

CITY COUNCIL STAFF REPORT

MEETING DATE: June 21, 2023

PREPARED BY:

Matthew Mahood, Economic Development Director

APPROVED BY: City Manager

APPROVE AN IMPACT FEE FREEZE AGREEMENT WITH MERSHO INVESTMENTS, LLC AND CLAYTON PLAZA, LLC FOR INDUSTRIAL DEVELOPMENTS ON 6 PARCELS TOTALING 20.14 ACRES IDENTIFIED BY ASSESSOR PARCEL NUMBERS 726-31-038, APN 726-31-025, APN 726-33-026, APN 726-33-025, APN 726-25-026 , AND APN 726-32-025

RECOMMENDATION(S)

1. Approve an Impact Fee Freeze Agreement with Mersho Investments, LLC and Clayton Plaza, LLC for the development of six (6) separate industrial/commercial facilities located throughout Morgan Hill Ranch and Madrone Business Park; and
2. Authorize the City Manager to execute the Impact Fee Freeze Agreement.

COUNCIL PRIORITIES, GOALS & STRATEGIES

City Council Ongoing Priorities

Maintaining and Enhancing Infrastructure

2022-2023 Strategic Priorities

Fiscal Sustainability

Economic Development

Guiding Documents

Economic Blueprint

REPORT NARRATIVE:

On June 21, 2017, the City Council adopted a Development Impact Fee Freeze Program. This program locks the impact fee to a specific date for a period of three years, giving the developer increased certainty as to the costs they will incur and creating an incentive to help offset the ever-increasing cost of new development. In return, the developer agrees to develop and apply for building permits within the three-year period.

Most recently, in May 2022, City Council received an update on the Impact Fee Freeze Program. At this time, the City Council established and locked City's Impact Fees to the

Impact Fees at the time of the executed agreement for up to three years for new commercial and industrial development provided the prospective development secures entitlements and submits for building permits within three years of the date of the agreement.

Details and Analysis:

Mersho Investments LLC and Clayton Plaza LLC, (the Developer) whose principals are the founding family of Shoe Palace and have made other significant investments in our community, are proposing to develop approximately 407,323 square feet of new speculative commercial/industrial facilities across six (6) parcels totaling 22.54 acres located throughout the Morgan Hill Ranch and Madrone Business Parks. The specific locations and detail are:

Address	Application #	APN	Acres	Proposed Building Square Footage
760 Jarvis	BCOM2022-0013	726-31-038	2.4	43,900
645- 741 Jarvis Dr - Mersho #1	SR2022-004	726-31-025	2.40	42,578
850 LightPost Way - Mersho #2	SR2022-005	726-33-026	3.39	54,299
18635 Madrone Pkwy - Mersho #3	SR2022-006	726-33-025	5.03	92,260
887-895 Jarvis Dr- Mersho #4	SR2022-007	726-25-026	7.00	132,270
626-666 Jarvis Dr - Mersho #5	SR2022-008	726-32-025	2.32	42,000
		Totals	22.54	407,323

The Mersho family has submitted plans to the City and is currently seeking entitlements to the above-mentioned projects with the anticipation that they will submit building plans once their sites have been approved. The proposed Impact Fee Agreement will utilize the most recent development impact fee schedule, updated May 15, 2023 (Attachment 2). The developer will have until June 30, 2026, to apply for, and receive building permits, to benefit from the impact fee freeze. The estimated impact fees using the most recent Fee Schedule are \$5,420,249.

Once completed and operational, it is estimated the new 407,323 square feet of commercial/industrial space could generate in excess of \$81,000 in new property tax, assuming a Santa Clara County assessment rate of approximately \$200 per square foot. In addition, depending upon the buildings' specific end users, sales tax revenue may be generated as well. Both sales tax and property tax contribute to the City's General Fund. If the Developer applies for building permits before July 2024, the estimated benefit received to the developer from the impact freeze is \$216,810. If the developer applies for building permits after July 2024, but before July 2025, the estimated benefit of the impact freeze is estimated at \$442,292. If the developer applies for building permits after July 2025, but before July 2026, the estimated benefit of the impact freeze is estimated at \$676,794. The estimates assume that the City's Impact Fees will increase at a rate of 4% per year. While the developer receives cost savings for each year the project is deferred, it is very likely that the cost of construction will

continue to escalate in the coming years and therefore continued delays on building permit submittal will likely cost the developer more than the savings received from an impact fee freeze.

Year	Agreement Base Year	2024*	2025*	2026*
Impact Fee Schedule	05/15/2023	2023/2024	2024/2025	2025/2026
Impact Fee Estimate	\$ 5,420,249	\$ 5,637,059	\$ 5,862,541	\$ 6,098,842
Potential Savings to Development		\$ (216,810)	\$ (442,292)	\$ (676,794)
*Estimated fee escalation of 4% per year				

Conclusion

Approving a Fee Freeze Agreement with Mersho Investments, LLC is consistent with the Impact Fee Freeze Program and aligns with the Economic Blueprint Strategy #3 “Attract New Development,” Action #5, “Explore Incentive Programs to Attract Industry Specific Development.”

COMMUNITY ENGAGEMENT:

Inform

The table below addresses the requirements set forth in State of California AB 562 (Government Code 53083) for publication of information related to an economic development subsidy and public hearings.

Name/address of the beneficiary of the subsidy: Mersho Investments, LLC
Clayton Plaza, LLC
5752 Country Club Pkwy
San Jose, CA 95138

Start and end dates, schedule for the subsidy: The Fee Freeze Agreement is for a period of three years, starting June 30, 2023 and ending June 30, 2026.

Describe the subsidy, estimated total amount of expenditure of public funds or revenue lost: The Impact Fee Freeze Agreement allows the beneficiary to lock-down the project impact fees at the current year's Impact Fee Schedule for a period of up to three years. Impact Fees must be paid by the beneficiary prior to receiving building permits. The potential revenue lost ranges from \$216,810 in year 1, \$442,292 in year 2 and \$676,794 in year three.

State of public purpose: Expand and enhance economic opportunities for businesses in the City, continue to expand the City's employment base, and continue to generate the hereinafter defined Property Tax and Sales Tax that the City can utilize to fund general governmental services such as police, fire, street maintenance, and parks and recreation programs.

Projected tax revenue: The projected increase in property tax collected

Estimated number of jobs created by subsidy:

from improvements to these sites is approximately \$81,000 annually. The construction of these six projects will generate approximately 200 temporary construction jobs. When the projects are completed and occupied, they could generate hundreds of new full-time jobs of varying skills levels and educational requirements.

ALTERNATIVE ACTIONS:

The City of Morgan Hill could choose not to enter into a Fee Freeze Agreement with Mersho Investments and Clayton Plaza to freeze impact fees. This option potentially saves the City at minimum \$216,810 in impact fee revenue, but it also puts the project at risk of not being completed.

PRIOR CITY COUNCIL AND COMMISSION ACTIONS:

In June 2017, City Council approved the Citywide Impact Fee Freeze Program establishing FY 2016-17 Development Impact Fees as the basis for the three-year term for any new commercial/industrial development project that enters into a Development Agreement for an Impact Fee Freeze approved by City Council.

In June 2020, City Council reviewed the Impact Fee Freeze Program and established FY 2017-18 Development Impact Fees as the basis for the three-year term for any new commercial/industrial development project that enters into a Development Agreement for an Impact Fee Freeze approved by City Council.

In May 2022, City Council received an update on the Impact Fee Freeze Program. At this time, the City Council established and locked City's Impact Fees to the Impact Fees at the time of the executed agreement for up to three years for new commercial and industrial development provided the prospective development secures entitlements and submits for building permits within three years of the date of the agreement.

FISCAL AND RESOURCE IMPACT:

The potential loss of revenue to the City from entering into this Impact Fee Freeze Agreement is expected to range between \$216,810 to \$676,794. On the other hand, the City expects to receive one-time construction benefit of construction jobs and ancillary economic impact in the form of sales tax from local spending. Once operational, the City could receive an ongoing additional property tax revenue of approximately \$81,000 per year to the City's General Fund.

CEQA (California Environmental Quality Act):

Not a Project

An Environmental Impact Report (EIR) for the Morgan Hill 2035 Project, which included the General Plan Update, was prepared in accordance with the California

Environmental Quality Act (CEQA) and certified by the Morgan Hill City Council on July 27, 2016. Commercial and industrial development as discussed above is consistent with the general plan policies for which the EIR was certified. There is no substantial evidence that freezing impact fees will have a significant effect on the environment beyond that already analyzed in the certified EIR; therefore, no further environmental analysis is required.

Any project specific development that occurs in the future will undergo an independent analysis pursuant to the requirements of CEQA.