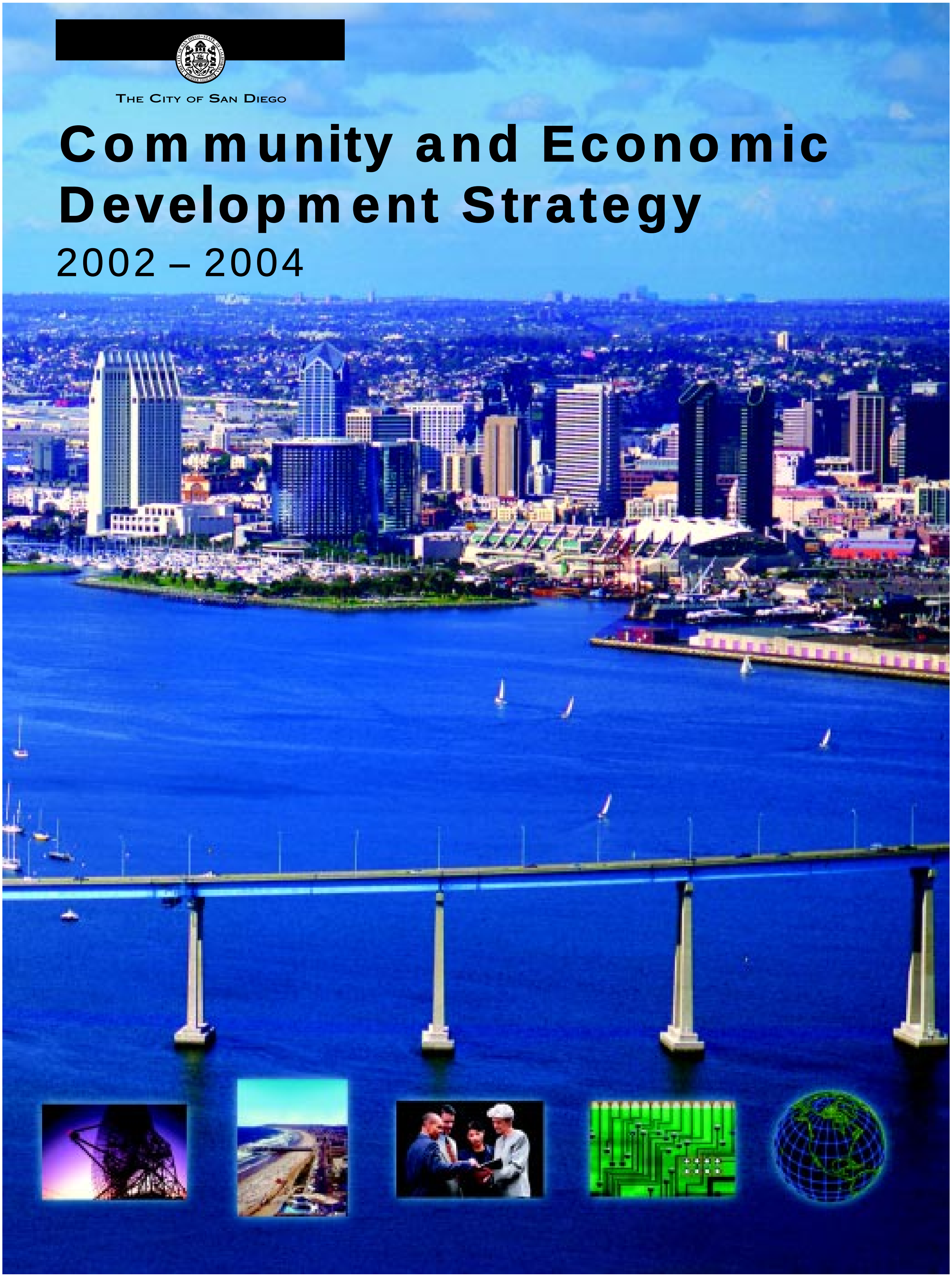
The City of San Diego

Community and Economic Development Strategy

2002 – 2004



EXECUTIVE SUMMARY

COMMUNITY AND ECONOMIC DEVELOPMENT STRATEGY

FY 2002 – 2004

The City's current economic development strategy was adopted as a response to the economic downturn of the early and mid-1990's, and provides for business development assistance to the six targeted industry clusters of telecommunications, biomedical / biosciences, software, electronics manufacturing, financial and business services, and defense and space manufacturing. Since that strategy's adoption, the regional economy has improved and, further, more detailed research on industry clusters has been completed. However, San Diego's economy is increasingly being threatened by such issues as traffic congestion, air and water pollution, the cost of energy, and neighborhood quality. Projected population increases will place further pressure on such "quality of life" issues. As the City Council considers updating its General Plan consistent with the "City of Villages" concept to deal with these issues, it is timely to reconsider and update the Community and Economic Development strategy.

The proposed Strategy update covers five issue areas with the following recommended changes:

- Regional Economic Prosperity – continuing business development incentives, but more narrowly focused on key middle income-producing industries;
- Increasing Economic Opportunity – expanding job training and skills development for the "new economy," and connecting jobs to the training;
- Implementing "Smart Growth" – coordinating redevelopment and business development activities to achieve smart growth goals
- Energy Independence – collaborating with the Energy Conservation and Management Division to implement and promote conservation and related measures to businesses; and
- Revenue Enhancement – continuing revenue enhancement activities.

The proposed Strategy also includes recommendations for issues to research and consider for future action, such as new revenue sources.

I. Regional Economic Prosperity

The single major factor affecting the San Diego regional economy is the condition of the national economy. There have been troubling signs in the national economy through the second half of 2000, including a declining stock market, declining consumer confidence, an increase in unemployment claims, and declines in other key economic indicators. Some of these trends have increased sharply as this report is being prepared.

However, San Diego's economic resurgence in the last five years has been more broadly based than some other areas. San Diego's growth has not been driven by the "dot.com" business model that imploded in recent months in other parts of the nation. In the short run, San Diego will likely weather the current business cycle with only modest job losses in selected sectors and slower growth overall. An understanding of San Diego's current economic structure, coupled with a description of how we got there, can help fashion public policies that can help maintain a solid regional economy.

San Diego's Economic Growth

Since the Second World War, San Diego's economic base (defined as the sectors that import dollars into the region for local circulation) has been in manufacturing, particularly its defense manufacturing sector. Manufacturing as a whole in the United States, once the foundation of secure middle income jobs, has largely left the U.S. for Ireland, Puerto Rico, Mexico, Thailand, Indonesia, and other low-wage "off-shore" locations. While it may be argued that the global economy is creating new markets for U.S. goods and services, as indicated by the growth of international trade, this trend nonetheless is contributing to the decline of middle income households and to a lessening of job stability and opportunities for career ladders. In San Diego, manufacturing as a whole has declined, but between defense contracting and the uniformed military presence, the regional economy has tended to wax and wane more in relation to federal defense appropriations than with the national business cycle.

In the early 1990's, San Diego suffered its greatest economic reversal since the Great Depression. The region was impacted by the multiple effects of worldwide corporate restructuring that led to a worldwide recession, the collapse of speculative Savings and Loan real estate investments that had prompted overbuilding in the region, and, most significantly, massive reductions in U.S. Defense Department military contract expenditures. The best example of the impact of defense reductions was the closure of General Dynamics, which went from 17,000 employees to 0 in four years. The economic downturn lasted from late 1989 through mid-1995, much longer than the two-year recession in most of the U.S.

Since mid-1995, however, the San Diego region has rebounded strongly. Part of the increase is due to the strength of the national economy led by technology investment. But much of the improvement has resulted from the diverse economic base that grew out of defense contract reductions and corporate down-sizing, the passage of the North American Free Trade Agreement and the resulting increase in cross-border trade, and to a lesser degree the growing importance of tourism. While uniformed military and defense manufacturing remain important, they have been eclipsed by, not one, but several sectors. Most of these sectors, such as biotechnology and electronics manufacturing, were already present in San Diego but grew into prominence during the 1990's, while others such as communications and software/computer services emerged as new sectors in San Diego. The defense sector has undergone a transformation of its own, with the core of aerospace manufacturing replaced by research and information systems, led by SAIC, General Atomics, and Cubic Corporation. Also, the Navy's Space and Warfare Systems Command (SPAWAR), which provides command and communications systems for the fleet, has added an estimated $1 billion to the local economy for contract services.

The number of jobs represented by these new industries is relatively modest (at 16% of regional employment), but their significance arises from three factors: first, they export goods or services from the region and therefore import new dollars; second, they offer employee wages higher than the regional median, thus having a strong multiplier effect on retail and service sectors; and third, many of the sectors are part of the so-called "new economy" which is technology-driven and growing at a faster rate than other export segments. Tourism, stimulated by the completion of the Convention Center, is contributing increasing value to the local economy. While its wage rates do not match those in the technology sector, therefore resulting in only modest multiplier effects, it is nonetheless a stable importer of dollars and was the one industry that continued to grow during San Diego's early-1990's recession.

Industry Clusters

As the recession deepened in the early 1990's, City officials commissioned the first industry cluster studies to better understand the structure of the local economy and to tailor economic development policies to specific opportunities. Industry clusters are a grouping of linked or related industries which have an employment or gross revenue base that is greater than the national average and which, therefore, export proportionately more goods or services and import proportionately more dollars. As net importers of dollars, these base industry clusters drive other business transactions and thus create additional jobs ("multiplier effect"). (For a more detailed description, see, "San Diego Regional Employment Cluster: Engines of the Modern Economy," SANDAG, May-June, 1998.)

That first study identified six clusters as drivers of the local economy and which therefore should be targeted for public support. These clusters were telecommunications, biomedical / biosciences, software, electronics manufacturing, financial and business services, and defense and space manufacturing. This last cluster, while declining significantly in economic importance, was identified as a key cluster because of its high multiplier effect. Environmental technology was added later as a targeted industry. The San Diego City Council adopted Council Policy 900-12, which authorized advocacy support and financial incentives for these targeted industries. Under Council Policy 900-12, incentives include advocacy and assistance on development permit applications, expedited permit processing, rebate of manufacturing personal property taxes, fee credits or reimbursements, use tax credits, and reduction of water and sewer capacity fees. The City Manager established the Business Expansion and Retention (BEAR) Team in the Economic Development Division to implement Council Policy 900-12. The City Council adopted numerous actions to reduce the tax burden and improve the regulatory climate for all businesses. Finally, the contract with the Regional Economic

Development Corporation (EDC) was revised to include outreach to and liaison with targeted industries, in addition to its traditional role of business attraction through marketing, trade show attendance, and international trade delegations.

Local businesses made investments, achieved market successes, and hired the new employees, leading to San Diego's economic resurgence. However, without the City's targeted industry cluster support, many of San Diego's businesses may well have relocated elsewhere and our region would not be as economically diverse and strong as it now is. Some of the firms that took advantage of the City's targeted industry strategy, resulting in major new investments, include Sony, ComStream, Ligand Pharmaceuticals, Parker-Hannifin, AMCC, Intuit, Dura Pharmaceuticals, S-T Microelectronics, Qualcomm, Alliance Pharmaceuticals and many others. These firms' success, in turn, has had a "snowball" effect. As the region has become more prominent as a "new economy" locale, that image, combined with the region's high quality of life, has made it more attractive for new business investment, both for entrepreneur relocations and for major firms' expansion sites. Examples of unprecedented new corporate investment in the region include Johnson & Johnson, Nokia, Gateway 2000, Novartis, SUN Microsystems, and, most recently, Intel. As the region's economic marketing agency, the EDC has branded – and burnished - this image as "Technology's Perfect Climate."

Factors Affecting the Growth of Local Clusters

Three characteristics of these clusters' growth that must be considered in particular are the importance of R&D operations, the growth of international exporting, and the large number of small businesses. Over 90% of San Diego businesses have twelve or fewer employees, and the average employer size is 59 employees. Regionally, 97% of businesses have 100 or fewer employees. In 1990, 60% of regional employees worked for a firm with 100 or more employees, while in 2000 only 48% do so. The majority of San Diego's small businesses are in the retail and service sectors, but many of the "new economy" sectors also consist of small businesses; furthermore, some of the now-large employers were once small. Thus, small businesses and entrepreneurism have played a particularly strong role in San Diego's recent economic growth, as verified by various economic studies of San Diego's resurgence.

The region's research institutions, including universities, nonprofit foundations, and for-profit R&D operations, have been critical to nurturing high technology entrepreneurism. The number of jobs in R&D and research institutions and their contribution to the gross regional product are unquantifiable because of the way that industry data are maintained, but their importance is clear. UCSD's Connect Program, which provides entrepreneurial support to science-based business applications, has been a particularly significant contributor.

International trade has contributed strongly to growth across almost all industry sectors. Twenty-five percent of the increase in regional gross product from 1995 to 1998 was attributable to international trade, and 44% of that was trade with Mexico. The growth of maquiladora manufacturing in Tijuana has leveraged the growth of headquarters, R&D, pilot manufacturing, and warehousing in San Diego.

Recent Industry Cluster Research

SANDAG, the San Diego State University Geography Department, the Regional Technology Alliance, the San Diego Workforce Partnership, and the Center on Policy Initiatives have continued and expanded industry cluster analysis to achieve a more sophisticated understanding of the regional economy and to make recommendations for public policies. Results have included an identification of at least sixteen regional industry clusters that are economic drivers, an understanding of the occupations within the clusters and changing skill requirements of the workforce, anticipated increases or declines in specific clusters' economic significance, and the limitations of a cluster-based strategy. These studies have implications regarding public policies.

For the City of San Diego's policies, the following key points about industry clusters may be considered:

- Biomedical Products – Grouped in the earlier study with biotechnology, this manufacturing cluster has declined somewhat both in economic significance as well as wage rates, due to the general decline in manufacturing described above as well as cost cutting in the health care sector as a whole.

- Biotechnology and Pharmaceuticals – Despite substantial volatility, this cluster continues to contribute importantly to job growth, local investment, and, importantly, San Diego's image as a high technology center. For reasons related to FDA product review and the timing of capital investments, the cluster is highly sensitive to local regulatory processes.

- Business Services – This cluster has seen the fastest job growth of all clusters in the San Diego region. The growth and wage rates are highly variable, and are responsive to market conditions. Local economic development policies have little impact on this cluster.

- Communications – A decade ago, this industry cluster was simply a subset of defense manufacturing. San Diego's telecommunications industries now lead the world in innovation. Local economic development policies have been critical to, initially, retaining this vital cluster in San Diego and, later, assisting its rapid growth in jobs and investment. As with biotechnology, the cluster is highly sensitive to local regulatory processes. The sector will likely face substantial changes in the next few years.

- Computer and Electronics Manufacturing – As noted above, the growth of the "new economy" has been accompanied by the decline of manufacturing. Fortunately for San Diego, the region has bucked this trend over the last decade with slow but steady job growth in computer and electronics manufacturing. The region has maintained these jobs, in part, because some of manufacturing has required job skills not readily available off-shore and, in part, because the rapid growth of manufacturing in Tijuana has leveraged specialized manufacturing requirements in San Diego. The trend to off-shore manufacturing will continue, and SANDAG projects that this cluster will gradually decline as a part of the regional economy. However, manufacturing operations are highly capital intensive and, once made, tend to remain in use. These investments can sometimes be leveraged by local economic policies, especially those providing significant operational savings such as Enterprise Zones.

- Defense and Transportation Manufacturing – Despite its dramatic losses in the early 1990's, the SPAWAR presence in San Diego and recent increases in defense contracting may help soften declines in other clusters locally. However, this sector varies according to federal budgetary policy rather than local economic development policies. However, state tax savings provided to the shipbuilding industry through the Metro Enterprise Zone have contributed to that industry's efforts to commercialize.

- Entertainment and Amusement – Previously considered a subset of tourism, this sector has emerged as a growing influence on the regional economy. The sector is both highly variable and volatile, yet it has seen steady growth as the region has prospered. Further, wage rates in constant dollars in this cluster are above those in the visitor industry and have improved.

- Environmental Technology – Environmental technology has not achieved the growth nationally or locally that was predicted for it in the late 1980's, primarily because it was driven by regulatory compliance requirements. While initially growing, the industry contracted as regulatory standards have been met or were relaxed. In San Diego, this sector's already small base has declined substantially in jobs and revenues and has little foreseeable likelihood of growth.

- Financial Services – Previously grouped with business services, this cluster has declined significantly in San Diego as a result of mergers, acquisitions, and national regulatory changes. While wage rates in this cluster range widely, they are falling as a whole in constant dollars.

- Medical Services – This cluster has also seen rapid employment growth along with declining real wages. With the aging of "baby boomers," it will likely see even greater job growth in the next twenty years. However, this cluster has been highly volatile due to pressures for cost containment, changes in federal reimbursement formulas, and other factors. While further shake-outs will likely continue in this cluster, there will be significant job opportunities, especially for skilled nurses and in-home supportive service providers.

- Software and Computer Services – As with business and financial services, this cluster is highly responsive to market conditions, and thus local economic development policies have little impact on this sector. Wage rates, however, are above the regional norm. After short-term variability, this will likely remain a growing cluster.

- Visitor Industry Services – Part of the earlier study's tourism cluster, this cluster has seen steady and rapid employment growth (second only to business services), yet its growth has not matched the pace of growth in most other large cities. The wages of employees in this sector, while highly variable, in the aggregate have declined in constant dollars. The City of San Diego makes numerous public investments in support of this cluster, including financial support of CONVIS, financing the expansion and operation of the Convention Center, use of public facilities (the Zoo, Wild Animal Park, the beaches, etc.), and infrastructure investments. In return, the cluster contributes importantly to City general fund revenues.

- Other Clusters – The SANDAG cluster study identifies four other clusters that are significant to the regional economy. These are fruits and vegetables, horticulture, recreational goods manufacturing, and uniformed military. The first three, while significant for the region, have but a modest presence in the City of San Diego. Uniformed military, while arguably having more impact on the regional and the City economy than any other cluster, defies application of the methodological tools that SANDAG applied to the other clusters. Furthermore, as with defense contracting, it varies with federal appropriations decisions rather than with market conditions or in response to local economic development policy.

Where is San Diego's Economy Going?

The leading local indicator of economic activity is the number of new permits issued for base industries. These permits predict job creation, which predicts the market for housing roughly two years later. Housing in turn drives the market for retail activity, both in permits and in sales, and thus in City revenues. As a result, City revenues shift upward and downward two to three years after base industry investment shifts. The number of new permits issued for base industries (except for visitor industry services, which continues to increase) peaked in the current business cycle in late 1999, indicating a probable peak in housing permit activity in 2001 followed by a gradual decline. This also implies a gradual reduction in City revenue growth after 2002. The decline in base industry permits has been gradual, contrary to the national trend, which has seen substantial reductions in other economic indicators. This predictor therefore indicates continuing, but slowing, economic growth for San Diego.

There is anecdotal evidence that base industry investment may be forced into a rapid slowdown because prime employment land has become scarce and, as a result, prices for the few remaining parcels have increased greatly. Otay Mesa is the one remaining area with substantial employment development opportunity. There is also evidence that rapidly rising housing costs may soon impose wage pressures on employers, thus creating local inflationary pressures and reducing new facility investments, as has already happened in Silicon Valley. There is evidence that the quality of local K-12 education may limit economic prosperity, in the short run, by reducing San Diego's desirability as a place to live for families of high technology employees and, in the long run, by failing to provide the necessary education foundation for future employees' high technology skills. Finally, there is anecdotal evidence that other quality of life issues, including traffic congestion and the quality of public amenities, may affect business investment decisions.

Implications for the Community and Economic Development Strategy

ACTIONS:

1. Continue to provide business development incentives authorized under City Council Policy 900-12 and through the Enterprise Zone Program for businesses and projects that provide middle income job opportunities (manufacturing, R&D, and wholesale trade and distribution) and for the targeted clusters of biotechnology and pharmaceuticals, communications, and computer and electronics manufacturing.

2. Discontinue business development incentives under City Council Policy 900-12 for retail sales and industry clusters not identified in this strategy, unless such firms are provided assistance consistent with the economic opportunity, smart growth, energy independence, or revenue enhancement provisions of this strategy described below.

3. Continue and expand the services of the Office of Small Business and the Business Finance Program to include technical and financial assistance for small, emerging technology firms and firms involved in international trade.

4. Continue to contract with the Regional Economic Development Corporation (EDC) for services that promote the region's image as a high technology center.

5. Continue the Foreign Trade Zone Program with its strong incentives for cross-border trade, and enhance its marketing and promotion.

RESEARCH AND POLICY CONSIDERATIONS:

1. Continue to review and incorporate SANDAG, San Diego Workforce Partnership, and Center on Policy Initiatives industry cluster studies into the City's economic development strategy.

2. Continue to review the effectiveness of education institutions, at all levels, in providing the skill levels needed for the region's continuing prosperity, and continue to build relationships with those institutions.

3. Engage in regional solutions to address the shortage of employment lands and affordable housing (see "Implementing Smart Growth" below). In particular, work with the County of San Diego and the City of Chula Vista to establish a coherent vision and action plan for Otay Mesa's future as an employment center.

4. Engage in a comprehensive study of the Border Development Zone, as authorized by State law, to identify financing opportunities for infrastructure or other appropriate investments to enhance San Ysidro and Otay Mesa as manufacturing and border trade areas and to facilitate cross-border travel.

5. Review the effectiveness and, if appropriate, expand support of partnership agencies which provide technical and financial assistance for small, emerging technology firms and firms involved in international trade (e.g., CDC Small Business finance Corporation, San Diego World Trade Center, Regional Technology Alliance).

II. Expanding Economic Opportunity

Despite the region's current economic strength, the prosperity is not evenly distributed. Recent studies conducted by the Center on Policy Initiatives have indicated that certain employment sectors are paying less in constant dollars than they did twenty years ago, and that the proportion of households living in poverty has increased rather than declined during the 1990's. While the rate of unemployment in the region has declined to a level under 4%, certain neighborhoods continue with double-digit unemployment rates. There has been growth in the proportion of both high-end and low-end paying jobs, while the proportion of middle-income jobs has declined. Instead of a traditional "bell curve" distribution of incomes, the distribution is now skewed with peaks at the both the low and high ends. However, the peak at the low end is much larger than the peak at the high end, with forty-four percent of San Diego households now meeting the HUD definition of "low or very low income." The Center on Policy Initiatives calls this the "hourglass economy."

Income inequality is exacerbated by a highly competitive housing market that is pushing prices and rents to unaffordable levels. The region's population increases and other factors have forced up the cost of land so that housing developers have little economic reward to develop affordable housing. Publicly funded housing programs barely scratch the surface of the affordable housing need. As a result, low-income households are concentrated in the oldest and least expensive parts of the City. A concentration of poverty leads to what sociologists refer to as a "culture of poverty," in which social interactions are governed by short term survival, including success in high-risk, high-reward, illegal activities, while the values of the broader culture, such as workforce responsibility and success in school, are avoided. Schools in these neighborhoods fail, not because the teachers or school districts are doing the wrong thing, but because their message ceases to be relevant to the dominant culture of poverty. When the schools fail, the remaining middle income and upwardly mobile households take flight, further concentrating the culture of poverty. The combination of fewer middle income jobs, the concentration of poverty, the culture of poverty, and the increasing high end job opportunities, all point to a region with increasing income, social, and spatial disparities. These disparities in turn impose increased service costs on the City and on County funded social service agencies.

Low-income households are further challenged by the difficulty of securing health insurance. It is estimated that 37% of San Diego's full-time employees, and a majority of those with half-time or less employment, are uninsured. Families without health insurance, besides lacking basic health security, impose disruptions on schools and the workplace. They often defer routine health concerns until they become emergencies, thereby resulting in much higher hospital emergency room costs, which are ultimately borne by taxpayers.

Land Use and Business Impacts of Economic Disparity

Spatial disparities based on social and economic disparities impose land use impacts that are felt directly by residents of all economic strata. Businesses throughout the region, including those high technology firms with high salaried employees, still hire many employees at moderate wages for numerous clerical, service, and entry-level occupations. These moderate-wage employees typically live in older parts of the region, and thus travel long distances to work, adding to freeway congestion and air pollution. In many cases, however, potential moderate-wage employees do not have access to automobiles or realistic transportation alternatives, and thus become isolated in their neighborhoods, are unable to compete for these jobs, and eventually become further isolated culturally and educationally. Retail and personal service businesses also suffer as a result of being unable to find employees at moderate wage rates, or the employees they do hire are unreliable because of transportation difficulties. As a result business service quality - and profits - suffer.

Changing Jobs Skills

An emerging characteristic of the New Economy is that job skills are no longer a static set of skills that an employee can be trained once to fill. Rather, as technology changes rapidly, the employee skills must change as well. Furthermore, it seems that all new jobs, even the lowest-paying service jobs, increasingly require basic computer skills. Job development no longer is simply training to fill a specific job, but instead requires training on how to increase skills that are relevant to advancement needs. Not surprisingly, employees who are already well-educated and highly skilled are adept at responding to changing skills needs and move quickly from job to job as technology changes, while those who are less-educated and skilled are often left behind by these changes. To further complicate the growing jobs skills gap, career advancement in the New Economy seldom occurs within the same firm but increasingly requires moving around among firms with changing technical skills requirements. From a jobs development perspective, this has two implications: first, jobs skills will increasingly require a solid base of experience and competence in using computers; and second, career advancement will increasingly require knowledge, not of specific new technologies, but rather of how to continually acquire new competencies.

Implications for the Community and Economic Development Strategy

ACTIONS:

1. Authorize business development incentives as provided under City Council Policy 900-12 to firms which make a written commitment to hire at least ten full-time employees through the One-Stop Career Centers; to pay employees a wage that will meet a family's self-sufficiency needs, as defined by the San Diego Consortium Policy Board's "Self-Sufficiency Definition for Employed Adults and Dislocated Workers," (January 12, 2001); and to provide family health care benefits.

2. Collaborate with the San Diego Workforce Partnership to implement businesses' written commitments to hire employees through the One-Stop Career Centers at defined family self-sufficiency levels and with family health care benefits.

3. Continue and expand the City's support for K-12 education through the "6-to-6 Program," and ensure that the Program includes opportunities for exposure to computer literacy efforts.

4. Continue and expand the City's support for working families through the provision of child care centers, including the provision of business incentives under City Council Policy 900-12 and other financial incentives, as appropriate.

5. Continue and expand City programs which provide support for disadvantaged individuals to become active participants in the mainstream economy, including disability services, welfare-to-work programs, homeless family services, and youth diversion programs.

6. Continue and expand development permit review processes and public facility improvements that enhance accessibility for persons with disabilities.

7. Continue the Enterprise Zone Program with its generous tax incentives for manufacturing businesses as a means of furthering middle income manufacturing jobs and for connecting jobs in the Zones to residents in identified low-income census tracts.

8. Continue to contract with the EDC for services which promote the relocation and expansion of high technology and manufacturing businesses into the City's adopted redevelopment project areas and Enterprise Zones.

9. Expand the services of the Office of Small Business and its partnership agencies (Asian Business Association, Contracting Opportunity Center, ACCION, etc.) to include technical assistance and financial support for community serving businesses, with an emphasis on job creating opportunities.

RESEARCH AND POLICY CONSIDERATIONS:

1. Research and adopt a City Council Policy that ensures that decisions regarding the allocation of Community Development Block Grant funds, social service funds, and other discretionary funds are made consistent with federal or other applicable laws and regulations; that reflect adopted City Council priorities (such as this Strategy); and that take into account the effectiveness and capacity of recipient organizations.

2. Research and consider support for initiatives to provide health care coverage for those currently uninsured.

3. Support community development corporations and other community-based organizations that provide for education support programs, community-based skills development, and programs to bridge the "digital divide."

4. Support and participate in the Regional School-to-Career Partnership.

5. Pursue designation of a federal Empowerment Zone, to take advantage of the substantial federal program funding and for the tax incentives that encourage job-creating investments in low-income census tracts.

6. Support regional initiatives that encourage development of affordable housing and that improve the jobs/housing balance.

7. Support the continuation and expansion of San Diego Workforce Partnership programs that provide incumbent worker training, career path development, and computer skills training.

8. Support the continuation and expansion of San Diego Workforce Partnership programs that integrate workforce development with housing, social services, transportation alternatives, and other programs connecting work to community.

9. Encourage the San Diego Workforce Partnership to locate workforce development and training programs in those neighborhoods with high unemployment levels.

10. Collaborate with the San Diego Workforce Partnership to provide workforce development services through the City’s network of Community Service Centers.

III. Implementing Smart Growth

San Diego is becoming increasingly attractive for the relocation or expansion of Silicon Valley firms. This attractiveness has resulted, as discussed above, because of San Diego's growing reputation as a high technology center and because of the region's high quality of life. Technology firms that rely on a highly educated and skilled workforce know that quality of life is more important than low costs when it comes to finding and keeping employees. Intel's investment at the Scripps Ranch Business Park is the most recent example of this trend. Another factor is that, relative to Silicon Valley, our housing costs are low and transportation problems are small. San Diego has a reputation for a quality workforce, a legacy of good public education, quality post-secondary education at UCSD, SDSU, and the community colleges, and a labor pool of retired navy personnel. Finally, the San Diego jobs market has commanded relatively low wages because its high quality of life has served as an attraction.

Quality of Life as an Economic Development Issue

Despite this current competitive advantage, the San Diego region is growing rapidly and this growth imposes serious challenges to the region's quality of life. At some point, housing costs will impose inflationary pressures on wages. There is anecdotal evidence that this is already happening. While San Diego does not currently suffer from the serious air pollution problems and the gridlock of many other large cities, localized traffic congestion is starting to become a business investment consideration and, unless addressed, San Diego will succumb to air pollution and gridlock. The region's K-12 education system has recently ranked in national site selection publications at the "D" level or lower, strongly affecting employees' decisions about where they want to live. The City has faced consistent problems with water pollution, sewage breaks, and beach closures, affecting negatively the City's most unique quality of life assets. And finally, retaining our open spaces is an important component to the region's quality of life.

In addition to quality of life issues, San Diego suffers from an "hourglass economy," as noted above. San Diego does not have the inner-city "donut hole" abandonment phenomenon of certain cities, but it does suffer seriously from a concentration of poverty that leads to a culture of poverty. As previously described, a culture of poverty, in turn, leads to school failure, further flight by middle income households, an acceleration of crime, and other social costs. It has been estimated that the City of San Diego has a current deficit of $2.5 billion in unmet infrastructure needs, for parks, libraries, schools, roads, etc. San Diego citizens have responded to our K-12 facility needs with new investment commitments though passage of Proposition MM, but new school facilities alone will not address the growing culture of poverty. All of these factors affect San Diego's quality of life, its image as a high technology business location, and ultimately its prosperity.

The City of Villages

The City of San Diego is currently updating its General Plan. In response to growing quality of life issues and the need to plan for anticipated population growth, the City's Planning Department has prepared a draft plan update, characterized as a "City of Villages." To be implemented as a Strategic Framework Element to the General Plan, this approach to updating the General Plan incorporates “smart growth” principles. The City of Villages, while essentially a land use planning document, will require numerous tools for its implementation. For example, for the first time, the San Diego’s General Plan will include economic prosperity policies to be refined in an Economic Prosperity Element of the Plan.

Implementing “Smart Growth”

The Community and Economic Development Department is responsible for administering redevelopment, revitalization, and numerous other programs and projects which implement the General Plan, and thus the Department Strategy is intended to be a “bridge” to the Strategic Framework Plan in order to take advantage of smart growth project opportunities. As the first step to updating the City General Plan, the Strategic Framework must go through a number of further steps before it can be formally adopted. The Community and Economic Development Department’s Strategy is intended to incentivize private investments that improve the jobs/ housing balance, close the private financing gap for mixed-use and infill projects, encourage enhanced design to meet the requirements of neighborhoods in accepting additional development, etc. Future Department Strategy updates will reflect the Strategic Framework Update and Economic Prosperity Element, upon their adoption.

Redevelopment – the use of tax increment financing and land assembly as authorized under the California Community Redevelopment Act – is the most aggressive tool available to the City to deal with the physical manifestations of poverty and disinvestment. This broad grant of authority makes redevelopment the most powerful tool available to implement the City of Villages. The currently adopted redevelopment project area plans are inherently consistent with the City of Villages concept. The City currently has fifteen active redevelopment project areas located in the communities of greatest physical and economic need. The Centre City Development Corporation, a nonprofit corporation wholly owned by the City of San Diego that contracts with the San Diego Redevelopment Agency to implement redevelopment projects in the downtown, is well along the way of redeveloping the two downtown project areas as the central focus of a smart growth strategy. The other project areas are at varying levels of implementation, but all are conceptually consistent with “smart growth” policies, and specific redevelopment projects may be identified as City of Villages pilot projects.

Redevelopment is a powerful tool for community revitalization, but it must be used sparingly and judiciously, for two reasons. First, redevelopment law requires findings that a designated area meets the law’s definition of physical and economic deterioration. Second, tax increment financing diverts tax revenues from the City and other taxing entities, thereby reducing money to pay for basic public services. In implementing redevelopment projects, local government must balance the redevelopment needs in a specific neighborhood against the tax needs of the broader community. For this reason, the City has used other revitalization tools in identified areas. These tools have included focused public improvements, adoption of business improvement districts and landscape and lighting maintenance assessment districts, focused neighborhood improvement projects (such as Operation Weed & Seed), and support for community development corporations and other community based organizations.

While the City often plays a leadership role in revitalizing our oldest neighborhoods, most of the funding comes from private investments. The U.S. Small Business Administration (SBA) provides a variety of cost-effective small business financing tools. San Diego's CDC/Small Business Development Corporation is a leader in providing access to SBA Section 7(a) business loans, SBA micro-loans, and other financing products, and is the nation's largest provider of SBA Section 504 loans. SBA 504 loans provide businesses with the opportunity to own their own business real estate and, as with homeownership, this ensures that businesses have a stake in their communities. Small businesses in an Enterprise Zone or a redevelopment project area can qualify for a larger 504 loan amount.

Lending institutions are encouraged to make lending investments in our oldest communities by the City-County Reinvestment Task Force. The Task Force monitors and reports on lenders' compliance with the Community Reinvestment Act. With recent changes to this law, however, the Reinvestment Task Force is seeking a further means of promoting private investment into older neighborhoods, and is currently exploring establishment of a "San Diego Capital Collaborative" equity investment fund, similar to efforts taken in other large cities. In the meantime, the City's Redevelopment Agency is now prepared to consider providing gap financing of mixed-use and other smart growth projects on a case-by-case basis. These public and private financing tools, along with a redirection of other economic development tools to designated areas, must all be considered as part of a broad strategy in implementing the City of Villages concept.

Implications for the Community and Economic Development Strategy

ACTIONS:

1. Continue and, where appropriate, adopt new redevelopment project areas as the City's most powerful and aggressive tool for addressing physical and economic deterioration.

2. Continue and expand the use of revitalization tools, including focused public improvements (sidewalks, landscape improvements, signage, public art), focused neighborhood improvement projects (Operation Weed & Seed, Enterprise Community), storefront improvement grants, business improvement districts, landscape and lighting maintenance assessment districts, property-based business improvement districts, and neighborhood-focused clean-up and recycling campaigns, as appropriate to the needs of specific communities.

3. Continue and expand support for community development corporations and other community-based organizations that directly address the need for affordable housing and other goals of the City of Villages.

4. Continue and expand support for public/private initiatives that address quality of life issues, such as the Adams Avenue Business Improvement Association's work with the City to develop an elementary school for the San Diego Unified School District.

5. Continue and expand gap financing, based on project area tax increment, for infill, re-use, mixed-use, and affordable housing projects in redevelopment project areas, on a case-by-case basis.

6. Authorize the use of business development incentives under City Council Policy 900-12 for adopted redevelopment projects; for mixed-use projects, infill projects, and re-use projects in locations identified in the City of Villages Plan; and for housing which meets the needs for both low-income and middle-income households, consistent with the City's inclusionary housing policy.

7. Authorize the use of business development incentives under City Council Policy 900-12 for employment generating projects in areas identified in the City of Villages Plan as benefiting from increased employment to improve the jobs/housing balance.

8. Contract with the EDC for services which promote the relocation and expansion of employment generating projects, with a focus on high technology firms, in existing high-density residential areas identified in the City of Villages Plan.

9. Continue and expand the existing collaboration among the City, CCDC, the Downtown Partnership, the Regional Technology Alliance, and the EDC to take advantage of the downtown's fiber optic infrastructure through the "Bandwidth Bay" initiative as a location for digital technology business development.

10. Continue to contract with the EDC to serve as a liaison with the region's major employers to promote "civic entrepreneurism," as a means of including these firms in seeking solutions to the region's planning and infrastructure challenges and in engendering partnerships among firms and neighborhoods.

11. Authorize the use of Redevelopment Agency housing set-aside funds to help finance affordable housing which is developed outside redevelopment project areas in conformity with the City's inclusionary housing policy.

12. Market the availability of SBA Section 504 loans at increased eligibility levels in Enterprise Zones and redevelopment project areas.

RESEARCH AND POLICY CONSIDERATIONS:

1. Research and consider giving preference in City funding to community development corporations and other community-based organizations that provide for affordable housing.

2. Explore and, where feasible, implement cooperative arrangements (including revenue sharing, housing replacement plans, etc.) with other government jurisdictions which address issues of jobs/housing balance, the shortage of affordable housing, the appropriate redesignation of land uses, and other smart growth strategies.

3. Research and consider the expansion of property-based business improvement districts and/or the consolidation of assessment districts with other special purpose districts, to achieve efficiencies in implementing improvement projects.

4. Assess the results of the Bandwidth Bay initiative and, if appropriate, apply the concept to other communities that may be candidates to support digital technology small business growth.

5. Research and consider programs that encourage the adoption of strategies for market-based investment into older communities, such as the City-County Reinvestment Task Force's proposed "San Diego Capital Collaborative."

6. Research and consider new or increased sources of financing for affordable housing.

7. Research and consider City fee schedules that are tied to smart growth policies as described in the City of Villages plan.

8. In conjunction with the Planning Department, identify new pilot or demonstration smart growth projects in redevelopment project areas and work collaboratively to implement these projects; and ensure that the biennial update of the Community and Economic Development Strategy is consistent with the Strategic Framework Element and the Economic Prosperity Element, as each is adopted.

IV. Energy Independence

While SANDAG and the City of San Diego have adopted and pursued comprehensive, long-term, integrated economic development strategies based on industry cluster analysis, any local economy can be at risk from external pressures. An immediate threat to the San Diego region is the escalating cost and increasing unavailability of energy. The pressures facing the region have already imposed substantial costs on large and small businesses alike and threaten the region's long-term economic health. These threats have resulted from a complex mix of national and global issues that cannot be resolved through local action. However, local action can mitigate the short-term impacts and set the stage for long-term energy independence.

The Economic Development Division's Enterprise Zone staff are working to encourage development of a gas fired electricity generating "peaker" in the Zone. However, energy independence requires more than developing new energy suppliers, but must also include a mix of conservation and micro-generating capacity.

Implications for the Community and Economic Development Strategy

ACTIONS:

1. Continue to pursue the application of Enterprise Zone and business development incentives under City council Policy 900-12 to encourage new sources of electrical generating capacity in the region.

2. Through the City's various business outreach efforts, promote the availability of existing energy conservation and independence options, as provided by the California Energy Commission, San Diego Gas & Electric, and others.

RESEARCH AND POLICY CONSIDERATIONS:

- Under the direction of the City's "energy czar," research and consider authorizing business development incentives under City Council Policy 900-12, financing options, and other appropriate incentives for both business and residential construction projects that incorporate conservation "best practices" and on-site electricity micro-generating capacity.

V. Revenue Enhancement

The region's economic growth has stimulated population growth, but City revenues have not kept pace with the increased demand for services that accompanies the growth. The primary reason for this is that the California tax structure makes it difficult for local government to raise revenues to match service demand, an issue beyond the scope of the Community Development Strategy. However, there are revenue issues relevant to the Strategy.

The first issue is the relationship of service delivery to tax generation. The City of San Diego has 49% of the region's population yet a majority of the region's larger employers are located within the City limits, with an estimated 65% or the region's employees working in San Diego. While manufacturers and office users pay their proportionate share of property taxes, retail sales are collected from the retail point of sale. Retail centers are typically located adjacent to residential areas. As a result, the City receives less than half of regional sales taxes despite being the employment location for a majority of the region's employees and providing disproportionately for the employers' public services. This problem is exacerbated by some of the smaller cities in the region competing aggressively for sales tax-generating projects, especially new auto sales.

A second issue is that property tax receipts reflect both the valuation of the property taxed and the frequency of property sales transactions (and thus upward reassessments). The City of San Diego accounts for the greatest proportion of the region's low and moderate income households. These units have lower valuations per unit, in part because they are older and in part because they are more frequently part of a multi-unit complex. Further, they change ownership less frequently because they are often held as investment property. As a result, the City of San Diego receives less property taxes per capita than all but a few other cities in the region.

A third issue is that use taxes, which are levied on purchases of goods from out-of-state at the same rate as sales taxes, are supposed to be distributed to local jurisdictions based on the location of the purchaser. The largest payment of use taxes is on business-to-business transactions for major manufacturing equipment. However, the State Board of Equalization distributes use taxes according to the sales tax distribution, which as noted above favors cities with proportionately greater retail sales centers. With the City of San Diego accounting for more than half of the region's use tax payers but less than half of the retail tax collectors, the City fails to receive its proportionate share of use taxes to cover service demands. It is estimated that the City of San Diego annually loses between $14 million and $20 million in use taxes that are legally San Diego's to other cities throughout the state.

Implications for the Community and Economic Development Strategy

ACTIONS:

1. Continue and expand programs, both based on tax increment revenues in redevelopment project areas as well as market-driven programs (e.g., the College Eastern Area Revitalization and Economic Review), which encourage first-time homeowners and move-up home buyers.

2. Contract with the EDC for it to establish a marketing program or special rate mortgage program to encourage employees of high technology firms to purchase homes in older neighborhoods.

3. Encourage the development of market rate and mixed rate homes in redevelopment project areas, in conjunction with an effectively enforced inclusionary housing policy.

4. Continue and expand the Business Cooperation Program, which commits major use taxpayers to file through a direct pay permit thereby increasing City use tax revenues.

5. Establish a mechanism for conducting an independent cost/benefit analysis, reflecting not just fiscal impacts but broad economic and social impacts and the quality of jobs created by the specific project, on permit application reviews for major projects under consideration by the Planning Commission and/or the City Council and on recommendations for development incentives requiring City Council approval.

6. Continue to provide business development incentives under City Council Policy 900-12 to development projects or firms that generate new, net, annualized revenues to the City in the form of property, sales, and/or use taxes of $500,000 or more.

RESEARCH AND POLICY CONSIDERATIONS:

1. Research and consider new financing mechanisms or the expansion of existing mechanisms, including but not limited to: landscape and lighting maintenance assessment districts; property-based business improvement districts; assessment districts which allow a deferral of collecting the assessments until transfer of title; an increased business tax certificate fee; an increased property transfer fee; a utility users fee; a trash collection fee; and "best practices" followed in other jurisdictions.

2. Working with the Intergovernmental Relations Department, pursue changes in state and federal laws and regulations that ensure the maximum return of revenues to which the City is legally entitled, including but not limited to use taxes misdirected as a result of State Board of Equalization practices or use taxes uncollected as a result of lax enforcement of interstate internet or catalogue sales.