

## **MEMORANDUM**

To: Piu Ghosh and Catarina Kidd, City of Cupertino

From: Economic & Planning Systems, Inc.

Subject: Economic and Fiscal Analysis of the Hotel Development Application; EPS #151151

Date: January 21, 2016

*The Economics of Land Use*



The City of Cupertino retained Economic & Planning Systems, Inc. (EPS) to prepare this economic and fiscal impact analysis of an application for a General Plan Amendment (GPA). The applicant is proposing a “5 star” full-service hotel on a 1.29-acre site located at 10931 North De Anza Boulevard. The proposed development envisions a 270-room hotel with restaurant and meeting/banquet space.

The EPS analysis assesses the effect of the proposed development on the City of Cupertino’s General Fund. The objective of the analysis is to quantify whether the proposed GPA will generate adequate revenues to cover the costs of providing ongoing services to associated new residents and employees. The analysis does not consider the impact of the proposal on potential capital facilities cost requirements or other one-time costs. The analysis compares the impact of the proposed GPA at buildout to the baseline impact of existing uses in the project area.

This fiscal analysis is intended as a planning-level document to inform land use policy. EPS does not make tenant-specific assumptions as project tenants likely will change over time. The analysis is based on the City’s 2015-16 Adopted General Fund budget and presents findings in constant 2015 dollars.

A summary of fiscal impact estimates attributable to proposed GPA is provided below. Actual fiscal impacts will depend on a number of factors that cannot be predicted with certainty, including the market performance of the project, future changes in City or State budgeting practices, and the efficiency of various City departments in providing services. Key analytical inputs and assumptions used in this analysis are from the GPA application, City documents, information from City staff, and EPS industry knowledge.

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## Summary of Findings

### 1. *The proposed hotel project will result in an annual net fiscal benefit to the City of Cupertino General Fund.*

This analysis estimates that the net annual fiscal impact of the GPA proposal on the City's General Fund is approximately \$1.7 million to \$2.6 million. **Table 1** presents the estimated fiscal impact assuming the applicant's anticipated room rate of \$300 per night. In this scenario, the net increase in General Fund revenues from the project at buildout is estimated at roughly \$2.62 million more annually than existing uses. The net increase in General Fund expenditures associated with the Project is estimated at approximately \$53,000 more per year than existing uses.

**Table 1    Fiscal Impact Summary (2015\$)**

Revenue / Expense Category	Fiscal Impact at Project Buildout	Fiscal Impact Baseline	Net Fiscal Impact
General Fund Revenues	\$2,628,000	\$14,000	\$2,615,000
General Fund Expenditures	<u>\$57,000</u>	<u>\$4,000</u>	<u>\$53,000</u>
<b>Net Impact on General Fund</b>	<b>\$2,571,000</b>	<b>\$10,000</b>	<b>\$2,562,000</b>

### 2. *At project buildout, Transient Occupancy Tax will account for the largest revenue source to the City.*

The City of Cupertino currently levies a 12 percent transient occupancy tax (TOT) on room revenue generated by hotels in the City. The proposed 270 hotel rooms included in the GPA proposal are projected to generate over \$20.7 million in annual room revenue, providing the City's General Fund with an estimated \$2.5 million in annual TOT revenue. If the average room rate is lower than the anticipated \$300 per night, TOT revenue will be less. For example, an average room rate of \$200 per night would generate an estimate \$13.8 million in annual room revenue and \$1.7 million in TOT revenue. Under this scenario, the project's annual net impact on the General fund would fall from \$2.6 million to \$1.7 million. **Table 2** on the following page illustrates the differences in net fiscal impacts when reducing the daily room rate from \$300 to \$200.<sup>1</sup>

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<sup>1</sup> This sensitivity analysis reflects potential variation in the market performance of the proposed hotel. The City has limited ability to influence the hotel's market positioning after project entitlement.

**Table 2 Hotel Sensitivity Analysis (2015\$)**

<b>Revenue / Expense Category</b>	<b>Net Fiscal Impact (\$300/room night)</b>	<b>Net Fiscal Impact (\$200/room night)</b>
General Fund Revenues	\$2,615,000	\$1,787,000
General Fund Expenditures	<u>\$53,000</u>	<u>\$53,000</u>
<b>Net Impact on General Fund</b>	<b>\$2,562,000</b>	<b>\$1,734,000</b>

**3. The proposed hotel project will directly support about 270 jobs within the City of Cupertino.**

The hotel development likely will support about 270 jobs in hotel and associated restaurant and meeting facility positions. A relatively small fraction of these jobs are likely to be high-value management positions. Accounting for the existing retail use of this site, the GPA proposal likely will directly support a net increase of roughly 250 jobs in the City.

## **Fiscal Impact on the General Fund**

This section describes the methodology and key assumptions used to estimate the fiscal impacts of the proposed GPA. The analysis is based on information from three key sources:

- (1) the GPA application material submitted
- (2) interviews with City planning and finance staff
- (3) existing EPS industry knowledge

EPS has not conducted an independent audit of the City's budget, performed in-depth interviews with service-providing City departments, or conducted detailed market analysis.

### **Proposed General Plan Amendment**

The applicant is proposing a hotel project to be developed on a 1.29-acre site located at 10931 North De Anza Boulevard. The proposed development envisions a full-service 270-room hotel with restaurant and meeting/banquet space. **Table 3** below presents the proposed GPA program identified by the applicant. The table also presents EPS assumptions concerning the population and employment that would be supported by the project at buildout. A variety of revenues and costs included in this fiscal analysis are based on the anticipated "service population" shown in **Table 2**, which weights a local employee's service burden at 50 percent of a resident's burden.

**Table 3 Development Program and Service Population**

Item	Development Program	Resident or Worker Density Assumptions (1)		Population	Employment	Service Population (2)
Commercial Uses						
General Office	0 Square Feet	0	SF / Employee		0	0
Retail	0 Square Feet	0	SF / Employee		0	0
Subtotal	0				0	0
Hotel	270 Rooms	1.0	Room(s) / Employee		270	135
Residential Rentals						
Market-Rate Apartments	0 Dwelling Units	0.00	Residents / HH	0		0
Senior Apartments						
Market-Rate	0 Dwelling Units	0.00	Residents / HH	0		0
Below-Market-Rate (Low-Income)	0 Dwelling Units	0.00	Residents / HH	0		0
Below-Market-Rate (Very Low-Income)	0 Dwelling Units	0.00	Residents / HH	0		0
Subtotal	0			0		0
Total				0	270	135

(1) Household and employment densities vary based on specific tenant and space sizes. EPS assumptions reflect typical conditions.

(2) Per-person employee burden on City service is weighted at 50 percent of resident burden.

## General Fund Revenues

New General Fund tax proceeds attributable to the proposed GPA will include property tax, property tax in lieu of vehicle license fee (VLF), property transfer tax, TOT, utility user tax, franchise fees, and business licenses. While sales tax revenue is not considered here, the project's restaurant likely will contribute sales tax revenue to the City's General Fund.<sup>2</sup> **Table 4** provides a summary of the Cupertino 2015-16 Adopted General Fund revenue budget and a description of the forecasting method relied upon for each relevant revenue source.

**Table 4 FY2015 - 16 Revenue Budget Summary and Fiscal Impact Estimating Factors**

Item	FY2015-16 Total	Estimating Factors
Sales Tax		
Business to Business Sales Tax (1)	\$13,905,880	- not estimated
Other Sales Tax	\$6,454,120	- not estimated
Property Tax		
Property Tax in Lieu of VLF (2)	\$5,782,541	0.7% of Citywide Assessed Value
Other Property Tax	\$10,272,459	5.8% of base property tax rate (1%)
Transient Occupancy Tax	\$5,072,000	12% of total TOT revenue
Utility Tax	\$3,100,000	3.4% of utility bills
Franchise Fees	\$2,800,000	\$37.98 per service population
Other Taxes (3)		
Construction Tax	\$2,147	- not estimated
Business License	\$512,649	\$18.34 per employee
Property Transfer Tax	\$553,860	\$0.55 per \$1,000 in value
Other Taxes	\$331,344	- not estimated
Licenses & Permits	\$6,171,000	- not estimated
Fines & Forfeitures	\$550,000	- not estimated
Use of Money & Property	\$742,530	- not estimated
Intergovernmental	\$600,000	- not estimated
Charges for Services	\$10,590,878	- not estimated
Miscellaneous	\$720,895	- not estimated
<b>Total Revenues</b>	<b>\$68,162,303</b>	

(1) FY2015-16 total reflects 68% allocation of the sales tax total. Budget detail provided by the City.

(2) FY2015-16 total reflects 36% allocation of the property tax total. Budget detail provided by the City.

(3) FY2015-16 total reflects allocation of other taxes based on detail provided by the City.

<sup>2</sup> The GPA application materials did not provide detail concerning the size or type of restaurant that is envisioned for the hotel project.

### Property Tax Revenue

Property tax revenue estimates are based on the estimated assessed value of the proposed project. Relying on the applicant's proposed development program, EPS estimates the project's assessed value at about \$135 million at buildout, as shown in **Table 5**. Commercial value assumptions reflect a review of recent sales in the market area. The City's General Fund captures 5.8 percent of the base 1.0 percent property tax rate. This tax rate factor is specific to the tax rate area that covers the project location.

**Table 5 Property Tax Revenue**

Item	Assumption / Factor		Total at Buildout
Property Tax			
Assessed Value Estimate			
Office	\$0	Per Square Foot	\$0
Retail	\$0	Per Square Foot	\$0
Market-Rate Rental	\$0	Per Unit	\$0
Below-Market-Rate Rental	\$0	Per Unit	\$0
Hotel	\$500,000	Per Room	\$135,000,000
Subtotal			\$135,000,000
Property Tax	1.0%	Base Property Tax Rate	\$1,350,000
Cupertino General Fund Revenue (1)	5.8%	Allocation to Cupertino General Fund	\$78,109
Property Tax In Lieu of VLF			
Existing Citywide Property Tax in Lieu of VLF			\$5,782,541
Citywide Assessed Value (2)			\$19,200,000,000
Project Net Assessed Value Increase (3)			0.70%
Property Tax In Lieu of VLF Revenue (4)			\$40,658

(1) Per Santa Clara County Tax Collector AB8 factor (post ERAF).

(2) FY2014-2015 value based on the Santa Clara County Assessor Annual Assessor's Report.

(3) Calculated by dividing the new assessed value by citywide assessed value.

(4) Calculated by multiplying existing property tax in lieu of VLF by project net assessed value increase.

### Property Tax In Lieu of VLF

In 2004, the State of California adjusted the method for sharing VLF with local jurisdictions. Recent State budget changes replaced VLF with property tax, which grows proportionately with increases in assessed value of the City. The proposed project will add about 0.7 percent to the current assessed value in Cupertino (assuming no other assessed value growth for simplification purposes) and will generate the same increased percentage in in-lieu VLF revenues (see **Table 5**).

### Property Transfer Tax

The project will generate real estate transfer tax revenue associated with future turnover in ownership. This analysis assumes that ownership of the hotel is likely to turnover every 25 years, an annual turnover rate of 4.0 percent.<sup>3</sup> The property transfer tax rate accruing to the City General Fund is \$0.55 per \$1,000 of the property value, as shown in **Table 6**.

**Table 6 Property Transfer Tax Revenue**

Item	Assumption / Factor		Annual Total at Buildout
<b>Property Value</b>			
Office	\$0	Per Square Foot	\$0
Retail	\$0	Per Square Foot	\$0
Market-Rate Rental	\$0	Per Unit	\$0
Below Market Rate Rental	\$0	Per Unit	\$0
Hotel	\$500,000	Per Room	<u>\$135,000,000</u>
Total			\$135,000,000
<b>Average Annual Turnover</b>			
General Office	4.0%		\$0
Retail	4.0%		\$0
Market-Rate Rental	4.0%		\$0
Below-Market-Rate Rental	4.0%		\$0
Hotel	4.0%		<u>\$5,400,000</u>
Subtotal			\$5,400,000
<b>Property Transfer Tax Revenue</b>	\$0.55 per \$1,000 in value		<b>\$2,970</b>

<sup>3</sup> For institutional investors of commercial real estate a typical holding period is five to seven years (Ciocchetti and Fisher, 2002). This analysis assumes a significantly longer holding period due to the property tax benefits of long-term ownership in California.

### Transient Occupancy Tax

The hotel expected to help satisfy the strong lodging demand in the local market. Consistent with the GPA application, this analysis assumes the 270 hotel rooms planned for the project achieve an average daily room rate of \$300. This analysis assumes that the hotel stabilizes at 70 percent occupancy, 10 percentage points lower than projected by the applicant. The estimate of TOT is calculated by applying the current rate of 12 percent to the total room revenue generated by new hotel, as shown in **Table 7**.

**Table 7 Transient Occupancy Tax Revenue**

Item	Assumptions	Annual Total at Buildout
Hotel Rooms		270
Average Daily Room Charge	\$300	
Average Occupancy	70%	
Average Annual Revenue		\$20,695,500
<b>Total TOT Revenue</b>	12.0%	<b>\$2,483,460</b>
% of Total Citywide FY2015-16 TOT Revenue (illustrative)		49.0%

### Utility Tax

The City of Cupertino collects tax revenue on utility charges for services provided in the City. New residents and employees will expand the use of utilities in the City. This analysis estimates an average monthly utility expense of \$120 per employee. The City of Cupertino collects 3.4 percent of utility charges. **Table 8** presents utility user tax revenue attributable to the proposed project at buildout.

**Table 8 Utility User Tax Revenue**

	Assumption	Annual Total at Buildout
<b>Residential</b>		
Total Residential Population	0 Residents	
Monthly Utility Cost	\$75 per resident per month	
Annual Total		\$0
<b>Commercial</b>		
Total Employees	270 employees	
Monthly Utility Cost	\$120 per employee per month	
Annual Total		<u>\$388,800</u>
Total Annual Utility Expenses		\$388,800
<b>Utility User Tax Revenue</b>	3.4% of utility bill	<b>\$13,219</b>



### Revenues from Other Taxes and Fees

In addition to the key revenues described above, other taxes and fees are estimated to be generated by the project. Specifically, franchise fee revenue and business license revenue, which reflect averages derived from City budget documents (see **Table 4**), are calculated for the hotel. **Table 9** presents forecasting assumptions and revenue estimates.

**Table 9 Revenue from Other Taxes and Fees**

Item	Allocation Factor	Project Characteristic	Annual Total at Buildout
Business-to-Business Sales	\$0.20 per square foot of office	0 square feet	\$0
Franchise Fees (1)	\$37.98 per service population	135 service pop.	\$5,127
Business License (1)	\$18.34 per employee	270 employees	<u>\$4,952</u>
<b>Subtotal</b>			<b>\$10,079</b>

(1) Franchise Fee and Business License allocation factors are both based on existing general fund revenue per capita.

### **General Fund Expenditures**

This fiscal analysis estimates the costs attributable to population and employment growth by characterizing how expenses will change for each City department. For some departments, population and employment growth in the City will not dramatically alter operations. For example, administrative functions in the City are not likely to scale up significantly to accommodate new projects. Alternatively, departments that provide services directly to residents and businesses likely will increase their operations and costs to accommodate new populations.

It is important to note that a range of external factors may influence responses to growth and cost effects in the future. Examples of factors that are beyond the control of the City and its departments that may act to magnify or reduce department costs over time include:

- Regional growth;
- Technology;
- State and federal policies; and
- Environmental factors.

This study does not speculate regarding the potential effects of such exogenous influences on the general fund expense budget. It focuses only on those factors attributable directly to the population growth, employment growth, and land use changes generated by the proposed GPA.

The fiscal analysis model relies on categorization of the likely budgetary response to population and employment growth for each department. The anticipated response to growth is expressed for fiscal modeling purposes in terms of “fixed expenses” and “variable expenses” within the department budget.

The fixed expenses are the portion of a City department’s budget which is not affected by population and employment growth. Even a department which is anticipated to grow largely in step with the City’s service population likely would have some fixed cost. For example, in most cases each department has only one director position, which is a fixed expense for the department. While the department may increase staffing to accommodate growth, the department will not add another director.

The variable expenses of a department are those that do increase with growth. As the City grows, increased demand for services requires some departments to scale up operations to meet new demand. The portion of a department’s budget that scales up is identified as the variable share of the budget.

EPS uses a per-capita cost approach to estimate department costs attributable to new residents and workers. The variable portion of each department budget is used to determine the per-capita cost, as shown in **Table 10**. Then, to determine the new General Fund expenditures generated by the proposed project, the per-capita factors are multiplied by the projected increase in service population or population, as appropriate. Public Affairs and Non-Departmental expenditures are not estimated because the project is not expected to generate new ongoing costs in to these service providers.

**Table 10 FY2015-16 Expenditure Budget Summary and Fiscal Impact Estimating Factors**

Item	City General Fund Expenses (FY2015-16)	Percent Variable (1)	Annual Variable Expenses	Estimating Factors		Per Capita General Fund Expense	Project Population/ Service Population	Annual Total at Buildout
General Government (2)	\$8,551,349	10%	\$855,135	73,731	Service Pop.	\$11.60	135	\$1,566
Police (3)	\$10,994,684	90%	\$9,895,216	73,731	Service Pop.	\$134.21	135	\$18,118
Public Affairs (4)	\$462,298	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Recreation & Community Services	\$6,157,107	75%	\$4,617,830	59,756	Population	\$77.28	0	\$0
Planning & Community Development	\$7,235,383	50%	\$3,617,691.50	73,731	Service Pop.	\$49.07	135	\$6,624
Public Works (5)	\$22,563,247	75%	\$16,922,435	73,731	Service Pop.	\$229.52	135	\$30,985
Non-Departmental	<u>\$11,610,985</u>	N/A	N/A	N/A	N/A	N/A	N/A	<u>N/A</u>
<b>Total Expenditures</b>	<b>\$67,575,053</b>							<b>\$57,292</b>

(1) Percentage of costs that are population-dependent, as opposed to fixed costs or costs recovered through fees or charges.

(2) Includes Council and Commission, Administration, and Administrative Services.

(3) Reflects the contract portion of the police department's budget. To the extent the cumulative effect of new growth triggers the contract terms exceeding the cap agreed upon in 2014, the cost impact may be above that estimated based on the average cost approach.

(4) Includes public affairs, IT, government channel, and City website.

(5) Includes administration, environmental programs, development services, service center, grounds, streets, trees and right of way, facilities and fleet, transportation, and other programs.

## Fiscal Impact of Proposed Project

**Table 11** summarizes the fiscal impact of the hotel development proposal on the City of Cupertino's General Fund, with forecasted revenues and expenditure estimates based on the methodology described above. The annual fiscal impact of the proposed GPA is estimated at about \$2.6 million.

**Table 11 Summary of Fiscal Impact Analysis – Hotel at Buildout (2015\$)**

Item	Annual Fiscal Impact
<b><u>General Fund Revenues</u></b>	
Sales Tax (excl. business-to-business sales)	\$0
Business to Business Sales	\$0
Property Tax	\$78,000
Property Tax in Lieu of VLF	\$41,000
Property Transfer Tax	\$3,000
Transient Occupancy Tax	\$2,483,000
Utility Tax	\$13,000
Franchise Fees	\$5,000
Business Licenses	\$5,000
<b>Total Revenues</b>	<b>\$2,628,000</b>
<b><u>General Fund Expenditures</u></b>	
General Government	\$2,000
Police	\$18,000
Recreation & Community Services	\$0
Planning & Community Development	\$7,000
Public Works	\$31,000
<b>Total Expenditures</b>	<b>\$57,000</b>
<b>Net Impact on General Fund</b>	<b>\$2,571,000</b>

## Existing Conditions Estimate

In order to quantify the fiscal impact of the existing shopping center located at 10931 North De Anza Boulevard, the same fiscal methodology is applied to existing land use program as the proposed GPA. The site currently is occupied by an automobile service establishment located within a building of approximately 8,000 square feet. The existing use provides a positive fiscal impact to the City's General Fund of about \$10,000 a year, as shown in **Table 12**.

**Table 12 Summary of Fiscal Impact Analysis – Hotel Existing Conditions (2015\$)**

Item	Annual Fiscal Impact
<b><u>General Fund Revenues</u></b>	
Sales Tax (excl. business-to-business sales)	\$11,000
Business to Business Sales	\$0
Property Tax	\$1,000
Property Tax in Lieu of VLF	\$1,000
Property Transfer Tax	\$0
Transient Occupancy Tax	\$0
Utility Tax	\$1,000
Franchise Fees	\$0
Business Licenses	\$0
<b>Total Revenues</b>	<b>\$14,000</b>
<b><u>General Fund Expenditures</u></b>	
General Government	\$0
Police	\$1,000
Recreation & Community Services	\$0
Planning & Community Development	\$0
Public Works	\$2,000
<b>Total Expenditures</b>	<b>\$4,000</b>
<b>Net Impact on General Fund</b>	<b>\$10,000</b>

## Net Fiscal Impact

This hotel project, as proposed, will result in an annual net fiscal benefit to the City of Cupertino General Fund. This analysis estimates that the net annual fiscal impact of the GPA proposal on the City's General Fund is approximately \$2.6 million, as shown in **Table 13**. The net increase in General Fund revenues from the project at buildout is estimated at roughly \$2.62 million annually more than existing uses. The net increase in General Fund expenditures associated with the Project is estimated at approximately \$53,000 per year more than existing uses.

**Table 13 Net Fiscal Impact Summary (2015\$)**

Revenue / Expense Category	Fiscal Impact at Project Buildout	Fiscal Impact Baseline	Net Fiscal Impact
General Fund Revenues	\$2,628,000	\$14,000	\$2,615,000
General Fund Expenditures	<u>\$57,000</u>	<u>\$4,000</u>	<u>\$53,000</u>
<b>Net Impact on General Fund</b>	<b>\$2,571,000</b>	<b>\$10,000</b>	<b>\$2,562,000</b>