Memorandum

To: Mitali Ganguly, Opticos Design; Eric Lee, City of Davis

From: Matt Kowta, MCP, Managing Principal

Date: September 5, 2019 - Revised

Re: Fiscal Impact Analysis for Downtown Davis Plan

Introduction
The purpose of this memo is to present the results of the fiscal impact analysis for the Downtown Davis Plan. The fiscal analysis projects the General Fund fiscal impacts to the City of Davis from net new development that could occur under the proposed Downtown Plan update. This fiscal analysis evaluates the potential impacts from an amount of new downtown area development (see item 1 below, under Methodology) that corresponds to development assumptions being analyzed in the Downtown Plan project environmental impact report (EIR). This quantity of new development represents an envelope of potential new development that could occur by 2040 under favorable conditions for Downtown Plan implementation (e.g., political support, resource availability, prevailing local and regional economic health, willing property owners, etc.), with a goal of providing environmental clearance, including necessary mitigation of adverse impacts, so that the Downtown Plan can facilitate foreseeable downtown economic growth that is consistent with the plan without requiring substantial additional environmental review. Although the development assumptions may somewhat exceed market

This fiscal impact analysis focuses on the recurring annual operating cost and revenue impacts to the City of Davis General Fund. It does not analyze one-time capital costs; nor does it analyze economic impacts to the greater community from factors such as job creation and personal or business income generation. Further, this memo does not consider the financial feasibility of the new development projects, from the standpoint of private investors.

Methodology
The fiscal impact analysis is conducted using an adaptation of the City’s fiscal impact model, which the City has previously used to evaluate major development projects such as the Nishi Property, West Davis Active Adult Community, and 3820 Chiles Road developments. City staff provided a copy of model to BAE for modification, for the purpose of analyzing the Downtown Plan fiscal impacts. BAE updated key components of the model as follows:

1. Updated development assumptions to reflect the anticipated Downtown Plan net new development by horizon year 2040. This includes a total of up to 1,000 new residential units, including 200 small single-family for-sale residential units; 800 rental
apartment units; and 600,000 square feet of new commercial development, which is assumed to include up to approximately 450,000 square feet of office space\(^1\) and up to approximately 150,000 square feet of new hotel space. It also includes new maintenance responsibility for 33,500 square feet of proposed new plaza space in the E Street Plaza, 10,000 square feet of plaza space in the G Street Plaza, and up to 5,000 square feet of plaza space in the Amtrak station area. For projection purposes, the absorption assumptions generally assume that no new development will occur under the plan until 2021-2022 fiscal year (Year 3) and that there will be somewhat slower absorption in the first part of the projection period for each land use type, and slightly faster absorption during the second part of the projection period.

2. Updated base City budget information for current revenue and expenditure levels to reflect 2019-2020 fiscal year, based on information published in the City of Davis Proposed 2019-20 Budget and 2020-21 Financial Plan and additional budget detail provided by City staff.

3. Updated existing base City population using data published by the California Department of Finance for 2019 and base City employment using data from a special tabulation of data regarding employment in the City of Davis between 2005 and 2016-2107 fiscal year furnished by the California Employment Development Department, trended to 2019.

4. Updated real estate valuation assumptions for small single-family for-sale ($325,000 per unit, apartments ($280,000 per unit), office space ($350 per square foot), and hotel ($300 per square foot) based on real estate development cost information from the Downtown Plan feasibility pro-forma analysis conducted by BAE. These assumptions are net of land value, so that the fiscal model projects increased property taxes, property taxes in-lieu of vehicle license fees, and property transfer taxes based only on incremental increases to the assessed value of property in the Downtown Plan area. Further, the land values which have been netted out of the assessed value assumptions reflect estimates of current land values. In reality, many properties that would be redeveloped have assessed values that are below current market values, due to the effects of longer-term ownership and the restrictions of Proposition 13 on increases in assessed value. To the extent that this occurs, the fiscal model’s projections of net increase in assessed value for a given quantity of new development will be conservative. Similarly, the projected increases in property transfer tax will also tend to be conservative.

\(^1\) Note that the office space is assumed to include approximately 300,000 square feet of traditional office space and 150,000 square feet of lab/R&D space.
5. Updated the City General Fund’s share of new property taxes paid on the net increase in assessed value to reflect the tax increment allocation factor for the predominant downtown TRA (27.5% of the one percent ad-valorem property tax rate).

6. Updated population and employment density assumptions for small single-family for-sale (2.16 persons per unit), apartments (2.16 persons per unit), office space (309 square feet per employee), and hotel (2,759 square feet per employee) to align with assumptions used in the Downtown Plan EIR.

7. Extended all cost and revenue projection worksheets out to 2039-2040 fiscal year.

8. Modified formulas in the property tax projection worksheet to allow for ownership turnover and Proposition 13 reassessment at current market values for small ownership units 12 years after absorption, per the fiscal model’s property turnover assumptions. No multifamily, office, or hotel properties are assumed to change ownership during the projection period.

9. Updated sales tax projection worksheet assumptions with most recent available per capita sales tax data from State Department of Finance and State Department of Tax and Fee Administration, and US Bureau of Labor Statistics Consumer Price Index (inflation factors to use for future per capita taxable sales increases; assumes 2008-2018 average rate of inflation applies to future years, through 2040).

10. Adjusted Municipal Service Tax and Public Safety Tax rates to current year figures. Park Maintenance Tax (fixed rate) is not changed.

11. Modified the formula for projecting increased Community Services program revenues to eliminate “utilization factor” and project increases based on current average “per dwelling unit equivalent” (DUE) revenues.²

12. Updated per-acre maintenance cost for new/expanded public plaza areas is pending. The model currently estimates plaza maintenance costs as equal to the 2016-2017 fiscal year average cost per acre for mini-parks.

13. Used Public Works cost projections worksheet provided by City staff to project increases in General Fund expenditures for Public Works based on the increase in DUEs generated by the Downtown Plan. Although the Downtown Plan does not propose expansion of the City’s street network, it is possible that some Downtown Plan

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² The application of a “utilization factor” to the average per DUE revenues resulted in a “double discounting” of the potential revenues. By dividing total revenues by total DUEs, including DUEs that do not utilize Community Services programs, the average per DUE revenues already reflect the utilization rate.
features such as new bicycle facilities may require or, optimally, be provided with higher levels of maintenance than existing downtown maintenance levels. Such costs have not been specifically quantified in this analysis; however, it is assumed that if this is the case, the cost increases will be marginal and it is assumed that the overall increase in Public Works service responsibility inferred by the increase in DUEs will reflect this increased maintenance responsibility.

14. Adjusted non-personnel and personnel cost inflators to synchronize with 2019-2020 fiscal year as Year 1, and extended inflators to 2040. The City fiscal model was set up with 2017-2018 fiscal year as Year 1, and extended out 15 years, to 2031-2032 fiscal year. BAE adjusted the model so that the cost inflators from the City fiscal model that were applicable for the 2020-2021 fiscal year line up with Year 2 in the Downtown Plan fiscal model. BAE also extended the inflators through 2039-2040 fiscal year by assuming that the annual inflation factors used in the City fiscal model for the 2031-2032 fiscal year would continue to apply through 2039-2040 fiscal year.

15. Adjusted per capita sales tax inflators to synchronize with 2019-2020 fiscal year as Year 1, and extended inflators to 2040, in the same fashion as the adjustments to the non-personnel and personnel cost inflators.

16. Adjusted “other revenue” inflators to synchronize with 2019-2020 fiscal year as Year 1, and extended inflators to 2040, in the same fashion as the adjustments to the non-personnel and personnel cost inflators.

17. Adjusted the cumulative total and NPV summaries for the projected General Fund net fiscal impact on the Summary of Fiscal Impacts page to include the entire projection period, extending through 2039-2040 fiscal year.

**Findings**
After making the modifications described above, the Downtown Plan fiscal model projects the fiscal impacts from the potential Downtown Plan development for the 2019-2020 through 2039-2040 fiscal year period. As summarized in the attached table (Exhibit 1), the fiscal model projects that new development under the plan would create annual fiscal deficits in 2020-21, 2021-22, and 22-23 fiscal years, but thereafter would generate steadily increasing annual fiscal surpluses, rising to a projected annual fiscal surplus of approximately $2.1 million (nominal dollars) by 2039-2040 fiscal year. The projected deficits in early years are because the fiscal model programs Police Department cost increases to occur in the year prior to absorption of the new development that triggers the increased costs, but after three years of absorption, the fiscal model estimates that the new revenues would catch up and exceed the projected cost increases. Using the fiscal model’s 2.0 percent annual discount rate, the projected 2039-2040 fiscal year surplus would be equivalent to $1.6 million in 2019 dollars.
The sum of the discounted annual net fiscal impacts from 2019-20 to 2039-40 fiscal year (i.e., Net Present Value, NPV) is $11.6 million.

BAE believes that projected positive fiscal results are reasonable. The projected cumulative surplus is due to a combination of favorable factors, including relatively high property tax revenues, relatively low assumed downtown household sizes, and the potential for efficiencies in providing services to new downtown development. The high property tax revenue potential is attributable to the fact that downtown real estate values for a given product type are among the highest in the City of Davis due to the desirable location and the fact that the Downtown area is the part of Davis where the City General Fund receives the highest share of property tax revenues (approximately 27.5 percent of net property tax increment). The relatively low assumed downtown household sizes reflect existing downtown residential patterns and the fact that households in higher density housing types such as those envisioned for the Downtown Plan area tend to be smaller, on average than those elsewhere in Davis where larger housing units tend to prevail. The potential for service efficiencies for new Downtown development is due to the fact that Downtown is an infill location, centrally located, and already served by City services. For example, the existing Downtown fire station will continue to serve the Downtown Plan area and, as mentioned previously, the Downtown Plan will not add to the existing roadway network.

It should be noted that the fiscal model is conservative in that it does not assume a net increase in the City’s transient occupancy tax revenues. This is consistent with the structure of the City’s fiscal model, which does not attribute increases in transient occupancy taxes to increases in other new non-residential or residential development within the City, but rather assumes that transient occupancy tax revenues are driven by more exogenous factors, such as highway traveler demand or demand created by activity at UC Davis that draws visitors to the City. However, it is unlikely that two new hotels would be constructed in Downtown Davis (as assumed in the baseline fiscal analysis) without underlying demand increases that would support the new hotels in addition to the City’s existing lodging places. If each new hotel is successful in capturing additional lodging demand that otherwise would have been accommodated outside the City, this could generate substantial additional TOT revenue for the City that is not accounted for in the baseline analysis.

In contrast to the fiscal results for two recent projects for which the City analyzed fiscal impacts – the West Davis Active Adult Community and the Nishi Property – the fiscal results for the Downtown Plan are quite strong. The two previous projects both involve annexations of unincorporated property and each is projected to be fiscally neutral to slightly positive. In these annexation areas, the City’s property tax share will be a function of the existing property tax share controlled by Yolo County and the terms of revenue sharing agreements reached with Yolo County. In the cases of both West Davis Active Adult and Nishi Property, the division of the County’s former share of the property taxes means that the City will receive a relatively small share of the property tax revenues once those two projects begin to develop. This
translates to reduced revenue potential as compared to if the same development were to occur in the Downtown Plan area, where the City receives a more robust share of the property tax revenue.

The fiscal model incorporates cost savings based on assumed efficiencies in downtown service provision. This an important factor, along with the City’s relatively high share of property taxes generated in the downtown area, in creating the Downtown Plan’s projected cumulative fiscal surplus. Nevertheless, the fiscal model does project substantial increases in costs for the Community Development, Community Services, Police, and Fire Departments, and General Government functions. These costs are based on the increase in downtown DUEs, assuming 75% of the existing average costs per DUE are variable and will increase as the Downtown Plan adds DUEs in the form of new residential units and new non-residential development. In total, the fiscal model projects increased General Fund service costs of $2.6 million (2019 $) by the 2039-40 fiscal year. This includes costs of approximately $812,000 per year (2019 $) by the 2039-2040 fiscal year for increased Police Department expenditures to serve the Downtown Plan area and approximately $589,000 per year for increased Fire Department expenditures in addition to other miscellaneous departmental General Fund expenditure increases.

About 62 percent of the total new revenue projected by the 2039-2040 fiscal year of the analysis is derived from the increased valuation of new development that could occur within the Downtown area, including property taxes, property transfer taxes, and property tax in-lieu of vehicle license fees. This means that the projected fiscal surpluses are sensitive to the assumed valuation for new development. Given that these three property-related revenues are projected to generate approximately $3 million in annual revenue by 2039-2040 fiscal year, and the projected annual fiscal surplus is about $2 million, it would take an approximately 62 percent drop in property-related revenues to erase the projected fiscal deficit. This means that average property valuations could drop by around two-thirds and the new Downtown Plan development would still generate revenues sufficient to cover projected service cost increases.

Another key assumption that contributes to the projected cumulative fiscal surplus is the assumption that the average household sizes in new Downtown Plan area apartments will be relatively small, at 2.16 persons per unit. However, sensitivity analysis indicates that even if the population density in new Downtown Plan area housing were double the assumed 2.16 persons per unit, the projected new development would still generate a cumulative fiscal surplus with an NPV of $4.3 million, albeit reduced from the $11.6 million projected when assuming 2.16 persons per unit.

The fiscal results are not particularly sensitive to the mix of land uses that are assumed to expand within the downtown area. For example, if it is assumed that there is no office or hotel expansion within the downtown plan area, the 1,000 new residential units would still generate
cumulative fiscal surpluses of approximately $7 million. If instead, it is assumed that no new residential development occurs, the assumed new office and hotel development would generate cumulative fiscal surpluses with a net present value of approximately $4 million. In these two examples, the reductions in the projected net present value of cumulative surpluses is more related to the reduction in the quantity of new development than the type of new development.

Overall, the fiscal analysis indicates that the City of Davis should benefit fiscally from new development in the Downtown Plan area, due to a combination of strong revenue potential and cost-effective service provision. To the extent that the City has potential to experience near-term fiscal shortfalls due to the timing of increased service costs relative to the timing of revenue increases, these will be offset by mid- to long-term cumulative fiscal surpluses. The City may also have flexibility to adjust timing of service cost increases by delaying service expansions if this would not adversely affect Downtown service quality. Various sensitivity analyses discussed above indicate that actual conditions could vary substantially from the assumptions incorporated into the fiscal analysis and the City would still likely benefit from cumulative fiscal surpluses from new Downtown Plan area development, whether that is due to changes in market conditions or changes in the City’s service cost or revenue structure.
Attached Table 1
# Exhibit 1: Summary of Fiscal Impacts for City of Davis General Fund

### Project: Downtown Plan

#### Revenues

<table>
<thead>
<tr>
<th>Year</th>
<th>Police</th>
<th>Property Tax In-Lieu of Vehicle License Fees</th>
<th>Prop. 172 Public Safety Sales Tax</th>
<th>Business License Tax</th>
<th>Franchise Fees</th>
<th>Property Tax In-Lieu of Vehicle License Fees</th>
<th>Gas Tax Revenues</th>
<th>Public Works</th>
<th>Community Development</th>
<th>Community Services</th>
<th>Asset Management</th>
<th>Police</th>
<th>Sale</th>
<th>General Government</th>
<th>Sub-Total Revenues</th>
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</thead>
<tbody>
<tr>
<td>2019</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>11,610,785</td>
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<tr>
<td>2020</td>
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<td>0</td>
<td>0</td>
<td>0</td>
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</tbody>
</table>

#### Present Value (Year 1=2019-20 fiscal year)

<table>
<thead>
<tr>
<th>Year</th>
<th>Public Works</th>
<th>Community Development</th>
<th>Community Services</th>
<th>Asset Management</th>
<th>Police</th>
<th>Sale</th>
<th>General Government</th>
<th>Present Value (2019 $) (a)</th>
<th>Cumulative Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>2019</td>
<td>$11,610,785</td>
<td>$0</td>
<td>$0</td>
<td>$0</td>
<td>$0</td>
<td>$0</td>
<td>$0</td>
<td>-$56,832</td>
<td>$15,055,678</td>
</tr>
</tbody>
</table>

### Notes:
(a) Utilizes a 2.0 percent annual discount factor, per Leland Model.

Sources: City of Davis Fiscal Model, updated by BAE, 2019