DRAFT TECHNICAL MEMORANDUM

To: City of Davis

From: David Zehnder

Subject: Davis Innovation Centers: Response to Finance and Budget Committee Questions and Concerns – Nishi

Date: February 4, 2016

The Economics of Land Use

Purpose and Executive Summary

Following the suggestion of the City Council, EPS met with members of the City of Davis Staff and representatives of the City Finance and Budget Commission to discuss outstanding questions and concerns the Commission has regarding the previously released Economic and Fiscal Impact Analysis of Proposed Innovation Centers in Davis (September Report) as it pertains to the Nishi Project (Project). The purpose of this technical memorandum is to assist in resolving the outstanding issues and concerns of the Commission. This Memorandum will include a discussion of the following issues:

- Make Whole Provisions
- Supplemental Sales Tax Revenue
- Assessed Value Assumptions
- Sales Tax Revenue from Business to Business Sales
- Public Service Cost Assumptions

The City Council's direction reflected a desire to identify mechanisms to ensure neutral-to-positive impacts on the City's General Fund. In summary, a combination equivalent to a make-whole provision for properties removed from the tax rolls ($93,000 per year) plus privatization of costs of maintain parks, greenbelts, and streets ($181,000 per year) would lead to neutral to positive impacts under all scenarios. One method to secure funding for these provisions would be to implement a land-secured financing district, which would be established to fund public service costs incurred by the City.

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On Tuesday February 2, the City Council requested analysis of the capacity of the Project and property owners to absorb obligations of a land-secured financing district. Staff is working with A. Plescia & Co. and Goodwin Consulting to confirm capacity of the project to absorb these costs and will provide updated calculations on Monday.

Make-Whole Provision

The Project Developer has committed to a make-whole provision to fund any loss of revenue resulting from the inclusion of Public and Non-Profit land uses within the Project. To account for this commitment, EPS has adjusted the Base Development Scenario and all additional sensitivities to include the additional revenue. Table 1 shows the value of the make whole provision and the remaining deficit attributed to the Base Development Scenario with the make whole provision[1]. It is estimated that the developer must provide alternative funding for approximately $93,000 as a part of the make whole provision. The inclusion of a make whole provision brings the base development program to a fiscally neutral outcome.

Table 1
Nishi Fiscal Impact Analysis - FBC Commentary
Make Whole Provision

Item	Base Development Program		Difference
	Without Provision	With Provision	
	a	*b*	*c=b-a*
City General Fund			
Annual Revenues	$1,245,000	$1,320,000	$75,000
Annual Expenditures	$1,351,000	$1,333,000	($18,000)
Annual General Fund Surplus/(Deficit)	**($106,000)**	**($13,000) [1]**	
Make Whole Provision	**-**	**$93,000**	

provision

Source: EPS

[1] For all intents and purposes this result reflects a fiscally neutral outcome.

Attachment 1 shows the ten sensitivity scenarios analyzed in the September Report with the inclusion of the make whole provision as well as an additional three sensitivity scenarios described below. In order to fully offset the lost revenue from Public and Non-Profit space from each scenario, the make whole provision amount varies from $81,000 to $124,000 of additional revenue that the developer has committed to offset through other means. The inclusion of this provision improves the fiscal results of all scenarios. In the case of the Property Tax Sharing Allocation 75%/25% alternative, Increased Taxable Sales alternative, and an alternative with an

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[1] In cases where project assumptions produce a positive result, the amount attributed to the loss of revenue from Public/Non-Profit occupancy is identified for purposes of disclosure. The need for the make-whole provision under such circumstances may be subject to future discussions between the project applicant and the City.

increased Sale Tax Capture rate of 75%, the anticipate fiscal deficit is brought to a surplus with the inclusion of the make whole provision.

For the remainder of this Memorandum, any discussion of the Base Development Program includes the additional revenue from the make whole provision.

Best and Worst Case Scenario

Table 2 provides a range of possible scenario combinations including best case, baseline case, and worst case scenarios. It is assumed in all three of these scenarios that the policies have been established to maximize privatization of park and public works expenditures, or an alternate funding sources has been identified to cover City costs of maintenance. The best case combination of scenarios results in a net fiscal surplus of $613,000. The Nishi Hotel scenario was excluded as the impact of the development of a hotel in the Project is not directly

Table 2
Nishi Fiscal Impact Analysis - FBC Commentary
Best and Worst Case Scenarios Assuming Maximum Privatization of Maintnenance and Operations Cost

Fiscal Impact Analysis Scenario	Adjustment to Base Development	Annual Fiscal Impact at Buildout
Best Case Scenarios		
4. Property Tax Sharing Allocation: Alt. 1	$109,000	
6. Increased Taxable Sales	$93,000	
7. Sales Tax Capture: Alt. 1	$40,000	
10. Ongoing Operations & Maintenance Responsibility: Alt. 2 [1]	$181,000	
11. Supplemental Sales Tax	$121,000	
12. Increased Assessed Values	$82,000	
Total		**$613,000**
Baseline Case		
10. Ongoing Operations & Maintenance Responsibility: Alt. 2 [1]	$181,000	
Total		**$168,000**
Worst Case Scenario		
5. Property Tax Sharing Allocation: Alt. 2	($ 109,000)	
8. Sales Tax Capture: Alt. 2	($ 39,000)	
10. Ongoing Operations & Maintenance Responsibility: Alt. 2 [1]	$ 181,000	
13. Decreased Taxable Sales	($ 38,000)	
Total		**($18,000)**

FBC_scen

Source: EPS.

[1] Scenario 10 reflects the most positive policy result and is included in all three scenarios.

relatable to the other sensitivity scenarios. The Baseline scenario results in a fiscal surplus of $168,000. The Worst Case Scenario still results in a relatively fiscally neutral result of a slight deficit of $18,000. An adjustment to any of the scenarios included would bring the worst case scenario to a fiscal surplus. [2]

Additional Sensitivity Scenarios

Supplemental Sales Tax

The City currently has an additional 1% sales tax beyond the 7.5% collected by the State. As a conservative estimate, EPS assumed that this supplemental sales tax would not be renewed when it is set to expire in 2020 in the September Report. A sensitivity scenario was created to include the revenue from the supplemental sales tax if it is renewed. To remain conservative, EPS included one half of the total possible revenue from the supplemental sales tax.

As shown in **Attachment 1**, the inclusion of one half of the potential supplemental sales tax results in a fiscal surplus of approximately $108,000 annually, an increase of $121,000 from the Base Development Scenario.

Increased Assessed Value

In establishing assessed values for the September Report, EPS conducted an internal review of assessed values of similar products in the region. To ensure a conservative analysis, EPS found it prudent to utilize reduced assessed value assumptions, however EPS found the assessed value assumptions of A. Plescia and Co. and Goodwin Consulting Group to be the most up to date and reliable information available. The methodology utilized by A. Plescia and Co. and Goodwin Consulting Group is described in further detail in **Attachment 2**. The scenario increases the assessed value assumptions to the values consistent with the assessed value assumptions as estimated by A. Plescia & Co. as of February 1, 2016.**Table 3** shows the difference between the assessed values assumptions utilized in the base development scenario and those utilized in this sensitivity scenario.

As shown in **Attachment 1**, the increased assessed value assumption results in a fiscal surplus of approximately $69,000 annually, an increase of $82,000 from the Base Development Scenario.

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[2] The analysis of the feasibility of a make whole provision will be discussed at the Finance and Budget Commission on February 8th, 2016.

Table 3
Nishi Fiscal Impact Analysis - FBC Commentary
Assessed Value Assumptions

	Assessed Value		
Land Use	EPS	A. Plecsia & Co.	**Difference**
Residential	*Per Unit*	*Per Unit*	
Owner-Occupied	$460,000	$460,000	$0
Renter-Occupied	$308,000	$325,000	$17,000
Commercial (Sq. Ft.)	*Per Sq. Ft*	*Per Sq. Ft*	
Office/Flex/R&D			
Office	$225	$350	$125
Flex: R&D/Office	$245	$350	$105
Retail			
Industrial Commercial	$225	$370	$145
Ancillary Retail	$225	$295	$70

value_comp

Source: City of Davis; Urban Land Institute (ULI); Andy Plescia/Goodwin Consulting Group; ESRI; CoStar; Loopnet;

Taxable Sales Assumption

Analyses of similarly situated companies and innovation centers in other regions show a large amount of revenue generated by major technology and hardware companies to their respective cities resulting from the non-retail sale of large scale, high value equipment and hardware to other businesses. Business to business and non-retail transactions, as well as internet retail sales, generate sales tax revenue at a designated point of sale. Companies have discretion as to where the point of sales for non-retail transactions will be recorded and this can be negotiated as part of a development agreement. Large scale hardware manufacturing and high technology office buildings can result in levels of taxable sales well above the estimates used by EPS in the September Report; though high levels of variance from year to year argue for the use of more conservative figures.

In an effort to provide a conservative analysis and account for a variety of potential conditions including the potential for uneven year to year performance in this regard, EPS has conducted an additional sensitivity scenario in which all taxable sales assumptions are decreased by 25%. This reduction in taxable sales assumptions increases the existing fiscal deficit by $38,000 to a net fiscal deficit of $51,000, as shown in **Attachment 1**.

Additional Considerations

Public Service Costs

EPS utilized standard industry methods to compute the expenditures for both the Annual Fire and Police expenditures. In response to concerns over the level of public service cost associated with the project, EPS conducted interviews the Chief of Police, Darren Pytel and Assistant Fire Chief, Rick Martinez.

Chief Pytel indicated that the estimates made by EPS were reasonable and appropriate particularly given concerns of difficulties in enforcement within the area due to constrained access. Similarly, Assistant Chief Martinez advised against running any scenarios with reduced Fire Department costs due to a need for increased labor resulting from the population and employment growth attributed to the project. Based on these interviews, EPS did not construct any additional sensitivity scenarios to reflect lower public service costs.

ATTACHMENT 1:

Estimated Annual Fiscal Impacts of Sensitivity Scenarios (2015$) - Make Whole Provision

Attachment 1
Nishi Fiscal Impact Analysis - FBC Commentary
Estimated Annual Fiscal Impacts of Sensitivity Scenarios (2015$) - Make Whole Provision

Fiscal Impact Analysis Scenario		Item	Annual Nishi Fiscal Impact at Buildout: Without Provision	Annual Nishi Fiscal Impact at Buildout: With Provision	Make Whole Provision [1]
Base Development Program [2]			**($106,000)**	**($13,000)**	**$93,000**
Sensitivity Scenarios [3]					
3	**Nishi Hotel** *Optional addition of 70,000 sq. ft., 125-room hotel in Nishi. Assumes displacement of 70,000 square feet of Office, Flex, Industrial Commercial, and Public/Nonprofit uses.*	**Total Annual Fiscal Impacts** Difference from Base	**$389,000** $495,000	**$470,000** $483,000	**$81,000**
4	**Property Tax Sharing Allocation: Alt. 1** *The Base Development Program assumes a 50%/50% split of the applicable property tax rate between the City and County. This alternative assumes a 75%/25% allocation to the City and County.*	**Total Annual Fiscal Impacts** Difference from Base	**($4,000)** $102,000	**$96,000** $109,000	**$100,000**
5	**Property Tax Sharing Allocation: Alt. 2** *The Base Development Program assumes a 50%/50% split of the applicable property tax rate between the City and County. This alternative assumes a 25%/75% allocation to the City and County.*	**Total Annual Fiscal Impacts** Difference from Base	**($207,000)** ($101,000)	**($122,000)** ($109,000)	**$85,000**
6	**Increased Taxable Sales** *This sensitivity scenario models increased taxable sales per square foot assumptions (relative to the Base Development Program), based on data from land uses in the 2nd Street Corridor and Interland URP.*	**Total Annual Fiscal Impacts** Difference from Base	**($44,000)** $62,000	**$80,000** $93,000	**$124,000**
7	**Sales Tax Capture: Alt. 1** *The Base Development Program assumes a 50% capture rate of taxable sales generated by Project development within the City. This alternative assumes a 75% capture rate.*	**Total Annual Fiscal Impacts** Difference from Base	**($65,000)** $41,000	**$27,000** $40,000	**$92,000**
8	**Sales Tax Capture: Alt. 2** *The Base Development Program assumes a 50% capture rate of taxable sales generated by Project development within the City. This alternative assumes a 25% capture rate.*	**Total Annual Fiscal Impacts** Difference from Base	**($146,000)** ($40,000)	**($52,000)** ($39,000)	**$94,000**
9	**Ongoing Operations & Maintenance Responsibility: Alt. 1** *The Base Development Program assumes ongoing operations and maintenance will either be publicly- or privately-funded. Refer to Table E-1 and Table E-2 for a listing of these items and the assumed responsibility for the Base and Alternative scenarios.*	**Total Annual Fiscal Impacts** Difference from Base	**$27,000** $133,000	**$120,000** $133,000	**$93,000**
10	**Ongoing Operations & Maintenance Responsibility: Alt. 2** *The Base Development Program assumes ongoing operations and maintenance will either be publicly- or privately-funded. Refer to Table E-1 and Table E-2 for a listing of these items and the assumed responsibility for the Base and Alternative scenarios.*	**Total Annual Fiscal Impacts** Difference from Base	**$75,000** $181,000	**$168,000** $181,000	**$93,000**
11	**Supplemental Sales Tax** *Assumes the supplemental Citywide sales tax does not sunset. As a conservative estimate, only 50% of the supplemental Sales tax revenue is incldued.*	**Total Annual Fiscal Impacts** Difference from Base	**$12,000** $118,000	**$108,000** $121,000	**$96,000**
12	**Increased Assessed Values** *Increases the Assessed Value Assumptions to the levels used by A. Plescia & Co. in the Preliminary Analysis of Infrastructure Funding Alternatives*	**Total Annual Fiscal Impacts** Difference from Base	**($33,000)** $73,000	**$69,000** $82,000	**$102,000**
13	**Decreased Taxable Sales** *Decreases taxable sales assumptions across all land uses by 10%*	**Total Annual Fiscal Impacts** Difference from Base	**($140,000)** ($34,000)	**($51,000)** ($38,000)	**$89,000**

prov_scen

Source: City of Davis; EPS.

[1] In cases where project assumptions produce a positive result, the amount attributed to the loss of revenue from Public/Non-Profit occupancy is identified for purposes of disclosure. The need for the make-whole provision under such circumstances may be subject to future discussions between the project applicant and the City.
[2] Represents the Base Development Program as described in the memorandum and documented in the attached technical appendices.
[3] Excludes MRIC specific scenarios 1 and 2.

ATTACHMENT 2:

Estimated Annual Fiscal Impacts of Sensitivity Scenarios (2015$) - Make Whole Provision