



Office of the City Auditor

**Report to the City Council
City of San José**

**STREET AND UTILITY
IN-LIEU FEES:
TRANSPARENCY AND
COORDINATION CAN
IMPROVE THE
ADMINISTRATION OF
FEE PROGRAMS**

**Report 19-08
September 2019**

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September 30, 2019

Honorable Mayor and Members
Of the City Council
200 East Santa Clara Street
San José, CA 95113

Street and Utility In-Lieu Fees: Transparency and Coordination Can Improve the Administration of Fee Programs

New development can strain the City's infrastructure and amenities, and must meet City standards to be built. The City's General Plan states "new development should finance capital and facility needs..." directly attributable to the site. Developers are required to either construct some portion of the improvements in the area surrounding their property, or help pay for their share of improvements through an "in-lieu fee." These fees, required as a condition for permit approval and subject to the California Mitigation Fee Act, may also be referred to as "mitigation fees" or "impact fees." In accordance with the Mitigation Fee Act, the Administration reports annually to the City Council on the status of fees collected and their intended use.

The objective of this audit was to review the collection, tracking, and use of in-lieu fees, with a focus on street- and utility-related fees. The audit addressed fees related to: traffic impacts, utility undergrounding, traffic signals, landscaped median islands, street improvements, and storm collection system improvements. These fees are collected by the Department of Public Works, and tracked and used by Public Works and the Department of Transportation (DOT).

Finding 1: Consistency and Transparency in Fee Calculation Can Be Improved.

Calculating in-lieu fees is often complicated. Public Works engineers must consider a variety of factors about a development, such as its location, size, use, number of parking spaces, and traffic impacts on the surrounding area. This may involve coordination with City staff in other work groups or departments, as well as with developers to ensure that fees are charged fairly and accurately. Overall, there were few instances in our sample in which we found that developers had not been charged in-lieu fees appropriately. However, it was not always clear whether a developer paid an appropriate fee, because decisions surrounding fee calculations were not always clearly documented. This lack of documentation may also affect staff's ability to use fees received, as discussed in Finding 2. To improve transparency of fees charged, we recommend Public Works develop guidelines for appropriate documentation. To improve the assessment of utility undergrounding fees, we recommend that staff clarify procedures surrounding undergrounding fees, and develop a digital tool to identify streets designated for utility undergrounding, including whether a parcel has frontage on a designated street and whether undergrounding fees have previously been paid.

Finding 2: Improved Tracking and Coordination Would Enable Program Staff to Better Use In-Lieu Fee Revenue. Collection of street-related in-lieu fees has tapered off in recent years, though the City had \$11.2 million in its reserves for street-related in-lieu fees at the end of Fiscal Year (FY) 2018-19. During our review, we identified at least \$810,000 in unspent in-lieu fees intended for public improvements that have already been constructed, and that should be reimbursed to either the City or the entity that constructed the improvement. We estimate that about half of the 40 unspent traffic signal in-lieu fees and a quarter of the 30 unspent median island fees may relate to public improvements that have already been completed. We recommend that staff review these in-lieu fees and public improvements to determine whether any monies should be transferred, improve coordination between program staff going forward, and update the annual in-lieu fee report to ensure that information is accurate.

Additionally, we noted that though most fees are correctly put into funds intended for in-lieu fees, it appears that a few were incorrectly placed in a separate fund intended to track deposits made by developers. These deposits are usually unrelated to the in-lieu fee process. As a result, these in-lieu fee revenues have not been used to fund public improvements appropriately. We also recommend that staff review the fees in the Depositor Fund to determine whether any in-lieu fees are held there erroneously.

Finding 3: The City Should Clarify Expectations of the Utility Undergrounding In-Lieu Fee Program. The City undergrounds utility lines through Rule 20A projects on major thoroughfares (funded by PG&E) and Rule 20B projects, which can be on major arterials, collectors, or near commercial zones (funded by the City and/or developers). Our review focused on the Rule 20B (in-lieu fee) program.

Rule 20B utility undergrounding is a time-consuming and capital-intensive process. Part of the 20B program's slow pace is due to the limited revenue generated through the City's in-lieu fees. Though 20B projects can be combined with 20A funding or completed by developers, the in-lieu fees are the only source of City funding to support this program. In recent years, the City has collected an average of \$1.3 million annually through undergrounding in-lieu fees, which amounts to just 0.3 percent of the \$382 million necessary to complete the current Undergrounding Master Plan. This is due, in part, to the way that the fee is structured. Fees are only charged when parcels are developed, and the fee only covers half the cost of undergrounding the frontage of the parcel. Though Public Works provides the City Council with annual reports on the City's undergrounding programs, unclear expectations on scope, timelines, and funding make it difficult to evaluate the 20B program's success. Given the slow collection of in-lieu fees, we recommend Public Works provide more realistic timeframes and more clearly describe the long-term nature of the program. We also recommend Public Works review the base fee to ensure it closely compares to the actual cost of undergrounding. If the City wants to pursue utility undergrounding more aggressively, it will need to identify additional funding for the program.

Finding 4: The City Has Improved Management of Revenues for Traffic Impact Fee-Funded Areas, But TIF Funding Will Remain Slow. The City has collected \$85 million in developer fees for transportation infrastructure improvements in the North San José, Evergreen, US-101/Oakland/Mabury, and Winchester/280 areas (of which \$68 million is still in reserves). In total, the City needs \$1.2 billion for identified improvements, most of which are in and around North San José. Funding through traffic impact fees (TIFs) have been slow because there has been less development than anticipated (particularly within North San José) and developers receive

credits (effectively reducing the TIF) for existing use, entitlements pre-dating the policies, or constructing public improvements. In addition, the City instituted incentive programs to spur certain types of development in the North San José and US-101/Oakland/Mabury areas, effectively reducing or waiving fees. The City has only spent about \$14 million from TIF funds, in part due to lack of matching funds. While the City anticipates that Measure B funds will help address funding needs for many improvements, and it has corrected reconciliation for an additional funding stream, TIF revenues will likely remain slow. We make two recommendations to improve the transparency and coordination of TIF waivers.

This report has 8 recommendations to improve the collection, tracking, and use of street and utility in-lieu fees. We plan to present this report at the October 7, 2019 meeting of the Transportation and Environment Committee of the City Council. We would like to thank the Department of Public Works; the Department of Transportation; the Department of Planning, Building, and Code Enforcement; the Office of Economic Development; the City Attorney's Office; and the Budget Office for their time and insight during the audit process. The Administration has reviewed the information in this report, and their response is shown on the yellow pages.

Respectfully submitted,



Joe Rois
City Auditor

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JR:lg

Audit Staff: Alison Pauly
Stephanie Noble
Leonard Hyman

cc: Dave Sykes	Rick Doyle	Jennifer Maguire
Matt Cano	Jim Ortbal	Jim Shannon
John Ristow	Kim Walesh	Vera Todorov
Matt Loesch	Chris Burton	Jon Calegari
Ryan Do	Enrique De Anda	Jennifer Pousho
Joe Provenzano	Chris Petak	Egan Hill
Sandra Castellano	Sal Kumar	Leo Ruiz

This report is also available online at www.sanjoseca.gov/audits.

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APPENDIX A

Proposed Transportation Improvements in Each Area Policy

US 101/Oakland/Mabury (2007)	North San José (2005)
<ul style="list-style-type: none"> • Improvement of the US-101/Oakland Road interchange <ul style="list-style-type: none"> ○ widening Oakland Road between Commercial Street and US-101 to 8 lanes, with dual left turn lanes in both directions ○ widening US-101 on-ramps and off-ramps ○ widening eastbound Commercial Street ○ signal modifications at: <ul style="list-style-type: none"> ▪ US-101 and Oakland Road ▪ Oakland Road and Commercial Street • Construction of the US-101/Mabury Road interchange <ul style="list-style-type: none"> ○ new northbound diagonal off-ramp and new loop on-ramp on southeast quadrant of US-101/Mabury ○ new southbound diagonal off-ramp and new loop on-ramp on southwest quadrant ○ installation of new traffic signals at Mabury Road 	<p>PHASE 1</p> <ul style="list-style-type: none"> • Widen Montague Expressway¹ • Improvement of the US 101/ Trimble Road interchange • Montague Expressway / Trimble Road Connection <p>PHASE 2</p> <ul style="list-style-type: none"> • Charcot Avenue extension • Zanker Road widening <p>PHASE 3</p> <ul style="list-style-type: none"> • North First Street / SR 237 interchange • McCarthy Boulevard / Montague Expressway interchange <p>PHASE 4</p> <ul style="list-style-type: none"> • Zanker Road / Skyport Drive connection • US 101 / Mabury interchange <p>As well as:</p> <ul style="list-style-type: none"> • 33 intersection improvements (increase capacity) • North San José grid system improvements • Bicycle, pedestrian, and transit improvements
Evergreen (2008)	I-280/Winchester (2016)
<ul style="list-style-type: none"> • Improvement at Capitol Expressway and Quimby Road to add exclusive northbound and eastbound right-turn lanes • Improvement to Nieman Boulevard and Yerba Buena Road to add second westbound left-turn lane • Improvement to Tully Road and McLaughlin avenue to add an exclusive northbound right-turn lane • Improve White Road and Aborn Road intersection to add a second westbound left lane • Convert a westbound lane at US 101 and Yerba Buena Road (East) to a shared through/right-turn lane • improve White Road and Aborn Road to add a second northbound left-turn lane • Improve San Felipe Road and Yerba Buena Road (South) to add a second eastbound left-turn lane and second southbound left-turn lane • New/modified traffic signals at: <ul style="list-style-type: none"> ○ Ruby Avenue/Norwood Avenue ○ I-680 Ramps (N)/Jackson Avenue ○ Ruby Avenue/Tully Road/Murillo Avenue ○ Story Road/Clayton Road ○ Marten Avenue/Mt. Rushmore Drive ○ Marten Avenue/Flint Avenue ○ Quimby Road/Scottsdale Drive ○ Nieman Boulevard/Daniel Maloney Drive ○ Story Road/Lancelot Lane ○ Ocala Avenue/Hillmont Avenue ○ Ocala Avenue/Adrian Way 	<ul style="list-style-type: none"> • Partially fund planned freeway off-ramp from northbound I-280 to Winchester Boulevard

¹Due to a 2006 settlement agreement, the City and Santa Clara County are obligated to make additional improvements beyond the ADP, such as constructing improved interchanges along portions of Montague expressway and widening portions of San Tomas Expressway. Also note that North San José improvements are being rephased.

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Memorandum

TO: JOE ROIS
CITY AUDITOR

FROM: Matt Cano
John Ristow

SUBJECT: SEE BELOW

DATE: September 20, 2019

Approved

Date

9-26-19

SUBJECT: RESPONSE TO THE AUDIT OF STREET AND UTILITY IN-LIEU FEES

The Departments of Public Works and Transportation have reviewed the Audit of Street and Utility In-Lieu Fees. The Departments greatly appreciate the important work of the City Auditor's Office and commends their efforts to provide recommendations supporting process improvements and efficiencies in the administration of Street and Utility In-Lieu Fees. The Departments are in agreement with the recommendations identified in the report. The following are the Departments' responses to each of the auditor's recommendations.

Finding 1: Consistency and Transparency in Fee Calculation Can Be Improved.

Recommendation #1: To ensure decisions during in-lieu fee assessment are transparent, Public Works should develop guidelines for the appropriate documentation of the calculation of in-lieu

Response: Staff agrees with the recommendation and will develop clear written guidelines for the appropriate documentation of in-lieu fee calculation.

Target Date of Completion: June 2020

Recommendation #2: To ensure consistent assessment of utility undergrounding in-lieu fees across developments and to make the process more transparent, Public Works should:

- a) Develop standard procedures for when and how undergrounding in-lieu fees are assessed and provide training to staff on these procedures, and
- b) Create a digital tool that includes designated utility undergrounding streets and previously paid undergrounding fees.

Response: Staff agrees with the recommendation and will develop a clear written procedure, provide training to staff, and create a digital tool to manage utility underground in-lieu fees.

Target Date of Completion: The written procedures and training will be completed by June 2020. The tool for managing the fees will be completed by December 2020.

Finding 2: Improved Tracking and Coordination Would Enable Program Staff to Better Use In-Lieu Fee Revenue.

Recommendation #3: To ensure that fee revenues are appropriately spent on intended public improvements, Public Works should:

- a) Work with program staff in relevant departments to identify which in-lieu fees were collected for public improvements that have been completed, and transfer fee revenues accordingly;
- b) Going forward, coordinate with program staff when new in-lieu fees are paid to ensure program staff are notified that new revenues are available; and
- c) Update the annual development in-lieu fee report to accurately describe the identified public improvement for unspent in-lieu fees.

Response: Staff agrees with the recommendation and will coordinate with relevant departments. This will be an iterative process to go through all existing fees to determine which fees should be kept for future improvements and which fees may be transferred to existing City funds for work already performed, such as the Traffic Capital Improvement Program funds. This analysis for existing fees will be completed by the end of 2020. On an ongoing basis, staff will update the annual development in-lieu fee report and coordinate with relevant departments on an annual basis regarding in-lieu fees paid.

Target Date of Completion: December 2020

Recommendation #4: To ensure appropriate tracking and use of in-lieu fee payments, Public Works should review the fees in the Depositors Fund to determine whether any monies should be refunded or transferred to other funds

Response: Staff agrees with the recommendation and will review fees in the Depositors Fund and take appropriate actions.

Target Date of Completion: June 2020

Finding 3: The City should clarify expectations of the Utility Undergrounding In-Lieu Fee Program.

Recommendation 5: To ensure that the City's utility undergrounding fee is a fair estimate of the cost of utility undergrounding projects, Public Works should reassess the utility undergrounding in-lieu fee.

Response: Staff agrees with the recommendation to reassess the utility undergrounding in-lieu fee. However, the Mitigation Fee Act limits fee increases to ensure that developers are not paying more than their share of the cost of improvements. The City cannot control where, when or the rate that development occurs, which limits setting the in-lieu fee rate to a level to match when the actual construction occurs. In 2009, the City Council approved an amendment to the Underground Fee Ordinance that allows the fee to be adjusted annually according to the Engineering News Record (ENR) 20-City Average Construction Cost Index (CCI). Since then, the fee has been adjusted accordingly to align with construction cost trends and staff intends to reassess the fee once a sample of Rule 20B projects are completed. The review of the base fee was intended to occur more frequently as 20B projects were completed. Unfortunately, the delays by PG&E on the Delmas/Park project has prevented that review. The Delmas/Park and McKee/Jose Figueres 20B projects are expected to be completed by the end of 2020 and 2021, respectively. The In-Lieu Fee will be reassessed by June 2021, after the completion of the Delmas/Park project. The fee will then be re-assessed annually thereafter utilizing the ENR CCI.

Target Date of Completion: June 2021

Recommendation 6: To increase transparency about the 20B undergrounding (in-lieu fee) program, Public Works should provide more realistic timeframes for anticipated full project funding or construction of 20B utility undergrounding project in annual reports to the City Council. The reports should also more clearly describe the long-term nature of the program. If the City wants to pursue utility undergrounding more aggressively, staff should consider securing additional funding mechanisms.

Response: Staff agrees with the recommendation related to providing more realistic timeframes for anticipated full project funding in the annual report to the City Council. Additionally, staff agrees additional funding would be needed to implement undergrounding more aggressively. However, staff is not recommending prioritizing funding for this effort at this time, given the significant other infrastructure needs throughout the City, and electrical infrastructure is the responsibility of PG&E at this point in time.

The 2018-19 report was the first time staff provided dates on the Master Plan as a target date for full funding. Given the nature of the development projects, the City cannot control where, when or the rate at which development or fee payments will occur. So, the timelines included are only estimates. Staff will include more details on time lines and expectations in future reports to Council.

Currently, developers are given the option to self-perform the utility undergrounding or pay the in-lieu fees. Prior to development project approval and fee collection, staff performs research and feasibility study of the area for utility undergrounding and compares it against the 5-Year Utility Undergrounding Workplan. Staff will continue to take additional steps in reviewing projects against 5-Year Utility Undergrounding Workplan, Utility Undergrounding GIS map, and potential development and communicate it clearly to developers about the long-term nature of the program. Staff is currently updating the utility underground GIS map which will allow easier access to project updates, and assist in the coordination with in-lieu fee collection and transparency. The GIS map will be available to general public on the City website upon completion.

Staff has continued to complete utility undergrounding through PG&E's Rule 20A program and developer undergrounding projects. Whenever feasible, staff will continue do 20B projects or combine with PG&E's Rule 20A projects, even though, at the time of construction of the undergrounding projects, 100% of In-Lieu fees may not have been collected within the 20B project limits. In 2009, the City Council approved an amendment to the Underground Fee Ordinance to allow reimbursement to developers who choose to underground. As a financial incentive to encourage and facilitate undergrounding, a developer who elects to underground is reimbursed any fees previously collected within the limits of the undergrounding.

Staff will provide estimated timelines on when Master Plan locations could be expected to be completed based on 20A and 20B projected funding. Projections will continue to fluctuate due to PG&E's lack of prioritization of 20A projects, the CPUC's Order Instituting Rulemaking, PG&E's bankruptcy and their prioritization to restore wildfire damaged areas over non-emergency related Rule 20A projects.

Target Date of Completion: June 2020

Finding 4: The City Has Improved Management of Revenues for Traffic Impact Fee-Funded Areas, but TIF Funding Will Remain Slow.

Recommendation #7: Public Works should establish a process to alert the Office of Economic Development to potential waivers under incentive programs, ensuring developments receiving waivers meet all eligibility criteria (including agreements with the City, as applicable).

Response: Staff agrees with the recommendation and will develop a clear written procedure to alert the Office of Economic Development to potential waivers under incentive programs.

Target Date of Completion: December 2019.

Recommendation #8: To ensure transparency in the application of economic development incentives, the Administration should take to the City Council a recommendation for the adoption of the industrial incentive criteria for inclusion in the US-101/Oakland/Mabury Transportation Development Policy.

Response: The Administration conceptually agrees with the recommendation for improved transparency. The Administration is implementing the council approved US-101/Oakland/Mabury TDP (TDP) direction to exempt some new or expanded industrial developments. The TDP exempts 115 trips related to new or expanded industrial developments from the TIF. To support this exemption, sources of funding (state, regional, city) were identified to cover a proportionate funding of those 115 trips towards the TDP's improvements. To implement the exemption, an internal process clarifies eligibility and ensures that the industrial exemption would not be allocated to one large industrial development at the expense of the smaller industrial developments proposed for intensification, in line with the original intent of the TDP.

The audit recommendation is based on a comparison between the industrial incentives in the TDP and those in the North San Jose Area Development Policy (ADP). The context for the North San Jose ADP incentives differs from that of the TDP. The City Council amended the North San Jose ADP to forego certain TIFs through reduced fees and outlined the eligibility criteria. The US-101/Oakland/Mabury TDP incentives were included at first adoption and supporting funding was identified. The internal process serves the purpose of implementing council direction.

The Administration will continue to follow a clear and transparent practice of allocating economic development incentives in the US-101/Oakland/Mabury TDP through the process developed in the internal process. The Administration will increase transparency by posting the process to the City's website with the TDP. Transparency will also be improved through implementation of Recommendation #7.

Target Date of Completion: December 2019

/s/

Matt Cano
Director of Public Works

/s/

John Ristow
Director of Transportation

For questions, please contact Matt Cano, Director of Public Works, at 535-8477 or John Ristow, Director of Transportation, at 535-3845.