



MILPITAS

General Plan Update

MEMORANDUM

June 12, 2018

TO: Milpitas General Plan Advisory Committee (GPAC)

FROM: Ben Ritchie, De Novo Planning Group

SUBJECT: General Plan Advisory Committee Meeting #8 – Economic Development and Fiscal Sustainability

DATE: June 12, 2018

INTRODUCTION

The June 20th GPAC meeting will focus on the topics of Economic Development and Fiscal Sustainability. These are both optional General Plan topics. GPAC members should read the follow pages prior to the next meeting, and come prepared to discuss individual thoughts and responses to the questions posed below. Select sections from the Existing Conditions Report are also included in this meeting packet, and should be reviewed prior to the next meeting.

POPULATION AND ECONOMIC DEVELOPMENT CONTEXT

Milpitas is a growing community with a significant concentration of high-income households. With a population of approximately 76,100, Milpitas has experienced substantial population growth in recent years, adding more than 13,000 residents between 2000 and 2017. This growth averaged 1.1 percent annually—faster growth than that recorded for Santa Clara County or the Bay Area. Although the city's current household composition is weighted heavily towards family households with children, the surge in new multifamily residential development has attracted many new smaller households with no children, primarily Millennial-generation households. In updating its General Plan, the City should consider ways it can continue to attract highly educated, younger residents which in turn makes the community more attractive to employers.

Milpitas offers a large and skilled resident labor pool and manufacturing is a major source of employment for Milpitas residents. There are 35,800 employed residents in the City and nearly one-fourth (24.3 percent) of all employed residents work in the industry, compared to 17.6 percent of Santa Clara County residents and 10.2 percent of Bay Area residents. Given the high education levels of the City's residents and the nature of the Silicon Valley economy, it is likely that many residents employed in manufacturing work in high-tech fields. In 2017, 21.7 percent of employed residents worked in computer, engineering, and science occupations, compared to 18.0 percent in the County and 11.3 percent in the Bay Area.

With a jobs-to-employed residents ratio of 1.37, Milpitas is a strong employment cluster that depends on substantial in-commuting of workers from areas outside of the City. Employment in Milpitas is concentrated in manufacturing (29.3 percent), professional and business services (17.3 percent), and

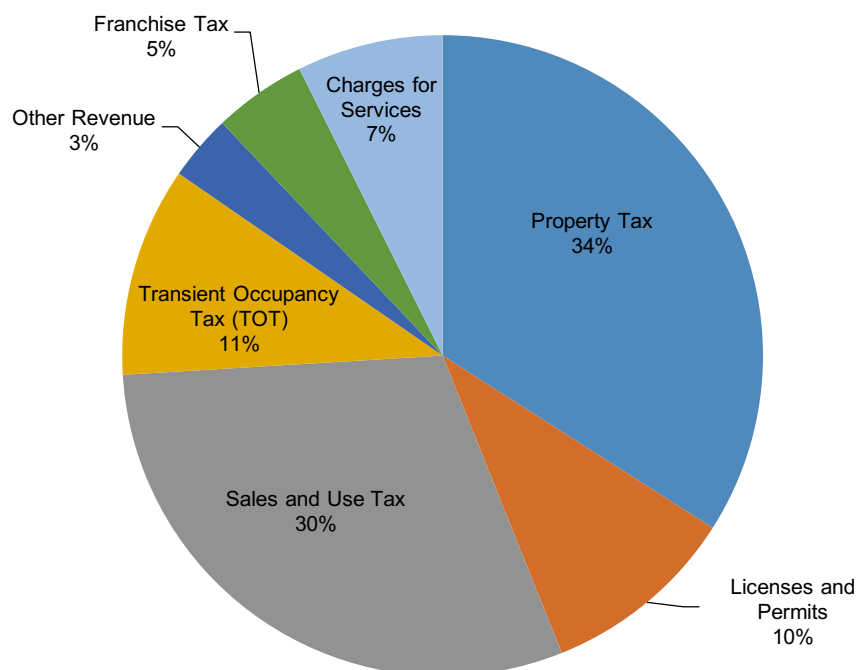
leisure and hospitality (11.4 percent). Milpitas has a much larger share of manufacturing employment than the county, where manufacturing accounts for only 15.3 percent of total jobs. The significant concentration of manufacturing employment in Milpitas is due to the presence of several high-tech firms in the computer and semiconductor fields, including KLA-Tencor, Flextronics, SanDisk, and Linear Technology. Just under half of the city's total manufacturing employment in 2016 was in the semiconductor and other electronic component manufacturing subsector.

FISCAL SUSTAINABILITY CONTEXT

Economic development and the vitality of the economy can directly affect revenues to the City's General Fund. The City's General Fund is heavily dependent on discretionary revenue sources such as property taxes, sales taxes (both retail and business-to-business sales taxes), and transient occupancy taxes.

According to the Adopted FY 2017-18 Budget, the City's General Fund revenues total approximately \$84.8 million, excluding transfers. Property taxes (including in-lieu payments) and sales taxes account for approximately 64 percent of total General Fund revenues. The remaining 36 percent of revenues are accounted for by transient occupancy tax (11 percent), licenses and permits (10 percent), charges for services (7 percent), franchise tax (5 percent), and "other" sources such as business license tax, real estate transfer tax, fines, and forfeitures (3 percent).

FIGURE 1: FY 2017-18 GENERAL FUND REVENUES



Despite the General Fund's recent growth, the City faces major fiscal challenges due to escalating service and employee benefits costs and the loss of the City's Redevelopment Agency following the statewide dissolution of Redevelopment. Prior to the dissolution of the Milpitas Redevelopment Agency, Redevelopment funds contributed \$7 million annually to the City's General Fund. The direct loss of these funds led to drastic cuts in staffing and resources and has prevented the City from successfully completing several major infrastructure, economic development, and affordable housing projects.

THE OFFICE MARKET

Issue: Relatively Weak Market Support

The office market in Santa Clara County consists of several submarkets with varying demand for office space, which is generally reflected in vacancy, lease, and absorption. Palo Alto is typically considered to be the top tier in the Santa Clara County office market supporting the highest rents and lowest vacancies. Portions of West Silicon Valley, including the Mountain View/Los Altos and Sunnyvale/Cupertino submarkets, have also traditionally been highly desirable due to their large concentration of major tech employers such as Google, Apple, Facebook, LinkedIn, and Yahoo. According to Colliers, a major commercial brokerage firm, the most desirable office locations in the Bay Area offer modern buildings near Caltrain offering a high level of amenities, flexible floor plans, high ceilings, and views. East Silicon Valley cities along Interstate 880 have historically been less competitive typically garnering the lowest rents and experiencing the highest vacancies.

With an office inventory of approximately 4.7 million square feet, Milpitas itself accounts for a small portion of Santa Clara County's 126.3 million square foot office inventory. Most office space in Milpitas is contained in larger Class B or Class C buildings. As of the first quarter of 2018, there was only one Class A office building in the City. In contrast, Class A space comprises approximately 32 percent of the office space in the larger county market. A large share of the city's Class B office space is concentrated west of Interstate 880, which is an area dominated by newer research and development (R&D) office and industrial uses. Class C office properties are concentrated in the Midtown Area along the Main and Abel Street commercial and industrial corridors. The southwestern corner of the city, which borders the fast-growing Golden Triangle tech employment area, is home to several major office complexes and large corporate campus developments.

Although Milpitas has a large jobs base and is home to several prominent technology-based businesses, the City's office rents tend to be much lower than the regional and county averages. In general, average full-service office rents are around 40 percent lower in Milpitas than in the county. Recent large occupancy losses from tenants such as Cisco have put even more downward pressure on office rents in recent quarters. During the first quarter of 2018, the average monthly full service asking rent for all office classes was just \$1.91 per square foot in Milpitas, which was about 45 percent lower than the average reported in Santa Clara County (\$3.50 per square foot).

Opportunities - Office

Although Milpitas currently has a weak office market, many office properties in the City are well-located and could provide promising opportunities for redevelopment. In addition, several recent market trends may help create potential market support for additional office development in the city over the mid- to long term (e.g., 5+ years):

- The City's proximity to the area bounded by Highways 101, 237, and I-880 known as the 'Golden Triangle' in which technology companies are locating or expanding. This has been one of the nation's fastest growing area for jobs during the recovery from the Great Recession. Currently there are several "creative office" and "creative industrial" projects at State Route 237 and North 1st Street in San Jose¹. Milpitas would be a logical extension for this growth and it has, in fact, begun to see some of the 'creative' industrial development interest. To the north of Milpitas, both Tesla and Facebook have crossed over the Dumbarton Bridge to lease large blocks of space at Ardenwood Business Park in Fremont, for example, to reduce employee commute time by being closer to where employees live –as well as take advantage of lower office leasing costs.
- A preference by office workers to commute via public transportation, potentially making sites at or near BART and VTA Light Rail stations attractive to Class A office developers. Milpitas Boulevard at Montague Expressway near the Milpitas BART station is one such area that could be a prime office and commercial district.
- Milpitas offers large land parcels that can accommodate demand from rapidly growing technology companies seeking large blocks of contiguous space for corporate campuses (500,000 to 2 million square feet). Many technology firms are being pushed out of core Silicon Valley locations on the westside due to lack of available space and high rents. For the City to attract a corporate end user, it is important to have entitled sites at development intensities in excess of a .55 FAR available for large single users so when a large end user appears, the City will have ready-to-go sites.

Questions – Office

- Where are prime locations in Milpitas that you think will have potential for office uses in the future?
- What are barriers that the City needs to overcome to attract office tenants?
- Should Milpitas permit significantly higher densities in certain districts to be ready for future office users seeking large blocks of space or a campus?

¹ "creative office" and "creative industrial" refer to new or renovated Class A office and industrial projects that offer a high level of onsite amenities and flexible interior space and can obtain a rent premium in the market.

THE INDUSTRIAL/WAREHOUSE MARKET

Issue: Conversions to Non-Industrial Uses

Milpitas has lost a considerable amount of industrial space since 2007. In 2007, the City was home to 20.3 million square feet of industrial space in 389 properties. As of the first quarter of 2018, the industrial building inventory had fallen to 17.4 million square feet in 333 buildings.

Industrial land uses in Milpitas are concentrated west of Interstate 680 within the M1 (Light Industrial), M2 (Heavy Industrial), and MP (Industrial Park) zoning districts. These areas are in close proximity to the Midtown Specific Plan and Transit Area Specific Plan areas, where the City is actively encouraging high-density residential and mixed-use development. Due to high industrial vacancies in the last recession and strong demand for housing near Silicon Valley tech employment, there has been considerable pressure to convert the surrounding industrial land and buildings to residential uses. In addition to these market pressures, there has been a visible shift in the use of existing industrial space for non-profit or public-assembly uses. While this loss of industrial land and tenancies has permitted the City to accommodate more housing and community groups and service-providing establishments, the reduction of industrial land and users can mean a loss of associated business-to-business property taxes as well as a net loss of jobs.

Due to lack of new construction, the industrial buildings in the city are generally older and not up to modern industrial standards. Only 13 percent of the City's stock of industrial buildings are less than 20 years old. In contrast, the share of newer industrial buildings is much greater in Newark, where 26 percent of industrial buildings are less than 20 years old, and Fremont, where 22 percent of industrial buildings are less than 20 years old. The age of structure and its functionality do matter: new large-scale warehouse distribution facilities, for example, need to have a clear height of 35 feet or 36 feet to accommodate automated warehouse operations.

Opportunity – Industrial/Warehouse

The current e-commerce boom will have major implications for the industrial market, as companies such as Amazon and Walmart push for "Last Mile" distribution locations to speed up shipping times. These last-mile facilities are typically smaller (less than 200,000 square feet) light-industrial or warehouse properties located in or near urban infill areas. Compared to large-scale or big-box distribution centers, they normally feature lower ceiling heights (28 feet or less), fewer loading docks, and less parking. As the commercial brokerage CBRE notes, it is the location that is most crucial for these facilities. Another active commercial broker, Kidder Mathews, notes that demand for distribution facilities, and high-quality industrial space in general, is especially high along the I-880 corridor.

In addition to opportunities to accommodate logistics users, advanced manufacturing is another growing industrial market. Advanced manufacturing production processes are extremely complex and often require high-levels of automation. According to commercial brokerage firm Lee & Associates, tenants are willing to pay the premium for more efficient, first generation industrial space with higher beam clearance

to take advantage of newer advanced automation and robotic technologies. In the Bay Area, advanced manufacturing companies typically seek higher value spaces that are 50,000 to 150,000 square feet in size.² Advanced manufacturing typically requires a highly skilled labor force and Milpitas is well-positioned to attract advanced manufacturing firms with its large resident skilled labor pool.

The City of Milpitas is poised to benefit from a rapidly growing transportation manufacturing sector due to its close proximity to Tesla, which is the largest manufacturing employer in the Bay Area. The growth of Tesla has encouraged many suppliers to establish operations nearby in Fremont and Newark. Tesla's third-party suppliers, such as South Bay Solutions, Futuris Automotive, and SAS Automotive, have all recently relocated to the area to be closer to Tesla.

Conversion of industrial properties to residential use needs to be carefully managed to avoid creating real or perceived conflicts between industrial tenants and residential communities. Industrial brokers have reported to City staff that users prefer industrial locations with no proximity to residential to ensure that their operations will not be constrained by having to respond to complaints from nearby residents. To preserve the long-term viability of warehouse and industrial uses in Milpitas, the City could consider potentially designating priority industrial areas specifically for manufacturing and associated industrial uses to preserve their integrity. Fremont, for example, has designated almost all its land west of 880 as industrially zoned. There is low pressure of conversion from office or residential uses in these areas, which has had the effect of attracting and encouraging growth in high tech industrial users.

Questions – Industrial

- What priority should the City give to preserve its industrial and warehouse jobs base?
- Should the City take stronger steps to protect its industrial districts? If 'yes', then what steps would make sense for Milpitas?

² Bergsman, Steve. (First Quarter 2017). "Advanced Manufacturing". *SIOR Commercial Real Estate Report, Spring Edition, Vol. 76, Number 1.*

THE RETAIL MARKET

Issue: Rise of E-Commerce Impact on Sticks and Bricks Retail

Overall, Milpitas has a successful retail economy, suggesting that the city is relatively well-served by its existing 5 million square feet of retail offerings that allow a large share of resident spending and spending from residents living in other areas to occur in Milpitas. On a per capita basis, taxable retail sales in Milpitas (\$17,520) are high relative to Santa Clara County (\$12,553) and the region (\$12,534). In 2016, the most recent year for which there are data, the three largest retail categories were: (i) clothing and clothing accessories, (ii) food services and drinking places, and (iii) motor vehicles and parts dealers. Together, these three retail categories accounted for 61.3 percent of the City's 2016 \$1.3 billion of total taxable retail sales. The City's approximately \$4,500 per capita sales in clothing and clothing accessories stores, for example, were almost 350 percent higher than Santa Clara County's per capita sales (\$1,300), and 367 percent higher than the nine-county Bay Area region's per capita sales (\$1,227) in 2016, reflecting the positive impact of the Great Mall in the City. Despite this strength in the retail sector, however, the City will need to proactively plan to preserve and enhance retail in Milpitas to remain competitive and protect its sales tax revenue which makes up a large part of the City's general fund.

Some of the City's shopping centers are struggling to attract or retain anchor tenants or need capital improvements. The retail environment has changed significantly since the advent of e-commerce and e-retailers such as Amazon and eBay. While many independent and formula retailers continue to thrive, many have closed their doors, leaving shop vacancies or centers without anchors. The best performing retailers have adapted, and are now promoting sales through multiple channels, including physical stores, retail websites, social media, and other media (often referred to as "omnichannel retailing")³. Examples of these efforts include retailers such as Macy's, Target, and Walmart, which have established robust e-commerce operations and utilize their stores as fulfillment centers for online order pick-up and returns.

The share of online spending by consumers also continues to grow annually. In 2016, e-commerce sales accounted for 8.1 percent of total retail sales nationwide. CBRE forecasts that online sales will reach 12.8 percent of all retail sales by 2019. Currently, Milpitas residents make online purchases totaling \$102 million.⁴ Assuming average sales of \$500 per square foot, this translates to 205,000 square feet in reduced demand for sticks and bricks retail. To remain competitive, retail property owners and retailers in Milpitas will need to respond to these market changes.

Opportunities – Retail

The consensus among retail analysts is that brick and mortar will continue to be the foundation of omnichannel retailing since stores provide a sensory experience of the offered goods as well as

³ Retail Systems Research, Inc., *Gaming Google: The Growing Importance of Omniretail*, March 2011.

⁴ Based on national e-commerce trends of 8.1 percent of total retail sales in 2016.

convenience. This has led to many shopping centers repositioning their centers to serve as social hubs in the community to attract shoppers and keep them onsite for longer periods of time with food and beverage offerings and non-retail services and events.

To support new shopping center development and enhance existing centers, the City could consider ways to promote shopping center owners to reinvest and reposition their centers by identifying municipal code requirements that might constrain experiential retail, including such elements as outdoor food trucks, outdoor seating, pop-up retail, outdoor kiosks, music, and other special events.

With new multifamily residential development in Milpitas drawing younger residents, there are increasing opportunities to provide more nightlife in the City and the General Plan update can help guide where new night-life oriented establishments should be located. Having a robust nightlife in the City will help it enhance its quality of life and support its efforts to retain and attract younger workers and residents. Population growth in general in Milpitas will generate new retail spending power that the City can encourage to be spent in Milpitas and may support new large format retail.

Questions – Retail

What actions can the City take to support shopping center owners and developers to invest in new or revitalized retail? Are there barriers in the City's zoning code and development standards that should be addressed?

- Would one or more business improvement districts be of interest to the business community?
- Should the City promote a nightlife and entertainment sector and, if 'yes', what district would be most appropriate for this use?

CURRENT GENERAL PLAN AND ECONOMIC DEVELOPMENT

The City's current General Plan addresses economic development only very briefly in the Land Use Element where it dedicates three pages to discuss the City's job housing balance and future land availability for job-generation with no specific goals, policies, or actions presented.⁵ The City could consider expanding the General Plan's treatment of economic development to provide more guidance to staff and decision-makers.

Questions – Economic Development

- What do you think the City's top three goals should be related to economic development?
- What kind of economy do you envision in the future for Milpitas?
- What have other cities done that Milpitas should consider as part of the General Plan update to promote economic vitality?

⁵ See City of Milpitas General Plan, Land Use Element, pages 2-17 through 2-19.