HOUSING AND THE STRIP: RETHINKING THE FISCAL PARADIGM

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Hosted by

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July 14th, 2022

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THE CONTEXT

Cities seek to better understand the fiscal trade-offs of redeveloping retail with residential, because…

- **Commercial districts and corridors are struggling:**
  - The pandemic has affected work and shopping patterns
  - The rise of e-commerce
  - Retail consolidation / bifurcation
- **Need to address housing crisis, inlcuding..**
  - New State housing laws
  - Aggressive RHNAs goals

THE HYPOTHESIS

Housing development can help revitalize struggling commercial corridors and provide net fiscal gains to cities, because…

1. Successful commercial corridors adapt to changing retail landscape
2. Housing development drives retail demand and sales tax (e.g., “retail follows rooftops” and foot traffic)
3. Property tax gains from higher density housing development will more than offset sales tax loss from prior uses
4. Successful commercial properties are unlikely to convert to housing

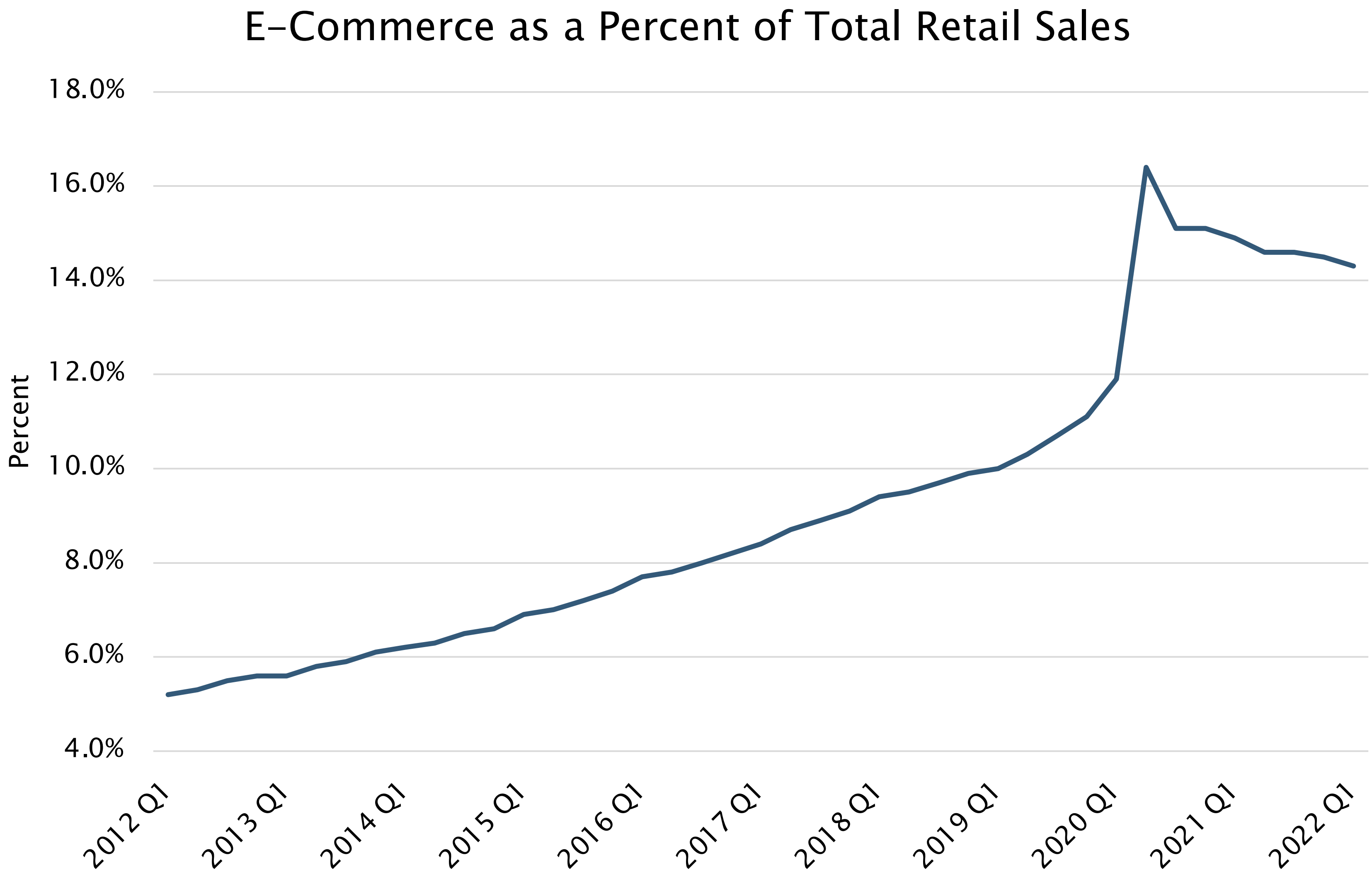
1. COMMERCIAL CORRIDORS ARE CHANGING

BECAUSE “BRICK & MORTAR” IS IN FLUX

- Retail jobs started decline in 2017 (pre-pandemic)
- Brick & Mortar job share never recovered to pre- “Great Recession” levels
- Reflects structural shifts in shopping patterns

Source: U.S. Bureau of Labor Statistics; Analysis by Economic & Planning Systems, Inc.

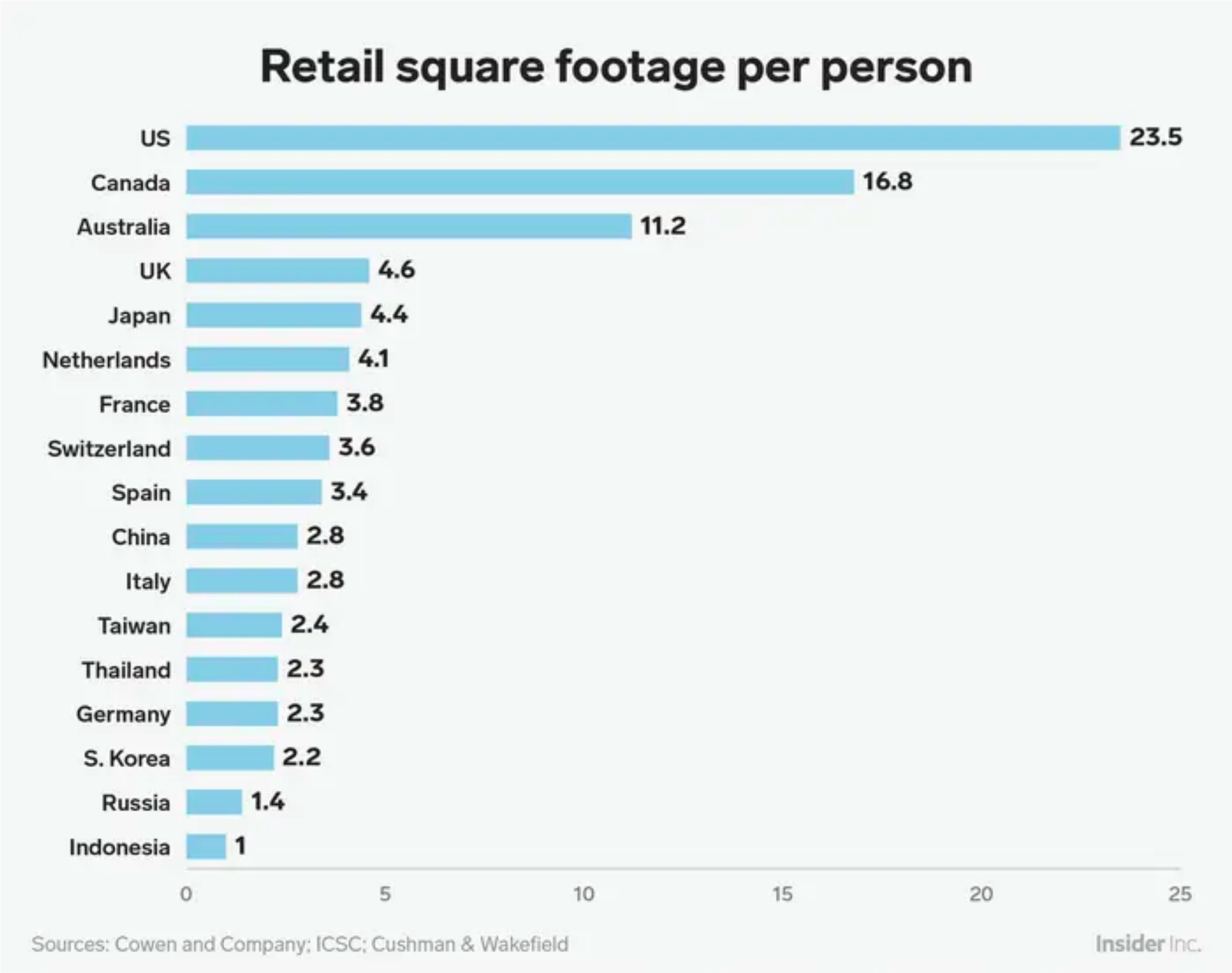
WHILE E-COMMERCE CONTINUES TO EXPAND



Source: U.S. Census Bureau; Analysis by Economic & Planning Systems, Inc.
Note: Total Retail Sales Excludes Food Services and Drinking Places

CONTRIBUTING TO GLUT OF RETAIL SPACE

- U.S. retail space per capita far exceeds all other countries
- Replacing inefficient retail space with housing can increase sales per square foot
- And a net gain for City budgets



Source: U.S. Bureau of Labor Statistics; Analysis by Economic & Planning Systems, Inc.

"PLACE" IS REPLACING "SPACE"

- Evolving shopping patterns changing retail landscape in favor of "placemaking" and "experiential" environments
- Stand-alone, arterial retail centers are an increasingly outmoded format
  - Sales, occupancy, and lease rates usually fall below regional norms
  - "Big box" and "power centers" cannibalizing demand
- Replaced by strategic mixed-use investment that:
  - Enhances public realm
  - Creates vibrant activity centers; increasing overall commercial / economic activity

Source: Urban Footprint study for Fresno Better Blackstone Corridor Design Challenge

NODAL DEVELOPMENT PATTERNS REPLACE LINEAR

Redevelopment of entire block -- Broadway Ave., Oakland

- 2 mid-rise apartments with podium parking
- Grocery anchored commercial center with roof-top parking
- $325M increase in assessed value

Before (2011)

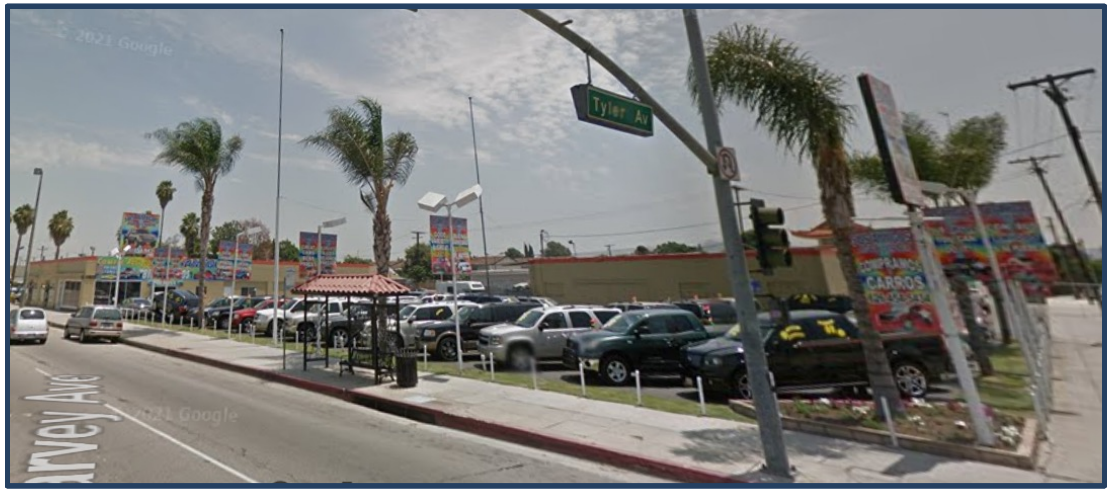
After (2020)

NEW RETAIL FORMATS CREATE NEW HOUSING SITES

Old → New

70 Townhomes replaces car dealership in *El Monte, CA*

Before



After


City Ventures project

$31M net gain in assessed value

Tesla Showroom:
Broadway Plaza, Walnut Creek

2. HOUSING DRIVES RETAIL DEMAND

RETAIL FOLLOWS ROOFTOPS & FOOT-STEPS

- Housing development increases local retail spending
  - New households typically spend above average (e.g., on home furnishings)
  - Retail tenants benefit from proximity to their customers
- Vibrant corridors include vertical and horizontal mixed-use
  - **Horizontal**: Retail tenants can coexist with housing
  - **Vertical**: Retailers locate in nearby commercial clusters or nodes

Total sales can increase even if square footage declines

Vertical mixed-use in Watsonville*: 54 market rate units + ground floor retail*

THE RETAIL / HOUSING REINVESTMENT CYCLE

New Housing on one side of Street → Supports new retail on other side


Before: AV ~ .67M


After: 165 market rate units / AV ~ $17.9M

Horizontal Mixed-Use in Riverside

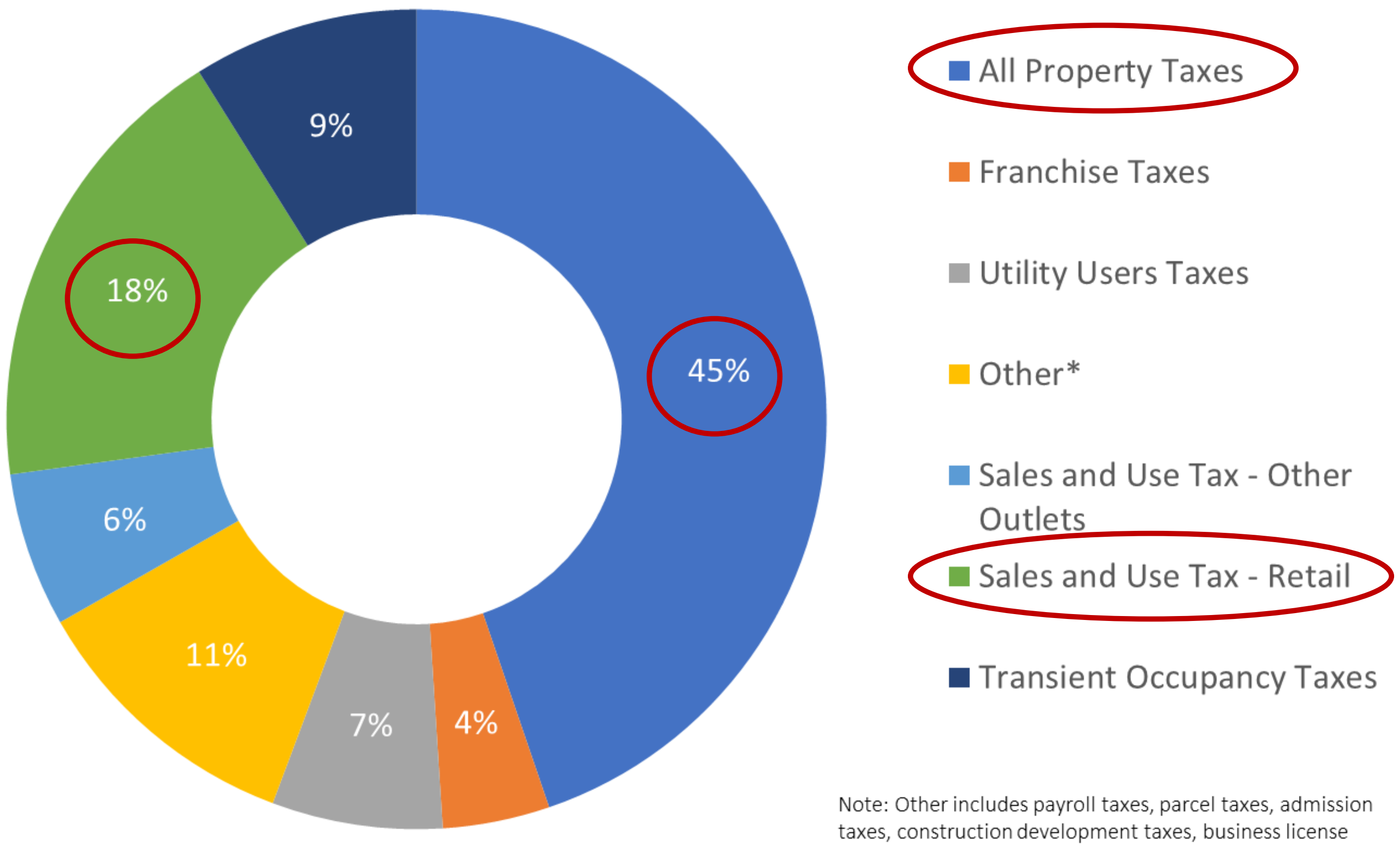

Before

After
14,000 sq. ft.
market hall

3. PROPERTY TAXES CAN OFF-SET SALES TAXES

PROPERTY TAX MOST IMPORTANT CITY REVENUE

State of California – All Cities
Average Distribution of General Fund Tax Revenue in FY 2018



Note: Other includes payroll taxes, parcel taxes, admission taxes, construction development taxes, business license taxes, delinquent taxes, as well as penalties, and interest.

Sources: State of California Controller's Office; Economic & Planning Systems, Inc.

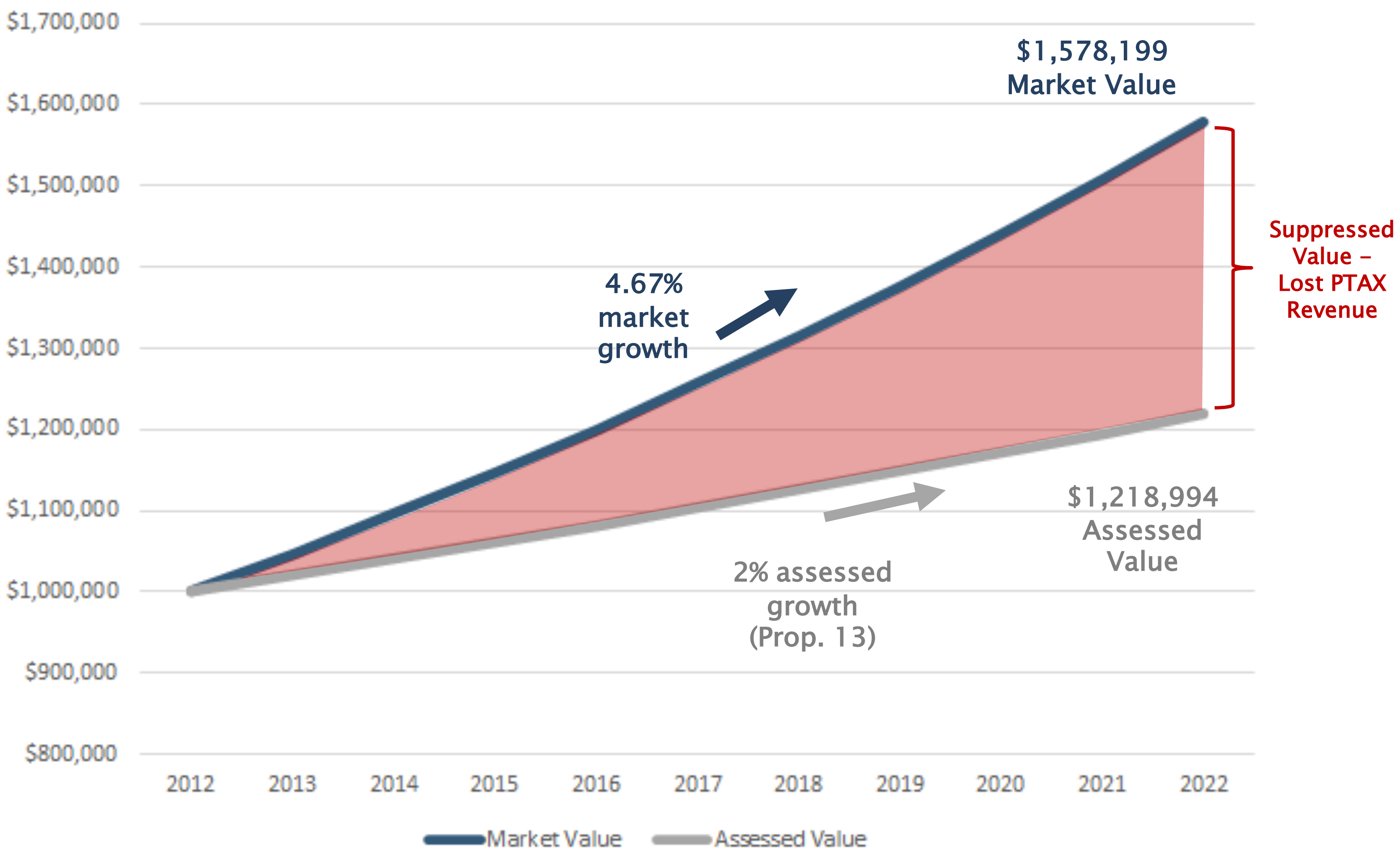
REDEVELOPMENT "RESETS" ASSESSED VALUES

- Prop. 13 has significantly suppressed assessed values
  - Commercial property has low turnover
- Redevelopment of poorly performing retail sites will "reset" assessed value to higher market value
- Assessed value increase further when higher density residential replaces low density commercial
- Cities gain more than just property tax
  - Property transfer tax
  - Motor-vehicle in-lieu
  - Other population-based revenues

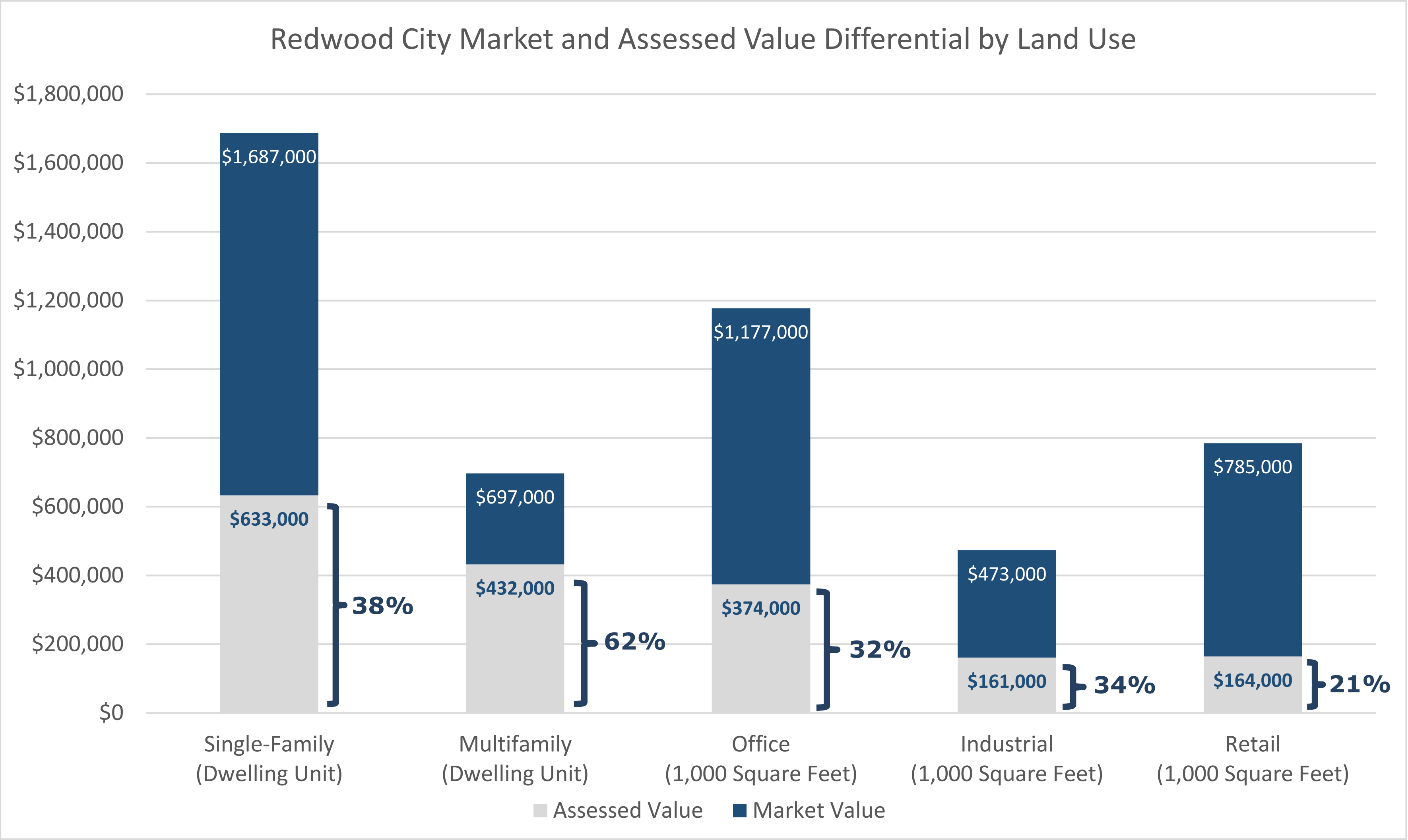
Stockton Blvd., Sacramento

…AND UNLOCKS PROPERTY TAX

- Growth in market value of retail property in CA has more than doubled assessed value growth
- If a $1M retail property built in 2012 doesn't sell, assessed value will be 77% of market value by 2022



RETAIL ASSESSED VALUE RELATIVELY LOW



TAXES -- NEW HOUSING BEATS OLD COMMERCIAL

Recent EPS studies for Redwood City and Fresno found:

- Redevelopment of aging retail into higher density housing likely to increase City tax revenues
- Citywide assessed value for existing retail space was relatively low
- New, higher density housing increased all City revenues, except sales tax

Item	Corridor Retail	New Multifamily
Project Protoype		
Lot Size (square feet)	10,890	10,890
Development Square Feet	4,356	13,613
Market Rate Units	0	13
Assessed Value PSF	$164	$666
Total Assessed Value	$714,384	$9,061,000
Redwood City General Fund Revenues		
Property Tax	$1,237	$15,685
Property Tax In Lieu of VLF	$282	$3,581
Property Transfer Tax	$75	$398
Sales and Use Taxes	$9,913	$3,141
Franchise Fees	$75	$527
Transient Occupancy Taxes	$490	$293
Business License Taxes	$527	$0
Utility User Tax	$374	$2,644
Licenses and Permits	$212	$1,498
Fines and Forfeitures	$20	$144
Total Annual G.F. Revenues	**$13,206**	**$27,911**
Fresno General Fund Revenues		
Sales Tax	$1,641	$2,067
Property Tax	$2,116	$6,008
Business License	$800	$0
Franchise Fees	$104	$761
Room Tax	$188	$117
Other Taxes and Fees	$35	$257
Cannabis	$11	$82
Total Annual G.F. Revenues	**$4,895**	**$9,292**

… AND CAN PRODUCE NET GENERAL FUND GAINS

2018 Redevelopment on El Camino Real

(Redwood City)

Item	Replaced Development	New Development	Net (New - Replaced)
General Fund Revenues			
Property Tax	$22,503	$189,736	$167,233
Property Tax In Lieu of VLF	$5,138	$43,324	$38,186
Property Transfer Tax	$286	$4,815	$4,529
Sales and Use Taxes	$24,101	$33,103	$9,002
Franchise Fees	$287	$5,554	$5,268
Transient Occupancy Taxes	$1,721	$3,083	$1,361
Business License Taxes	$1,691	$0	-$1,691
Utility User Tax	$1,438	$27,865	$26,427
Licenses and Permits	$815	$15,791	$14,976
Fines and Forfeitures	$78	$1,517	$1,439
Total Revenues	$58,058	$324,788	$266,730
General Fund Expenditures			
General Government[1]	$299	$5,794	$5,495
Community Dev. & Transportation	$1	$13	$12
Parks, Recreation, & Comm. Svcs.	$1,178	$22,827	$21,649
Library Services	$875	$16,964	$16,089
Public Works	$184	$3,564	$3,380
Fire	$4,203	$81,460	$77,257
Police	$6,639	$128,675	$122,036
Total Expenditures	$13,379	$259,297	$245,919
Net Impact on General Fund	$44,679	$65,491	$20,811

Source: Economic & Planning Systems

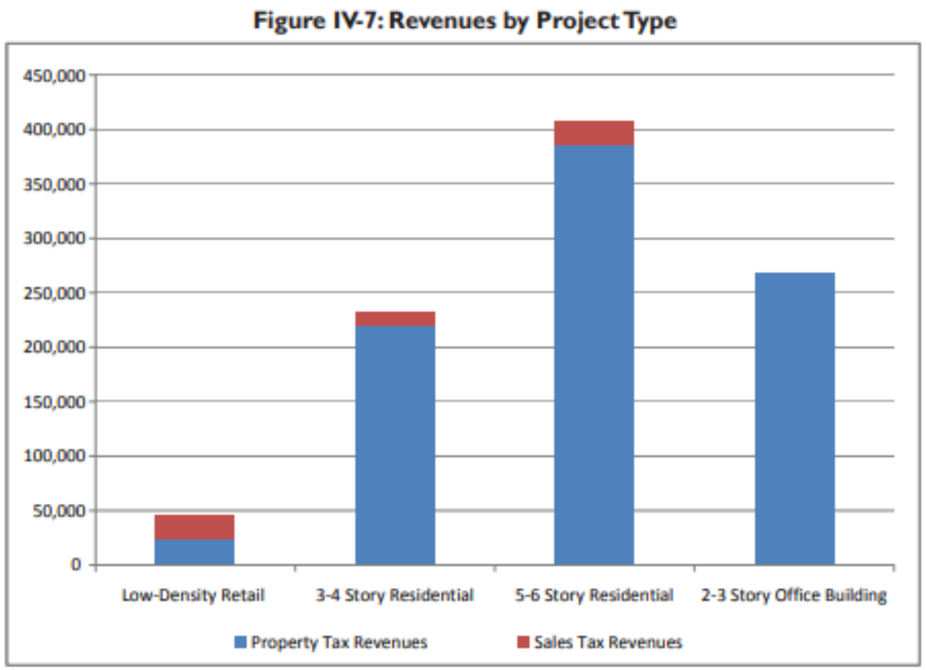
Results:

- Assessed Value: from $13M to $110M
- Net General Fund Gain: $20K per year

OTHER STUDIES GENERATE SIMILAR FINDINGS

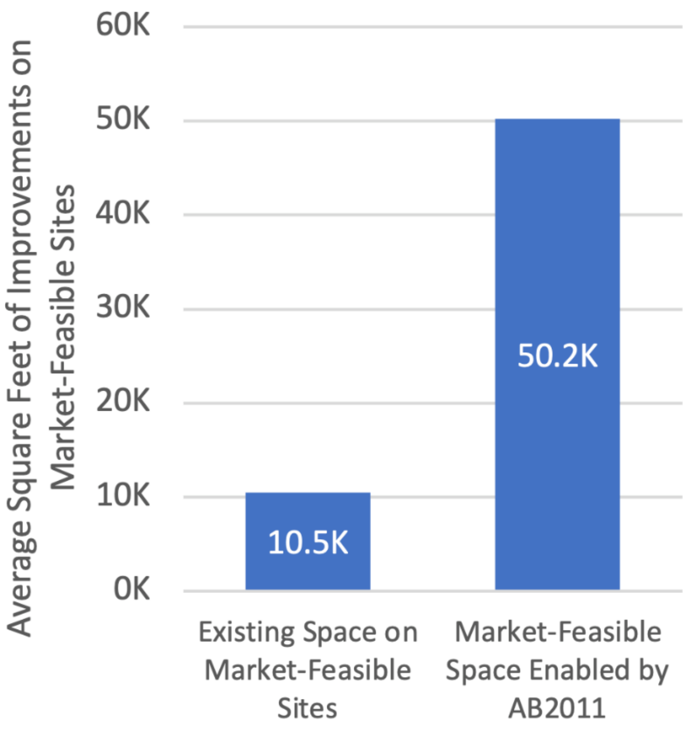
- **Grand Blvd. / El Camino Real Study:** In-fill housing generates substantially more taxes than existing retail

- **AB 2011 Study for entire State**: AV for feasible redevelopment 21X greater than existing uses

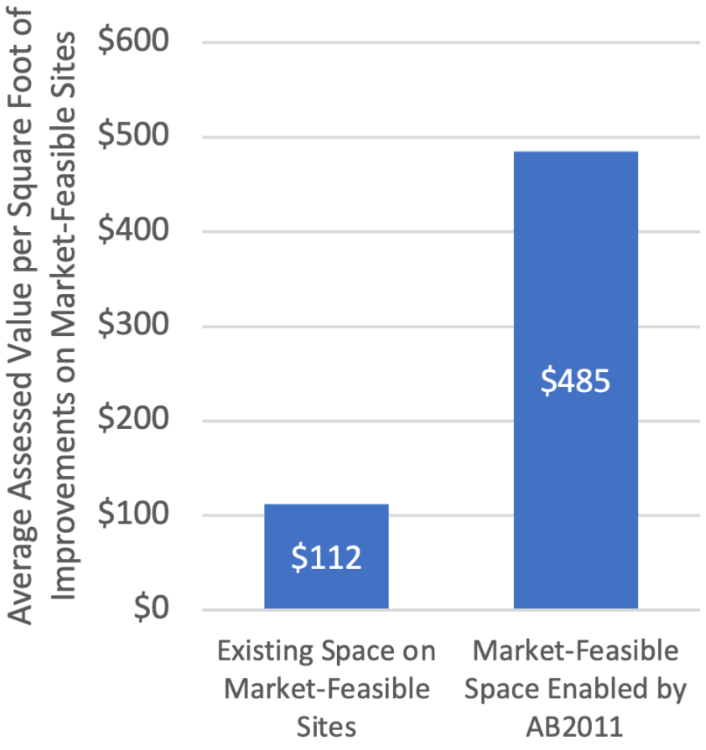


Source: Strategic Economics

5x more building sq. ft.



4x more AV / sq. ft.



Source: MapCraft; Urban Footprint

4. VIABLE COMMERCIAL PROPERTIES WON’T TURN-OVER

REDEVELOPMENT FOR HOUSING ISN'T EASY

- Owners of commercial buildings won't sell unless price exceeds value of existing uses
- Commercially viable buildings provide a secure revenue stream to owners
- Selling also triggers costly tax events (e.g., capital gains, property, and real estate transfer taxes)
- Successful retail tenants often have long-term lease agreements

Housing Development Costs

…BECAUSE SUCCESSFUL RETAIL IS MORE VALUABLE

- EPS compared market value of occupied retail in Hayward with residual for two hypothetical housing projects
- Results suggest housing will be more valuable but <u>not</u> cover land and development costs
- Studies in other locations show similar result: *<u>viable redevelopment of successful retail is exception, not the rule</u>*

Assumption / Output	Occupied Retail Property	Residentail Redevelopment Scenarios: Multi-Family (rental)	Residentail Redevelopment Scenarios: Townhome (for sale)
Project Descriptions			
Site Size (acres)	1.5	1.5	1.5
FAR or DU / Acre	0.2	80	30
Land Use	13,000 retail sq. ft.	120 units	45 units
Market Lease Rate / Sale Price[1]			
Annual Per Sq. Ft. or Unit	$40	$32,400	$900,000
Total for Site	$520,000	$3,888,000	$40,500,000
Market Value of Land Use			
Operating Costs	3% of gross Revenue	$9,000 / unit	NA
Vacancy Allowance	5%	5%	
Capitalization Rate	6%	5%	NA
Capitalized Value or Sale Prices	$7,970,000	$56,160,000	$40,500,000
Development Cost (excluding Land)			
Per Unit		$450,000	$780,000
Total for Site		$54,000,000	$35,100,000
Residual Land Value		$2,160,000	$5,400,000
Feasibility of New development (Value of existing use less RLV)		($5,810,000)	($2,570,000)

[1] Does not account for inclusionary zoning requirements

CAVEATS AND CONCLUSIONS

OUTCOMES WILL VARY BY LOCATION

Net fiscal impact of new housing on "old" commercial sites will also need to consider:

- Cities with higher property tax allocation rates will benefit more from redevelopment
- <u>Net</u> fiscal benefits depend on cost of providing public services for new housing versus "old" retail
  - Can additional revenues pay for new public services to residents?
- Evolving tax laws around e-commerce creating new "winners and losers"
- Regional disparities, particularly in underserved communities, can distort outcomes

WRAP UP

- Cities should revisit old assumptions about fiscal benefits of housing
- Redevelopment of struggling commercial corridors / districts can be a "win-win"
  - Much needed housing
  - Improved public realm
  - More tax dollars
- Other factors affecting outcomes include:
  - Innovation in residential construction
  - Multimodal transportation solutions
  - Legal and regulatory changes (e.g., CEQA, tax policy, construction defect liability)
  - Other?

ABOUT EPS

- California based firm established in 1983
- Specialists in urban economics and public finance
- Balance of public and private sector clients
- Providing budget analysis for numerous cities

REAL ESTATE ECONOMICS

PUBLIC FINANCE

LAND USE & TRANSPORTATION

ECONOMIC DEVELOPMENT & REVITALIZATION

FISCAL & ECONOMIC IMPACT ANALYSIS

HOUSING POLICY

PUBLIC–PRIVATE PARTNERSHIP (P3)

PARKS & OPEN SPACE ECONOMICS

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