Ad Hoc Subcommittee of Finance and Budget Commission
Submittal on Aggie Research Campus (ARC)

To: City Planning Staff, City Finance Staff, and Council Liaisons Carson and Partida
From: Douglas Buzbee, Raymond Salomon, and Michelle Weiss
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We appreciate the opportunity to spend more time synthesizing the inputs we received on the EPS Fiscal Impact report and are providing in this memo three parts:

- **Part One** consists of a set of essential questions that may require some work on the part of EPS or City Staff. We are asking for the information we believe is essential to provide a comprehensive picture of the fiscal impact of this development proposal. We would appreciate responses to these questions in time to be included in the FBC packet for our May 27th meeting.

- **Part Two** consists of comments for the City Council and Planning staff that relate to financial matters that are relevant to negotiating the Development Agreement.

- **Part Three** consists of additional comments relative to economic or fiscal matters.

Part One - Questions:

- **Number of Employees:** We would like to ask EPS to review the data around number of City of Davis employees as it appears that the number is inflated by UC Davis employees working on campus which is outside the city limits. If this number is inflated then we would ask for the model to be re-run with a more accurate persons served calculation, See Table B-2.

- **Reconciliation:** The 2015 fiscal Impact analysis by EPS of the then "MRIC" revealed a less favorable fiscal picture than the ARC 2020 analysis. We recognize that there are some differences in the projects, but could EPS provide a financial reconciliation of the difference between the two? We stress the term high-level as we are focused more on differences in assumptions and methodology rather than exact numbers. We seek an explanation that conveys the essence of the difference between the two projects fiscally.

- **Non-Profit:** While there is no explicit mention of either UCD or another non-profit, and therefore tax exempt organization, as a key tenant for the ARC, there appears to be a strong desire as witnessed by the naming of the development as "Aggie" to show an affiliation in some way with UCD. When questioned the EPS team believed that the marketing pull of a UC as a tenant would more than offset any revenue loss, but they did not model UCD or any non-profit in the mix. In addition, major commercial and industrial firms often seek substantial property tax abatements and other incentives in exchange for bringing jobs to an area. Therefore, we suggest that EPS model a 5%, as they did with the MRIC analysis, and a 10% mix of non-profit or tax-exempt entities.

- **Property Valuation:** We would like to see a more conservative assumption for property valuation given both the substantial increase from the MRIC property value per square foot modeling and present economic realities. We would also like to see support for the valuations (e.g., anything that may have been gathered for the property valuations in the model that may have been obtained as part of model development).

- **Affordable Housing:** The analysis assumes the payment of fees in lieu of including affordable housing. We would like to see a scenario in which rather than paying the fee, affordable housing in line with city guidance/requirements is included in the analysis.

- **Capital Replacement Costs:** During the presentation, EPS discussed with the FBC the possibilities to account for, and ultimately reserve funds for, the future costs of repair and replacement of project infrastructure such as roads, sewer and drainage infrastructure (e.g. lift stations), park and street lighting, and landscaping. Possibilities discussed included a maintenance/repair/replacement CFD, a landscape and lighting district, and an owners' association that would reserve funds for infrastructure replacement. What is EPS's recommendation on how the City should account and reserve funds for long-term capital repair and replacement of project infrastructure?

- **Property Tax:** Property tax is an important component of the analysis as it represents 45% of project revenue at build-out. We would like to see a more conservative split of allocated property tax for <u>all elements</u> of property tax (i.e., including the East Davis Fire District and the County Road District #2) done with a 50/50 city county split.

- **Capital Improvement Costs:** We would like to see the effect of adding Capital Improvement Costs to the model as the ARC project would result in more people being served by the infrastructure and amenities of the city. Further the addition of these people would result in additional wear and tear. Our suggestion for modeling this would be to take 5.4% (4,523 additional people divided by 83,710 people served = 5.4%) of the Capital Improvement budget as an expenditure. We are certainly open to other ways to model this.

- **Variable Costs:** We would like to see the effect of modeling city department costs at 100% (vs. 75%) of the average per person costs given:

- Overhead costs and other fixed costs would likely increase due to the effect of increased volume (e.g., more wear and tear on facilities, more equipment required due to the number of employees).
- While it is true, for example, that there would still be a single police chief, it's also likely that s/he (and his/her managers and support staff) would reasonably seek a salary increase reflecting a larger department with more employees, more responsibility, and peer comparators from cities of greater size.

- **Substitution:** We would like to see the potential substitution modeled **as t**he SEIR indicated that more than 313,000 sq. ft. of existing space would potentially become vacant as a result of competition from the ARC (page 3-181). The SEIR further noted "*ALH Economics concluded that the illustrative analysis suggests that regardless of the amount of space, some increment of existing office and industrial space is at risk of sustained vacancy following development of the ARC Project."* (page 3-182).

- **Developer Financial Sensitivity:** We believe that it would help the city in negotiating to understand the sensitivity of the analysis to additional capital investment at each stage of the project. For example, what is the effect of $5M of additional investment at the beginning phase. Understanding the effect of changes to the project on the developer's return could prove very useful.

Part Two – Development Agreement (DA):

- **Compensation:** There are a number of city assets, including 6.8 acres of City open space, being utilized by the applicant. We would expect to see in the DA an external appraisal of any assets and fair market compensation for them.

- **Tax Exempt Organizations:** We suggest that the City protect itself from any property tax reduction by writing in language to the development agreement to shield the city from lease or acquisition by entities exempt from paying property taxes.

- **Uncertainty:** While the overall project on both a leveraged and an unleveraged basis look to have a healthy return for the developers, in the EPS report they state that "Phases 1 and 2 rates of return are significantly stronger than for those of Phases 3 and 4." We suggest that the City assess any risk here to best ensure that the project gets built out over the >20 year time horizon so that Davis gets the full fiscal benefits. One way to do that would be to consider a different phasing of the housing perhaps moving more into the latter phases to provide the target return in all phases.

Part Three – Other:

- **COVID-19:** We recognize that the EPS analysis was done prior to the global pandemic and that it would be very difficult to forecast the effects of COVID-19 on the model. However, it is our new reality and tough to ignore. Unless it is believed that a full economic recovery will take place prior to completion (and thus property tax valuation of the initial construction) it's reasonable to assume follow-on effects in the overall economy will affect at least initial demand for ARC property, and thus the underlying valuation. As property tax increases are capped at 2% regardless of any increase in the value of the underlying property (i.e., as a result of economic recovery), any shortfalls in initial valuation would roll through the financial model.

- **Semiconductor Manufacturing**: Calling out semiconductor manufacturing as a potential onsite user of the advanced manufacturing site did raise concerns from citizens as it does involve potentially toxic and carcinogenic chemicals albeit it can be "clean" manufacturing if removal of potential hazards is done correctly. While not specifically part of a DA, the city may want to be sure that any additional costs for safety and inspection and training of fire personnel if such an entity were to be part of ARC, were borne by others and not passed on to the city.

- **Impact Fees:** FBC has no way to assess that the impact fees and construction taxes outlined in Table 4 of the EPS report are sufficient to cover future costs such as the roadway improvements. We assume that the city will do appropriate analysis on these to ensure that is a "good deal" for the city.

- **Innovation:** Members of the FBC who are actively engaged with innovation specifically around technology believe there is not much in the proposal to encourage innovation. Specifically, how it helps small business (1-50 employees) especially those working on technology transfer. It would be good to tie this to other initiatives in the city for innovation/entrepreneurship perhaps by negotiating a portion of the build out to be designated to incubate new entrepreneurs and start-ups based in Davis.