

## ***DRAFT MEMORANDUM***

To: Gian Martire, City of Cupertino

From: Benjamin C. Sigman and Taylor Henry;  
Economic & Planning Systems, Inc.

Subject: Fiscal Analysis of the Homestead GPA Application;  
EPS #201111

Date: December 23, 2020

*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 low/medium density residential development on a 0.46-acre parcel located at 19820 Homestead Road. The proposed development envisions four single-family residences, two of which have attached accessory dwelling units (ADUs), yielding a total of six housing units.

This EPS fiscal 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 cost of providing ongoing services to new residents. The analysis does not consider the impact of the proposed project 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 the existing use of the project site.

The EPS analysis offers a planning-level perspective to inform land use policy. EPS does not employ specific assumptions about the real estate product formats or the composition of the households that will occupy the proposed housing. The analysis does reflect typical housing development in the flats of Cupertino and household income characteristics derived from anticipated unit pricing. The analysis reflects the City's 2019-20 Actual General Fund Revenues and Expenses and presents findings in constant 2020 dollars.

The Summary of Findings below describes estimated fiscal impacts attributable to proposed GPA. 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

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analysis are from the GPA application, City documents, information from City staff, and EPS industry knowledge. EPS has not performed detailed market research as part of this study effort.

## Summary of Findings

### 1. *The proposed Homestead 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 \$7,600 per year. **Table 1** presents the estimated fiscal impact, which assumes the project's single-family homes will sell for \$3.1 million per unit. The analysis assumes homes with an attached accessory dwelling unit will sell for \$3.8 million each.

**Table 1 Annual Fiscal Impact Summary (2020\$)**

Revenue / Expense Category	Fiscal Impact at Project Buildout	Fiscal Impact Baseline	Net Fiscal Impact
General Fund Revenues	\$16,300	\$3,100	\$13,200
General Fund Expenditures	<u>\$7,100</u>	<u>\$1,400</u>	<u>\$5,700</u>
<b>Net Impact on General Fund</b>	<b>\$9,300</b>	<b>\$1,700</b>	<b>\$7,600</b>

### 2. *At project buildout, property tax will account for the largest revenue source to the City.*

Property tax revenue is based on the estimated assessed value of the proposed project. The proposed development program results in an estimated assessed value of approximately \$13.7 million. The City of Cupertino will receive 7.0 percent out of the 1.0 percent base property tax levied on property in the City. Before consideration of baseline impacts (i.e., tax revenue from the existing property), the total amount of property tax collected is estimated at \$137,300, and the City's General Fund would receive \$9,600 per year.

### 3. *If the Accessory Dwelling Units are not occupied by additional households, the estimated fiscal benefit of the proposed project is greater.*

Property tax revenue is based on the estimated assessed value of the proposed project, and will not decrease if the ADUs are kept off market (e.g., as an office or for visitors). And while sales tax revenue and other population-dependent revenues accruing to the General Fund would be slightly less in this scenario, the decrease is modest. Meanwhile, the reduced project occupancy would reduce the expected cost to the City to provide services to the project. If the two ADUs remain unoccupied by additional households, EPS estimates the net fiscal impact of the project at approximately \$8,800 per year, roughly 15 percent higher than if the ADUs are occupied.

## 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) information from City planning and finance staff; and
- (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 residential project to be developed on an 0.46-acre site located on Homestead Road in Cupertino. The proposed development project envisions four single-family residences, two of which will have attached accessory dwelling units. Two of the single-family homes are planned for 2,985 square feet, two are planned for 3,242 square feet, and the accessory dwelling units are each 640 square feet.

**Table 2** below presents the proposed GPA program identified by the applicant. The table also presents EPS assumptions concerning the population that would be generated by the project. A variety of revenues and costs included in this fiscal analysis are based on the anticipated "service population" shown in **Table 2**.

**Table 2 Development Program and Service Population**

Item	Development Program	Resident Density Assumptions [1]	Population	Service Population
<b>Residential For-Sale</b>				
Single-Family Units	4 DU	2.96 Residents / HH	11.8	11.8
Accessory Dwelling Units	2 DU	1.50 Residents / HH	<u>3.0</u>	<u>3.0</u>
<b>Total</b>	<b>6 DU</b>		<b>14.8</b>	<b>14.8</b>

[1] Household resident densities vary based on product type. EPS assumptions for single-family units reflect the citywide average (State of California Department of Finance), 2.96 persons per household. EPS assumptions for accessory dwelling units are based on a 2012 UC Berkeley study on secondary units that reports an average occupancy of 1.5 persons.

### General Fund Revenues

New General Fund tax proceeds attributable to the proposed GPA will include sales tax, property tax, property tax in lieu of vehicle license fee (VLF), property transfer tax, utility user tax, and franchise fees. **Table 3** provides a summary of the Cupertino 2019-20 Actual General Fund Revenues and a description of the forecasting method relied upon for each relevant revenue source.

**Table 3 FY2019 - 20 Revenue Budget Summary and Fiscal Impact Estimating Factors**

Item	FY2019-2020 Total	Factors Applied to Estimate Project Revenue
Sales Tax	\$26,651,250	1.0% of estimated taxable sales
Property Tax		
Property Tax in Lieu of VLF	\$8,489,541	0.1% of Citywide Assessed Value
Other Property Tax	\$18,117,303	7.0% of base property tax rate (1%)
Transient Occupancy Tax	\$7,286,083	- not applicable
Utility Tax	\$3,182,087	2.4% of utility bills
Franchise Fees	\$3,418,909	\$40.01 per service population
Business License	\$771,946	
Other Taxes	\$630,056	
Property Transfer Tax	\$599,962	\$0.55 per \$1,000 in value
Licenses & Permits	\$4,692,845	- not estimated
Use of Money & Property	\$4,189,877	- not estimated
Intergovernmental	\$747,942	- not estimated
Charges for Services	\$11,986,328	- not estimated
Fines & Forfeitures	\$327,833	- not estimated
Miscellaneous	\$1,217,670	- not estimated
Other Financing Sources	\$451,439	- not estimated
Transfer-In	<u>\$10,012,000</u>	- not estimated
<b>Total Revenues</b>	<b>\$102,173,109</b>	

## Retail Sales Tax Revenue

The proposed GPA is expected to generate retail sales tax revenue accruing to the City General Fund from project residents' household spending at retailers in the city (**Table 4**). This fiscal analysis relies on data from the U.S. Bureau of Labor Statistic Consumer Expenditure Survey to establish the retail spending pattern of households. Spending patterns reflect household consumer behavior observed nationally for households with specified levels of annual income.

This analysis uses anticipated residential price points to estimate household income. Then, to identify taxable retail expenditures, the analysis identifies and isolates taxable retail spending from total household spending. EPS estimates that for the proposed single-family units, households are likely to spend approximately 16 percent of gross household income on taxable retail purchases. For the accessory dwelling units, which provide housing for median income households, this analysis estimates that 25 percent of gross household income is spent on taxable retail purchases. Of the total taxable retail spending potential from all unit types, the analysis assumes that about 25 percent of the taxable retail spending will be captured within the City.

**Table 4 Sales Tax Estimate**

Item	Assumptions	Factor/ Estimate
<b>Project Households Retail Purchases in Cupertino</b>		
Estimated Annual Household Income [1]		
Single-Family Unit	35% of income is Housing Costs	\$368,618
Accessory Dwelling Unit	35% of income is Housing Costs	\$96,572
Household Taxable Retail Spending [2]		
Single-Family Unit	15.5% percent of income	\$56,991
Accessory Dwelling Unit	24.9% percent of income	\$24,066
Weighted Average Household Spending		\$46,016
Household Retail Spending in Cupertino [3]	25% of retail expenditures	\$11,504
Project Households		6
<b>Net New Taxable Retail Sales Captured in Cupertino</b>		<b>\$69,024</b>
<b>Total Sales Tax Revenue</b>	1.0% of taxable sales	<b>\$690</b>

[1] Income estimate relies on typical mortgage financing and the assumption that housing costs represent 35 percent of gross household income.

[2] Based on Bureau of Labor Statistics Consumer Expenditure Survey for respective income groups.

[3] Assumes 25 percent of taxable retail spending by Cupertino residents is captured by the retailers within the City based on discussions with the City's Economic Development Manager.

Sources: State Board of Equalization, ICSC Research Survey, U.S. Bureau of Labor Statistics

## 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 \$13.7 million at buildout, as shown in **Table 5**. The City levies a one percent property tax rate, with approximately 7.0 percent accruing to the General Fund.<sup>1</sup>

### 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 0.05 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, as shown in **Table 5**.

**Table 5 Property Tax Revenue**

Land Use	Assumption / Factor		Total at Buildout
<b>Assessed Value Estimate [1]</b>			
Single-Family Unit (For-Sale)	\$3,113,500 per Unit		\$12,454,000
Accessory Dwelling Unit (For-Sale)	\$640,000 per Unit		<u>\$1,280,000</u>
<b>Total Assessed Value</b>			<b>\$13,734,000</b>
Property Tax	1.0%	Base Property Tax Rate	\$137,340
<b>Cupertino General Fund Revenue [2]</b>	7.0%	Allocation to Cupertino General Fund	<b>\$9,614</b>
<b>Property Tax In Lieu of VLF</b>			
Existing Citywide Property Tax in Lieu of VLF			\$8,489,541
Citywide Assessed Value [3]			\$25,397,331,860
Project Net Assessed Value Increase [4]			0.05%
<b>Property Tax In Lieu of VLF Revenue [5]</b>			<b>\$4,591</b>

[1] EPS assumption based on nearby comparables, in-depth market study not prepared. Top of market for newly built single-family product in Cupertino falls within the \$3.5 to \$4.0 million range, though homes sold at this price point are on larger lots than the units planned at Homestead.

[2] Legislation requires Counties to provide "no/low tax" cities with a Tax Equity Allocation equal to 7 percent of property tax share.

[3] FY2020-2021 value based on secured assessed value from Santa Clara County's Annual Assessor's Report.

[4] Calculated by dividing the new assessed value by citywide assessed value.

[5] Calculated by multiplying existing property tax in lieu of VLF by project net assessed value increase.

<sup>1</sup> Property tax rate anticipated at project delivery; City of Cupertino 2020-21 Adopted Budget, page 108.

Property Transfer Tax

The project will generate real estate transfer tax revenue associated with future turnover in ownership. This analysis assumes that ownership of each home is likely to turnover approximately every 16 years, an annual turnover rate of 6.0 percent. 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**

Land Use	Assumption / Factor	Annual Total at Buildout
Property Value [1]		
Single-Family Unit (For-Sale)	\$3,113,500 per Unit	\$12,454,000
Accessory Dwelling Unit (For-Sale)	\$640,000 per Unit	<u>\$1,280,000</u>
Total		<b>\$13,734,000</b>
Average Annual Turnover	6.0%	\$824,040
Property Transfer Tax Revenue	\$0.55 per \$1,000 in value	\$453

[1] EPS assumption based on nearby comparables, in-depth market study not prepared. Top of market for newly built single-family product in Cupertino falls within the \$3.5 to \$4.0 million range, though homes sold at this price point are on larger lots than the units planned at Homestead.

Utility Tax

The City of Cupertino collects tax revenue on utility charges for services provided in the City. New residents will expand the use of utilities in the City. This analysis assumes an average monthly utility expense of \$95 per resident. The City of Cupertino collects 2.4 percent of utility charges. **Table 7** presents utility user tax revenue attributable to the proposed project at buildout.

**Table 7 Utility User Tax Revenue**

Item	Assumption	Annual Total at Buildout
Total Residential Population	15 Residents	
Monthly Utility Cost	\$95 per resident per month	
Annual Total		\$16,918
<b>Utility User Tax Revenue</b>	2.4% of utility bill	<b>\$406</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, which reflects an average derived from City budget documents (see **Table 4**), is calculated for the residential development. **Table 8** presents forecasting assumptions and the revenue estimate.

**Table 8 Revenue from Other Taxes and Fees**

Item	Allocation Factor	Project Characteristic	Annual Total at Buildout
Franchise Fees [1]	\$40.01 per service population	15 service pop.	\$594
<b>Subtotal</b>			<b>\$594</b>

[1] Franchise Fees based on existing general fund revenue per capita.

**General Fund Expenditures**

This fiscal analysis estimates the costs attributable to population growth by characterizing how expenses will change for each City department. For some departments, population 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. The variable portion of each department budget is used to determine the per-capita cost, as shown in **Table 9**. 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 9 FY2018-2019 Expenditure Budget Summary and Fiscal Impact Estimating Factors**

Item	City General Fund Expenses (FY2019-2020)	Percent Variable [1]	Annual Variable Expenses	Estimating Factors		Per Capita General Fund Expense	Project Population/Service Population	Annual Total at Buildout
General Government [2]	\$11,575,004	10%	\$1,157,500	85,446	Service Pop.	\$13.55	15	\$201
Police [3]	\$14,151,412	90%	\$12,736,271	85,446	Service Pop.	\$149.06	15	\$2,212
Innovation and Technology [4]	\$3,556,368	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Recreation & Community Services	\$7,688,940	75%	\$5,766,705	59,549	Population	\$96.84	15	\$1,437
Planning & Community Development	\$8,458,229	50%	\$4,229,115	85,446	Service Pop.	\$49.49	15	\$735
Public Works [5]	\$19,159,180	75%	\$14,369,385	85,446	Service Pop.	\$168.17	15	\$2,496
Non-Departmental	<u>\$30,892,319</u>	N/A	N/A	N/A	N/A	N/A	N/A	<u>N/A</u>
<b>Total Expenditures</b>	<b>\$95,481,452</b>							<b>\$7,080</b>

[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. Modeling assumes no change in the structure of the contract terms.

[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 FY2019/20 Actuals

## Fiscal Impact of Proposed Project

**Table 10** summarizes the fiscal impact of the residential 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 \$9,300.

**Table 10 Summary of Fiscal Impact Analysis – Residential Homes at Buildout (2020\$)**

Item	Annual Fiscal Impact
<b><u>General Fund Revenues</u></b>	
Sales Tax	\$700
Property Tax	\$9,600
Property Tax in Lieu of VLF	\$4,600
Property Transfer Tax	\$500
Utility Tax	\$400
Franchise Fees	\$600
<b>Total Revenues</b>	<b>\$16,300</b>
<b><u>General Fund Expenditures</u></b>	
General Government	\$200
Police	\$2,200
Recreation & Community Services	\$1,400
Planning & Community Development	\$700
Public Works	<u>\$2,500</u>
<b>Total Expenditures</b>	<b>\$7,100</b>
<b>Net Impact on General Fund</b>	<b>\$9,300</b>

## Fiscal Impact of Existing Uses

In order to quantify the fiscal impact of the existing home located at 19820 Homestead Road, the same fiscal methodology is applied. The site currently is occupied by a 2,500 square foot dwelling unit. The existing home provides a positive fiscal impact to the City's General Fund of about \$1,700 a year, as shown in **Table 11**.

**Table 11 Summary of Fiscal Impact Analysis – Existing Use (2020\$)**

Item	Annual Fiscal Impact
<b><u>General Fund Revenues</u></b>	
Sales Tax	\$100
Property Tax	\$1,800
Property Tax in Lieu of VLF	\$900
Property Transfer Tax	\$100
Utility Tax	\$100
Franchise Fees	\$100
<b>Total Revenues</b>	<b>\$3,100</b>
<b><u>General Fund Expenditures</u></b>	
General Government	\$0
Police	\$400
Recreation & Community Services	\$300
Planning & Community Development	\$100
Public Works	<u>\$500</u>
<b>Total Expenditures</b>	<b>\$1,400</b>
<b>Net Impact on General Fund</b>	<b>\$1,700</b>

## Net Fiscal Impact

This analysis estimates that the GPA proposal will generate a positive annual fiscal impact on the City's General Fund, as shown in **Table 12**. The net increase in General Fund revenues from the project at buildout is estimated at roughly \$13,200 more annually than the existing use on the site. The net increase in General Fund expenditures associated with the project is estimated at approximately \$5,700 more per year than the existing uses. Net fiscal impacts for the project are estimated to be \$7,600 annually.

**Table 12 Net Fiscal Impact Summary (2020\$)**

Revenue / Expense Category	Fiscal Impact at Project Buildout	Fiscal Impact Baseline	Net Fiscal Impact
General Fund Revenues	\$16,300	\$3,100	\$13,200
General Fund Expenditures	<u>\$7,100</u>	<u>\$1,400</u>	<u>\$5,700</u>
<b>Net Impact on General Fund</b>	<b>\$9,300</b>	<b>\$1,700</b>	<b>\$7,600</b>