HOUSING AND THE STRIP: RETHINKING THE FISCAL PARADIGM

Prepared by Economic & Planning Systems
Hosted by CIVICWELL

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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, including:
  - New State housing laws
  - Aggressive RHNA 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

WHILE E-COMMERCE CONTINUES TO EXPAND

E-Commerce as a Percent of Total Retail Sales

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

![Retail square footage per person chart]

“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
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
NEW RETAIL FORMATS CREATE NEW HOUSING SITES

70 Townhomes replaces car dealership in El Monte, CA

Before

After

$31M net gain in assessed value

Old

New

Tesla Showroom: Broadway Plaza, Walnut Creek

City Ventures project
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

Horizontal Mixed-Use in Riverside

Before: AV ~ 0.67M

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

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

- All Property Taxes: 45%
- Franchise Taxes: 11%
- Utility Users Taxes: 6%
- Other*: 9%
- Sales and Use Tax - Other Outlets: 4%
- Sales and Use Tax - Retail: 7%
- Transient Occupancy Taxes: 4%

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

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

Before: AT&T Call Center AV ~$17M

After: 213 units / 4.3K sq. ft. retail AV ~$87.4M
...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
### Redwood City Market and Assessed Value Differential by Land Use

<table>
<thead>
<tr>
<th>Land Use</th>
<th>Assessed Value</th>
<th>Market Value</th>
<th>Differential (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Single-Family (Dwelling Unit)</td>
<td>$633,000</td>
<td>$1,687,000</td>
<td>38%</td>
</tr>
<tr>
<td>Multifamily (Dwelling Unit)</td>
<td>$432,000</td>
<td>$697,000</td>
<td>62%</td>
</tr>
<tr>
<td>Office (1,000 Square Feet)</td>
<td>$374,000</td>
<td>$1,177,000</td>
<td>32%</td>
</tr>
<tr>
<td>Industrial (1,000 Square Feet)</td>
<td>$473,000</td>
<td>$1,610,000</td>
<td>34%</td>
</tr>
<tr>
<td>Retail (1,000 Square Feet)</td>
<td>$164,000</td>
<td>$785,000</td>
<td>21%</td>
</tr>
</tbody>
</table>
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

### Project Prototype

<table>
<thead>
<tr>
<th>Item</th>
<th>Corridor Retail</th>
<th>New Multifamily</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lot Size (square feet)</td>
<td>10,890</td>
<td>10,890</td>
</tr>
<tr>
<td>Development Square Feet</td>
<td>4,356</td>
<td>13,613</td>
</tr>
<tr>
<td>Market Rate Units</td>
<td>0</td>
<td>13</td>
</tr>
<tr>
<td>Assessed Value PSF</td>
<td>$164</td>
<td>$666</td>
</tr>
<tr>
<td>Total Assessed Value</td>
<td>$714,384</td>
<td>$9,061,000</td>
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</tbody>
</table>

### Redwood City General Fund Revenues

<table>
<thead>
<tr>
<th>Item</th>
<th>Corridor Retail</th>
<th>New Multifamily</th>
</tr>
</thead>
<tbody>
<tr>
<td>Property Tax</td>
<td>$1,237</td>
<td>$15,685</td>
</tr>
<tr>
<td>Property Tax In Lieu of VLF</td>
<td>$282</td>
<td>$3,581</td>
</tr>
<tr>
<td>Property Transfer Tax</td>
<td>$75</td>
<td>$398</td>
</tr>
<tr>
<td>Sales and Use Taxes</td>
<td>$9,913</td>
<td>$3,141</td>
</tr>
<tr>
<td>Franchise Fees</td>
<td>$75</td>
<td>$527</td>
</tr>
<tr>
<td>Transient Occupancy Taxes</td>
<td>$490</td>
<td>$293</td>
</tr>
<tr>
<td>Business License Taxes</td>
<td>$527</td>
<td>$0</td>
</tr>
<tr>
<td>Utility User Tax</td>
<td>$374</td>
<td>$2,644</td>
</tr>
<tr>
<td>Licenses and Permits</td>
<td>$212</td>
<td>$1,498</td>
</tr>
<tr>
<td>Fines and Forfeitures</td>
<td>$20</td>
<td>$144</td>
</tr>
<tr>
<td>Total Annual G.F. Revenues</td>
<td>$13,206</td>
<td>$27,911</td>
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</tbody>
</table>

### Fresno General Fund Revenues

<table>
<thead>
<tr>
<th>Item</th>
<th>Corridor Retail</th>
<th>New Multifamily</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales Tax</td>
<td>$1,641</td>
<td>$2,067</td>
</tr>
<tr>
<td>Property Tax</td>
<td>$2,116</td>
<td>$6,008</td>
</tr>
<tr>
<td>Business License</td>
<td>$800</td>
<td>$0</td>
</tr>
<tr>
<td>Franchise Fees</td>
<td>$104</td>
<td>$761</td>
</tr>
<tr>
<td>Room Tax</td>
<td>$188</td>
<td>$117</td>
</tr>
<tr>
<td>Other Taxes and Fees</td>
<td>$35</td>
<td>$257</td>
</tr>
<tr>
<td>Cannabis</td>
<td>$11</td>
<td>$82</td>
</tr>
<tr>
<td>Total Annual G.F. Revenues</td>
<td>$4,895</td>
<td>$9,292</td>
</tr>
</tbody>
</table>
AND CAN PRODUCE NET GENERAL FUND GAINS

2018 Redevelopment on El Camino Real

(\textit{Redwood City})

\textbf{Results:}

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

\begin{table}
\begin{tabular}{|l|c|c|c|}
\hline
\textbf{Item} & \textbf{Replaced Development} & \textbf{New Development} & \textbf{Net (New - Replaced)} \\
\hline
\textbf{General Fund Revenues} & & & \\
Property Tax & $22,503 & \textcolor{red}{$189,736$} & $167,233$ \\
Property Tax In Lieu of VLF & $5,138 & \textcolor{red}{$43,024$} & $37,886$ \\
Property Transfer Tax & $286 & \textcolor{red}{$4,815$} & $4,529$ \\
Sales and Use Taxes & $24,101$ & \textcolor{red}{$33,103$} & $9,002$ \\
Franchise Fees & $287$ & \textcolor{red}{$5,554$} & $5,268$ \\
Transient Occupancy Taxes & $1,721$ & \textcolor{red}{$3,083$} & $1,361$ \\
Business License Taxes & $1,691$ & \textcolor{red}{$0$} & $-1,691$ \\
Utility User Tax & $1,438$ & \textcolor{red}{$27,865$} & $26,427$ \\
Licenses and Permits & $815$ & \textcolor{red}{$15,791$} & $14,976$ \\
Fines and Forfeitures & $78$ & \textcolor{red}{$1,517$} & $1,439$ \\
\hline
\textbf{Total Revenues} & $58,058$ & \textcolor{red}{$324,788$} & $266,730$ \\
\hline
\textbf{General Fund Expenditures} & & & \\
General Government & $299$ & \textcolor{red}{$5,794$} & $5,495$ \\
Community Dev. & \textcolor{red}{$1$} & \textcolor{red}{$13$} & \textcolor{red}{$12$} \\
Transportation & & & \\
Parks, Recreation, & $1,178$ & \textcolor{red}{$22,827$} & $21,649$ & \\
& & & \\
Comm. Svcs. & $875$ & \textcolor{red}{$16,964$} & $16,089$ & \\
Library Services & $184$ & \textcolor{red}{$3,564$} & $3,380$ & \\
Public Works & $4,203$ & \textcolor{red}{$81,460$} & $77,257$ & \\
Fire & $6,639$ & \textcolor{red}{$128,675$} & $122,036$ & \\
Police & & & \\
\hline
\textbf{Total Expenditures} & $13,379$ & \textcolor{red}{$259,297$} & $245,919$ & \\
\hline
\textbf{Net Impact on General Fund} & $44,679$ & \textcolor{red}{$65,491$} & $20,811$ & \\
\hline
\end{tabular}
\end{table}

Source: Economic & Planning Systems
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.

5x more building sq. ft.  
4x more AV / sq. ft.

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Source: Strategic Economics

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

- Marketing and sales
- Construction
- Project Administration
- Infrastructure
- Site prep. (clean-up, demo, grading)
- CEQA
- Local approvals
- Planning & Design
- Site Acquisition
- Financing and Equity
EPS compared market value of occupied retail in Hayward with residual for two hypothetical housing projects.

Results suggest housing will be more valuable but not cover land and development costs.

Studies in other locations show similar result: viable redevelopment of successful retail is exception, not the rule.

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### Assumption/Output

<table>
<thead>
<tr>
<th>Project Descriptions</th>
<th>Occupied Retail Property</th>
<th>Residential Redevelopment Scenarios</th>
</tr>
</thead>
<tbody>
<tr>
<td>Site Size (acres)</td>
<td>1.5</td>
<td>1.5</td>
</tr>
<tr>
<td>FAR or DU / Acre</td>
<td>0.2</td>
<td>80</td>
</tr>
<tr>
<td>Land Use</td>
<td>13,000 retail sq. ft.</td>
<td>120 units</td>
</tr>
<tr>
<td></td>
<td></td>
<td>45 units</td>
</tr>
<tr>
<td>Market Lease Rate / Sale Price</td>
<td>$40</td>
<td>$32,400</td>
</tr>
<tr>
<td></td>
<td>Total for Site</td>
<td>$520,000</td>
</tr>
<tr>
<td></td>
<td></td>
<td>$3,888,000</td>
</tr>
<tr>
<td>Market Value of Land Use</td>
<td>3% of gross Revenue</td>
<td>$9,000 / unit</td>
</tr>
<tr>
<td></td>
<td>Vacancy Allowance</td>
<td>5%</td>
</tr>
<tr>
<td></td>
<td>Capitalization Rate</td>
<td>6%</td>
</tr>
<tr>
<td></td>
<td>Capitalized Value or Sale Prices</td>
<td>$7,970,000</td>
</tr>
<tr>
<td>Development Cost (excluding Land)</td>
<td>Per Unit</td>
<td>$450,000</td>
</tr>
<tr>
<td></td>
<td>Total for Site</td>
<td>$54,000,000</td>
</tr>
<tr>
<td></td>
<td></td>
<td>$35,100,000</td>
</tr>
<tr>
<td>Residual Land Value</td>
<td>$2,160,000</td>
<td>$5,400,000</td>
</tr>
<tr>
<td>Feasibility of New development (Value of existing use less RLV)</td>
<td>($5,810,000)</td>
<td>($2,570,000)</td>
</tr>
</tbody>
</table>

[1] Does not account for inclusionary zoning requirements.

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...BECAUSE SUCCESSFUL RETAIL IS MORE VALUABLE

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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

- Net 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