

Date: January 3, 2016
To: Members, Finance and Budget Commission
From: Dan Carson
Subject: Draft FBC Comments on Nishi Gateway

Introduction. Both the Planning Commission and the City Council will decide in a series of meetings between now and early February whether to submit the Nishi Gateway project to a citywide Measure R vote in June 2016. Some other city commissions have weighed in with their comments in regard to whether they feel the project complies with Guiding Principles adopted a year ago by the City Council within their respective policy jurisdictions. We may not have a chance to similarly provide our input regarding the project complies with the Guiding Principles relating to the economic and fiscal impacts of the project if we do not do so now. Given all the work and attention we have given to this subject, I believe it is appropriate for our commission to stake out its position on these matters at our upcoming meeting.

City Council Established Economic and Fiscal Goals for Innovation Center Projects.

With formal input from our commission and other parties, the City Council adopted various goals outlining what benefits it expects the city to receive from the proposed innovation center projects, including both the Mace Ranch Innovation Center and Nishi Gateway. Guiding Principle #7 concerns the economic and fiscal benefits that are to come from such projects. Below are all of Guiding Principle #7 declarations, as approved.

- Project should achieve fiscal neutrality with regard to city services and provide substantial surplus annual revenue and positive economic impacts/multipliers citywide, and net community benefits (including social and environmental).
- Project is expected to create net new annual revenue beyond project-based service costs.
- Infrastructure and direct costs (construction) of the project are expected to be absorbed into the project.
- Positive economic impacts are expected to include new job creation, property taxes, sales and use taxes, transient occupancy tax (TOT), fees and permits.
- Consideration needs to be made for positive fiscal impacts to County revenue.
- City and project proponent will balance fiscal project feasibility against revenue generation based on fiscal model and negotiated into the development agreement
- Project should consider formation of an assessment district above and beyond standard taxes, mitigations and impact fees to create positive ongoing revenue generation for the City (an annual per square foot charge that is assessed to owners, for example).
- Fiscal considerations should reflect the current industry standards.

City Staff Has Already Commented on Fiscal Impacts. City staff has already concluded, in a December 16, 2015 staff report to the Planning Commission, that the project meets Principle #7. Specifically, staff noted various fiscal commitments that the project applicant has made to ensure that the project would have a positive net fiscal benefit on

the city. The city staff report reflects those additional commitments by the applicant and changes to the project that would improve its direct fiscal benefit to the city:

- A commitment by the applicant to partly offset the loss of property tax or real property transfer tax revenue that results from the exemption of public or nonprofit uses of the project site.
- The potential addition of a hotel project onsite.
- Agreement to privately manage certain parks, open space, and public works components of the project.
- Reimbursement (on a one-time basis) of pre-development costs advanced by the city under a cost-sharing agreement.

In a more recent city staff report sent to the Planning Commission last week, city staff reiterated its view that the Nishi Gateway project would provide an economic uplift to the City of Davis and the surrounding region. In regard to the direct fiscal impact on the city, staff recommended support for the project because “the provisions of the development agreement will address (the) fiscal impact on the General Fund.”

New EPS Report Emphasizes Potential for Nishi Revenue Gains. Economic and Planning Systems Inc. (EPS), one of the city’s economic development consultants, has completed a December 2015 report providing additional information about its economic and fiscal projections for the Nishi Gateway project. City staff submitted the report, termed an Executive Summary, to the Planning Commission last week and is also sending it to our commission for review.

In its earlier September report, EPS had concluded that the Nishi Gateway project would result in a modest deficit, when direct city revenues from the project are compared to the cost of providing city services to the site, of about \$78,000. In response to Commissioner Salomon’s discovery of a computational error, EPS amended its findings in November to reflect a net \$106,000 deficit. However, in its December Executive Summary, EPS emphasizes that, “Nishi’s fiscal impact, depending on the scenarios below, could result in a fiscal surplus up to \$465,000,” mainly because applicant commitments made in negotiations over the development and the potential for a new hotel on the project site.

Draft FBC Comments. While addressing the key aspects of the Guiding Principles in summary form, neither the city staff report nor the new EPS Executive Summary comment specifically as to whether all of the specific elements of Guiding Principle #7 have been met by the Nishi project. However, we as a commission still have an opportunity to do so.

Over the past few months, I have analyzed various economic and fiscal consultant reports as well as the project EIR; met with city staff and the consultants to obtain their further responses to a large number of the commission’s written questions; and obtained information from various other knowledgeable sources, including a representative of the project applicant.

The two main findings, as explained in more detail in Attachment A, are that (1) we find the economic analysis showing that the Nishi Gateway project would have a significant positive economic impact to be credible and reasonable and (2) a mid-range analysis shows that the project could have a direct net fiscal benefit to the city of more than \$2 million annually with additional one-time fiscal benefits in the millions of dollars.

Attachment A provides a draft of Finance and Budget Commission comments that could be sent to City Council relating to the economic and fiscal impacts of the Nishi Gateway project. Attachment B details my analysis supporting those comments, which is based on the concept of providing a mid-range estimate of the net fiscal benefits to the city of the Nishi Gateway project in addition to what EPS' self-describes as its "very conservative" estimates of direct city fiscal impacts.

The proposed comments and my analysis do not reflect: (1) the final terms and specific language of the publicly released draft development agreement, which is still under negotiation, (2) responses to questions I have submitted to city staff relating to the Goodwin Consulting Group infrastructure financing study, (3) the results of an ongoing consultant analysis to determine if there is sufficient market demand for additional hotel room at the Nishi site or elsewhere in Davis, and (4) a pending update of the Goodwin Consulting Group infrastructure report to account for additional project costs for a bridge over Putah Creek and for changes to the configuration of parking on the Nishi site. Accordingly, my analysis below could change significantly once this important additional information is available.

Nishi Gateway is a work in progress. Thus, my analysis could also change as policymakers on the Planning Commission and City Council make further changes in the project and the development agreement.

Based on my analysis of the information available to date, however, I recommend that the FBC adopt the comments contained in Attachment A, along with any amendments it deems appropriate. I welcome any questions about my analysis and discussion we may have about these matters when we meet.

Attachments

Attachment A

Draft Finance and Budget Commission Comments on the Nishi Gateway Project

The Finance and Budget Commission finds that the Nishi Gateway project would provide a significant economic benefit to the city and the surrounding region in greatly increased economic activity, jobs, business-to-business sales opportunities, and productive partnerships with Davis' largest employer, UC Davis. Estimates of the economic benefit of the project prepared by the city's economic experts are reasonable and credible.

The projections capture the gross impact of the project. The net economic impact would be lower to the extent that development of Nishi Gateway substitutes for some development that might otherwise have occurred elsewhere in the city or the region. However, the city's economic development experts make a good case that the so-called "substitution effect" within the city would be limited by the configuration and availability of alternative sites for such projects. Moreover, the development of Nishi Gateway would itself generate significant demand for commercial real estate development within remaining tracts within the city and spur business activity in nearby downtown Davis.

The commission also finds that the Nishi Gateway project would achieve a significant direct net fiscal benefit to the city that, in the long term at full build-out, could exceed \$2 million annually, with one-time net fiscal benefits in the millions of dollars. Other local agencies, including the county and Davis Joint Unified School District, would also cumulatively receive millions of dollars in additional revenues as a result of the project.

In addition to very conservative estimates prepared by a city consultant, the commission considered a mid-range estimate of both the revenues the project would generate and the costs that would actually be incurred for providing city services to Nishi Gateway residents and workers. In addition to technical differences in the assumptions, our estimates include additional fiscal impacts not within the scope of work performed by the city's economic consultant. Our estimates also reflect changes that are occurring in the project via the negotiation of a development agreement, and the potential addition of a hotel site, allowed as a conditional use of project land in city planning documents.

Last year, the City Council adopted a set of Guiding Principles outlining the city's goals for innovation centers like Nishi Gateway. The commission finds that the projects as currently proposed appears to meet each of the specific components of section 7 of the Guiding Principles pertaining to the economic and fiscal impacts of proposed innovation centers, with one exception. The draft development agreement currently does not identify a financial mechanism, via an assessment district or some alternative approach, that would create positive ongoing revenue generation for the City of Davis, as the Guiding Principles endorse. We believe that the creation of such an additional revenue stream is feasible and necessary to meet the city's goals for innovation centers.

The commission intends to review these findings after a development agreement has been completed and additional information related to the project is available and to inform the City Council of the results of that review.

Attachment B
Analysis of Economic and Fiscal Impacts of the Nishi Gateway Project
(Dan Carson)

Economic Impacts of the Nishi Gateway Project

There is strong evidence that the Nishi Gateway project would provide a significant economic benefit to the city and the surrounding region in the form of greatly increased economic activity, new jobs, business-to-business sales opportunities, and productive partnerships with Davis' largest employer, UC Davis.

One of the city's economic consultants, Economic and Planning Systems Inc. (EPS), estimated that the ongoing economic benefit to the City of Davis at full build-out would total between 1,500 and 1,800 jobs, \$315 million to \$385 million of economic activity, and \$89 million and \$107 million of labor income. EPS further estimated that the one-time economic impact of building out Nishi Gateway would result in 1,000 jobs, \$186 million in economic activity, and \$75 million in labor income. Upon examining the EPS report and underlying economic data, I found their estimates of significant economic benefit to Davis and the region to be reasonable and credible.

As EPS confirmed, these estimates represent the *gross* economic impact of Nishi Gateway. EPS acknowledged, in response to the commission's questions, that the *net* economic impact of the project within the city of Davis to be at least 80 percent of the gross impact it has estimated. The difference reflects the extent to which development on that site took the place of economic activity that might otherwise have occurred in other already appropriately zoned locations within the city limits. On the other hand, discussions with EPS confirmed our belief that this so-called "substitution effect" would be limited because of the configuration and limited availability of alternative commercial building sites suitable for innovation center occupants.

Moreover, the EPS analysis notes that the build-out of Nishi Gateway (and Mace Ranch Innovation Center) could spur significant demand for commercial real estate development within remaining tracts within the city, such as expansion of business-to-business enterprises that could serve the new commercial development at Nishi Gateway. The project location also makes it highly likely that it will generate additional business activity in nearby downtown Davis.

Finally, as referenced in public testimony received by the commission, economic projects such as Nishi Gateway can create economic vitality in Davis by adding workers to the mix in demographic groups more likely to make purchases that result in sales and property tax revenues. They can also diversify the city's economic base, adding to the city's resiliency when more difficult economic times someday return. While the exact value of these additional economic benefits cannot be calculated given the current available data, they are significant factors that policymakers – and ultimately Davis voters – may wish to consider as they make decisions about this project.

Direct Fiscal Benefits of the Nishi Gateway Project

My analysis also indicates that the Nishi Gateway project would achieve a significant direct net fiscal benefit to the city that, in the long term at full build-out, could exceed \$2 million annually, with additional one-time fiscal benefits in the millions of dollars.

As EPS noted, its estimates of direct fiscal impact on the city were deliberately constructed to be “very conservative” and included only certain specified factors within its scope of work. My finding of a substantial net fiscal benefit differs from the modest net fiscal deficit for Nishi Gateway found by EPS in its September 8, 2015, report for a number of reasons discussed below. A table summarizing my calculations and key assumptions can be found at the end of this analysis.

Ongoing Changes to the Project. The Nishi Gateway project is still a work in progress, and those changes will accelerate as city staff negotiates a development agreement and policymakers at the Planning Commission and the City Council make their imprint on the proposal.

As EPS itself emphasized in its original September report, as well as its new follow-up Executive Summary report, these various modifications to the project result in higher revenues and-or reduced costs to provide services to employees and residents of the project. In my analysis, I assumed that certain project changes – including some “scenarios” estimated by EPS as well as other changes included in the draft development agreement -- would be a part of the project and thereby substantially improve the fiscal outcome for the city. These include the potential future inclusion of a hotel within the project, a shift to private responsibility for certain public services, and the partial offset of property and transfer tax losses for any occupancy by public or nonprofit agencies.

Technical Estimating Differences on Revenues. EPS calculated, for certain components, what amounts to a worst-case scenario to test whether project-generated tax revenues would exceed the cost of providing city services to the project. EPS’ work in this regard is professional and worthy of careful consideration, but I also examined an alternative way of looking at the project: a mid-range estimate of its direct fiscal impacts. A mid-range estimate, the kind I often prepared in my 17-year career as a state budget analyst, is one intended to have an equal chance of being too high or too low. The mid-range estimate I prepared for the Nishi Gateway project shows that it is likely to generate more tax revenues than EPS had estimated and that the cost of providing city services to the project would be lower than assumed by EPS.

One example of such a technical difference relates to what future sales tax measures are assumed to be in place when build-out of the Nishi Gateway is complete. Specifically, EPS assumed that a half-cent sales tax measure that has been a part of the city’s tax base for almost 12 years would not be renewed by voters in 2020 and thus would not be in place to generate revenues for the city at build-out of Nishi Gateway. Yet, EPS took a

different approach and assumed that a landscape and lighting parcel tax measure that would expire after June 2018 – but that has been repeatedly renewed by voters -- would continue to be in place and generate revenues for the city.

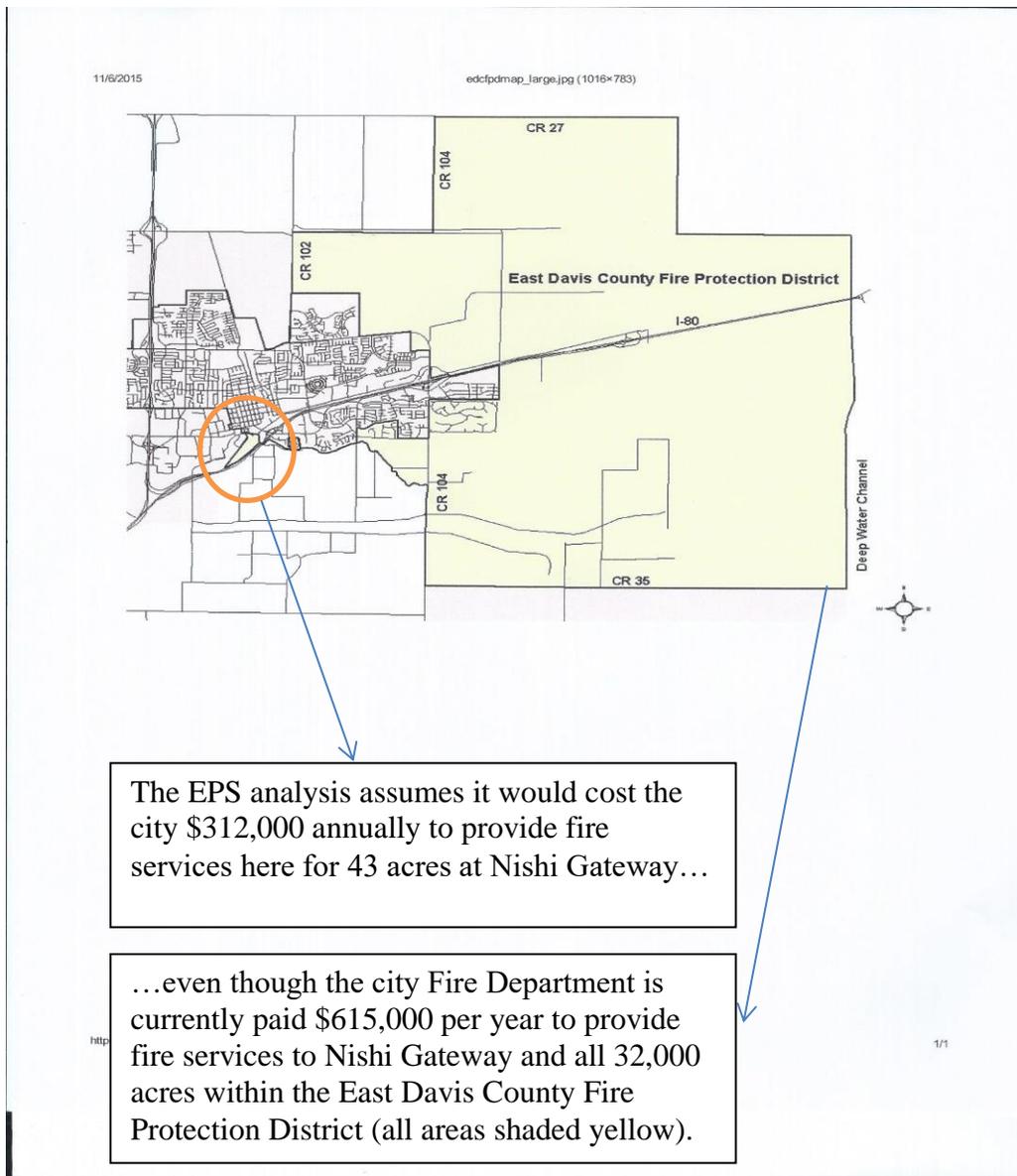
I took what I believe is an analytically more consistent approach overall, by assuming that all tax measures that have been previously renewed by city voters would continue to be in place at full build-out. Like EPS, I assumed the parcel tax would be renewed at its present level and remain in place. But, unlike EPS, I assumed that a half-cent city sales tax originally enacted by city voters in June 2004, and renewed by them since then, would remain in force. This assumption means the project would generate more sales tax revenue than assumed by EPS.

Because this was intended to be a mid-range estimate, I did not include all possible additional tax revenues that the project might generate. For example, like EPS, I further assumed that the additional half-cent increase in the sales tax enacted by the voters as Measure O for the first time in 2013 would expire in 2020 and thus that Nishi Gateway would not generate additional revenues from such a tax. Likewise, I did not include in my mid-range estimate the \$83,000 in additional revenues that I estimated would be generated annually from the Nishi Gateway project if the City Council and city voters increased parcel taxes and hotel taxes in June.

Technical Estimating Differences on Costs to Serve the Project. My mid-range estimate also reflects technical differences with EPS regarding the costs to the City of Davis to provide public services to the project.

For example, using an average cost model, the EPS estimated an annual cost of \$312,000 for the city to provide fire services to the 47 acres at Nishi Gateway that would be annexed to the city. That cost estimate appears to be high, given that the City of Davis Fire Department currently provides fire services under contract for the entire 32,000-acre East Davis Fire Protection District for about \$615,000 annually, as shown in the figure below.

(See figure on next page)



The EPS estimates assume that, if Nishi Gateway is built, the City Council budget would have to increase \$4,000 and the City Manager’s Office would need \$57,000 in additional funding. The same is assumed for various other city administrative functions. However, city staff could cite no statistical evidence that costs of providing fire and police and certain other services to new developments actually grow in keeping with average citywide costs for those services, as EPS assumed in its calculations. In fact, one key benefit of infill projects such as Nishi Gateway is that they hold down governmental costs by taking advantage of existing program capacity and infrastructure.

The final Environmental Impact Report (EIR) for the Nishi project concludes, logically, that the costs of expanding fire coverage to an infill project like Nishi Gateway would be relatively modest. “Service to the project site can be provided at the same level as is provided to the rest of the service area without the need for additional facilities or

equipment and thus, the project is not anticipated to require additional fire services,” the EIR states on page 2-78. The EIR further states that, for any such fire service costs, “...the project applicant would be required, in accordance with the City’s established development impact fee program, to provide funding for the maintenance of adequate public facilities, including fire protection facilities within the City of Davis.”

Accordingly, my mid-range estimate took a different approach to estimating the costs of providing city services to the Nishi site, one that focused on the marginal additional cost of providing services to the project rather than the average per capita costs (for employees and residents) of providing such services on a citywide basis. This alternative approach is also considered valid by economic development experts. For example the University of North Carolina Community and Economic Development Bulletin advocates using a marginal-cost estimation approach in cases where the city affected by a project has additional capacity to provide services within its existing governmental operations. Notably, EPS itself relied on a marginal cost approach in estimating the costs for operating parks, managing open space, and operating public works at Nishi Gateway, but took a different approach to estimating fire and police and certain administrative services.

In order to take a more consistent mid-range estimating approach, I estimated the marginal cost to city taxpayers to provide fire and police and certain administrative services to Nishi Gateway. Specifically, I assumed the marginal costs would be roughly a third of the full average costs estimated by EPS for these particular city services. (A more precise estimate is theoretically possible but could not be completed within the time constraints for completing this analysis.) My assumptions reflect the conclusions in the Nishi EIR that city government has the capacity to provide certain public services to the site without significant additional staffing or facilities and-or that any necessary additional costs would be offset at least in part by development impact fees paid by the project applicant.

Additional Revenue Factors. My analysis included potential revenue sources outside the scope of those examined by EPS. For example, EPS’ calculations did not take into account development impact fees and construction tax revenues that the city ordinarily receives from such projects, the proceeds of which the City Council has broad discretion to appropriate for the benefit of Davis citizens. I estimated the potential general fiscal benefit to the city that could result from the creation of a community facilities district or CFD in our calculations, as discussed further below. I also included a very rough estimate of the one-time sales tax revenues that could result from the construction of Nishi Gateway facilities and its related public improvements.

Community Facilities District Could Benefit City Finances. Based upon this analysis, I found that the project meets all of the components cited in Guiding Principle #7 except one. The draft development agreement, at least at this point, does not identify an assessment district or comparable mechanism that would “create positive ongoing revenue generation for the City.” While a community facilities district (CFD) has been proposed to finance the estimated \$24 million in public infrastructure required for the

project, no part of the revenue is currently contemplated to provide a revenue stream for the fiscal benefit of the city.

Based upon the infrastructure financing analysis prepared for the City by the Goodwin Consulting Group (GCG), I believe the City and the applicant should explore whether a CFD for infrastructure could be modified to additionally provide a revenue stream that would benefit the city overall.

GCG found in a February 2015 report that the project must generate about \$9.1 million to plug a “gap” in infrastructure funding costs. (The consultant found that the remainder of the infrastructure costs could be covered directly by the project.) The financing analysis found that the project could generate more funding than would be needed over the life of a CFD to fill an infrastructure gap of that magnitude. The surplus funding stream from a CFD could – at least in theory -- be redirected toward citywide needs.

Moreover, my analysis indicates that office and research space would not pay a proportional share of CFD costs, under GHG’s proposed structure for the financing program. While office and research space would comprise about 29 percent of the Nishi development, and about 34 percent of the total assessed value of the developed property, the CFD as proposed would allocate only 9 percent of CFD assessments to this segment. If the contributions from office/research could be increased to pay a proportional share of the CFD assessments, still additional funding would be generated that also could be redirected toward citywide needs.

I estimate that the city could derive a revenue stream of as much as \$400,000 annually if larger proportional assessments could be imposed on office/research space and if surplus CFD revenues were dedicated to the benefit of the Davis public.

Before adopting such an approach, the city’s economic experts would have to carefully examine the point at which an increase in CFD assessments would hinder the marketing of the development to would-be tenants. The parties would also have to verify that the estimate of a \$9.1 million gap in infrastructure costs is still valid. For example, an additional \$2 million may be added to pay for a bridge over Putah Creek to permit access to the project from West Olive Drive. (An anticipated increase in costs for reconfigured parking lots would likely be borne by parking fees.) On the other hand, it is possible that contributions from UC Davis and other grant funds could relieve the project of part of its infrastructure cost burden. That would open the door for an expanded CFD (or an alternative assessment mechanism) that would ensure that the Nishi project meets the components of the Guiding Principle #7 calling for a new revenue stream for the benefit of Davis citizens.

Benefit to Other Agencies. Significant new revenue from the project amounting collectively to millions of dollars annually would also accrue to Yolo County, the Davis Joint Unified School District, and certain special districts that would continue to serve the Nishi Gateway property. Their revenues would also increase as the project was developed and it generated additional property tax revenues and assessments earmarked for these

agencies. Also, DJUSD would receive additional apportionments of funding for taking in new students residing within Nishi Gateway. Some of these agencies would also incur additional costs for providing public services to project workers or residents. We have not estimated the net fiscal impact on these other public agencies.

Conclusion. Because of time constraints for the commission to weigh in on the Nishi Gateway project, this analysis does not reflect: (1) the final terms and specific language of the publicly released draft development agreement, which is still under negotiation, (2) responses to questions I have submitted to city staff relating to the Goodwin Consulting Group infrastructure financing study, (3) the results of an ongoing consultant analysis to determine if there is sufficient market demand for additional hotel room at the Nishi site or elsewhere in Davis, and (4) a pending update of the Goodwin Consulting Group infrastructure report to account for additional project costs for a bridge over Putah Creek and for changes to the configuration of parking on the Nishi site. My analysis could change once this additional information is available. It could also change as policymakers on the Planning Commission and City Council make further changes to the project.

Mid-Range Estimates of Net Fiscal Effect of Nishi Gateway Project (With 1/4/15 Correction)		
		<i>Comments</i>
<u>Ongoing revenues</u>	\$1,245,000	Corrected EPS estimate
<i>Modifications to revenue estimates</i>		
Assume hotel eventually added to Nishi site	494,000	EPS estimate of Scenario 3
Assume sales tax generation per employee is larger	6,000	EPS estimate of sales tax per employee based on national averages does not reflect at least 10% higher costs in California.
Update parcel tax estimate	-5,000	Reflects direct calculation of tax based on 650 units and 7 commercial parcels estimated by applicant
Assume 1/2 cent sales tax from 2004 is renewed (but not additional 1/2 cent added with Measure O in 2013)	127,000	Assumes increase in sales tax base of \$730,000 above original EPS estimate of \$24.6 million
Assume additional revenue stream from Community Facilities District	420,000	Assumes \$250,000 revenue gain from increasing office/research assessments to pay proportional (29%) share of CFD revenues. Assumes additional \$170,000 in revenues not needed for site infrastructure could be redirected to benefit the public.
Applicant offsets loss of property tax and real property transfer tax revenue from government/nonprofits	135,000	Assumes 60,135 of 80,180 SF public/nonprofit with assessed value of \$225 per SF taxed at 1% rate (\$180,000) plus minor effect on real property transfer tax revenue
<i>Subtotal of changes to revenue estimate</i>	1,177,000	
Total ongoing revenues from Nishi	2,422,000	
<u>Ongoing costs for public services</u>	\$1,351,000	Original EPS estimate
<i>Modifications to cost estimates</i>		
Assume all parks and open space and public works maintenance funded through private sources	-181,000	EPS estimate of Scenario 10
Assume marginal instead of average costs for police and fire services and city management and-or offset with development impact fees noted in final EIR	-734,000	Calculated reduction as one-third of full average costs in original estimate for fire (-\$209,000) and police (-\$355,000) and other administrative services including City Attorney, City Council City Manager's Office, Administrative Services, Community Dev. and Sustainability (reduction of \$170,000 to one-third of average costs instead of 75% assumed by EPS). More precise analysis of marginal costs is possible.
<i>Subtotal of changes to expenditure estimate</i>	-915,000	
Total ongoing costs for public services for Nishi	436,000	
<u>Net ongoing fiscal effect of Nishi on city operations</u>	\$1,986,000	
<u>One-time fiscal benefits</u>		
Construction tax	\$3,120,000	Municipal code sets fees at \$3.10 per SF (with inflation adjustments) for commercial and owner-occupied residential and at \$2.47 per SF for apartments. Revenues are placed in a special fund but can be used "for any public purpose" authorized by the City Council.
Development impact fees	Unknown	Officially called the Major Projects Financing Fee, fee levels are subject to negotiation. The adjacent hotel/convention center project, for example, is to contribute \$3 million in development impact fees. Under the Municipal Code, fee proceeds shall be used to pay for public improvements to implement the city General Plan -- giving the city broad discretion over their use.
Sales tax revenues from project construction	\$1,700,000	Assumes the equivalent of 1,000 construction employees, \$22.20 per day employee expenditures, 50% capture rate, sales tax rate that includes 2004 half-cent sales tax: \$40,000. Assumes one-half of non-labor economic activity (\$315 M - \$89 M = \$226 M net). or \$113 M is for materials and fixtures by contractors or subcontractors that generate \$1.7 M sales tax revenues with a tax rate that includes revenues from a 2004 sales tax measure but not Measure O.
Refund of city's share of pre-development agreement costs	\$350,000	Applicant and city equally shared certain pre-development costs for the Nishi project. Refund of city's half required under terms of pre-development agreement for Nishi project approved by City Council in November 2012. Funding source shifted from redevelopment funds to General Fund in October 2013. Refund occurs if city and voters approve the project.
SF=square foot		