



Memorandum

TO: HONORABLE MAYOR
AND CITY COUNCIL

FROM: Kim Welsh
Rosalynn Hughey
John Ristow

**SUBJECT: STATUS REPORT ON
NORTH SAN JOSE AREA
DEVELOPMENT POLICY
UPDATE**

DATE: May 2, 2019

Approved

Date

5/3/19

COUNCIL DISTRICT: 3 & 4

RECOMMENDATION

Accept staff's status report on its work to propose minor amendments to the North San José Area Development Policy to advance 8,000 units of the existing housing capacity to make it available for development in response to the Council's 2018 and 2019 adopted priorities.

OUTCOME

Following staff's report, the City Council will have an understanding of the history and current status of the North San José Area Development Policy, and the potential policy amendments that staff are currently exploring to allow 8000 housing units to move forward.

BACKGROUND

North San José Employment Growth Area and Area Development Policy

North San José plays a vital role in the achievement of the City's economic, housing, transportation, and fiscal goals. North San José is the City's largest employment district and is designated in the Envision San José 2040 General Plan as an Employment Center because of its proximity to regional transportation infrastructure. It is home to many important leading technology companies and a key growth area for the City.

In 2005, the City adopted the North San José Area Development Policy (Policy), which revised an established policy framework to guide on-going intensified mixed use development in this critically important employment center and innovation district. The Policy continues to be the key implementation document for this area. The Policy provides for the expansion of the City's

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key North San José employment area, allowing for the addition of 26.7 million square feet of new office/industrial development, 32,000 housing units, 2.7 million square feet of commercial uses and 1,000 hotel rooms. Consistent with San José's Smart Growth principles, this growth capacity is focused primarily into higher density development at transit-oriented sites. The plan includes:

- A grid street system to create more walkable, urban blocks within the central part of North San José.
- Urban, mixed-use housing, parks, and services to build neighborhoods in close proximity to employment growth.
- The City's first Traffic Impact Fee on both residential and employment development to partially fund the identified regional transportation improvements.
- A development-phasing plan that links job and housing growth to the construction of the specified regional transportation improvements.

A fundamental component of the current Policy is allowing the conversion of 285 acres of industrial land to accommodate new residential development. The additional residential units provide the transportation benefit of internalizing traffic trips within North San José. This traffic internalization allows for significantly more development than the 6.7 million square feet of new office/industrial uses envisioned by the previous Policy.

To ensure that the jobs and housing occurred in a balanced manner and that the regional (not project specific) transportation improvements are funded and completed to serve North San Jose development under the Policy, development is divided evenly into the four phases indicated in Table 1 below. The transportation improvements specified in the Policy are only partial mitigation of transportation impacts identified in the NSJADP EIR. The impacts identified in the NSJADP EIR were still considered significant and overridden by the Council. Because the City could not anticipate where development would actually occur within the Policy area, the City envisioned where it might occur first and specified the correlating transportation improvements that would correlate approximately to where the anticipate development would be located. The 23 intersection and nine major transportation improvements identified in the Policy are also divided into four phases based upon their cost and relative benefit to support anticipated development in each phase. Each phase has a minimum and a maximum amount of residential units which may receive planning permit entitlements as part of the phase. In order for the next phase of capacity to become available, the specified minimum amount of industrial, commercial, and residential development must have received entitlement. In addition, construction of 85% of the infrastructure improvements for each phase must be reasonably assured to the satisfaction of the Director of Public Works, and all of the improvements from any proceeding phase must be constructed before the industrial or residential development of the next phase may be issued Building Permits.

Table 1: Current Phasing Plan (2005 Policy)

Phase	Planning Permit Entitlements for New Office/Industrial Development (Maximum Sq. Ft.)	Planning Permit Entitlements for New Commercial Development (Minimum Sq. Ft.)	Planning Permit Entitlement Capacity for New Residential Units			
			Min.	Max. Market Rate	Affordable (BMR) Reservation	Max. Total Units (MR & BMR)
1	Up to 7 million	100,000	0	6,400	1,600	8,000
2	Up to 14 million	200,000	4,000	12,800	3,200	16,000
3	Up to 21 million	300,000	8,000	19,200	4,800	24,000
4	Up to 26.7 million		16,000	25,600	6,400	32,000

2006 North San José Settlement Agreements

Following the certification of the NSJADP EIR and the adoption of the Policy, the County of Santa Clara, the City of Santa Clara, and the City of Milpitas filed separate actions challenging the adequacy of the NSJADP EIR, on the grounds of the lack of sufficient traffic congestion mitigation on County expressways in the neighboring cities adjacent to NSJ.

These actions were consolidated and, after trial, the superior court ruled in favor of the challengers, issuing a writ of mandate finding that the EIR failed to adequately mitigate traffic impacts in the neighboring city and county jurisdictions. Subsequently, the parties entered into settlement agreements which discharged the writ of mandate on December 5, 2006, rather than requiring the City of San José to rescind the EIR and NSJ Area Development Policy. As a result of this settlement agreement City of San José and the County of Santa Clara are obligated to contribute funds to construct transportation improvements in addition to those specified in the Policy. The additional improvements included funding or constructing improved interchanges along, and the widening of, portions of Montague Expressway, and support widening of portions San Tomas Expressway.

North San Jose Development Capacity

The Policy was developed to add net new development capacity over and above the area's existing building stock and legacy entitlements that predated its approval. The Policy converts traffic capacity into industrial and commercial building square footage, and residential units, for the purpose of collecting the traffic impact fee and tracking development through the

“reservation” (through approval of Planning development permits) and “allocation” (through issuance of Building Permits or payment of the traffic impact fee) of capacity.

This development capacity is reserved and allocated to projects that are either adding net new building square footage, or through intensification resulting from a change in use or the addition of new parking facilities. For example, a project constructing an approximately 600,000 square foot building on a site that contains an existing 300,000 square foot building would only utilize development capacity from the Policy for the net new 300,000 square feet. Alternatively, if a user was adding a parking garage to an existing building to accommodate additional employees, then the additional parking spaces would be converted to equivalent industrial square feet.

Residential projects constructed on existing industrial sites similarly benefit from the existing buildings located on the site. Development credit is given for the existing industrial building on site and off-sets the Traffic Impact Fee for the residential project. To ensure that sufficient Traffic Impact Fees are collected, the offsetting industrial capacity is added back to the industrial development capacity included in Phase 1. Approximately 2.2 million square feet of industrial buildings were demolished in Phase 1 to construct 7,937 residential units. As such, the industrial development pool was increased to approximately 9.2 million square feet. In addition to new industrial uses, the Policy provides for some of this capacity to be utilized for the development of regional or “Large Scale” commercial uses (single occupant greater than 100,000 square feet) and hotels. The Policy limits these uses to one million square feet of regional retail distributed throughout the Policy area, and 1,000 hotel rooms, which if fully built out would be equal to approximately 2 million square feet of industrial development. While some of the additional development capacity created through demolitions of existing buildings has been utilized to construct 464 net new hotel rooms within the Policy area, it has largely contributed to the deficit of industrial development that has become a barrier to future residential development in the area.

Implementation of the North San José Development Policy

Development Activity Since 2005

Following the Policy’s adoption in 2005 and subsequent litigation, a variety of early development applications resulted in the reservation, but not allocation, of both industrial and residential development capacity. The Great Recession of 2008 stalled development throughout San José and Silicon Valley, including a significant amount of entitlements in NSJ that weren’t already under construction or completed. As the region began to recover, interest in North San José focused primarily on new multi-family development, with almost all of the Phase 1’s 8,000 residential unit capacity allocated between 2010 and 2013.

Industrial (primarily office/R&D space) vacancy throughout the Policy Area had increased to above 20% during the Great Recession, resulting in an oversupply of available space. This combined with the Industrial Traffic Impact Fee, which had been initially set at \$10.44 per square foot for all new industrial development, but had continued to be adjusted based on 3.3% annual escalation, became a barrier to new industrial development in North San Jose. In 2012, City Council directed staff to introduce a near term Traffic Impact Fee incentive for industrial

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projects over 100,000 square feet (reducing the TIF from \$12.69/SF to \$5/SF for up to 1.25 million square feet of net new development). This resulted in industrial development projects for companies such as Cisco, Samsung, Broadcom, Super Micro, and Apple.

To incent additional new development in North San Jose, the City Council further amended the near term incentive in 2013 to include a further reduction for projects over 1 million square feet (reducing the TIF from \$13.54/SF to \$2/SF for up to 4 million square feet of new industrial development across both categories). The only project to move forward under this deeper TIF incentive was the Peery Arrillaga development located at North First Street and Brokaw Road.

While not all of projects entitled under both of the above TIF incentive programs have begun construction, these incentives have resulted in Planning development permits of over 3.4 million square feet and construction of approximately 1.5 million square feet of net new office/R&D development.

In addition to the 3.4 million square feet of development entitled under the near-term TIF incentive, another approximately 5.2 million square feet of development entitlements have been approved throughout North San Jose. Of the approximately 8.6 million square feet approved through the entitlement process, only 3.6 million square feet of net new development capacity has actually been constructed, used for site intensification, or been allocated through the payment of the Traffic Impact Fee. Normally many of these entitlements (approved between 2010 and 2014) would have expired and the square footage returned to the available pool of industrial development capacity. Due the timing of the recovery from the Great Recession some projects were given longer than the normal two year expiration plus two one-year extensions that typical development permits have. In addition, a number of large projects have approved development agreements which maintain their reservation beyond the typical timeframe. This has resulted in approximately two thirds of the development capacity reserved in Phase 1 not currently moving forward and may impact other future industrial projects, which desire to build in the near term, from being developed.

Part of the challenge for new industrial development in the area has been the availability of existing building stock, which has been reconditioned for the current market demand. Over five million square feet of existing space in North San Jose was renovated and repositioned for tenants in the market. While these renovated buildings have provided space for has new and the expansion of existing business in North San Jose, it has also discouraged new construction.

Table 2: Residential and Industrial Development-to-Date

Phase	Development Allowed	Activity-To-Date
Phase 1	Industrial: 7 MSF <i>(+2.2 MSF additional from demolitions of existing industrial to accommodate residential projects)</i>	3.6 MSF “allocated” (constructed, used for site intensification, or been allocated through the payment of the Traffic Impact Fee) 4.8 MSF “reserved” (received a Planning development permit)
	Residential: 8,000 units <i>1,600 affordable</i>	7,937 units <i>390 affordable</i>

Affordable Housing in Phase 1

During Phase 1, the housing building permit pipeline was administered separately for market-rate and affordable units. While there was strong demand for the market-rate allocation, much of the affordable allocation was not realized. There are several reasons for the underperformance on the affordable housing goal. The most significant barrier was the City’s inability to fully implement its inclusionary housing programs. In 2010, the City suspended its inclusionary housing requirements for new rental housing construction due to a lawsuit in Southern California, *Palmer/Sixth Street Properties L.P. v. City of Los Angeles* (2009) 175 Cal.App.4th 1396 (*Palmer*) which interpreted state law to prohibit government imposed restrictions of rents when there is no government subsidy of the project. Although state law has since changed in reaction to the *Palmer* decision, during this time of demand for apartment construction, over 7,000 apartments were constructed without any required construction of affordable apartments, and without the payment of an alternative inclusionary in-lieu fee. Second, the economic downturn depressed real estate lending significantly, including a slowdown in lending for affordable housing. Third, and partially because of the outfall of the *Palmer* decision, the City did not have enough funds to subsidize as many affordable units as allocated in the Policy. The City’s shortage of funds was exacerbated as it had to increase subsidy levels for those deals that did move forward during the recession, as the City used its capital to backfill behind both State and private funding commitments so construction could occur. Finally, the elimination of redevelopment tax-increment financing in 2012 removed the City’s primary funding source of \$38 to \$40 million per year to support affordable housing production in North San José and throughout the City.

Major Transportation Improvements Currently Completed

To date, the City has constructed five of the 23 intersection improvements and completed two of the major improvements included in the Policy, widening of Montague Expressway and the Guadalupe River Trail. Currently six of the nine major improvements are partially complete or

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in the project delivery development pipeline, including the Coyote Creek Trail, Trimble-101 and Mabruy-101 interchange, and the Zanker-101 and Charcot overcrossings. These transportation improvements are partially funded through the payment of TIF imposed on residential and commercial development in the Policy Area. The TIF is paid by developers at the time of issuance of the building permit. While nearly all the current Phase 1 industrial capacity has been fully reserved, only about 50% of this capacity has been allocated and thus paid the TIF. This has led to a lack of funding for the Policy's required regional transportation improvements. Absent construction of the Policy transportation improvements, the Policy does not allow authorize North San José to move to Phase 2, which would make 8,000 more units of residential capacity available for development.

Prior Direction from the City Council

Since 2016, City Council direction relating to the Policy has consistently expressed the goal of modifying the Policy to facilitate additional housing in North San José. On April 12, 2016, Council directed staff to evaluate the Policy in order to:

- Analyze a framework to allow 1,500 residential units from Phase 2 to move forward in the near term prior to the full build out of the 10 million industrial capacity required by the Policy in order to move from Phase 1 to Phase 2,
- Identify a comprehensive strategy for build out of retail, restaurants and other basic amenities that make North San José a more compelling place to work and live,
- Present options for a reduced Traffic Impact Fee for Office/R&D development,
- Assess utilities and other infrastructure needed to support the proposed jobs and remaining housing capacity allotted within the Plan, and
- Evaluate the transportation implications of the proposed changes and the opening of BART at the Berryessa/North San José Station.

On August 30, 2016, staff returned to Council with a recommendation to defer any major Policy updates due to the complex nature of the work required and because of two extenuating circumstances:

1. The City filed a lawsuit on the City of Santa Clara "City Place" project, and
2. the VTA had placed a regional transportation sales tax funding measure on the November ballot (Measure B) that has the potential to provide significant regional transportation funding toward the build-out of infrastructure in North San José.

At that time, Council approved staff's recommendation but directed staff to return to Council to:

1. Assess whether to resume work on potential amendments to the Policy and,
2. Present Council with a list of recommendations that will spur development of much-needed amenities - retail, recreation, restaurants, and athletic facilities on or adjacent to corporate campuses in the area.

Since August 30, 2016, the “City Place” lawsuit was settled and Measure B was approved by the voters. On May 9, 2017, staff brought forward the North San José Retail and Amenity Strategy Workplan, followed by accompanying General Plan and Zoning Code amendments to allow local-serving retail commercial uses in the IP Industrial Park Zoning District within the Policy Area, and facilitate greater flexibility to temporary retail and amenity uses within the Policy Area.

On October 17, 2017, Council placed the review of the North San José development policies, fees, and development capacity allocations at #11 on the City Council Priority list. This item included the direction to move 4,000 housing units into Phase 1 of the North San José Area Development Policy (from the Mayor’s memorandum on ‘Responding to the Housing Crisis’ on September 28, 2017).

Current Direction from the City Council

On June 12, 2018, Council directed staff to implement a Housing Crisis Workplan that prioritizes implementation and policy actions that facilitate the development of 15,000 market-rate and 10,000 affordable residential units by 2022 City-wide. Item #4 on the workplan is the review and update of the North San José Development Policy to complete analysis and proposed policy amendments necessary to advance 8,000 housing units from Phase 2 into Phase 1. At the City Council’s priority setting session on March 5, 2019, the North San José Area Development Policy work item was moved up from priority number 11 on the Council’s Priority List to number 8.

ANALYSIS

Proposed Amendments to the North San Jose Area Development Policy

Staff has analyzed opportunities to advance housing development within the context of the Policy and its environmental clearance. To accelerate housing development within the timeframe necessary to meet City’s housing goals, staff is developing a focused proposal that takes the simplest path to advance housing entitlement and generate funding for supportive regional transportation infrastructure.

Staff intends to propose that Council amend the Policy by consolidating the current four development phases into two, allowing a limited amount of residential development to move forward upon the adoption of a Policy Amendment by the City Council. The proposed amendment would make no major changes to the NSJ ADP itself. The total development capacity, the location of planned development (land use plan), and the projects on the list of transportation improvements do not change. The overall development capacity/levels of the NSJADP (26.7 MSF of industrial office/R&D, 32,000 residential units, up to 2.7 MSF of retail/commercial, and 1,000 hotel rooms) and land use plan remain the same.

Table 3: Development Capacity in Current and Proposed Plan Phasing

Original Policy Phasing	Development Allowed	Activity-to-Date	Proposed Phasing
Phase 1	Industrial: 7 MSF (+1.8 MSF credit from demolished buildings)	1.5 MSF allocated 6.9 MSF reserved	Phase A
	Residential: 8,000 units (including 1,600 affordable)	7,937 units (including 390 affordable)	
Phase 2	Industrial: 7 MSF	-	Phase B
	Residential: 8,000 units (including 1,600 affordable)	-	
Phase 3	Industrial: 7 MSF	-	Phase B
	Residential: 8,000 units (including 1,600 affordable)	-	
Phase 4	Industrial: 5.7 MSF	-	Phase B
	Residential: 8,000 units (including 1,600 affordable)	-	

In addition to advancing housing production, the proposal will accelerate investment in the Policy Area’s transportation network. This will make it easier for residents and workers to move across the region. Staffs proposal modifies the phasing of the already identified transportation improvements based on the location of actual Phase 1 development and its needs, observed travel patterns, funding availability, and project readiness. This re-phased transportation plan will deliver the most effective projects faster.

The City has already collected \$55 million towards transportation improvements in the Policy Area. Of these funds, the City has spent more than \$10 million, with the remaining funds allocated to projects in the deliver pipeline. Santa Clara County has completed improvements along Montague Expressway to improve road conditions throughout the area. In addition, in 2016, voters in Santa Clara County passed Measure B which invests approximately \$6.3 billion in the transportation network, including a number of improvements planned in the Policy. Measure B funds are enabling the City, County, and VTA to accelerate the delivery of some of the largest and most impactful transportation improvements in the North San José Plan.

Staff will propose Policy amendments to ensure that, of the 8,000 units of housing capacity that would be made available through the proposed amendments, a minimum of 20% or 1,600 units are built as affordable units consistent with the Policy. Consistent with the percentage of

housing that was required under the former Redevelopment Law and carried over into the current Policy, current residential development is subject both to the Policy and to the City's Inclusionary Housing Ordinance, which provides compliance alternatives. The goal is for the required affordable units to be built, and built in the near-term rather than delayed to the end of the proposed Phase A or moved into Phase B. Although the current requirement is not intended to change, staff will propose Policy amendments to facilitate the creation of required affordable housing in Phase A. To construct the unbuilt Phase 1 capacity of 1,210 affordable units, staff will not propose greater contributions by market rate housing development. The City will need to identify additional resources and opportunities to develop this unbuilt Phase 1 capacity. One way to get additional affordable homes built, for instance, is through the City's financial support for 100% affordable developments.

Issues raised by the City of Santa Clara

Given that the 2006 Settlement Agreements with the City of Milpitas, the City of Santa Clara, and the County of Santa Clara included completion of identified transportation improvements on the County Expressway system, San José staff has met on multiple occasions, and continues to meet, with the staff from these jurisdictions to discuss the proposed changes to the Policy and the proposed changes to the timing of planned regional transportation improvements.

On March 22, 2019 the City received a letter from the City of Santa Clara asking for clarification of the proposed Policy amendments and concern with the scope and timing of improvements included in the settlement agreement, and raised the issue that the 2006 settlement agreement may need to be updated based on proposed changes. In the coming weeks, staff will be meeting with the City of Santa Clara to answer questions and address concerns raised. As part of the 2018 City Place Settlement Agreement, the City of Santa Clara agreed to make a good faith effort to support any modifications to the Policy that accelerated the construction of housing units so long as such modifications include revision of the timing, nature, and scope of related traffic improvements where necessary to serve the acceleration of housing under the NSJ ADP.

Following further discussion and response to issues and questions raised by the City of Santa Clara, further discussion with the County, and the completion of the CEQA clearance document, staff will be prepared to bring the proposed Policy amendments to Planning Commission for its recommendation and then to Council for its consideration.

Conclusion

Staff anticipates that advancing the housing capacity in North San José is one of the most impactful work items that will move the City towards its goal of having 25,000 housing units built, under construction, or entitled by the year 2022. In Summer of 2019 staff intends to present to City Council a proposal for minor amendments to the North San José Development Policy that will allow 8,000 housing units to move forward in this growth area.

EVALUATION AND FOLLOW-UP

This work is anticipated to be completed over the spring and summer with Council consideration of Development Policy amendments and appropriate CEQA clearance in summer 2019.

PUBLIC OUTREACH

The memorandum will be posted on the City's website for the May 14, 2019 City Council agenda.

COORDINATION

The memorandum has been coordinated with the Department of Planning Building & Code Enforcement, the Office of Economic Development, Department of Public Works, the Department of Transportation, the Housing Department, and the City Attorney's Office.

COMMISSION RECOMMENDATION/INPUT

A progress report was accepted by the Community and Economic Development Committee on October 22, 2018.

CEQA

Not a Project, File No. PP17-009, Staff Reports, Assessments, Annual Reports, and Informational Memos that involve no approvals of any City action.

/s/
KIM WALESH
Deputy City Manager
Director of Economic Development

/s/
ROSALYNN HUGHEY
Director, Department of Planning
Building & Code Enforcement

/s/
JOHN RISTOW
Director, Department of Transportation

For questions on items related to the following Departments, please contact:

Economic Development: Chris Burton, Deputy Director, at (408) 535-8114,
Planning, Building and Code Enforcement: Michael Brilliot, Deputy Director, at (408) 535-7831,
Transportation: Ramses Madou, Division Manager, at (408) 975-3283,
Housing: Kristen Clements, Division Manager, at (408) 535-8236.