CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: HONORABLE MAYOR AND CITY COUNCIL

FROM: Councilmember Raul Peralez

SUBJECT: Downtown High Rise Incentive

DATE: September 23, 2019

Approved by:

Date: 9/23/19

RECOMMENDATION

Accept staff recommendation with the following modifications:

1. Accept Strategic Economics' feasibility analysis for all projects except those under the subcategories of:
    a. Co-living as defined by our municipal code[1]
    b. Parking ratios, defined by planning permits, that are below Strategic Economics' prototype ratio of 0.8 parking spaces per dwelling units.[2]

2. Projects under subcategories 1(a) or 1(b) that choose to opt in to the extended Downtown High Rise Incentive and AHIF Downtown High-Rise Exemption programs shall be subjected to the Private Development Workforce Standards.

3. Should staff or anyone wish to exempt subcategories 1(a) or 1(b) from the Private Development Workforce Standards then further analysis by a third party would need to be conducted in accordance with the Private Development Workforce Standards policy to determine the subcategory's feasibility.

---

[1] SJMC 14.10.100 (C): A specified use as defined in Title 20 of the San Jose Municipal Code

[2] SJMC 14.10.100 (B): A specified building typology

BACKGROUND

Since taking office, I have been supportive of finding a balance between incentivizing much needed new housing and achieving additional resources through parks, construction and affordable housing fees. We are in a housing crisis and bringing residential units, both market rate and affordable housing, is key to leveling out the high demand and low supply dynamic that has exacerbated our affordability crisis. Our general plan has allocated high density into our downtown, paving the way in the next four years could be 3,740 residential high-rise units, 890 of those units are already under construction. Unlike most other downtown environments, we are uniquely constrained by a high water table from below and by airplanes from above. The remaining 2,850 units are stalled, dependent on a variety of factors including the overall cost of development. I have also been supportive of ensuring that any fee reductions or incentives are not only beneficial to developers but that they should be subjected to our Private Development Workforce Standards, approved in April 2018[3]. In providing any fee reductions or incentives, I oppose exempting projects from the Private Development Workforce Standards unless I can be convinced they would be infeasible. In reviewing Staff's memo and Strategic Economics' report, and after conducting my own further analysis, I came to the recommendations before you today.

ANALYSIS

Co-Living Uses

In February of this year, I along with my council colleagues voted to approve an amendment to Title 20 (The Zoning Ordinance) of the San José Municipal Code to add Co-Living Facilities as a new use in the Downtown. This use will provide a creative avenue to increase our housing stock. At the same time, I am aware that this is a new area of land-use development that is still being explored. As Strategic Economics' report stated, "it is difficult to draw concrete conclusions about the feasibility of co-living developments given the untested nature of the market. It is also not known whether sufficient demand exists to support additional development of this type." I concur with this sentiment that there are still a lot of unknowns regarding this new use. Based on my office's analysis using Strategic Economics' model, the high volume of co-living units and adjusted revenue from rent rates, these projects would be able to achieve feasibility with the Private Development Workforce Standards.

Reduced Parking

The report assumes a conceptual prototype of 0.8 parking spaces per residential unit. In Downtown where we are shifting towards a multimodal future less reliant on the car, there are many opportunities to take dramatic reductions in parking requirements or even have a lower baseline. Per SJMC 20.90.060, the parking requirement for residential uses prior to reductions in downtown is one parking space per residential unit. Co-living for example has a baseline of 0.25 parking spaces per co-living unit. Other projects would be able to take as much as a 50% reduction per SJMC 20.90.220. I am supportive of

[3] https://sanjose.legistar.com/View.ashx?M=F&ID=7556820&GUID=531149BE-5AF0-4B2D-8FDE-CB60275659B9

these policies and agree that lowering our parking ratios will incentivize shifts in everyday mode use.

However, this also consequently means that projects who take these reductions also benefit in savings from the high costs of building parking. The report's conceptual prototype suggests $75,000 per parking space with "mechanical parking stackers having similar average construction cost per space." Using this data point and the Conceptual High Rise Prototype Parking, there are projects that could have up to approximately $24 million in savings from reduced parking.

Conceptual High Rise Prototype Parking

	0.8 Ratio**	**1.0 Ratio**	**0.5 Ratio**
Number of Units	550	550	550
Number of Parking Spaces	440	550	225
Price Per Space	$75,000	$75,000	$75,000
Total	$33,000,000	$41,250,000	$16,875,000
$ Change from 0.8 Ratio		-$8,250,000	-$16,125,000
$ Change from 1.0 Ratio	-$8,250,000		-$24,375,000

***Ratio Used By Strategic Economics*

Comparing the feasibility ratios using the Conceptual High Rise Prototype, a parking reduction will bring the project much closer to penciling out. Based on the chart below, the range indicates there is room for projects with substantial parking reductions to include workforce standards and still be feasible.

Conceptual High Rise Prototype Parking - Project Yield-to-Cost

	(1) No Incentives, No Workforce Standards	**(2) Incentives Only**	**(3) Incentives + Workforce Standards**
Yield-to-Cost at 0.8 Parking Ratio**	4.13%	**4.26%**	3.99%
Yield-to-Cost at 0.5 Parking Ratio	4.38%	4.52%	**4.23%**
Yield-to-Cost at 1.0 Parking Ratio	4.02%	4.14%	3.87%

***Ratio Used By Strategic Economics*

Premium on Workforce Standards

Citing a recent report analyzing state and census data[4], labor advocates have raised concerns about how the premium (denoted at 9% but actually 8.75%)[5] on the Private Development Workforce Standards was calculated. According to that report, construction worker wages and benefits account for 22% of hard costs in the California multi-family construction industry. It is unlikely this figure translates directly over to our unique downtown high rise development, but even if it were a close estimate it would be inconsistent for Mechanical, Electrical, and Plumbing trades (MEP) wages and benefits, which are merely a subset of total construction worker's wages and benefits, to equal 30-40% of overall hard costs. They believe the premium is likely no more than an additional 2.8% overall, much lower than the 8.75% increase calculated by Strategic Economics.

My office used the proposed variance on the premiums for workforce standards with Strategic Economics formula across all of the nine projects. Our calculations show that while there was a delta, the end results still showed that most projects were infeasible based on the project yield-to-cost threshold of 5.25%. However, we did find that projects under the two subcategories of co-living and under-parked projects turned out feasible. Hence why I have asked for those two subcategories to be subjected to the Private Development Workforce Standards or be re-evaluated. For future Private Development Workforce Standards feasibility analyses, staff should provide better insight into all calculations, especially the premium.

CONCLUSION

I am interested in working to find a solution that will allow projects to be more feasible without eliminating the opportunity to generate affordable housing revenue or even better to include affordable units in these projects.

We are seeing affordable housing projects finally opening doors, especially thanks to the voter-approved $950 million Measure A bond. However, we cannot simply rely on bond measures as the only means to generate these dollars as we have seen recently with Measure V, a $450 million bond that failed to pass. Our funding sources for affordable housing must be diverse. We are exploring a Commercial Linkage Fee for developers that would generate the dollars to balance the potential job growth. Fortunately, this work for market-rate housing development has been long approved: first by implementing the AHIF, then followed by the Inclusionary Housing Ordinance (IHO), deemed lawful by the California Supreme Court. We have long exempted Downtown high rises from the equation and while we do not want to halt the momentum of development - the need for affordable housing should continue to be prioritized.

In November, staff is expected to return to council with a discussion on our citywide development fees. That discussion and any future incentive programs should examine a

---

4 Lantsberg, A. (2017) *The Value of Linking Good Construction Jobs to California's Housing Reforms*, SmartCitiesPrevail.org. Retrieved from http://www.smartcitiesprevail.org/wp-content/uploads/2017/03/SCP_HousingReport.0314.pdf

5 The actual figure that is included in the calculation behind the sensitivity analysis table in the report is 8.75% but the written analysis rounds this figure to 9%.

fee structure that prioritizes the creation of more affordable housing, and it should be noted that any reductions of fees will require another feasibility analysis per the Private Development Workforce Standards.