



Memorandum

TO: HONORABLE MAYOR
AND CITY COUNCIL

FROM: Kim Welsh
Joe Horwedel

SUBJECT: NORTH SAN JOSE TRAFFIC IMPACT FEE INCENTIVE PROGRAM
DATE: January 17, 2012

Approved

Date

1/18/12

COUNCIL DISTRICTS: 3 & 4

RECOMMENDATION

- a. Adopt a resolution amending the North San José Area Development Policy to promote near-term industrial development through a temporary incentive program allowing for reduction in the traffic impact fee for qualifying industrial development completed within a timeframe to be specified in a development agreement.
- b. Approve an ordinance amending Title 14 of the San José Municipal Code to amend Section 14.29.040 of Chapter 14.29 (North San José Traffic Impact Fee Requirements) to provide that the traffic impact fee shall be paid prior to issuance of a building permit or in accordance with the schedule specified in a development agreement.

OUTCOME

Approval of the proposed amendment will accelerate investment in new office/industrial development in North San José.

BACKGROUND

The North San José area plays a vital role in the achievement of San José's economic goals. In 2005, the City adopted the North San José Area Development Policy which established a policy framework to guide the ongoing development of the area as an important employment center for San José. 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 José Traffic Impact Fee based on a nexus study analyzing, among other

January 17, 2012

Subject: North San José Traffic Impact Fee Incentive Program

Page 2

things, expected trip generation for categories of development. 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 \$12.69 per square foot and is set to rise again in 2013 to \$13.54 per square foot.

In addition to creating new employment-generating development capacity, the creation of the North San José Area Development Policy was intended to bring additional consistency and predictability to the development process by standardizing mitigation responsibilities within the Policy boundaries through the adoption of a Traffic Impact Fee.

Unintentionally, this Policy has created a near-term competitive disadvantage for North San José during a period of economic recession and slow recovery. This stems from the distribution of the fee evenly across all four phases. This has meant that near-term development within the Policy area must equally bear the burden of mitigation resulting from all development in the entire area over the next 20 to 30 years, where other competing jurisdictions need only mitigate traffic impacts within the scope of individual projects. In the long term, North San José will benefit from the approach created in the Policy as the cost of mitigating development in surrounding communities becomes prohibitive; however, considerable development must take place before then. In the meantime, San José is not well positioned to receive near-term development with existing traffic impact fees.

On December 13, 2011, the Council directed staff to return to Council in January with an amendment to the North San José Area Development Policy to promote near-term development.

ANALYSIS

Staff is recommending that the North San José Area Development Policy be amended to include a short-term incentive program to secure near term industrial development of projects larger than 200,000 square feet, that places the burden of the amount of the traffic impact fee exceeding \$5 per square foot on the City. The incentive would be available from February 1, 2012 to June 31, 2014, would be capped at 1,000,000 square feet of net new development (development capacity created by the demolition and replacement of square footage in existing industrial buildings would not count towards the cap), and would require the negotiation and execution of a Development Agreement between the City and the developer. Under the incentive program, in exchange for actual completion of such development within a specified expeditious timeframe, the amount of the traffic impact fee paid by the developer would be reduced to approximately \$5 per square foot. The City would bear the burden of the traffic impact fee exceeding \$5 per square foot that would otherwise be payable by the developer, and the traffic impact fee would be paid at a later point in the development process rather than at issuance of building permits as is generally required by Section 14.29.040 C of the San José Municipal Code.

The incentive would be a limited and temporary exception to the general traffic impact fee requirements for qualifying development, and would need to be implemented through the negotiation and execution of a Development Agreement between the City and each developer. The proposed ordinance modifying the North San José Traffic Impact Fee Ordinance, Chapter 14.29 of the SJMC, would allow for payment of the traffic impact fee prior to issuance of

building permits as is currently done or in accordance with the schedule set forth in a Development Agreement.

Development Agreements are generally intended to provide assurance to development projects that have a longer time to completion, so that the project may proceed in accordance with the land use policies, rules, and regulations at the time of execution. Previously, the City's Development Agreement Ordinance provided that only developments of a large, single-user, corporate headquarters were eligible for a Development Agreement. The recent amendments to the Ordinance, adopted by Council on October 18, 2011, provide additional flexibility and have paved the way for shorter-term Agreements that can drive a broader scope of economic development projects. As proposed, the use of Development Agreements in the case of a near term North San José development incentive program would allow the City to carve out a limited exception to the requirements of San José Municipal Code Section 14.29.040 C which requires that no building permits shall be issued within the North San José Area development policy boundary unless and until the traffic impact fee has been paid in full. On a case by case basis, Council can consider the approval of Development Agreements for qualifying developments that allow the developer to defer payment of the fee until prior to occupancy, and place the burden of the traffic impact beyond \$5 per square foot on the City.

The Development Agreement Ordinance provides that development is eligible for a Development Agreement if it meets one of the following criteria:

- a. i. The developer will incur unusually substantial costs in order to provide public improvements, facilities or services from which the public will benefit; and
- a.i.i. The developer has made commitments to a very high standard of quality and agreed to development limitations beyond that required by existing city zoning code; or
- b. The development will make a substantial contribution to the economic development of the city in that it:
 - i. Will create new, net permanent jobs located within the city, will create substantial new, net revenues for the city, or will retain a substantial number of existing permanent jobs within the city; and
 - ii. Is located on a legal parcel of at least five acres; or
- c.i. The development houses a point of sales office that will generate sales tax revenue for the city or will be used as a corporate headquarters by the primary user of the development; and
- c.ii. Is located on a legal parcel of at least five acres or will consist of at least two hundred thousand square feet of new development.

The intent of the incentive is to drive near-term industrial development to benefit from the latest growth cycle in the regional economy. As a result of recent lease activity, there is a significant lack of large Class A office/Research and Development real estate. The development of larger

spaces above 200,000 square feet will meet demand in the market by larger technology related companies, thereby either creating and/or retaining permanent jobs in the City.

The current traffic impact fee for industrial development is \$12.69 per square foot and is set to rise again in 2013 to \$13.54 per square foot. In order to completely fund the cost of the improvements at the time of actual construction, the fees escalate annually in an amount of 3.3%. In the event that the City could pay its additional share attributable to the incentive program prior to 2015, the City would need to secure \$8,540,000 to fund the necessary transportation improvements associated with Phase 1 of the plan. If the City's contribution is not funded prior to 2015, the amount due will be determined subject to the escalator. Department of Transportation staff has analyzed the mitigation package associated with Phase 1 of the Policy and identified projects that may be a good fit for obtaining regional transportation grants in order to offset this deficit. Projects such as the 101/Trimble interchange, which have some amount of work already completed such as early stage design and environmental clearance, have a good possibility of being funded through a state or federal regional infrastructure program. In the event that the City could not secure appropriate funding from outside agencies, the City would be required to fund these improvements. This would be in addition to other commitments that the City has in North San José including contributions to the traffic impact fee that were assigned to the City and Redevelopment Agency, and \$50,000,000 of financial obligations resulting from the lawsuit filed by neighboring jurisdictions.

To gain better insight into the development process and the decision making that might advance near-term development in San José, staff engaged with key developers and brokers to discuss this proposal and other suggestions. The response from the group to a fee incentive program was very positive as it made San José more competitive on fees with other communities. Because of the nature of the current economic cycle, demand for commercial real estate has centered around the mid-Peninsula area. San José is at a geographical disadvantage as leasing and development gradually move south down the Peninsula. In addition to being more cost-competitive on fees, the group also emphasized that our permitting processes must be seamless in their ability to deliver with certainty on time, or ahead of time. It is critical that if the City makes an investment of \$8,000,000 to stimulate industrial development, all of our staff and other resources are aligned to make this investment a resounding success.

Since development agreements traditionally involve significant negotiation and processing, staff believes that setting out the parameters and requirements of the incentive program in the Policy and draft agreement template will streamline and expedite the process. The development agreement will include a timeframe for development and consequences for failure to meet that timeframe. For example, failure to pull a building permit for a minimum of 200,000 square feet within a specified time would constitute a failure to meet the requirements of the agreement and would render the agreement void. Failure to meet later construction or occupancy targets would require the developer to pay the full amount of the traffic impact fee. It is important to ensure that developers understand these consequences early in the process and the City's intent to accommodate actual near-term development.

EVALUATION AND FOLLOW-UP

The proposed change to the North San José Area Development Policy provides a necessary tool to implement the City's vision of North San José. Staff will be bringing forward up to five Development Agreements for consideration by Council, at which point staff will be able to analyze the success of the incentive.

PUBLIC OUTREACH/INTEREST

- ✓ **Criterion 1:** Requires Council action on the use of public funds equal to \$1 million or greater. **(Required: Website Posting)**
- Criterion 2:** Adoption of a new or revised policy that may have implications for public health, safety, quality of life, or financial/economic vitality of the City. **(Required: E-mail and Website Posting)**
- Criterion 3:** Consideration of proposed changes to service delivery, programs, staffing that may have impacts to community services and have been identified by staff, Council or a Community group that requires special outreach. **(Required: E-mail, Website Posting, Community Meetings, Notice in appropriate newspapers)**

This memorandum will be posted on the City's website for the January 31, 2012 Council Agenda.

COORDINATION

The memorandum has been coordinated with the Department of Planning, Building and Code Enforcement, the City Attorney's Office, Department of Transportation, Public Works Department, the City Manager's Budget Office and Redevelopment Agency.

BUDGET IMPACT

The City will be required to secure \$8,540,000 to fund its additional share attributable to the incentive program to ensure that the necessary transportation improvements associated with Phase 1 of the plan are constructed. In the event that the City has not secured these funds prior to 2015, the City's liability will escalate annually in an amount of 3.3% (compounded every two years). The trigger for payment by the City will be the need to move from Phase 1 into Phase 2 of the Policy. Beyond the 1,000,000 square foot incentive, an additional 5,000,000 square feet of industrial development would need to have been issued building permits for this to become a priority. Given the current state of the real estate market, and the amount of vacant real estate already in North San José, this will likely be five to 10 years out.

January 17, 2012

Subject: North San José Traffic Impact Fee Incentive Program

Page 6

With the creation of the Policy, the City conservatively predicted that just over 5% of the total mitigation would be funded by regional transportation grant opportunities. As other major infrastructure improvements are close to 100% funded, North San José can become a priority in applying for grant funds. Department of Transportation staff has analyzed the mitigation package associated with Phase 1 of the Policy and identified projects that may be a good fit for obtaining regional transportation grants in order to offset the deficit created by the incentive. Projects such as the 101/Trimble interchange, which already have early stage design and environmental clearance completed, will be made the focus of ongoing grant applications and as such, have a very high probability of being funded through a state or federal regional infrastructure program.

In the event that the City could not secure appropriate funding from outside agencies, the City would be required to fund these improvements through appropriate funding, such as the General Fund or construction taxes.

CEQA

North San José Environmental Impact Report, Resolution No. 72768 and Addenda thereto.

/s/
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Planning, Building and Code Enforcement

/s/
KIM WALESH
Director of Economic Development
Chief Strategist

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Attachment