TO: HONORABLE CITY COUNCIL

FROM: CITY MANAGER        DEPARTMENT: ADMINISTRATIVE SERVICES

DATE: JULY 14, 2008     CMR: 303:08

SUBJECT: REVIEW OF PROCESS FOR QUANTIFYING POTENTIAL FISCAL IMPACTS OF THE STANFORD UNIVERSITY MEDICAL CENTER AND STANFORD SHOPPING CENTER PROJECTS

RECOMMENDATION
The purpose of the study session is to provide the City Council with a preliminary overview of the process for quantifying the potential fiscal impacts of the Stanford University Medical Center (SUMC) Facilities Renewal and Replacement Project and the Simon Properties – Stanford Shopping Center (SSC) Expansion Project.

BACKGROUND
Review for this project has been divided into two phases: Phase I (Information Sharing and Preliminary Area Plan) from December 2006 through July 2007 and Phase II (EIR and Entitlements) from July 2007 through the end of 2008, culminating with certification of the EIR and the City’s decisions on the applications. A single EIR is being prepared for both the SUMC and SSC. The Draft EIR is tentatively scheduled to be released in Fall 2008.

Development applications were submitted in August 2007. There are five (5) main components to the SUMC project:

1. Hoover medical office building reuse and expansion;
2. Lucile Packard Children’s Hospital (LPCH) expansion;
3. Stanford Hospital and Clinics (SHC) replacement and reconstruction;
4. Medical School building reconstruction; and
5. Redevelopment of existing hospital site.

Simon Properties is proposing to expand the Stanford Shopping Center by adding 240,000 square feet of new retail stores and restaurants, a new 120 room hotel and parking for a net addition of 1,234 vehicles.
DISCUSSION
The purpose of this meeting is to provide a preliminary overview of the potential fiscal benefits and impacts of the two projects. Separate from the EIR, a contractor for the project applicants will produce an initial fiscal impact analysis and the City will then conduct a peer review report of that analysis. These reports and the scope of analysis are described in more detail below.

Potential Fiscal Benefits and Impacts:

Revenue Benefits
The Stanford University Medical Center and Stanford Shopping Center are key economic engines that provide a significant source of Utility and General Fund revenues for the City. They attract visitors to Palo Alto as centers of shopping and world class health and medical care. As some of the largest employers in Palo Alto, these two sites directly and indirectly generate revenues that support City services, such as police, fire, library, and recreation and community services.

The Stanford Shopping Center, as a single entity and geographical area, is the largest sales tax generator in the City of Palo Alto. In analyzing the potential impact of the Shopping Center expansion, it should be noted that expansion and enhancement of the Shopping Center’s ability to compete with other regional centers will be critical in order to avoid a decrease in retail sales over time. Currently, the Shopping Center sales taxes approximate $5.7 million or nearly 27 percent of the City’s annual sales tax revenues, comprising 4 percent of the City’s total revenue base. A decline in this source would have a significant impact on the City’s ability to provide services in future years.

On-going potential positive fiscal benefits of the projects include increased sales, property, and transient occupancy taxes (TOT). These revenues flow into the General Fund and can be used for a variety of municipal purposes. Payment of one-time fees such as building permits, connection fees and development impact fees will be another source of revenue and will offset the impacts to the city for direct costs of services. Each key revenue source is discussed below:

1. Sales Tax
Sales tax revenues will potentially increase from several sources, including expansion of the Shopping Center through the direct payment of point-of-sale taxes and, with Stanford’s close cooperation and consistent support, through the collection of a Sales and Use Tax for equipment, supplies and construction materials for both the SUMC and SSC projects.

   - **Stanford Shopping Center** – The proposed 240,000 square foot expansion of the Stanford Shopping Center will generate increased sales tax collections. Based on estimates of projected taxable sales by CBRE Consulting, the firm under contract with Stanford University and Simon Property Group to conduct a fiscal analysis, the shopping center expansion is projected to produce a $1.6 million increase in annual sales tax.
   - **Stanford University Medical Center** – To ensure that taxes from other taxable sales (e.g., the purchase of out-of-state equipment and materials) are received locally, the City has requested that Stanford alter its sales or use tax permits, as well as those of its
construction contractors, to designate Palo Alto as the point-of-sale for such purchases. Staff has approached Stanford on this effort in the past two years, but the SUMC representatives have not responded to date. An estimate of this revenue source can be provided once the hospitals provide potential purchasing information and agree to the point-of-sale designation.

2. Property Taxes
   - **Stanford Shopping Center** – The expansion at the shopping center is projected to produce an increase of $0.7 million in property taxes annually based on an estimate produced by CBRE Consulting. The estimate is based on the net improvement value of the project and includes related motor vehicle in-lieu property tax revenues.
   - **Stanford University Medical Center** – Increases in property tax revenues would occur based on the change in assessed value of any taxable properties, e.g., medical practitioner offices that are located within the City boundaries of Palo Alto. An estimate of the potential revenues will be determined in the fiscal study. The city is also exploring options for an “in-lieu” property tax applied to the tax-exempt development on the SUMC site, to be discussed in Development Agreement negotiations.

3. Transient Occupancy Tax
   The proposed construction of a new 120-room boutique hotel as part of the proposed Shopping Center expansion would generate a significant increase in Transient Occupancy Taxes (TOT) as well as taxable sales from its restaurant and catering facility. Based on PKF Consulting’s October 2007 market study, CBRE Consulting estimates that a new hotel will generate $1.1 million annually. Staff has commissioned a hotel study to evaluate the feasibility of increasing the size of the hotel and assuring that its location maximizes revenue potential to Simon and the City.

4. Utility Users Taxes
   Staff expects that the expansion projects will generate additional Utility User Taxes. Detailed estimates for each project will be developed in the fiscal impact study.

5. Development Impact Fees and Building Permits
   In addition to the revenues listed above, there are also one-time fees that will accrue to the City from the proposed Shopping Center expansion. These include Building Permit Fees of approximately $760,000 and Development Impact Fees of approximately $6.6 million for the project as proposed. The citywide Traffic Impact Fee could result in estimated fees from the proposed projects of approximately $2.2 million total, based on present plans. Only the shopping center and a portion of the medical center site are subject to housing impact fees under the City’s current fee structure.

Revenue Summary
Based upon the preliminary analysis, the Shopping Center expansion project could generate approximately $3 million annually in new General Fund Revenues and approximately $12.3 million when one-time fee and permit revenues are included. This revenue would offset some of the potential fiscal impacts of the projects. These numbers do not include all of the potential revenue streams due to the limitations identified above.
The table below summarizes the ongoing revenues for the Stanford Shopping Center Expansion as estimated by CBRE Consulting:

<table>
<thead>
<tr>
<th>Estimated Annual Revenue with Buildout (est. 2015)</th>
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<tbody>
<tr>
<td>Revenue</td>
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<tr>
<td>Sales Tax</td>
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<tr>
<td>TOT</td>
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<tr>
<td>UUT</td>
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<tr>
<td>Motor Vehicle In-Lieu Property Tax</td>
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<tr>
<td>Property Tax</td>
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<tr>
<td>Sub Total</td>
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Notes:
Source: CBRE Consulting
All revenue estimates are pending City peer review.

Revenue estimates for the Stanford University Medical Center are being developed as part of the fiscal impact analysis.

Expenses
Potential expenses encompass costs related primarily to public safety, recreation and community facilities, and utilities and public works. Impacts on these services may occur either directly through construction of the hospitals, clinics, and shopping center, or indirectly from new employees or from housing to support those employees.

1. Public Safety
As increased employment brings more people to Palo Alto, the demand for public safety services (police and fire) will increase. The impacts on public safety will be reflected in an increase in calls for police, fire and emergency services. Increased instances of crime, medical and other emergency incidents will require mitigating steps to ensure that public safety response is not compromised. These impacts will be addressed in the EIR and in the fiscal impact analysis. The work to define the fiscal component of these impacts is currently in the preliminary stages.

2. Recreation and Community Facilities
The definition of impacts on recreation and community services, particularly parks, libraries and community centers, will also be analyzed in both the EIR and in the fiscal impact analysis. Steps to mitigate these impacts will include the payment of fees, such as community facility impact fees.

3. Utilities and Public Works
The definition of impacts on utilities and public works, including streets, water, sewer, electricity, gas, and storm water, will also be analyzed in both the EIR and in the fiscal impact...
analysis. Steps to mitigate these impacts will include the payment of fees, such as utility connection fees and transportation impact fees.

4. Housing and School Impacts
Another area of fiscal impacts includes areas that are more indirect: housing and school impacts. The increased employment generated from the project will create increased housing demand, including affordable housing. While a City is not legally required to provide affordable housing for an employment project, staff believes that the affordable housing need generated by projects of this size should be addressed through the EIR and Development Agreements. Likewise, while the City is a separate entity from the school district, both the City and Stanford have historically worked with the school district to identify school impacts caused by large developments.

Summary of Process for Reviewing Fiscal Impacts:

There will be three key reports that focus on the fiscal aspects of the projects. These reports include the fiscal impact analysis, the peer review of the fiscal impact analysis, and a hotel study. The fiscal impact report will be separate from the EIR, but relevant data from the fiscal report will be incorporated into the EIR analysis. All reports are tentatively scheduled to be released in the Fall 2008.

Applicant’s Preliminary Fiscal Impact Analysis
A preliminary fiscal impact analysis, including a study of potential market area retail sales impacts (“urban decay study”), is being prepared by CBRE Consulting under contract with Stanford University and Simon Property Group.

The fiscal impact analysis will be based on a compilation of key project parameters and assumptions such as fiscal year financial data, employment estimates associated with the mall expansion, sales projections, property tax pursuant to ground leases, construction cost estimates, hotel occupancy and room rates, City of Palo Alto population and employment base data, and utility costs.

The City of Palo Alto budget will be reviewed and relevant revenue sources identified for inclusion in the study along with procedures for estimating revenues and costs. The key revenue sources will include sales tax, transient occupancy tax, new retail employee spending, utility users’ tax, franchise fees and other taxes. The fiscal impact analysis will exclude fee-based one-time revenues associated with the City’s building and construction program.

As part of the review of the City of Palo Alto budget, expense categories that are impacted by the project expansions will be identified. The relevant expense categories and estimation methodology will be reviewed with City staff.

The analysis of revenues and expenses impacted by the expansions will be used by CBRE to produce the net fiscal impact findings. These findings will look at the net impact on the City’s General Fund from the planned expansions.
A detailed update from CBRE on the status and scope of the fiscal impact analysis is attached to this report (Attachment A). It is expected that this report will be completed in mid-August.

Analysis of Market Area Retail Sales Impacts
A key component of the study is the retail demand and sales leakage analysis, which would estimate retail sales impacts of the Shopping Center expansion on surrounding retail, including downtown Palo Alto, Town and Country, and shopping districts in neighboring areas such as Menlo Park and Mountain View. This analysis is based on a model that uses data on households, income, and consumer spending patterns, and attempts to determine how much a market area is or is not capturing the retail spending potential of the resident population. Areas that are not realizing anticipated spending potential are experiencing “leakage” and areas that capture more sales than can be generated by the residents are called “attraction categories.” The analysis will estimate expected growth in retail demand over the project time period.

CBRE will define the market areas appropriate for analysis of the mall expansion focusing first on the primary market area and then secondary market areas that emerge from research. The primary market area is the area from which the majority of demand for the new mall tenants is expected to originate. The definition of the primary market area will include population estimates using generally accepted government resources in coordination with City of Palo Alto staff.

The fiscal impact analysis will also consider the cumulative impacts of the Stanford Shopping Center project in relation to other new development projects that are known or are planned in the market area of the project.

Ultimately, CBRE will provide a determination that will conclude whether or not a negative economic impact will occur as a result of the development leading to the closure of stores or retail properties remaining vacant in other geographic areas for an extended period. Such a determination will have taken into account the perspectives of commercial brokers active in the area on the potential for leasing and retailing activity in the area.

City Fiscal Analysis
The City will engage a fiscal consultant to conduct an independent review of the fiscal impact study prepared by CBRE and provide additional fiscal analysis. This work will review and validate all key assumptions and conclusions. Note that the City had retained Bay Area Economics (BAE) to perform this independent review, but BAE recently resigned due to a potential conflict. The City accepted BAE’s resignation and now staff is in the process of selecting a new fiscal consultant that will report to and be directed by the City.

The City’s Independent consultant will complete the following tasks as part of its review of the CBRE analysis and other analysis:

1. Peer Review of Fiscal Impact Study
   - Review soundness and appropriateness of methodologies used by CBRE
   - Review assumptions used for revenue estimates
   - Review assumptions used for municipal services cost estimates
• Review urban decay study prepared by CBRE
• Review appropriateness of all findings and mitigation recommendations (if applicable)

2. Additional Fiscal Analysis
• Analyze the impact of increased housing demand caused by the project
• Assess the fiscal impacts to schools caused by the projects
• Assess the opportunity cost of the projects on the non-residential development cap identified in Policy Number L-8 of the Palo Alto Comprehensive Plan (if applicable)

As part of the analysis of the fiscal impacts of the project, the City will review the property tax status of the projects before and after development. The City will ensure that it has taken into account any possible shift in property tax as a result of the change in status of individual assessed properties within the project area.

Hotel Study
The City will be conducting an independent review of the hotel study produced by PKF Consulting (on behalf of Simon Property Group). In addition, the City will prepare an independent study of the hotel demand. This independent study will determine the demand for additional hotel rooms in the Palo Alto area that serve Stanford University, its Medical Center, and Stanford Shopping Center. The study will consider the types of hotels that could possibly serve the area along with the potential revenues such hotels could generate. The report will be available with the release of the fiscal impact reports.

Housing Analysis
A housing analysis has been prepared for the City by Keyser Marston Associates (KMA) to identify potential housing needs generated by the new employment anticipated by the projects. The analysis further includes identification of the need for affordable housing for lower income workers at the projects. The study will form the basis for development agreement negotiations and has implications regarding the secondary impacts of housing on public services. The housing analysis report will be provided to the Council shortly and a study session with the Council to discuss housing issues will be scheduled for September or October.

PLANNING AND TRANSPORTATION COMMISSION REVIEW
On June 25, 2008, the Planning and Transportation Commission (PTC) heard an overview of the potential fiscal impacts of the projects and the process for preparing the fiscal study. The Commission provided extensive comments on the fiscal impact analysis and other fiscal studies. The minutes from the meeting are contained in Attachment B. Staff will incorporate many of the PTC comments into the fiscal analysis, but others may relate to the EIR or Development Agreements, and some suggestions may not be feasible within the scope of the analysis.

NEXT STEPS
In addition to the housing study session, ongoing study sessions and preliminary review of design guidelines and separate components for both projects are scheduled with ARB in the July through September timeframe. The fiscal impact analysis will be provided near the release of the EIR, in late 2008, with adequate time for each report to be reviewed.
ENVIRONMENTAL REVIEW
An EIR is under preparation for both projects. No discretionary action is requested at this time.

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ATTACHMENTS
Attachment A – CBRE Consulting memorandum providing an update on the fiscal impact analysis.
Attachment B – June 25, 2008 Planning and Transportation Commission minutes and answers to Planning and Transportation Commission questions

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