



Memorandum

TO: HONORABLE MAYOR
AND CITY COUNCIL

FROM: Kim Walesh
Harry Freitas
Jim Ortbal

SUBJECT: NORTH SAN JOSÉ TRAFFIC
IMPACT FEE INCENTIVE
PROGRAM

DATE: November 23, 2015

Approved

D. D. S. L.

Date

12/3/15

COUNCIL DISTRICT: 3 & 4

RECOMMENDATION

- a. Extend the deadline to qualify for reduced North San José Traffic Impact Fee under the Near-Term Industrial Development Incentive Program by two years to December 31, 2017; and
- b. Revise the criteria to qualify as a low intensity industrial use with traffic impact fee collectible based on trip generation of the use rather than building square footage.

OUTCOME

Approval of the proposed amendment extending the North San José traffic impact fee (NSJ TIF) incentive program will accelerate investment in new office/industrial development in North San José.

Approval of the revision to the low intensity use criteria will provide additional flexibility in applying this provision to industrial projects that demonstrate a very low vehicle trip generation rate and that adhere to controls to ensure the long-term use of the property at the proposed intensity or payment of the full NSJ TIF should the use change.

BACKGROUND

The North San José Area plays a vital role in the achievement of San José's economic and fiscal goals. In 2005, the City adopted the North San José Area Development Policy (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 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% construction cost 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.

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. This program 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 that expanded the square footage allocation by an additional 250,000 square feet (1.25 million square feet total) to accommodate qualifying development projects in the pipeline at that time (referred to as Tier 1 of the incentive).

On December 17, 2013, the City Council adopted a resolution increasing the total square footage available for the incentive program by 2.75 million square feet to 4 million square feet total, and reducing the Traffic Impact Fee to \$2.00/sq. ft. for any build-to-suit Office/R&D campus of over \$1 million square feet (referred to as Tier 2 of the incentive).

On June 10, 2014, the City Council adopted the Mayor's June Budget Message for Fiscal Year 2014-2015 and the Manager's Budget Addendum #8 that outlined a strategy to address an estimated \$50 million funding shortfall for Phase I of the North San José transportation improvements caused by the incentive program and the loss of funding that was previously anticipated from the San José Redevelopment Agency. The City Council committed the City to identify the funding to compensate for the reduction in the Traffic Impact Fee primarily payable by development projects that occur after July 1, 2014.

On November 18, 2014, the City Council adopted a resolution amending the North San José Area Development Policy, amongst other conditions, to extend the North San José Traffic Impact Fee Incentive deadline for Tier 2 projects (build-to-suit projects of over one million square feet) to obtain building permits for one year to December 31, 2015; and to receive a certificate of occupancy for one year to December 31, 2017.

ANALYSIS

Near-Term Industrial Development TIF Incentive

Since its introduction in January 2012, the incentive program successfully attracted significant development interest in the area, with two qualifying development projects entering into agreements with the City to implement the incentive and obtaining all planning and building approvals, including a certificate of occupancy, within the specified timeframe and thereby paying the reduced Traffic Impact Fee. These projects are the recently opened Samsung Semiconductor R&D/HQ expansion which utilized 394,659 square feet of the \$5/sq. ft. incentive, and the Cisco Systems headquarters intensification projects which built a total of three additional parking structures utilizing 345,300 square feet of the \$5/sq. ft. incentive. In addition to these completed projects, the City entered into an Industrial Project Completion Agreement with Ellis Partners to lock in the incentive for 440,000 square feet of the 660,000 square feet approved for their 101/Tech development proposal. Together, these projects have utilized 1,179,959 square feet, leaving 2,820,041 square feet remaining within the incentive.

When Council approved the extension of the Tier 2 incentive in November, 2014, staff was working with applicants on two additional development projects which intended to qualify for the incentive. These projects were the 2,025,000 square feet of the Peery Arrillaga development, and 1,415,000 square feet of the 1,550,000 square foot Super Micro development. In the interim, staff has continued to work with these applicants to advance their proposals in a timely manner. Due to nature of the sites involved and the shifting demands of the local real estate market, these projects have altered their scope and timelines, and in both cases are seeking additional planning approvals. As such neither project will be able to adhere to the December 31, 2015 expiration of the incentive. Given the range of potential issues facing large new development projects and the time required to obtain approvals through the planning, grading and building permit processes, it could be up to an additional year or more before these projects are ready to move forward with construction.

Staff believes the near term development incentive an important tool for accelerating new industrial development in North San José. While the commercial real estate market continues to improve in North San José with vacancy rates decreasing to 11.3% for existing R&D buildings (source: DTZ Silicon Valley RD Market Snapshot Q2 2015), it has yet to lead to new speculative or build-to-suit development.

The longer-term implications of the high cost of development in North San José are being addressed through staff's work to update the Policy and explore opportunities to reduce the TIF to a more competitive level. However, this work is anticipated to take more time than potentially remains in this development cycle. As commercial/industrial real estate in North San José continues to attract additional interest, staff anticipates that the vacancy rate in the area will drop to or below 10% by Q1 2016. Other cities in Silicon Valley continue to attract investment and approve new development projects that compete for the same relocation and expansion projects

from driving industry companies. A reduced TIF will help North San José capture more of this private investment.

Staff recommends extending the term of the Industrial Development Incentive program by two additional years to ensure that pipeline projects and other near-term projects can continue to work towards construction and attract new companies and investment in North San José. Beyond the extension of the timeframe, the parameters of the program will remain the same with 4 million square feet available at either \$5 per square foot for projects over 100,000 square feet or \$2 per square foot for build to suit projects over 1 million square feet.

Low Intensity Uses

The North San José Area Development Policy recognizes that some industrial uses may be determined to have a minimal impact on peak hour traffic such that their traffic impact fees may be assessed on a per-trip basis rather than based on building square footage, as applicable to industrial uses generally. Low intensity industrial uses potentially include highly automated manufacturing, warehouse, storage and distribution facilities.

In order to be considered a low intensity use for purposes of the TIF, the Policy requires that certain controls are in place to ensure the long-term use of the site at the proposed low intensity. The eligibility criteria requires a trip generation analysis approved by the Department of Public Works must demonstrate that the project will generate trips at a rate less than the rate for office, research and development uses, and that the amount of onsite parking be no more than 105% of the amount required to accommodate the low intensity use based on the trip generation analysis. Currently, to be eligible, the project must also conform to a planned development zoning or other zoning that does not allow more intensive uses than the proposed low intensity use.

The proposed Policy revision would allow projects to be considered a low intensity use even if the site's zoning allows for more intensive use, if other controls are in place to ensure that if the use were later converted to a more intense use, the full TIF would be paid by the applicant. Specifically, a project would be eligible if it conformed to a development permit that does not allow more intensive uses than those approved in the trip generation analysis and, based on the site and building design, the low intensity use could not be converted to another use without a new development permit, building permit or change of occupancy permit. Further, to receive the benefit of the lower TIF assessment, the applicant would enter into a recorded agreement with the City to pay the full TIF based on building square footage (minus the low intensity use TIF previously paid) should the low intensity use be converted to any other use in whole or in part.

As revised, the Policy would provide added flexibility to apply the low intensity use provision to uses that demonstrate they generate minimal peak hour trips while safeguarding the City's ability to collect the appropriate higher TIF payments should the low intensity use be changed.

PUBLIC OUTREACH

This memorandum will be posted on the City's website for the December 15, 2015 Council Agenda.

COORDINATION

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

COST SUMMARY/IMPLICATIONS

On June 10, 2014, the City Council adopted the Mayor's June Budget Message for Fiscal Year 2014-2015 and the Manager's Budget Addendum (MBA) #8 that outlined a strategy to address an estimated \$50 million funding shortfall for Phase I of the North San José transportation improvements caused by both the incentive program and the loss of funding that was previously anticipated from the San José Redevelopment Agency. While the City will attempt to address the shortfall with regional and outside funding sources, the approval of MBA #8 pledged the following sources to cover the funding gap if necessary:

- North San José New Development Reserve - future Building and Structure Construction Tax generated new developments in North San José (approx. \$35 million, \$1.2 million received and set aside to date)
- North San José Transportation Improvements Reserve - past Building and Structure Construction Tax previously set aside for future transportation improvements (\$8.0 million)
- Business Cooperation Program – future sales tax revenue received under the Business Cooperation Program related to the construction of new development in North San José (approx. \$7 million, no funding received to date)

It is important to note that staff's work in updating the Policy may result in a different suite and timing of transportation improvements, which could translate into reduced costs and lessen the amount of resources needed to cover the funding gap. Should that occur, staff will return to the City Council with recommendations to shift strategies to cover the funding gap, as applicable.

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November 23, 2015

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CEQA

Resolution No. 72768 and Addenda thereto.

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