TO: COMMUNITY & ECONOMIC DEVELOPMENT COMMITTEE

FROM: Harry Freitas
      Kim Walesh
      Hans Larsen

SUBJECT: SEE BELOW

DATE: May 8, 2015

SUBJECT: PROPOSAL TO AMEND THE NORTH SAN JOSE AREA DEVELOPMENT POLICY AND ENVIRONMENTAL IMPACT REPORT

RECOMMENDATION

Forward staff’s recommendation for actions related to the North San Jose Area Development Policy and the associated Environmental Impact Report (EIR) as described below:

a. Return to Council prior to the end of the calendar year with short-term modifications to facilitate near-term industrial development.


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) to establish a policy framework to allow and guide additional development in one of its most important employment centers. The Policy created additional development capacity in the area to accommodate 26.7 million square feet of new office/R&D development, 32,000 residential units, 2.7 million square feet of retail development, and 1,000 hotel rooms.

In order to provide certainty to the development community with regard to the infrastructure requirements associated with this level of intensification, the City adopted a program level Environmental Impact Report which included a standardized Traffic Impact Fee. When implemented, the 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 $14.44 per square foot and is set to rise again in 2017 to $15.41 per square foot. To ensure that the development of jobs, housing and transportation occurred in a balanced manner, the Policy was divided evenly into four phases.
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 a 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 completed both planning and building permits before December 31, 2014. The Policy was further amended to expand the near-term development incentive to include a lower fee for projects of 1 million square feet and to extend the timeframe.

On November 18, 2014, the City Council was given a presentation from staff in regards to extending the North San Jose Traffic Impact Fee and revising the North San Jose Design Guidelines. The City Council adopted a resolution to amend the North San Jose Area Development Policy and Urban Design Guidelines to:

(i) Extend the Traffic Impact Fee for projects over 1 million square feet to obtain building permits for one year to December 31, 2015;
(ii) Limit the amount of development capacity in the incentive to a total of 4 million square feet;
(iii) Designate when the time of payment occurs for the Traffic Impact Fee, or upon completion of an Industrial Project Completion Agreement; and
(iv) Revised guidelines to include interim development conditions that provide additional design flexibility for all project types within the Policy boundaries.

At this meeting, the City Council also discussed the merits of lowering the Traffic Impact Fee. The Council noted that the Traffic Impact Fee has been a deterrent to investors wanting to build in North San Jose. The Council agreed that by lowering the Traffic Impact Fee, North San Jose would become more competitive with the rest of Silicon Valley. Furthermore, staff was directed to address how to move forward with additional housing allocations in North San Jose. The Council noted there could be an opportunity where the development community could pay a transaction fee to help bridge the funding for transportation improvements.

Following Council’s direction, this memorandum constitutes staffs’ analysis of the Policy in the ten years since its adoption, its implementation, and potential impediments to the envisioned build out. This memorandum also provides an update on residential and industrial development activity, and a strategic work plan to amend the Policy to further encourage development in the area.

**ANALYSIS**

*Industrial Development Activity*

Entitlements for new industrial development in North San Jose have significantly increased over the past year. In the past year over 1.7 million square feet of new development has been approved within the Policy area. This additional development has brought the City closer to the industrial development cap of 7 million square feet, plus an additional 3.1 million square feet of created through the demolition of industrial buildings to accommodate new residential development in Phase 1. Based on current market conditions and interest, staff anticipates
between eight to twelve months before the Phase 1 industrial capacity is exhausted. While these entitlements are obviously a positive sign for North San Jose, only 1.2 million square feet have received building permits.

The Traffic Impact Fee is required to be paid at the issuance of building permits. In addition, to move from Phase 1 to Phase 2, the Policy requires that 85 percent of funding for transportation improvements for Phase 1 be secured. If the current level of development interest persists without actual construction commencing, new development will not be able to be approved beyond the Phase 1 cap until existing entitlements expire. The Policy envisioned development permits with a two year duration, but in reality permits have been approved with four to 15 year durations. As such, the City may not be able to approve additional industrial development until significant construction occurs.

<table>
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<tr>
<th>NSJ Industrial Development Allocation Phase 1</th>
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<tr>
<td>Phase 1 Capacity</td>
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<tr>
<td>Industrial Converted or Demolished</td>
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<tr>
<td>Total Capacity (Phase 1 and Conversion)</td>
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<td>Total Industrial R&amp;D Approved</td>
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<th>Phase 1 Approved and/or Under Construction to meet 85% Transportation Funding</th>
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<tr>
<td>Industrial Improvement Required</td>
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<tr>
<td>Industrial Land Built/Under Construction</td>
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<tr>
<td>Remaining Construction Capacity</td>
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It is critical to note that without receipt of funding, the reservation of industrial capacity through entitlements counts against the development capacity, preventing consideration of future development. Without the guaranteed improvements or funding, development beyond Phase 1 would not be allowed to proceed. Any delay in development once the capacity is met could create a de facto moratorium.

Residential Development Activity

The City has not considered any new residential development in North San Jose since 2011. The housing is fully subscribed, with only 61 units available for development until the remainder of industrial in Phase 1 has been built. Due to current Policy restrictions and the rate at which the industrial is being constructed, the City does not anticipate that any new residential development would be considered for another five to ten years.

<table>
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<tr>
<th>NSJ Approved Residential Unit Allocation Phase 1</th>
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<tr>
<td>Phase 1 Capacity</td>
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<tr>
<td>Phase 1 Total Number of Units Constructed</td>
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<tr>
<td>Remaining Phase 1 Reservation/Allocation</td>
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Additionally, residential in future phases will have to be built out at higher densities than anticipated by the Policy to achieve the 32,000 units (6,000 within the Core and 18,650 outside the Core). Phase 1 residential development, which occurred outside the Core, was built at a significantly lower density than anticipated under the Policy. The density of individual projects have been built as low as 35 dwelling units per net acre (i.e., subtracting land dedicated for right-
of-way, parkland, or other improvements). As a result, residential outside of the Core would have to build out at 118 dwelling units per net acre, which is higher than what is expected inside the Core (90 dwelling units per acre), the high-density focus area for the Policy.

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<th>Impact of Current Residential Development Under NSJ Policy</th>
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<td>Residential under the Transit Employment Residential Overlay (TERO) (55 DU/ acres across 200 acres)</td>
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<tr>
<td>Remaining Residential after Phase 1</td>
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<tr>
<td>Available acreage for development</td>
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<tr>
<td>DUs/ac to achieve build out of TERO</td>
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It is also worth noting that properties identified for future residential outside the Core (see image below) are currently designated for industrial uses. The approximately 160 acres would have to be converted from employment land, which is currently discouraged by the General Plan. Moreover, the current properties are small and are under fragmented ownership, presenting limited aggregation opportunities that would allow high-density housing to be potentially feasible.

Near-term Development Incentive

Since its introduction in January 2012, the incentive program has successfully attracted significant development interest in the area, with three development projects having actually obtained a building permit and, thereby, paid the reduced Traffic Impact Fee. These projects are the Samsung Semiconductor R&D/HQ expansion which utilized 394,659 square feet of the $5/sq. ft. incentive, and two Cisco Systems intensification projects which built a total of three additional parking structures utilizing 345,300 square feet of the $5/sq. ft. incentive. Collectively these projects have utilized 739,959 square feet, leaving 3,260,041 square feet remaining of the original 4 million square feet.

When Council approved the expansion of the incentive in December 2013, staff was aware of three additional development projects which would qualify for the incentive. Once adjusted for existing building credit, these projects comprise 440,000 square feet of the 660,000 square feet 101/Tech development (at $5/sq. ft.), the 2,025,000 square feet of the Peery Arrillaga
development (at $2/sq. ft.), and 1,415,000 square feet of the 1,550,000 Super Micro development (at $2/sq. ft.). At 3.88 million square feet, this would account for almost all of the 4 million square feet incentive.

The 101/Tech development remains locked in through an industrial satisfaction agreement. However the Peery Arrillaga and SuperMicro developments continue to evolve. To aid facilitation of these projects, staff will return to Council prior to the end of the calendar year to provide additional flexibility to ensure these projects proceed.

Short-and Long-Term Service Need/Rationale

Based on the aforementioned analysis, staff is recommending modifications to the Policy to improve implementation of its goals and encourage the market to proceed with industrial development. As demonstrated by the near-term industrial incentive, a modified traffic impact fee results in the expansion, retention, and attraction of new industrial development.

That being said, to avoid potential restrictions on development and future issues that would limit investment opportunities in North San Jose, staff proposes a short-term and long-term approach to amend the Policy.

The short term solution would be to adjust Phase 1 capacity to avoid a near-term moratorium. Staff would analyze increasing Phase 1 industrial capacity from 7 million square feet to 9 million square feet. With this proposal, the existing residential allocation would remain constant at 8,000 residential units. Under the current environmental clearance, staff would be able to demonstrate that there are no new significant impacts.

Simultaneously, staff would evaluate long-term policy changes to allow increased development interest in North San Jose to remain high. Comprehensive revisions to the policy and implementation strategies could identify less costly mitigation improvements, which in turn would allow a lower traffic impact fee to be applied equally for all development types. Moreover, changes would allow for modification to the phasing and timing of development to take advantage of market conditions and avoid a potential development moratorium over a period of time.
The preliminary scope to modify the Policy and update the Environmental Impact Report would consist of:

- Align the Policy with the City's General Plan Transportation Goals to maximize the use of multi-modal opportunities (such as light rail, BART, and bicycling) to reduce impacts.
- Updating the Policy and General Plan to identify appropriate areas for residential, industrial, commercial, or mixed use opportunities in North San Jose to create a quality community.
- Restructure the mitigation package in the near-term to reflect the impacts of early development phases.
- Redefine funding obligations and/or restructuring of the traffic impact fee to reflect regional funding opportunities.
- Maintain the full development capacity of the current Policy to ensure the longevity of North San Jose.

It is noted that the opportunity to secure new funding for regional projects included in the North San Jose plan can significantly reduce cost of a traffic impact fee for new development. The VTA's "Envision Silicon Valley" funding measure being considered for the 2016 ballot could potentially include such projects as 101/Zanker/Skyport overcrossing, 880/Charcot overcrossing, 101/Trimble interchange upgrade, 101/Maybury interchange and the Coyote Creek Trail.

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. Staff believes this approach will create a more attractive and sustainable area development policy.

COORDINATION

The preparation of this memorandum was coordinated with the City Attorney's Office.

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