MEMORANDUM

To: Jamie Goldstein, City Manager City of Capitola

From: Ken K. Hira, President Kosmont Companies
Tom Jirovsky, Senior Advisor Kosmont Companies

Date: November 7, 2019

Re: Capitola Town Square – Analysis of Fiscal Impact

Kosmont & Associates, Inc. doing business as Kosmont Companies ("Consultant" or "Kosmont") is pleased to present our findings from a Fiscal Impact Analysis ("Analysis") in connection with proposed 637 residential units and 600,000 square feet of commercial in the proposed mixed/blended use Capitola Town Square ("Project").

BACKGROUND

Merlone Geier Partners ("MGP"), owner of the Capitola Mall ("Mall") are seeking approval of a major redevelopment plan. As part of ongoing discussions / negotiations between MGP and the City for a new Project Concept Application and Development Agreement, it is important to understand the marginal impact the residential and commercial components will have on General Fund revenues and expenditures.

For purposes of this analysis only, Kosmont assumes that the average household size, based on the proposed average unit sizes ranging from 600 to 800 square feet, will range from 1.75 to 2.0 persons per unit. Prospective renters are expected to range from UC Santa Cruz students sharing units, to young professional, to empty nester households.

The City has compiled historic retail sales data for the Mall and surrounding block to help establish a base year amount. The data shows a significant annual decline in retail sales throughout the entire mall area since 2016. The 2018-19 annual sales for the entire mall area were approximately $130 million, or a little more than $200 per square foot.

- The 3rd party anchor stores (Macy's, Target, Ross Center, Olive Garden) totaling 270,000 square feet generated approximately $65 million in sales.
- The 370,000 square feet within MGP control generated $65 million in sales

The MGP Project calls for a reduction of 34,000 square feet of retail space versus the 640,000 square feet currently contained within in the Mall block. In order to finance construction of new retail, MGP has estimated gross annual sales will average $300 per square foot for MGP's

336,000 square feet (including Kohl's) of retail space following redevelopment. Assuming a 10% bump in sales at the major stores, the total annual mall block sales could reach $180 million, a $50 million increase. However, with no new tenants under contract, this should be considered a somewhat optimistic forecast.

SUMMARY

The proposed reconfiguration of the mall into a mix of residential and retail uses will improve the economic health of the overall shopping center, but depending on the growth in taxable retail sales, it may result in annual fiscal deficit to the City, as compared to the 2018 Mall fiscal impact.

FISCAL REVENUE ANALYSIS

Property Tax & In-Lieu of VLF

Secured property tax revenues are estimated based on the anticipated assessed value of the Project upon full build-out and the applicable property tax rates for the City. Acquisition costs were not included as part of the analysis, as the subject property is already on the tax rolls and title is vested under MGP's name. The City general fund receives an approximate 7.5% share of the annual 1.0% secured property tax general levy placed by the County.

Prior to 2004, a percentage of State motor vehicle license fees (VLF) were distributed to cities and counties. In 2005, the State of California instituted a revenue swap, guaranteeing that municipalities and counties within California receive a distribution equal to the VLF collected the prior year, plus a percentage equal to the annual increase in assessed value. Property tax in-lieu of VLF resulting from the Project is estimated based on the incremental amount of assessed value will add to the City; thereby increasing the City's apportionment. Based on review of the City CAFR, Kosmont estimates VLF will add an amount equal to 4.3% of assessed value.

Kosmont's survey of higher-end apartments in the area indicates monthly rents of +$4.00 psf, which would support assessed value of $400,0000 to $500,000 per unit. At an average of $450,000, the total assessed value from new residential would be $290 million. With a combined tax of 0.113%, the City General Fund would receive an additional $325,000 annually from property taxes.

Sales Tax (Off-Site / Indirect)

Off-site / indirect sales tax revenue is based on the taxable sales generated by the Citywide spending of Project residents, based on average household incomes and BLS Consumer Expenditure Survey data.

Kosmont's preliminary analysis indicates that the 637 residential units are expected to spend an average of $10,000 to $15,000 per unit on local serving goods and services, excluding the general merchandise expenditures at Macy's, Kohl's and Target that would be captured irrespective of the resident location. At an average of $12,500, this would result in approximately $8 million in incremental taxable sales, which would result in an estimated $80,000 in annual sales tax revenues for the City.

Measure O District Tax of 0.25% will result in an additional $20,000 in annual offsite sales taxes to City, while Measure F's 0.25% tax will yield additional $20,000 per year thru Dec. 2027.

On-site Sales Taxes

For this analysis, Kosmont is illustrating the impact from growth in retail sales above the 2018-19 base year. As mentioned earlier, the optimistic forecast for retail sales is a gain of $50 million, which could result in an additional $500,000 in annual sales taxes to the City.

Measure O District Tax of 0.25% could result in an additional $125,000 in annual offsite sales taxes to City, while Measure F's 0.25% tax could yield additional $125,000 per year thru 2027, for a potential total of $750,000.

Since the actual tenant mix is not determined and to allow for potential non-taxable uses such large tenants as movie theater and fitness center, Kosmont suggests using a more conservative $30 million increase in mall retail sales, which would yield $450,000 annually (including Measure O and Measure F).

Franchise Taxes

For 2019-20 budget, the City is estimated to collects $560,000 in Franchise taxes. For purposes of preliminary estimates, incremental franchise taxes are estimated on a per capita basis assuming 50% of revenue comes from non-residential uses. Based on estimated population of 10,100, the Franchise tax revenue factor is $28 per resident. Therefore, at full Project buildout of 637 units, Franchise taxes are estimated to bring $30,000 to the City General Fund annually.

Total Annual Fiscal Revenue

The total annual incremental fiscal revenues from the mall redevelopment are estimated to range from $900,000 (to $1.2 million per year under MGP optimistic forecast).

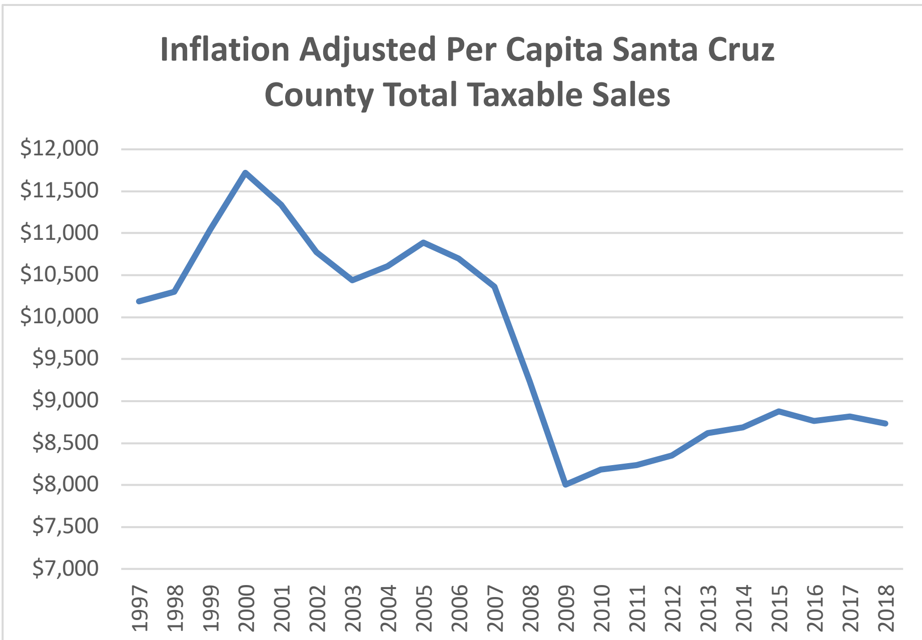
	Annual Taxes	
Property Taxes	$325,000	
Offsite Sales	120,000	
Onsite Sales	450,000	/1
Franchise Taxes	30,000	
Subtotal	$925,000	

/1 Assumes 30% growth in onsite sales

Long Term Growth

Given the national trends in retail sales being captured by e-commerce and big box discounters, it is likely that the future retail sales may not keep pace with cost inflation, resulting in greater risk to the City General Fund. In addition to the risks of economic recession, this potential long term deterioration is evidenced by historic Santa Cruz County per capita taxable sales, adjusted for inflation, have declined by 20 percent in the past 20 years.

Exhibit 1



For these reasons, it may be prudent for Capitola to conservatively estimate sales tax growth when considering the impact of a large-scale long-term project, such as mall redevelopment.

FISCAL EXPENDITURE ANALYSIS

The proposed Capitola Town Square project will substantially increase the population of the City. As noted earlier, the 637 units are estimated to increase the resident population by 1,115 to 1,275 people, a 12% increase above current population of 10,080, which has remained relatively flat for years.

Over 80% of the City's total expenditures represent salaries, benefits and contract services, indicating a high degree of sensitivity to increased service demands from the new population. Expenditures such as police/protective services, public safety, and other fiscal expenditures are usually measured on a per capita basis based on the City's Budget, and the relevant resident and employee populations within the City. However, complicating the analysis is the impact of tourists.

For this analysis, Kosmont interviewed City department heads. It was determined that the appropriate method to determine incremental per capita costs is to examine current budget by major category, and factor in current population of 10,080 plus an estimated 5,700 employees who work in the City, plus summer tourism. For each category, excluding police and public works, it was assumed that per capita incremental cost is derived by dividing the annual budget by 10,080 residents plus 5,700 employees x 50% (reflect reduced demand as compared to a resident).

The Police Chief estimated that 50% of annual cost is derived from resident population, while the Public Works Director estimated that 40% of costs during summer are related to residents and 70% of costs the rest of the year, for an average of 60%.

General Fund expenditures and allocated per resident cost estimates are summarized below:

General Fund Expenditures

	Annual	New Resident
Administrative	$2,582,000	$200
Police	6,152,000	305
Public Works	2,879,000	171
Community Development	363,000	28
CIP Funding	650,000	50
Recreation, Arts and Cultural	398,000	31
Subtotal (Before Transfers)	$13,024000	$785

With 1,115 to 1,275 net new residents in Capitola Town Square, there could be an increase in General Fund cost of $875,000 to $1 million per year, assuming a similar level of service.

NET FISCAL IMPACT

To give the City a better understanding of the potential impact, Kosmont provided a table that summarizes the net fiscal impact to the City using a range of net new residents. As shown in Exhibit 2, the Project could generate a $50,000 per year positive fiscal impact to a **negative** fiscal impact of **$75,000 per year**. The deficit can be attributed to the extremely low property tax share the City receives and nominal off-site sales taxes.

Exhibit 2
Capitola Town Square
Based on Net New Residents

		1,115 Residents	1,275 Residents
GF Revenues		$925,000	$925,000
GF Expenditures		($875,000)	($1,000,000)
Net Fiscal Surplus (Deficit)		**$50,000**	**($75,000)**

OTHER TOOLS TO GENERATE REVENUES

There are several potential financial tools available to improve the City's revenue picture:

1. Build New Hotel
2. Establish a (Community Facilities District (CFD) Maintenance Fee
3. Enact an Entertainment Tax
4. Negotiate Sales Tax Assessment Revenues Upfront Payment

Hotel

While no hotel is included in the initial plan, it is our understanding that MGP has preliminarily explored a 105-room select service hotel concept. Kosmont and the City have done preliminary market research indicating a 105 room upscale hotel could be supported within the next few years. Assuming a range of $160 to $190 Average Daily Rate (ADR) and 75% to 80% occupancy, Kosmont projects hotel tax revenues of over $550,000 to as much as $700,000 per year at 12% Transient Occupancy Tax (TOT) rate.

CFD Maintenance Fee

When large projects result in an increase in municipal service costs, some cities require a CFD maintenance district. A nominal $25 per month fee for each residential unit would generate almost $190,000 per year.

Entertainment Tax

Many new commercial uses, such as theaters, bowling alleys, arcades etc. do not generate taxable retail sales. By establishing a 5% tax on admission to such entertainment uses the City might generate $50,000 to $100,000 per year.

Sales Tax Assessment Revenue (STAR*)®

The City stands to lose $500,000 or more each year during the estimated three year demolition and reconstruction of the retail shops. Under a Development Agreement process, the City can negotiate an upfront payment from MGP to offset that loss, and protect themselves in the event that the redevelopment is delayed.