



Memorandum

TO: COMMUNITY AND ECONOMIC
DEVELOPMENT COMMITTEE

FROM: David Sykes
Kim Welsh
Hans Larsen

SUBJECT: SEE BELOW

DATE: February 13, 2014

Approved

Date

COUNCIL DISTRICT: 3 and 4

**SUBJECT: STATUS UPDATE ON THE IMPLEMENTATION OF THE NORTH
SAN JOSE AREA DEVELOPMENT POLICY**

RECOMMENDATION

Accept the update on the implementation of North San Jose Area Development Policy and refer to the full City Council for a comprehensive discussion.

BACKGROUND

The North San Jose area plays a vital role in the achievement of San José's economic goals. In 2005, the City adopted the North San Jose Area Development Policy (Policy) which established a policy framework to guide the ongoing development of the area as an important employment center for San Jose. The Policy provides for a specified amount of new development including an additional 26.7 million square feet of new industrial development and brings additional consistency and predictability to the development process by standardizing traffic mitigation responsibilities within the Policy boundaries. In order to provide certainty to developers with regard to the public infrastructure requirements and to fund roadway improvements to mitigate the impacts of increased traffic generated by new development under the Policy, the City adopted a North San Jose Traffic Impact Fee, based on a nexus study analyzing expected trip generation for categories of development and other variables. When implemented, this fee was set at \$10.44 per square foot of industrial development. Due to an annual 3.3% escalator (compounded every two years) included in the Policy, the current fee for industrial development is \$13.54 per square foot and is set to rise again in 2015 to \$14.44 per square foot (sf).

On January 31, 2012, the City Council adopted a resolution amending the North San José Area Development Policy to promote near-term industrial development of up to a total of 1 million square feet through Traffic Impact Fee Incentive Program which reduced the traffic impact fee to

\$5 per square foot for industrial development projects larger than 100,000 square feet that have completed both planning and building permits before December 31, 2014.

On February 12, 2013, the City Council approved a further amendment to the North San José Traffic Impact Fee Incentive Program that expanded the square footage allocation by an additional 250,000 square feet to accommodate the 465,000-square foot Samsung Semiconductor R&D/HQ expansion, the 440,000-square foot Ellis Partners 101/Tech development and the 340,000-square foot Cisco Systems HQ intensification parking structures. City Council also directed staff to analyze the potential impact on transportation improvements and bring recommendations to the Council in the budget process for modifications to the Transportation Capital Improvement Program or a funding plan to offset the potential required impacts.

On September 24, 2013, the City Council directed staff to return prior to the end of the calendar year with an ordinance to increase the total square footage available for the incentive program to 4 million square feet; to reduce the Traffic Impact Fee to \$2.00/sf for any build-to-suit Office/R&D campus of over 1 million square feet; to provide status update on implementation of the North San Jose Development Policy and an analysis of financing mechanisms that would support the implementation; and to provide analysis and recommendation as to whether and how the North San Jose Urban Design Guidelines should be amended or modified, based on staff's experience implementing them thus far. Companies seeking to participate in the North San Jose Incentive must obtain building permits and initiate construction by December 31, 2014.

On December 17, 2013, the City Council received a report with a number actions related to the Policy Area. City Council adopted a resolution to amend the North San Jose Area Development Policy to:

- (i) Increase the total square footage available for the incentive program to 4 million square feet;
- (ii) Reduce the Traffic Impact Fee (TIF) to \$2.00/sf for any build-to-suit Office/R&D campus over 1 million square feet;
- (iii) Require new development that received the reduced Traffic Impact Fee to make a good faith effort to meet the provisions outlined in the Business Cooperation Program;
- (iv) Allow projects outside of NSJ that contribute traffic trips on roads within the Policy area and consistent with NSJ EIR impacts to mitigate by payment to the TIF; and
- (v) Provide additional design flexibility to the Urban Design Guidelines for campus style development within the Policy boundaries.

At that time, the staff also noted it was still analyzing development activity and transportation improvement data per City Council direction at the September 24, 2013 meeting. It was staff's intent to return to City Council in March to share and discuss staff's analysis. City Council further requested staff to identify alternative funding options and establish a clear plan to secure funding for transportation infrastructure as part of the discussion.

This memorandum constitutes the Administration’s response to Council direction for a comprehensive analysis of development activity, transportation improvements, and a future transportation infrastructure funding strategy within the Policy boundaries. Discussion and recommendation regarding further revisions to the Urban Design Guidelines is under a separate memorandum.

ANALYSIS

Development Activity Update

Industrial Development Activity:

NSJ Industrial Development Allocation Phase 1	
Phase 1 Capacity	7 million square feet
Industrial Converted or Demolished	3 million square feet
Total Capacity (Phase 1 and Conversion)	10 million square feet
Phase 1 Industrial and R&D Development Approved and/or Under Construction	
Total Industrial R&D Approved	Approximately 4.5* million square feet
Industrial Land Built/Under Construction	1.2 million square feet

* - inclusive of Peery-Arrillaga proposal

Since the inception of the Policy, we have seen incremental growth within the industrial sector. The Peery-Arrillaga campus proposal (2 million square feet) and approval of the Ellis Partner, 101/Tech, and Cisco building/structure projects will add a substantial amount of capacity to meet Phase 1 goals. This is obviously a positive sign with regards to growing interest from the development community to improve job growth in North San Jose.

That being said, the Policy also clearly notes no net loss of industrial square footage. With the conversion of industrial land to residential, an equivalent addition as new non-residential construction is required to offset the loss for Phase 1 purposes. Currently, the 1.2 million square feet under construction will go to offset the industrial square footage lost to conversion (total estimate of approximately 3 M square feet). Therefore, even with the addition of the aforementioned projects, there is approximately 5.5 million square feet still necessary before Phase 2 can be contemplated.

Residential Development Activity:

NSJ Approved Residential Unit Allocation Phase 1	
Phase 1 Capacity	8,000 units
Phase 1 Total Number of Units Approved	8,854 units
Phase 1 Market Rate Reserved	7,428 units
Phase 1 Affordable Units Reserved	432 units
NSJ Phase 1 Residential Under Construction	
Total Number of Building Permits Issued	5,612 units

As a result of the total number of units entitled, Phase 1 residential capacity is completely subscribed. The City cannot consider new residential projects for approval under Phase 1 at this time. As of this date, 7,860 of the 8,000-unit build-out capacity have been reserved (based on Planned Development (PD) Permit approval) for construction. Only 140 units remain for reservation and they must be affordable-rate units. Residential projects without a current reservation will have to rely on units becoming available in the future to develop. This could occur if a project with an existing reservation chooses to reduce the overall unit count or if the permit expires. Under this scenario, any new construction would have to be reserved as affordable-rate units.

It is important to highlight that delivery of affordable units will be a key area of focus under Phase 2. The Policy originally anticipated a delivery of 1,600 affordable units with Phase 1 construction. As the City made adjustments in years 2011 and 2012 to increase the allocation of market rate units under Phase 1, it unilaterally reduced the amount affordable units that could be built. Phase 2 will be critical to achieving the affordable unit capacity to ensure there is an appropriate housing-type balance to meet all socio-economic groups.

Furthermore, it is safe to assume based on current industrial development activity (see above) and recent trends, Phase 2 is estimated to be five to ten years out before the City will be able to consider new residential development.

Commercial Development Activity:

NSJ Commercial Development Allowance			
	Neighborhood Retail	Large Format Retail	Hotels
NSJ Policy Allowance	1.7 million sq. ft.	1.0 million sq. ft.	1,000 rooms
Approved Sq. Ft./Rooms	335,700 sq. ft.	348,000 sq. ft.	757 rooms
NSJ Commercial Development Under Construction			
	Neighborhood Retail	Large Format Retail	Hotels
Built/Under Construction	114,200 sq. ft.	348,000 sq. ft.	157 rooms

Unlike residential and industrial development under the Policy, there are no limitations or development triggers on the amount of commercial space that can be developed. The Policy identifies an “allowance” of commercial square footage for two main purposes: (i) ensure a healthy balance and appropriate mix of amenities are provided to serve residents and employees and (ii) analyze traffic impacts comprehensively and include mitigation measures to offset impacts.

As of this date, current commercial development activity generally falls within the parameters above; however, with recent Planning applications, the number of hotel rooms could exceed the Policy limit. For this reason, the Council may wish to consider a future change to the Policy to increase hotel rooms above the current allowance.

Transportation Improvements Update

The transportation mitigation plan documented in the North San Jose Environmental Impact Report (EIR) in 2005 included a set of investments designed to provide and enhance multimodal travel options (walking, biking, transit, and driving) to and within the North San Jose (NSJ) area. The goal of the transportation plan is to support the planned land use intensification and to sustained economic vitality of the area by managing traffic congestion levels and providing viable transportation choices.

The NSJ EIR transportation plan initially had an estimated cost of \$520 million (in 2005 dollars). Lawsuits challenging the North San Jose EIR were filed by the County of Santa Clara, the City of Santa Clara, and the City of Milpitas. A key issue in the lawsuits related to the lack of sufficient traffic congestion mitigation on County expressways in the neighboring cities adjacent to the NSJ project area. The lawsuits were settled in 2006 and the City committed to supporting an additional investment of \$50 million for expressway improvements in Milpitas (valued at \$13 million) and in Santa Clara (valued at \$37 million). The source of additional funding for the lawsuit settlement agreements was intended to be covered by the San Jose Redevelopment Agency and regional sources. Exhibits 1 and 2 identify the scope, location, estimated cost and proposed phasing of the \$570 million NSJ transportation improvement plan.

The scope of the transportation improvements needed to support the Phase 1 level of job and housing development is estimated to cost \$200 million (accounting for past and future cost escalation – this same plan had an estimated cost of \$143 million in 2006\$ as referenced in Exhibit 1). Since approval of the NSJ plan, the Department of Transportation (DOT) has facilitated the completion of approximately \$40 million of the Phase 1 improvement plan projects and related planning activities. Approximately half of the funds were obtained from regional transportation grants. Key accomplishments include:

- Montague Expressway widening to 8-lanes from First Street to Route 880
- Lawsuit settlement payments to County for Montague Expressway widening in Milpitas
- Guadalupe River Trail from 880 to Alviso
- Light Rail Transit intersection signal upgrades
- Downtown couplet conversions (3rd/4th, 10th/11th, and Julian/St James)
- Master planning for First Street, Zanker Road, core area grid streets, bikeways, and Coyote Creek Trail
- Preliminary design and environmental clearance for the 101/Trimble interchange upgrade.

Completion of the NSJ Phase 1 transportation plan is estimated to cost \$160 million. The major projects include additional improvements to Montague Expressway, the 101/Trimble interchange upgrade, and various local improvements. Staff is exploring options to defer portions of the Montague Expressway improvements and the 101/Trimble project to a later phase and instead accelerate implementation of a new Route 101 overcrossing connecting Zanker Road and Skyport Drive. The 101/Zanker/Skyport project would provide better transportation service to the area of NSJ having the highest concentration of new job development (particularly the

proposed Peery-Arrillaga development).

The original plan for funding NSJ transportation improvements was heavily dependent upon the Traffic Impact Fee paid by private development and with some support from Redevelopment Agency funds. With the elimination of Redevelopment revenues and with the past City Council actions to discount fees on new job-generating developments, staff is considering a revised funding concept as summarized in the table below.

Figure 1 - Funding Concept for NSJ Phase 1 Transportation Improvements

Source of Funding	Original Plan	Proposed New Plan	Funding Amount
Redevelopment Agency	5%	0%	-
City Funds	0%	10%	\$20 million*
Regional Funds	15%	50%	\$100 million
Development Fees	80%	40%	\$80 million
Total	100%	100%	\$200 million

*This amount is anticipated to be paid for by the City's Traffic Capital Program

This new funding strategy proposes a significant reliance on regional funds for completing the NSJ Phase 1 transportation plan, particularly for regional improvements related to the freeway system. Currently, there are no significant regional funding opportunities available at the federal, state, or county levels – although new transportation infrastructure investment programs are being contemplated. To support this revised strategy, it is recommended that advocacy at all appropriate levels for new transportation investment become a high policy priority for the City Council and that steps be taken to consider establishing a contingency plan for increased local funding for NSJ transportation improvements if regional funds are not available in a timely manner so as to not delay continued economic development of the NSJ area.

Use of City Revenues to Fund North San Jose Traffic Improvements

On September 24, 2013, Council directed staff to explore mechanisms to provide the City funding required to complete remaining traffic improvements required for Phase I. Based on the amount spent on the completed projects discussed above and anticipated spending on upcoming projects, staff anticipates that the Traffic Capital Program will adequately fund the City's \$20 million contribution to Phase I traffic improvements. In addition, other local funding mechanisms are needed in the likely event that regional contributions fall short of the \$80 million to complete Phase I improvements. While this analysis is still ongoing and a recommendation will be brought forward for Council consideration later during the 2014-2015 budget development process, several options are under consideration.

One option is to capture tax revenue generated from construction and business operations of North San José developments, both one-time and ongoing, to fund traffic improvements in North San Jose. For example, the Peery-Arrillaga project consisting of two million square feet of office development is estimated to generate approximately \$7.5 million in Building & Structure

Construction Tax, a one-time revenue source, and approximately \$800,000 from sales and utility taxes. Normally allocated to the General Fund, the ongoing sales and utility tax revenue could be set aside for specified number of years and combined with the one-time Building and Structure tax revenue to leverage grants, initiate design, and construct North San Jose traffic improvements. However, these revenues would not be available for other City Council General Fund priorities such as the restoration of police, fire, libraries and community centers to January 1, 2011 service levels. Also, these General Fund monies would be unavailable for other needs in the North San José area, such as additional police, fire, community centers, code enforcement that were identified in the North San José Area Development Policy.

With the recent upsurge in development activity, another option being actively explored is to dedicate to North San José additional Building and Structure Construction Tax and Construction Excise Tax revenue collected from developments city-wide. For example, as noted in the 2013-2014 Mid-Year Budget Review, a total of \$19.0 million from these taxes is anticipated to be received this year. However, as these tax revenues are the primary source of funding for the Traffic Capital Program, such an allocation would reduce available resources for transportation improvements in other areas of San José.

Staff will continue to refine the total funding gap needed to implement the Phase I transportation improvements and evaluate the funding alternatives described above, or a combination thereof, as part of the 2014-2015 budget development process.

PUBLIC OUTREACH/INTEREST

A community meeting was held on January 15, 2013 to provide the North San Jose community with an update on Policy implementation. The community meeting was well attended by the public. Various presentations were provided to the community regarding updates to residential development activity, delivery of parks and social services (i.e. library), and VTA light-rail and bus operations. Members of the public discussed various topics such as roadway improvements, timing of Phase 2 residential development, new commercial development, enhanced transit services, Waste Water Treatment Plant improvements, and the impact of new development demand on existing water supply.

Participants were highly engaged in positive discussions with staff and presenters. The community was appreciative of the opportunity to share insights and comments. Attendees were very interested in the creation of more retail and amenities in North San Jose.

CONCLUSION

The goal of the Policy is to maintain a healthy, balanced economy; promoting economic activity, livability, and long-term vitality in a smart-growth manner. Progress is being made under the Policy to achieve this goal. As the economy continues to improve and development interest grows, Peery-Arrillaga and important private investments will serve as a model that development

February 13, 2014

Subject: Implementation of North San Jose Area Development Policy

Page 8

can occur under the Policy.

The Policy serves as a solid foundation to create a very active corridor with a mix of uses to meet resident and employee demands. It provides flexibility to guide job growth activity and to respond to market trends. The Policy includes triggers to limit how much residential can be developed in advance of new industrial to retain the focus on job growth. Therefore, the Administration considers the Policy to be working and a holistic review is not warranted at this time.

As the economy and built environment evolves, specific aspects of the Policy should be analyzed at that time to determine if changes are necessary to ensure we are working at the speed of business. It is the Administration's recommendation for the Committee to accept the update and cross-reference this item with the entire City Council for a comprehensive discussion.

COORDINATION

The preparation of this memorandum and the associated work was coordinated with the Department of Housing, Department of Public Works, the City Attorney's Office, and the City Manager's Budget Office.

/s/

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Attachments