTOWN HIGH-RISE  
RESIDENTIAL TAX AND FEE WAIVER FOR SCAPE AT 10 EAST  
REED STREET**

## RECOMMENDATION

Conduct a public hearing to approve an economic development tax and fee waiver in connection with a reduction in construction taxes and a potential reduction of the Inclusionary Housing Ordinance in lieu fee for a downtown residential high-rise at 10 East Reed Street in the amount of up to \$9,856,585 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 tax and fee waiver in the amount of \$9,856,585 in conjunction with the Downtown High-Rise Residential Program and the Inclusionary Housing Ordinance (IHO) Downtown High-Rise Term Limited In Lieu Fee Reduction for the project at 10 East Reed Street in downtown San José (Scape). The program includes the reduction to a zero in lieu fee for qualifying downtown high-rise projects that obtain a building permit before June 30, 2023, and a certificate of occupancy for 80% of the residential units before June 30, 2025, as approved by City Council in November 2019 and August 2020.

## **BACKGROUND**

The number of residents in downtown continues to be critical to support increased transit investment, diversification of retail, place-making, and the generation of more jobs in the City's core. With these objectives in mind, the City Council approved tax and fee reduction programs for high-rise residential development in 2007, in 2012, and again in 2016. These programs resulted in the construction of 2,412 units. This goal continues with even more importance as the City is recovering from the impacts of the COVID-19 pandemic.

On November 5, 2019, City Council accepted a Downtown High-Rise Feasibility Assessment that demonstrated a typical high-rise residential development in downtown San José is not financially feasible. The City Council adopted a resolution to extend the deadline of the Affordable Housing Impact Fee transition period for downtown residential high-rise development in the Downtown Core to June 30, 2025, and approved an ordinance creating a temporary 50% reduction of the construction taxes for residential high-rise development in the Downtown Planned Growth Area. City Council also directed staff to return with the appropriate resolutions to establish a \$0 IHO in lieu fee for downtown high-rise projects in addition to those projects included in the Affordable Housing Impact Fee transition program (\$0 fee for high-rise).

On August 18, 2020, City Council adopted a resolution to set the IHO in lieu to \$0 and gradually increase to the full fee amount over a five-year period for downtown high-rise rental and for-sale projects in the Downtown Core. To qualify for the \$0 in lieu fee, a project must obtain a building permit by June 30, 2023, and obtain a certificate of occupancy by June 30, 2025.

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

On August 24, 2014, 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 website 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 information found in the first table in the Fiscal/Policy Alignment section of this memorandum. California Government 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**

### **Background on Fee and Tax Reduction Programs**

The Downtown High-Rise Residential Program includes affordable housing fees (Affordable Housing Impact Fee or IHO depending on the date of approval), and a 50% reduction of the two most significant construction taxes applied to residential development.

To be eligible for the 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 the 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

Only the residential portion of the building is eligible for the 50% reduction of the B&S and CRMP construction taxes.

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 the reduction to a \$0 IHO in lieu fee a project must:

- Be a 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 and the development has 10 or more floors or stories in height not including any non-residential uses
- Record an Inclusionary Housing Agreement prior to issuance of a building permit
- Obtain a building permit prior to June 30, 2023
- Receive final certificate of occupancy for 80% of dwelling units on or prior to June 30, 2025

City Council approved the current Downtown High-Rise Residential Program in 2019 after receiving a feasibility study conducted by an economic consultant, Strategic Economics. The study demonstrated the difficult development conditions downtown for high-rise residential development at that time. The report can be found [here](#).

### Future of Residential High-Rise Program

Staff released a draft updated feasibility analysis for high-rise residential development included as a part of the update to the Report on the Cost of Residential Development. Based on the results of this work, staff plan to make recommendations to the City Council in fall 2022.

### Project Description

Scape is a 358,333 square feet, 23-story, high-rise residential tower on a 0.42-acre site at 10 East Reed Street (formerly known as Garden Gate at 600 South 1<sup>st</sup> Street). The tower contains 336 market-rate rental units, parking for 104 vehicles, and 5,323 square feet of ground-floor retail. The 23-story project includes three levels of below-grade parking and amenities on the second floor and roof level. There is a mix of studio, one-bedroom, and two-bedroom residential units. Renderings of the project are in the attached Appendix A. The project is located in both the Downtown Core and the Downtown Planned Growth Area, and meets the height and size requirements cited above for both programs. The project must also comply with its affordable housing compliance plan and record an Inclusionary Housing Agreement against the site memorializing the requirements under the IHO Downtown High-Rise Term Limited In Lieu Fee Reduction prior to building permit issuance. City staff will also execute a Project Completion Agreement to ensure the additional requirements of the tax reduction are met.

### Construction Taxes

The City's construction taxes include the B&S and the 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 or the developer's stated construction 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%. The B&S tax rate on commercial construction valuation is 1.5%, and the CRMP tax rate on commercial building construction valuation is 3%. 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 \$1,060,490, inclusive of the 50% reduction (\$1,012,585) for

the residential portion and full payment of retail portion of the building. The City will receive \$1,116,355 in total construction tax revenue, accounting for all construction taxes.<sup>1</sup>

### IHO

The IHO was adopted to require all residential developers constructing new or modified rental or for sale residential units to comply with a base requirement of 15% on-site affordable housing within the development. The original IHO allowed developers to pay a fee in lieu of constructing affordable housing. The IHO in lieu fee methodology that Scape is obligated to is based on the per unit calculation. The current fiscal year fee is \$132,000/unit. The projected total IHO in lieu fee for this project is \$8,844,000.

### Commercial Linkage Fee

The project is not subject to a fee under the Commercial Linkage Fee Ordinance as the planned commercial component is less than 50,000 square feet and is planned as retail.

### Proposed Tax and Fee Waiver

IHO in lieu Fee	\$8,844,000
50% reduction of B&S and CRMP Construction Taxes on the residential portion of the building	\$1,012,585
Total Tax and Fee Waiver	\$9,856,585

### CONCLUSION

A public hearing for Scape project, located at 10 East Reed Street, will be conducted as required under City and state law for the approval of the combined tax and fee waiver in the amount of up to \$9,856,585 in conjunction with the Downtown High-Rise Residential Tax Waiver and IHO Downtown Residential High-Rise Programs.

### EVALUATION AND FOLLOW-UP

City staff will execute a Project Completion Agreement with Scape San Jose, LLC, as required under San José Municipal Code Sections 4.46.039.11 and 4.47.089, and will monitor project construction to ensure requirements of the Downtown High-Rise Residential Program and the IHO Downtown High-Rise Term Limited In Lieu Fee Reduction are completed prior to the

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<sup>1</sup> This includes the “[Construction Tax](#),” the “[Residential Construction Tax](#).”

sunset date of June 30, 2025. The project must still comply with the affordable housing compliance plan and record an Inclusionary Housing Agreement against the site prior to building permit issuance.

### **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 25, 2022 City Council meeting agenda.

### **COORDINATION**

This memorandum has been coordinated with the City Attorney's Office, the Department of Planning Building, and Code Enforcement, the Department of Parks, Recreation and Neighborhood Service, 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:
    - Construction Taxes: \$1,116,355
    - Parkland In-Lieu Fees: \$4,905,600
- Total one-time revenue: \$6,021,955**

- Estimated recurring annual revenue to the City:
    - Property Tax: \$233,100
    - Business Tax: \$7,736
    - Sales and Transaction Tax: \$5,323
    - Utility User Tax: \$119,225
- Total recurring annual revenue: \$365,384**

The City receives 14% of one percent of assessed property value as property tax. The County of Santa Clara receives 18% of the property tax distribution (estimated at \$299,700). The corresponding school district (San José Unified School District) receives 44% of the property tax distribution (estimated at \$732,600). In addition, the corresponding school district will collect a fee of \$0.78/square foot for the commercial/retail space and \$4.79/square foot for residential.

The City 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 provided based on average usage data provided by the Environmental Services Department. Actual revenue may vary depending on usage.

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

<b>i. Accountability</b>	The Downtown High-Rise Residential Program suspends 50% of construction taxes for eligible developments and allows for payment of taxes to be delayed until the scheduling of the final inspection for the certificate of occupancy. The IHO Downtown High-Rise Term Limited In Lieu Fee Reduction provides a reduction to \$0 to the IHO in lieu fee for projects meeting certain conditions.
<b>ii. Net fiscal impact</b>	The project is estimated to generate one-time revenue of \$6,021,955 (Construction Taxes: \$1,116,355, and Parkland in-lieu fees: \$4,905,600) and recurring annual revenue of \$365,384 (Property Tax: \$233,100, Business Tax: \$7,736, Sales and Transaction Tax: \$5,323, and Utility User Tax: \$119,225) to the City of San José. The construction tax revenue gained on this project is \$1,116,355. The construction tax revenue forgone is \$1,012,585. The IHO in lieu fee revenue forgone is \$8,844,000.



<b>iii. Net job impact</b>	Based on estimates from the developer, the project will create approximately 240 full-time construction jobs. All of these construction jobs will generate an annual salary above \$80,000 and receive health insurance.
<b>iv. Housing impact</b>	This project will deliver 336 new market-rate (above 120% of Area Median Income) housing units (739 estimated residents) to downtown. Based on the reported net job impact above, no new ELI (Extremely Low Income) housing units would be required for employees hired to implement the project.
<b>v. Source of funds</b>	The programs do not provide funds directly to the project. It is a suspension of 50% of construction taxes, and a reduction to \$0 of the IHO in lieu fee. The project is estimated to generate one-time revenue of \$6,021,955 across multiple funds, and recurring annual revenue of \$365,384 to the City of San José.
<b>vi. Neighborhood impacts</b>	No significant impacts are anticipated on traffic or public infrastructure.

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

<b>i. Name/address of benefiting business entity</b>	Scape San Jose, LLC 88 Black Falcon Ave., Suite 301 Boston, MA 02210
<b>ii. Start and end dates for the subsidy</b>	Projects will become eligible for the subsidy per the current Downtown High-Rise Residential Program and IHO Downtown High-Rise Term Limited In Lieu Fee Reduction after the issuance of building permits prior to June 30, 2023, and receipt of Certificates of Occupancy prior to June 30, 2025. The subsidy will become finalized upon payment of fees, prior to the sunset date of the programs, subject to conditions therein.

<b>iii. Description of the subsidy, estimated total amount of expenditure of public funds or revenue lost</b>	<p>The City shall suspend 50% of construction taxes on the high-rise constructed at 10 East Reed 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 a reduction to \$0 in the IHO in lieu fee. The estimated economic development subsidy is \$9,856,585</p>
<b>iv. Statement of public purpose</b>	<p>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 José. 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 for the City of San José.</p>
<b>v. Projected tax revenue</b>	<p>The project is estimated to generate one-time revenue of \$6,021,955 (Construction Taxes: \$1,116,355, and Parkland in-lieu fees: \$4,905,600) and recurring annual revenue of \$365,384 (Property Tax: \$233,100, Business Tax: \$7,736, Sales and Transaction Tax: \$5,323, and Utility User Tax: \$119,225) to the City of San José.</p>
<b>vi. Estimated number of jobs created, broken down by full time, part-time and temporary positions</b>	<p>Based on estimates from the developer, the project will create approximately 240 full-time construction jobs. All of these construction jobs will generate an annual salary above \$80,000 and receive health insurance.</p>

HONORABLE MAYOR AND CITY COUNCIL

September 26, 2022

**Subject: Approval of a Downtown High-Rise Residential Tax and Fee Waiver for Scape at 10 East Reed Street**

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**CEQA**

Determination of Consistency with Downtown Strategy 2040 Final Environmental Impact Report, as supplemented and addenda thereto, Planning File Nos. SP18-001 and SPA18-001-01.

/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](mailto:jerad.ferguson@sanjoseca.gov).

**Attachments:**

Appendix A: Project Renderings

## Appendix A: Project Renderings



NORTHEAST PERSPECTIVE FROM E. REED STREET AND S. SECOND STREET



STREET PERSPECTIVE LOOKING ACROSS E. REED STREET AT RESIDENTIAL LOBBY ENTRANCE