MEMORANDUM

To: Gian Martire, City of Cupertino

From: Economic & Planning Systems, Inc.

Subject: Fiscal Analysis of the Cupertino Hotel GPA Application; EPS #171072

Date: July 21, 2017

The Economics of Land Use

The City of Cupertino retained Economic & Planning Systems, Inc. (EPS) to prepare this fiscal impact analysis of an application for a General Plan Amendment (GPA). The applicant is proposing a luxury full-service hotel on a 1.29-acre site located at 10931 North De Anza Boulevard. The proposed development envisions a 156-room hotel with an onsite restaurant, spa, and convention/meeting 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 2016-17 Adopted General Fund budget and presents findings in constant 2017 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 $1.0 million to $1.5 million. **Table 1** presents the estimated fiscal impact assuming the applicant's anticipated average daily 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 $1.5 million more annually than existing uses at the site. The net increase in General Fund expenditures associated with the Project is estimated at approximately $28,000 more per year than existing uses.

Table 1 Fiscal Impact Summary (2017$)

Revenue / Expense Category	Fiscal Impact at Project Buildout	Fiscal Impact Baseline	Net Fiscal Impact
General Fund Revenues	$1,531,000	$14,000	$1,517,000
General Fund Expenditures	$32,000	$4,000	$28,000
Net Impact on General Fund	**$1,497,000**	**$10,000**	**$1,487,000**

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 156 hotel rooms included in the GPA proposal are projected to generate about $12.0 million in annual room revenue, providing the City's General Fund with an estimated $1.4 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 $8.0 million in annual room revenue and $956,600 in TOT revenue. Under this scenario, the project's annual impact before consideration of baseline impacts on the General Fund would fall from $1.5 million to $1.0 million. **Table 2** illustrates the differences in net fiscal impacts when assumed daily room rates are reduced from $300 to $200.[1]

[1] 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 (2017$)

Revenue / Expense Category	Fiscal Impact ($300/Room Night)	Fiscal Impact ($200/Room Night)
General Fund Revenues	$1,531,000	$1,053,000
General Fund Expenditures	$32,000	$32,000
Net Impact on General Fund	**$1,497,000**	**$1,019,000**

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 156-room hotel with an onsite restaurant, spa, and convention/meeting 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 3**, 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)	Employment	Service Population (2)
Hotel	156 Rooms	1.0 Room(s) / Employee	156	78

(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.[2] **Table 4** provides a summary of the Cupertino 2016-17 Adopted General Fund revenue budget and a description of the forecasting method relied upon for each relevant revenue source.

Table 4 FY2016 - 17 Revenue Budget Summary and Fiscal Impact Estimating Factors

Item	FY2016-17 Total	Estimating Factors Applied to Estimate Project Revenue	
Sales Tax			
Business to Business Sales Tax (1)	$15,034,800	$0.20	per square foot of office
Other Sales Tax	$7,405,200	1.0%	of estimated taxable sales
Property Tax			
Property Tax in Lieu of VLF (2)	$7,106,000	0.4%	of Citywide Assessed Value
Other Property Tax	$11,635,000	7.0%	of base property tax rate (1%)
Transient Occupancy Tax	$6,708,000	12%	of total TOT revenue
Utility Tax	$3,122,000	2.4%	of utility bills
Franchise Fees	$2,900,000	$38.21	per service population
Other Taxes (3)	$1,600,000		
Construction Tax	$500,000	-	not estimated
Business License	$600,000	$17.67	per employee
Property Transfer Tax	$500,000	$0.55	per $1,000 in value
Licenses & Permits	$2,499,000	-	not estimated
Fines & Forfeitures	$776,980	-	not estimated
Use of Money & Property	$230,500	-	not estimated
Intergovernmental	$19,003,224	-	not estimated
Charges for Services	$600,000	-	not estimated
Miscellaneous	$383,300	-	not estimated
Total Revenues	**$79,004,004**		

(1) FY2016-17 total reflects 67% allocation of the sales tax total. Budget detail provided by the City.
Estimating factor reflects typical business-to-business sales tax generation in Silicon Valley offices.
(2) FY2016-17 total reflects 38% allocation of the property tax total. Budget detail provided by the City.
(3) FY2016-17 total reflects allocation of other taxes based on detail provided by the City.

[2] 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 $78.0 million at buildout, as shown in **Table 5**. The City levies a one percent property tax rate, with approximately 7.0 percent allocated to the General Fund.[3]

Table 5 Property Tax Revenue

Item	Assumption / Factor		Total at Buildout
Property Tax			
Assessed Value Estimate			
Hotel	$500,000	Per Room	$78,000,000
Property Tax	1.0%	Base Property Tax Rate	$780,000
Cupertino General Fund Revenue (1)	7.0%	Allocation to Cupertino General Fund	**$54,600**
Property Tax In Lieu of VLF			
Existing Citywide Property Tax in Lieu of VLF			$7,106,000
Citywide Assessed Value (2)			$21,350,000,000
Project Net Assessed Value Increase (3)			0.37%
Property Tax In Lieu of VLF Revenue (4)			**$25,961**

(1) Legislation requires Counties to provide "no/low tax" cities with a Tax Equity Allocation equal to 7 percent of property tax share.
(2) FY2016-2017 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.

[3] Property tax rate anticipated at project delivery; City of Cupertino 2016-17 Adopted Budget, page 80.

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 0.37 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. [4] 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
Property Value			
Hotel	$500,000	Per Room	$78,000,000
Average Annual Turnover			
Hotel	4.0%		$3,120,000
Property Transfer Tax Revenue	$0.55	per $1,000 in value	**$1,716**

[4] For institutional investors of commercial real estate a typical holding period is five to seven years (Ciochetti 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 is expected to help satisfy strong lodging demand in the local market. Consistent with the GPA application, this analysis assumes the 156 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. 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		156
Average Daily Room Charge	$300	
Average Occupancy	70%	
Average Annual Revenue		$11,957,400
Total TOT Revenue	12.0%	**$1,434,888**
% of Total Citywide FY2016-17 TOT Revenue (illustrative)		*21.4%*

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 $150 per employee. The City of Cupertino collects 2.4 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
Commercial			
Total Employees	156	employees	
Monthly Utility Cost	$150	per employee per month	
Total Annual Utility Expenses			$280,800
Utility User Tax Revenue	2.4%	of utility bill	**$6,739**

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 from other taxes and fees.

Table 9 Revenue from Other Taxes and Fees

Item	Allocation Factor		Project Characteristic		Annual Total at Buildout
Franchise Fees (1)	$38.21	per service population	78	service pop.	$2,981
Business License (1)	$17.67	per employee	156	employees	$2,757
Subtotal					**$5,738**

(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. Innovation and Technology 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 FY2016-17 Expenditure Budget Summary and Fiscal Impact Estimating Factors

Item	City General Fund Expenses (FY2016-17)	Percent Variable (1)	Annual Variable Expenses	Estimating Factors		Per Capita General Fund Expense	Project Population/ Service Population	Annual Total at Buildout
General Government (2)	$11,341,627	10%	$1,134,163	75,892	Service Pop.	$14.94	78	$1,166
Police (3)	$11,884,384	90%	$10,695,946	75,892	Service Pop.	$140.94	78	$10,993
Innovation and Technology (4)	$924,006	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Recreation & Community Services	$10,484,573	75%	$7,863,430	58,917	Population	$133.47	0	$0
Planning & Community Development	$10,273,323	50%	$5,136,661.50	75,892	Service Pop.	$67.68	78	$5,279
Public Works (5)	$19,343,167	75%	$14,507,375	75,892	Service Pop.	$191.16	78	$14,910
Non-Departmental	$12,971,373	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Total Expenditures	**$77,222,453**							**$32,349**

(1) Percentage of costs that are population-dependent, as opposed to fixed costs or costs recovered through fees or charges.
(2) Includes Administration, Administrative Services, and Council and Commissions.
(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) Formerly known as Public Affairs and includes services such as videography, applications, IT and GIS.
(5) Includes administration, environmental programs, development services,service center, grounds, streets, trees and right of way, facilities and fleet, transportation, and other programs.

Sources: City of Cupertino FY 2016/17 Adopted Budget

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 $1.5 million.

Table 11 Summary of Fiscal Impact Analysis – Hotel at Buildout (2017$)

Item	Annual Fiscal Impact
General Fund Revenues	
Property Tax	$55,000
Property Tax in Lieu of VLF	$26,000
Property Transfer Tax	$2,000
Transient Occupancy Tax	$1,435,000
Utility Tax	$7,000
Franchise Fees	$3,000
Business Licenses	$3,000
Total Revenues	**$1,531,000**
General Fund Expenditures	
General Government	$1,000
Police	$11,000
Planning & Community Development	$5,000
Public Works	$15,000
Total Expenditures	**$32,000**
Net Impact on General Fund	**$1,497,000**

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 (2017$)

Item	Annual Fiscal Impact
General Fund Revenues	
Sales Tax (excl. business-to-business sales)	$11,000
Property Tax	$1,000
Property Tax in Lieu of VLF	$1,000
Utility Tax	$1,000
Total Revenues	**$14,000**
General Fund Expenditures	
Police	$1,000
Planning & Community Development	$1,000
Public Works	$2,000
Total Expenditures	**$4,000**
Net Impact on General Fund	**$10,000**

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 $1.5 million, as shown in **Table 13**. The net increase in General Fund revenues from the project at buildout is estimated at roughly $1.5 million annually more than existing uses. The net increase in General Fund expenditures associated with the Project is estimated at approximately $28,000 per year more than existing uses.

Table 13 Net Fiscal Impact Summary (2017$)

Revenue / Expense Category	Fiscal Impact at Project Buildout	Fiscal Impact Baseline	Net Fiscal Impact
General Fund Revenues	$1,531,000	$14,000	$1,517,000
General Fund Expenditures	$32,000	$4,000	$28,000
Net Impact on General Fund	**$1,497,000**	**$10,000**	**$1,487,000**