

Land Value Capture Toolkit For San Mateo County Cities

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**COMMUNITY
LEGAL SERVICES**
IN EAST PALO ALTO

WHY LAND VALUE CAPTURE?

Land Value Capture refers to a range of public policy tools through which communities can recover and reinvest benefits from increased land value owing to public investment, private development, and other government actions.

The public sector contributes to rising land values in many ways: through the development of transit services and utilities for new developments, changes to the zoning code, and other incentives to spur development. The underlying principle of land value capture is that public action should accrue public benefits.

San Mateo County is currently undergoing a sustained wave of development, in part due to a strong economy and proximity to the Silicon Valley boom. Cities are facing serious challenges in keeping pace with these new developments, especially with regard to the increased use of public infrastructure, traffic, and rising rents and housing demand resulting from commercial developments. As a result, it is difficult to finance much-needed affordable housing projects, infrastructure repairs and upgrades, and economic development programs at the appropriate levels.

This brief toolkit lays out a series of policy options that local governments in San Mateo County should consider when thinking about how to capture public benefits from rising land values. It is not intended to be a comprehensive guide; rather, it is intended to expand the range of ideas available to local policymakers. After this brainstorming phase we recommend consultations with policy experts, who can help craft policies tailored to a specific city. These policies have taken different forms in the places they have been adopted, as jurisdictions vary with respect to the path of development and the range of solutions that are politically possible. Therefore, we hope this guide will spur creative thinking around these concepts and lead to the adoption of policies that capture and reserve public benefits for the public good.



LAND AND EMPLOYMENT TAXES

One land value capture strategy uses new or fortified tax measures to capture value from new developments and reinvest the proceeds in public benefits. Cities in San Mateo County already employ a diverse mix of tax measures: for example, on residential and commercial rents, business licenses, and gross receipts. A few cities already use “per employee” taxes to capture value from the added strain on the community caused by large numbers of employees, though the rates of such taxes are modest.¹ The advantages of a recurrent tax, compared with the other strategies discussed in this toolkit, is that a tax will continue to generate revenue year after year, which will significantly increase the total value of public benefits that can be captured. There are several varieties of such taxes:

PAYROLL TAXES

While all employers and employees pay Federal Insurance Contribution Act (FICA) taxes in relation to wages paid, a payroll tax in this context would tax employers an additional amount for payroll expenses, payable to local governments. The advantage to such a tax would be that it arguably bears a direct relationship to the impacts a particular employer is having in the local community: as payroll expenses rise, so too does pressure on traffic, rents, housing demand, and public services. Another benefit is that it is a relatively easy figure to calculate, since companies know the costs of their payroll in a given location. However, this tax is vulnerable to counter-arguments that because it specifically targets employment, it provides a disincentive for job creation.² Therefore it may invite critiques by the business community that there are more efficient ways to tax business income, especially if the region experiences a future economic slowdown.

GROSS RECEIPTS TAXES

This tax targets the total gross revenues of a company, regardless of source. One advantage to this tax is that it could be structured as a progressive tax: as companies earn more money, they could pay a higher share in taxes. A gross receipts tax also avoids the potential employment disincentives of a payroll tax. On the other hand, gross receipts taxes may create difficulties for enforcement and collections. A gross receipts tax has to be “apportioned” in a way that fairly captures the economic activity a business conducts in a particular jurisdiction, as opposed to the company’s worldwide earnings. This can be difficult to

estimate if a particular administrative location does not sell products or generate revenue at all. An additional challenge stems from the fact that many jurisdictions prefer to tax gross receipts at different levels by industry.³ If there are differential tax rates based on industry classification, businesses can try to claim exemptions or reduced tax rates by arguing that they fall into one category rather than another. Consider, for example, that a large company like Amazon might claim that it counts as wholesale trade, retail trade, warehousing, professional services, and potentially more. A city needs to be prepared to spend resources for enforcement (and potential litigation) if companies try to evade payment. Finally, a gross receipts tax can present difficulties for cities that house large numbers of start-up companies, which can be well-funded and employ large numbers of people yet not generate actual, taxable revenue for several years.

PER SQUARE FOOT TAXES

A per-square-foot tax is a relatively simple metric that should be roughly proportional to the overall impact a development is causing in a particular community. It is easy to calculate, since cities already have access to the square footage of particular parcels through property tax records. Other jurisdictions that have adopted these taxes have reported compliance rates of over 99%, since they measure a clearly defined value. Cities contemplating this option might consider setting a minimum threshold under which this tax would not apply, to avoid particularly high tax burdens for homeowners or small business owners. Alternatively, a City could specify that this form of taxation only apply to certain industries.

PARCEL TAXES

A parcel tax is a flat tax that is levied on units of property but is not dependent on the value of those units. It is commonly used in California to fund K-12 public education.⁴ If desired, it is possible to create categories of exclusions from this tax to target only specific sizes of parcels. Note that by law, voters must approve a parcel tax by a two-thirds margin, potentially limiting its appeal in divided cities.⁵

A further strategic decision is whether the tax should be general or specific. Under California law, the proceeds raised through a general tax go directly into the general fund of a city, which can spend it any way the City Council

sees fit. This affords maximum flexibility for elected officials to address the City's most pressing problems, even as they change over time. A general tax requires a simple majority of voter approval. In contrast, a specific tax details (at least in a general way) how its proceeds will be allocated in the text of the measure itself. While this limits the flexibility of future City Councils to allocate it, it also may buy trust among voters, who are guaranteed that the tax will in fact benefit the community in tangible ways. The price for this guarantee is that specific taxes require a two-thirds margin of voter approval.

Enacting a sound tax policy requires achieving a balance of four main principles: economic efficiency, administrability/enforceability, stability, and equity.⁶ While it is beyond the

scope of this toolkit to examine these ideas, it is wise to seek economic and equity analyses of a given proposal, especially in the context of a City's already existing taxes and policies.

In November 2018, several cities in Silicon Valley approved new taxes to counter the effects of large technology companies within their boundaries.⁷ East Palo Alto, Mountain View, and San Francisco passed different variations of the ideas presented above, motivated by the recognition that tech companies are exerting outsized pressure on their host cities' housing markets and traffic congestion. These cities were among the first in the nation to adopt such policies specifically in response to a handful of well-known large employers.

LOCAL HIRING POLICIES

Targeted hiring programs began to appear in the 1970s to promote equity in economic development, as policies that prioritized growth-centered business development often did little to promote the inclusion of racial minorities living in urban centers. First Source Hiring (FSH) programs address the spatial aspects of this disparity, where the majority of economic development occurs where a low-income population lives, yet the benefits of the development are highly unequal.

Though the specifics of each FSH policy differ, the basic idea is that an FSH organization acts as an intermediary between low-income job seekers, workforce development providers, and industries with positions to fill. FSH should embody a commitment by a city to develop demand-side labor relationships with employers, provide linkage staff to build these relationships, identify candidates for job placement, and enforce the commitment of businesses to hire low-income workers.⁸



An analysis of successful FSH policies reveals that they share a commitment to four “Rs”: rules, resources, relationships, and reporting:⁹

RULES

FSH policies must have clear statements of expected hiring practices and outcomes, enforcement protocols, and penalties for non-compliance. Language requiring only a “good faith effort” at compliance is a less desirable alternative because it allows opportunities for evasion and presents significant enforcement difficulties.

RESOURCES

FSH policies require an implementation team and at least one paid staff member to coordinate local hiring. That staff member needs to communicate with both employers and local job seekers, and be able to funnel the appropriate candidates to employers. To the extent it is difficult to identify and engage local workers who may be qualified for a given position, the staff member may have to conduct outreach with the local community to make contact with the right people. This is to say that an effective FSH policy cannot exist on paper alone; rather, the city must commit enough resources to make the program a success.

RELATIONSHIPS

Expanding on the previous point, the staff member charged with facilitating the program must develop relationships with local employers, both large and small; community groups, which likely have the strongest relationship with workers; and unions. These relationships are strengthened with the successful and timely placement of job seekers; once companies know they can rely on the program, they will be more likely to buy-in for future hires.

REPORTING

Accurate data is needed to assess the success of the FSH policy, as well as whether the current funding level is sufficient to meet its stated goals. Many FSH policies have suffered from inadequate data collection to track successes and challenges, which would provide a roadmap for course correction down the road.

One difficulty posed by FSH policies that may be relevant to cities in San Mateo County is the possible mismatch between local job seekers and the requirements of a particular employer. A recent case study from East Palo Alto illustrates this point. In February 2017, Amazon, Inc., sought approval from the City Council to move into a large commercial space downtown, a move that would add 1,300 jobs to East Palo Alto, a large increase in the City’s total jobs.¹⁰ Some have surmised that Amazon thought that East Palo Alto residents would not have the skills necessary for the jobs offered in this office. Rather than even attempt to comply with the City’s “good faith requirement” to hire local residents for its new facility, Amazon, in partnership with Sobrato, the property’s developer, instead proposed an alternative plan.

Strategy 2

They offered to fund a local jobs development center at \$1 million over 10 years, in addition to offering a 1,500 sq. ft. space in Amazon's building for the center. The Council approved Amazon's plan after the company implied that it would decline to lease the building without a workaround of the First Source Hiring policy.

This situation illustrates several key points about the effectiveness of a FSH program. First, the very existence of a FSH policy created a situation that forced Amazon to at least consider how it would comply. If East Palo Alto had not had a policy in the first place, it is unlikely the company would have offered to fund the alternative plan. Second, Amazon judged its ability to comply with the City's policy, even under the less binding "good faith" standard, using assumptions about the skills of local residents vis-à-vis the jobs it needed

to fill. An FSH coordinator should communicate the numbers of potential applicants the City might be able to supply through the program, so an employer does not have to make potentially inaccurate assumptions. This also highlights the importance of a match between the size of the job applicant pool and employers' requirements. FSH policies are most effective when the applicant pool is sufficiently large to supply the required jobs; if it is not, it will be very difficult to demand compliance. Finally, this example also demonstrates that a FSH policy is only as good as the political will to enforce it. Just as the policy must be written clearly with strong enforcement and consequences for non-compliance, local leaders must also insist on compliance. If companies know they can escape compliance by proposing alternatives that are ultimately less costly for them, the important goals of a FSH policy can be easily derailed.



COMMUNITY BENEFITS AGREEMENTS

Community Benefits Agreements (CBA) are legally enforceable agreements between a developer and a coalition of community organizations, through which developers voluntarily promise some package of community benefits in exchange for a smoother path to having their project approved.¹¹ Traditionally, the process begins when a developer proposes a large project that stands to affect local residents in a number of ways (e.g. through rent prices, traffic patterns, or displacement), and residents organize to demand that the development actually reap benefits for the local community, rather than only extract profits from it. While residents always have opportunities for participating in the planning process (e.g. by participating at Planning Commission meetings), the CBA process offers a more direct, proactive way for community involvement, since it involves a direct negotiation between the developer and community groups.

A promising environment for a CBA requires buy-in from community groups, the developer, and local government. Local government must resist a promise of automatic project approval, since that would likely destroy the developer's incentive to participate. Likewise, community groups need to be organized and have a specific set of achievable outcomes to guide the negotiation. Finally, the developer needs to have confidence that if it in fact delivers on the policies in the CBA, that the community groups will support the development (or at least not oppose it).

Procedurally, the best time to begin a CBA negotiation is at the beginning of the application process that the developer undergoes to obtain project approval from the City Council. Importantly, that application process requires compliance with the many requirements of the California Environmental Quality Act. If the developer is asked to participate in the CBA process after the project has been approved, the community organizations lose their leverage to drive the negotiations. Developers desire a fast approval process, as the longer they keep a plot of land undeveloped, the more money they lose as they pay large property taxes. Thus a CBA can be a way to speed up the approval of a project and prevent conflicts later in the approval process.

It can be difficult for City Councils to impose direct conditions on individual developments because of the need to prove a connection between the fees and conditions the city wants, and the actual measurable impact that the individual development will have (i.e. a proportionality requirement). In contrast, community organizations within a broad coalition have the freedom to ask for whatever conditions and community benefits they think are appropriate, and the developer can decide if they are willing to comply with these through the negotiation process.

Although every CBA is different, there are some aspects that should generally be included in every written agreement. First, a CBA should be legally enforceable. This can mean a few different things: there can be an independent review board assigned to oversee compliance by both the developer and the coalition; the coalition and developer can each have the ability to enforce each other's commitments through threat of force; or the local government can agree to enforce it. Second, a CBA should have successor's language. This means that the developer currently agreeing to a CBA may sell the land, but the next owner of the land will also be legally required to obey the CBA, guaranteeing that the commitments made in the agreement carry into the future.

Third, the CBA needs to have specific, detailed, and clear language so that the commitments are fully understood by everyone involved and there are no issues with enforcement and follow-through. Vague language in the agreement can result in the developer not actually having to honor the commitments that the community expected because the legal language was not clear enough about exactly what had to be done, how it would be done, and how it would be enforced. There also needs to be a requirement for frequent reporting and the release of information requested by the developer or coalition to check for compliance, as well as clear penalties for violations of the agreement.

Almost any benefit the community desires is possible to request in the CBA process. A few desirable outcomes might include:

- Increased affordable housing requirements
- Affordable housing units for the lowest-income categories
- Contributions to or the creation of an affordable housing fund or land trust
- Creation of an affordable childcare facility
- Creation of youth centers or family clinics
- Local hiring and/or job training programs for community members
- Living wages and safe workplaces for those hired by the developer
- Financial support for local non-profits

CASE STUDY: 2016 CBA Between Facebook and the Envision Transform Build – East Palo Alto (ETB-EPA) Coalition

In 2016, Facebook proposed an expansion of its corporate headquarters in Menlo Park known as the Facebook Campus Expansion Project (TE Project). The TE Project would involve the development of two new office buildings, totaling approximately 960,000 square feet, and an approximately 200-room hotel on a property located in Menlo Park.

ETB-EPA, a long-standing community coalition, began negotiations with Facebook within the context of a potential California Environmental Quality Act (CEQA) challenge to Facebook's project. Upon reviewing Facebook's Draft Environmental Impact Report, ETB-EPA found that it failed to mitigate both the increased demand for affordable housing and the potential displacement impacts of the expansion. Prior to this, the Coalition had been in touch with several organizations regarding potential legal support. The Coalition then engaged in the administrative processes necessary to launch a CEQA challenge. Facebook then reached out to ETB-EPA in order to enter into negotiations. After months of negotiations, the parties reached an agreement, which was formalized into a legally binding CBA.

A few of the basic terms of the CBA partnership include:

CATALYST HOUSING FUND

Facebook and ETB-EPA would create a Catalyst Housing Fund to identify and finance opportunities for the development and preservation of long-term affordable housing in the vicinity of the Facebook campus. Facebook would contribute approximately \$20 million to the fund in exchange for a waiver of the CEQA challenge to the Facebook Expansion Project and a number of other challenges under the Menlo Park General Plan Update.

TENANT ASSISTANCE

Facebook would provide \$500,000 for a tenant assistance fund, to be used for legal assistance to tenants threatened with displacement from evictions, unsafe living conditions, and other forms of landlord abuse.

PIPELINE TRAINING PROGRAM

Facebook would contribute \$625,000 to one or more non-profit organizations to provide training for science, technology, engineering and mathematics (or STEM) to local residents in East Palo Alto and Menlo Park.

COMMUNITY OPPORTUNITY LIAISON

Facebook would create the position of a Community Opportunity Liaison who would work to build relationships to facilitate employment of qualified local workers with Facebook and its vendors.



COMMERCIAL LINKAGE FEES

For years San Mateo County has suffered from a widening gap between the numbers of newly created jobs and the stock of available housing. While a strong economy has added prosperity to the region, this imbalance has put pressure on the housing market, which cannot absorb the heightened demand. This mismatch falls most heavily on low- and moderate-earners, who see the biggest difference between their wages and the availability of housing they can afford. Because the majority of new jobs created in San Mateo County in the next decade will be low- and middle-wage, those workers will continue to contribute to need affordable housing options.

A Commercial Linkage Fee, sometimes known as a Jobs Linkage Fee, is a per-square-foot fee assessed to new, non-residential construction to address the affordable housing demand created by new jobs.¹² Several cities in the County are already using this tool.¹³ While it provides a relatively straightforward and well-tested mechanism for cities to extract concessions from developers, these fees are only collected once (during the initial development phase), in contrast to the recurrent taxes discussed above.

The Housing Leadership Council of San Mateo County recommends a four-step process for localities considering these fees:

1. **Conduct a nexus study.** This study will examine the relationship between new commercial developments and their projected demand for affordable housing units.¹⁴ A nexus study typically examines different options for fee levels across various industries. For example, some cities impose lower fees on retail spaces (as compared with commercial), to minimize the added costs that could arguably be passed on to consumers. Cities should also have one eye tuned to the future during this process. In addition to considering whether a proposed fee would mitigate the increased demand for housing in the present, they should also forecast whether the fee will adequately address future job growth and housing demand.
2. **Conduct a feasibility analysis.** The flip side of a nexus study is a feasibility analysis that studies the impact of a proposed fee on developers' profits. This analysis, if conducted thoroughly, can counter developers' arguments that a fee would be crippling to their profit margin.
3. **Consider implementation and administrative issues.** There are various policy details that should be ironed out prior to implementation. For example:
 - How will the fees be used?
 - Will the city allow developers alternatives to paying the linkage fees, including the option to build a specific percentage of on-site or off-site affordable housing units?
 - Should different fees be assessed for different types of development, given that industries have different standards for employee density, and this density influences the demand for city services?
 - Should the fee be adjusted annually or indexed to inflation or some other growth standard?
4. **Adopt an ordinance with the appropriate fee.** Upon passage, cities may need to establish an Affordable Housing Fund to collect and disburse the fees. There are various options for how this Fund can be structured and managed, as well as the items on which its funds can be spent.

INCENTIVE ZONING PROGRAMS

Incentive Zoning refers to a collection of strategies that offer developers voluntary “bonuses” or incentives in exchange for building or otherwise making contributions to public benefits for the community. The types of incentives that can be offered to developers can vary widely, from increased density, height, or floor area ratio, to an expedited permitting process and waived impact fees.¹⁵ Similarly, the list of benefits received by the community can vary widely (see Strategy 3 above), though it is most common to require the construction of affordable housing units or funds that will be used for that purpose.



The benefit of incentive zoning is that it is voluntary: instead of a firm requirement that a developer make concessions to the public, it allows the developer to carefully weigh its options and choose a level of bonus/community benefits suitable for them. Thus, this system may avoid potential counterarguments about burdensome government regulation that hinders new development.

Greenbelt Alliance has identified five key considerations for policymakers approaching this issue:

1. **Geographic Target.** While incentive zoning programs can apply to an entire city, they can also be narrowly tailored to a specific neighborhood or corridor where the city wants to encourage development. A city will need to decide on which sectors the incentive zone applies.
2. **Public Benefits.** The City should take care to identify a list of public benefits that is suggested and approved by the community. As with the CBA approach, it is best to solicit direct community input about these goals

through participatory meetings, outreach sessions, and/or surveys and polls. Adopting an inclusive and robust feedback process from the beginning will build public trust that the outcomes received through this program match the desires of the community.

Also like the CBA approach, the city can propose a variety of creative options for public benefits: affordable housing, transit improvements, art and community facilities, legal defense for tenants facing eviction, parks and open space, living wage requirements for building contractors, etc. The city should take this opportunity to ensure that any developments approved under incentive zoning reflect the true values of the community in some way.

3. **Bonuses.** The city must also decide which “carrots” to offer to developers. Common bonuses include an increased intensity of use, in the form of an increased maximum floor area ratio, or an expedited permitting process. To be effective, the bonuses offered will match what the market will support. For example, added density benefits promised to the developer have to make sense in the context of where a developer thinks it is financially feasible to build higher. If this is not the case, developers will have little incentive to take advantage of the bonuses.
4. **Balancing Benefits and Bonuses.** Many cities have used a third-party analysis to determine the “sweet spot” between the bonuses promised to developers and the benefits extracted by the community. These studies estimate the projected increase in land value that would result from higher density, as well as quantifying how that increased value would impact developers’ return on investment. Some cities, such as San Francisco, present a “menu” of different levels of incentives/bonuses, so developers can choose the appropriate level of buy-in that make sense in their situation. Such programs offer graduated levels of higher density bonuses in exchange for higher guarantees of affordable housing.¹⁶ In addition, some cities explicitly reserve the right to change the benefits required as time goes on, choosing to gain developers’ opt-in at the beginning before deciding whether to increase requirements.

Note that in order for this program to be successful, there must be a significant delta between the

permissiveness of the underlying zoning and the enhanced incentive zoning. For example, if the underlying zoning is very permissive with regard to density and height requirements, developers will see little incentive to participate in the program. Rather, to make the incentive worthwhile, developers must clearly see the benefits to which they would otherwise not be entitled through the normal zoning procedures.

- 5. **Implementation.** Local governments need to implement a policy that provides clear guidance to developers, so that they can easily perform their own cost-benefit analyses about whether to participate in

the program. Many localities aim to employ a simple formula to calculate the benefits required for a given bonus.¹⁷ Care should be given to how the program will evolve as economic conditions change: what is the mechanism for increasing or decreasing the bonus formula, and which events will trigger its re-examination? Should the formula be linked to inflation in some way? How will success be measured over time? These questions will help with the creation of a strong yet flexible system that can be updated if conditions on the ground change down the road.



Founded in East Palo Alto, Community Legal Services in East Palo Alto’s mission is to provide transformative legal services that enable diverse communities in East Palo Alto and beyond to achieve a secure and thriving future. We specialize in immigration, housing, workers’ rights, and criminal records clearance. We work alongside low-income communities and partner with community-based organizations, churches, and schools to bring about long-term change.

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ENDNOTES

- ¹ For example, the City of Menlo Park uses a fixed tax per range of employees a company employs in that city, ranging from a \$50 tax for companies with 1-5 employees to a \$1,250 tax for companies that employ over 200 employees. Thus, a large company like Facebook likely pays the City \$1,250 under this particular tax.
- ² It is widely believed that similar criticisms of San Francisco's payroll tax, which had existed for decades, prompted voters in that city to approve a gradual switch to a gross receipts tax in 2012 (Proposition E, November 2012).
- ³ Many refer to the North American Industry Classification System (NAICS) to make these classifications.
- ⁴ See Sonstelie, Jon, *Parcel Taxes as a Local Revenue Source in California*, Public Policy Institute of California, April 2015.
- ⁵ California Proposition 218 (1996). This is true whether the parcel tax is general or specific.
- ⁶ For an example of how these factors are used to analyze a tax proposal, see *Improving San Francisco's Business Tax: An Analysis of Two Alternatives*, Office of Economic Analysis, San Francisco, May 2010.
- ⁷ See Sean Captain, Fast Company, *Silicon Valley Voters Just Demanded That Tech Companies Be Responsible For Their Communities*, November 7, 2018. For more information, see East Palo Alto's Measure HH (2018), Mountain View's Measure P (2018), and San Francisco's Proposition C (2018).
- ⁸ Douthat, Thomas and Leigh, Nancy, *First Source Hiring: An Essential Tool for Linking the Poor to Employment or a "Dead Letter" Progressive Policy?*, *Urban Affairs Review*, p. 3 (2016).
- ⁹ *Id.*, pp. 9-12.
- ¹⁰ Dremann, Sue, *East Palo Alto Changes First Source Hiring Rule to Accommodate Amazon*, Palo Alto Weekly, March 22, 2017.
- ¹¹ This section draws from *Development with the Community: A Toolkit for Community Organizers* (2017), prepared by Faith in Action Bay Area, Youth United for Community Action, and Community Legal Services in East Palo Alto. It also draws from the research of Julian Gross, Benjamin Beach, and the Partnership for Working Families.
- ¹² Housing Leadership Council of San Mateo County, *Commercial Linkage Fees: A Guide for San Mateo County*.
- ¹³ For example, see Urban Displacement's map of anti-displacement policy measures in different Bay Area cities, available at: <http://www.urbandisplacement.org/policy-tools/sf#>.
- ¹⁴ This can also be studied on the county level. For example, see 21 Elements, *The Grand Nexus Study: A Collaborative Effort to Study Residential and Commercial Impact Fees to Support Affordable Housing in San Mateo County*, March 2016.
- ¹⁵ This section draws from Chris Schildt, *Public Benefit Bonus Policy Brief*, Greenbelt Alliance, November 2012.
- ¹⁶ See *Affordable Housing Bonus Program Fact Sheet*, City and County of San Francisco.
- ¹⁷ See the Greenbelt Alliance memo, *supra* endnote 15, for examples of how different cities have phrased their ordinances.