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Memorandum

To: Thomas Rogers, Associate Planner, City of Menlo Park

From: Ron Golem, Principal, BAE

Date: September 20, 2011

Re: Findings from initial review of Strategic Economics Fiscal Impact Analysis for Draft El Camino Real / Downtown Specific Plan

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This memo presents our findings from a brief review of the City of Menlo Park General Fund fiscal impact analysis prepared by Strategic Economics for the Draft El Camino Real / Downtown Specific Plan. The review was in response to a request from the Planning Department, which is seeking to respond to resident concerns about methodological flaws in the sales tax analysis in the report, and by extrapolation in the overall fiscal impact analysis.

Approach to the Review

Our review involved the following steps: (1) review of Mr. Charles Bernstein's letter outlining his issues with the calculation of potential future sales tax revenue; (2) review of the Strategic Economics report and its associated work tables; (3) a telephone interview with Strategic Economics regarding its methodology and approach; and (4) our analysis of the issues. The review looked at the overall fiscal impact analysis, as well as the specific issue raised by Mr. Bernstein. Due to the limited time available to us, our review did not include a review of the spreadsheet model itself, or recreation of that model, to confirm the accuracy of calculations.

The review we conducted is based on our experience in doing fiscal impact analyses for numerous communities throughout California, as well as other jurisdictions in the U.S. We are familiar with the City of Menlo Park's analysis from our previous preparation of a fiscal impact analysis report for the Menlo Gateway project, as well as other projects in the City.

Mr. Bernstein has raised a couple issues with regards to the analysis of projected sales tax receipts. One issue he raises involved the failure to adjust projections to account for the fact that at any time some amount of the retail space will be vacant and therefore generate no sales tax revenues. This was resolved by adding an assumption that 10 percent of retail space on average would be vacant throughout the 30-year time period for analysis. A second issue he raises is that retail sales are not increased by an assumed rate of inflation in future years; when they are subsequently discounted to 2009 dollars this significantly undercounts potential sales tax revenues (approximately $115,000 per year, by his calculation).

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Findings

The fiscal impact analysis conducted by Strategic Economics is generally consistent in its approach and methodology with accepted conventions to how this work is done, by our firm as well as other firms in this field. There is no formal "industry standard" or other specification for how to conduct fiscal impact analysis; various methodologies have been developed and refined through a combination of academic research and real world practice.

Strategic Economics analyzed the proposed buildout in the draft Specific Plan. Since there were no alternative buildout programs, it conducted sensitivity analysis to determine how revenues might vary depending on the actual buildout for hotels and parking structures (since a Specific Plan provides for the maximum buildout, but the market determines how many hotel rooms will be built, and the City decides when to construct municipal parking structures). The methodology that Strategic Economics used involved the following steps:

- In general, use of a service population method to calculate per-resident and per-employee costs of providing City of Menlo Park services, applied to the increases in resident and employee populations that would result as development occurs.
- Interviews with City Departments to confirm the appropriateness of the resulting cost estimates, and for certain functions, revisions based upon further research and estimates of incremental expenses associated with the Specific Plan buildout.
- Expenses were increased at an annual rate of 4 percent, higher than the Consumer Price Index, to reflect the City's actual experience with the rate of increase in personnel and operating costs.
- For revenues, calculation of the increase from new development allowed by the Specific Plan (for example, transit occupancy tax (TOT) is a function of the number of hotel rooms, average room rate, and occupancy; property taxes are calculated at assessed value plus 2 percent growth per Proposition 13 until a property sells and it is reassessed to market value).

  Some of the revenue items do include an adjustment for inflation, specifically TOT and property and property transfer taxes, which in total account for 80 percent of new revenue. TOT is increased by the Consumer Price Index, while property is assumed to increase in value 4 percent per year, but with actual payments only growing 2 percent per year until an assumed period of time when property sells and is reassessed to current market value.

  Other, lesser revenue items do <u>not</u> include an adjustment for inflation. This applies to "per capita" revenues consisting of fees, licenses, fines, etc. (12% of total revenues), Vehicle License Fees (4% of total revenues), and sales tax receipts (3% of total revenues)[1]. Strategic Economics reasons for not inflating these items was two-fold. First, as it sought to be "conservative" in its projections of revenues, not inflating these figures would somewhat understate revenues from these smaller items. Second, some components of these items do not automatically increase at the rate of inflation (e.g. fines and some fees).

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[1] These percentages, and those for TOT and property and transfer taxes do not add to 100%, due to rounding to the nearest percent.

- Finally, revenues and expenses were calculated on a year-by-year basis to show net fiscal impact. These figures were discounted using a factor of three percent per year to show them in constant 2009 dollars. The discounting step is important since revenues and expenses grow at different rates, and discounting them makes it clearer, in terms of 2009 dollars, on the future relationship between new General Fund revenues and expenditures (as shown in Strategic Economics' graphs in its report).

Conclusions

The key issue with respect to Mr. Bernstein's comments is whether it was inappropriate for Strategic Economics to not use an inflation assumption for the smaller revenue categories of per capita revenues, Vehicle License Fees, and sales taxes. We understand Strategic Economics' objective of introducing a factor to make revenue projections more conservative by not inflating these items. In the same situation, in order to be consistent, we would likely have applied an inflation assumption to sales tax revenues and vehicle license fees (with more study needed to determine how to handle per capita fees), and perhaps lowered other assumptions that drive revenue growth to ensure a conservative approach to revenue projection.

Fiscal impact analyses are complex, and their results arise from a combination of a great many assumptions that need to be made about future revenues and expenditures. While we would have taken a different approach to inflation of sales tax and other revenues, we do not believe that Strategic Economics' choice calls into question or invalidates its overall analysis and its findings.

To look at this another way, Mr. Bernstein points out that sales tax revenues would be approximately 86 percent higher based on his calculation of inflation (we are not necessarily agreeing with his assumptions, but are using them to illustrate a point). Assuming the same factor applies to Vehicle License Fees (due to future increases in vehicle prices), the total understatement of revenue might be approximately $245,000 or approximately 6 percent of total revenues. Although there are no hard and fast rules for what is a reasonable "margin" of potential outcomes for a fiscal impact analysis, we believe that it is reasonable to assume at least a 5 percent range in potential outcomes in a 20-year+ analysis due to the inherent unpredictability as to the amount of development that will occur, when it will occur, and macroeconomic factors such as inflation.

As Strategic Economics correctly points out, potential variability in future TOT receipts presents a much higher risk to the City of not realizing projected revenues. If only the 80 room hotel envisioned in the Specific Plan is built, without the 300 room hotel, total new fiscal revenues to the City would decrease by more than $1.8 million in 2009 dollars.

Based on our review to date, we believe that Strategic Economics' overall methodology is appropriate, although we would recommend revisions to its inflation assumption for smaller revenue items. Upon further study, we might even reduce other inflation assumptions. However, Strategic Economics overall findings, and its focus on TOT revenues and parking garage costs as the key factors that affect net fiscal impact to the City, appears correct.