bae urban economics

Memorandum

To: Hans Grunt, City of Novato

From: Matt Kowta, MCP, Managing Principal

Date: November 27, 2017

Re: Peer Review of Fiscal Analysis for Hotel at Hanna Ranch

The purpose of this memo is to provide a peer review of the November 3, 2016 fiscal and economic impact analysis prepared by ALH Urban & Regional Economics on behalf of Hanna Novato, LLC, for the proposed Hanna Ranch project. This peer review evaluates only the portion of the ALH report dealing with the potential fiscal impacts of the hotel component of the larger Hanna Ranch project, which also includes a Costco gas station, restaurants, and retail space.

The fiscal portion of the ALH report focuses on the City of Novato General Fund and, for the most part, uses standard fiscal impact analysis methodology. The projections of increased General Fund costs and revenues are presented in aggregate for the whole project, including its retail, restaurant, and gas station components. It does not provide fiscal projections for the hotel component alone. Given the type of project, the projected overall fiscal impact results, which indicate potential for annual fiscal surpluses of approximately $1,371,000, are not surprising. Following is a review of key assumptions and methodologies relating to the hotel fiscal analysis.

General Approach

The fiscal impact analysis focuses on the impacts to the City of Novato General fund, at stabilized occupancy, and projects future city service costs and revenues in constant, current year dollars. This is essentially the same approach that BAE has utilized in preparing fiscal impact analyses for the proposed Residence Inn and Wood Hollow hotel projects, and this approach is appropriate for this type of project. The ALH report utilized the proposed 2016/2017 Novato City Budget for the base revenue and service cost figures, which is appropriate given the timing for preparation of the ALH report. BAE utilized the 2017/2018 City Budget for our more recent analyses of the Wood Hollow and Residence Inn hotel projects.

Cost and Revenue Projection Techniques

The ALH report primarily relies on cost and revenue multipliers, representing current average service costs and revenues per existing Novato service population[1], to project future increases in General Fund service cost and revenues because of the proposed hotel project. This technique is widely used by analysts to develop representative estimates of fiscal impacts from development projects, when a high degree of precision is not needed. Further, the ALH report does project key revenues, including property tax, property tax in-lieu of vehicle license fees, and transient occupancy tax on a case study basis. The modeling for these revenues is keyed to the specific characteristics of the proposed project, to provide a more fine-tuned projection of the project's revenue-generating potential. This hybrid approach to project costs and revenues provides a reasonable degree of precision, and is appropriate for this type of project. Combined with the assumption that all the City's existing service costs are variable and will increase proportionately with the increase in service population generated by the proposed project, this approach provides a reasonably conservative analysis.

Estimated Hotel Service Population

The ALH report estimated the Hanna Ranch service population by project component. The report estimated hotel employment based on an assumption of 1.2 employees per hotel room. This estimate was from the Trip Generation book, published by the Institute of Transportation Engineers, for the general hotel land use. BAE believes that this estimate may overstate the level of employment at the proposed Hanna Ranch hotel, based on our understanding that the proposed hotel would be a limited service establishment (i.e., no restaurant, limited common areas, meeting rooms and/or amenities requiring staffing). To the extent that this is the case, the Hanna Ranch analysis will tend to overstate the project's service population, which in turn will tend to overstate projected costs and revenues for those items that are calculated on an average per service population basis. Most of the project's key revenues are projected on a case study basis, and relatively minor revenue items are projected on an average per service population basis. The effect of this assumption on increasing service costs is greater than its effect on increasing revenues, meaning that the likely net effect is to reduce the projected net fiscal surplus by a small amount.

Base Service Population Estimates

Because the ALH report substantially relies on average per service population costs and revenues to project future changes, it is important that appropriate estimates of existing Novato residents and employment in Novato are used to calculate the existing average service costs and revenues. The ALH report uses base City of Novato service population data that are slightly lower, but comparable to those that we generated for our own analyses of the

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[1] Service population is an indicator commonly used by fiscal analysts to characterize the increase in service demand associated with a new development project. Service population is defined as the project's resident population plus one-half of the number of the project's employees. The discounting of the employees by one-half is meant to account for the fact that employees are typically not present within the community as many hours per day as residents, and are therefore assumed to generate reduced service demand and reduced revenue, as compared to residents.

Residence Inn and Wood Hollow hotel projects, considering that the local population and employment figures used by BAE are 2017 figures and the ALH report used 2016 figures.

Property Tax Revenue Assumptions

The ALH report uses an estimated hotel valuation of $221,000 per room. This is a key assumption driving both property tax and property tax in-lieu of vehicle license fee revenues. Based on our own research for the Residence Inn and Wood Hollow hotel projects, we believe that this represents a reasonable assumption for project value, although it is slightly higher than the $211,000 per room value that we estimated for the Residence Inn and Wood Hollow hotels.

The ALH projection of increased property taxes estimated that the City's share of the basic one percent ad-valorem property tax paid by the Hanna Ranch project would be 5.1 percent. Based on information collected from the Marin County Tax Collector's office, BAE believes that the City's share of new property tax collected in Tax Rate Area 10-025, which is where Hanna Ranch is located, will be approximately 8.32 percent. This indicates that the ALH report under-estimates the Hanna Ranch project's property tax-generating potential by a significant margin. To the extent that this is the case, the ALH report will tend to underestimate the project's fiscal benefits.

Transient Occupancy Tax Revenue Assumptions

Transient occupancy taxes (TOT) are the single most important General Fund revenue source for the Hanna Ranch hotel. The ALH report projects the hotel's potential TOT based on the City's 9% transient occupancy tax rate (this is the General Fund share of transient occupancy tax only), the proposed hotel room count given by the developer, an assumed $200 average nightly room rate, and a 75% average annual occupancy rate. The $200 average room rate is more aggressive than the $161 rate that BAE assumes for the Residence Inn and Wood Hollow projects. While BAE believes that all three hotels will fall into the broad "limited service" lodging category, there are varying levels of quality within the category and it can be expected that there will be some variation in the pricing between the three hotels. Nevertheless, it may be prudent for the City of Novato to take a more conservative view of the potential TOT generation of the Hanna Ranch hotel, given that it will compete with the other two new hotels, and to a lesser extent with existing Novato lodging establishments, for market share. To the extent that the Hanna Ranch hotel would charge rates lower than $200 per night, the ALH report will tend to overstate the project's potential revenues and fiscal benefits.

Property Tax In-Lieu of Vehicle License Fee Revenue Assumptions

The ILVLF projection in the ALH report is based on the net increase in assessed valuation, after accounting for the site's existing assessed value. This is appropriate, and yields a reasonable estimate of the amount of new ILVLF that the project could generate.

Other Revenue Assumptions

The ALH report projects some additional revenues from other minor revenue sources, such as business license tax, sales tax (from the gas station and retail project components) and franchise fee revenues. The ALH report projects increases in revenues from business license tax assuming a flat per hotel fee. The ALH report does not attribute increases in sales taxes to the hotel component of the Hanna Ranch project. Because the ALH report projects increased franchise fee revenues based on the current average revenue per service population, applied to the estimated project service population, it may overstate the franchise fee revenues that the hotel might generate, to the extent that the ALH report may overstate the number of hotel employees. Nevertheless, the franchise fee revenue has a minimal effect on the project's fiscal outcome.

Service Cost Assumptions

The ALH report models increased costs for Central Administration, Administrative Services, Police, Community Development, and Public Works on an average cost per service population basis, assuming all current City expenditures for these services are variable, and will increase proportionate to the increase in the City's service population. This is simplified but reasonable approach to this portion of the report's analysis, but appropriate for this type of study. As noted in the ALH study, the author did not have direct access to City staff who might be able to provide more detailed information regarding potential service cost increases that were tailored to the specific characteristics of the Hanna Ranch project. Based on input given to BAE by staff from the Novato Police Department regarding potential law enforcement service impacts associated with the three proposed hotel projects, we believe it is likely that the hotel projects will have very limited impacts on Police services, and that the cost projections using average cost multipliers for all services mentioned above provide a reasonable basis to estimate the magnitude of service cost increases associated with the proposed Hanna Ranch hotel. Further, to the extent that the hotel employment estimate is overstated in the ALH report, this will tend to overstate service cost increases associated with the hotel.

The ALH report calculates current city costs for the Parks, Recreation, and Community Services (PRCS) Department on an average cost per resident basis, because City residents are the primary users of these services. Since the proposed hotel would not accommodate any new residents, the ALH report estimates zero impact to the PRCS Department. This is consistent with how BAE evaluated the Residence Inn and Wood Hollow hotel projects.

General Fund Transfers Out

The ALH report does not address transfers of funds out of the General Fund. In analyzing the potential fiscal impacts from the proposed Residence Inn and Wood Hollow hotels, BAE conservatively assumed that General Fund transfers out would increase proportionate to the increase in the City's service population. To the extent that transfers out could increase as the service population increases, the ALH report may understate service costs; however, this is a minor cost item.

Potential Fiscal Impacts of Hanna Ranch Hotel Project

As mentioned in the introduction to this memo, the Hanna Ranch fiscal analysis projected the project's net fiscal impact on an aggregate basis, for all the project components, including retail, restaurants, and gas station, in addition to the hotel. To estimate the net fiscal impact for the hotel component alone, BAE adapted the fiscal model created for our separate analyses of the Residence Inn and Wood Hollow projects to fit the characteristics of the Hanna Ranch hotel. Using a set of assumptions, including the ALH report's 1.2 employees per hotel room, BAE's reduced room rate of $161 per night, and a reduced property valuation that averages $211,000 per room, BAE estimates that the Hanna Ranch hotel would generate an annual fiscal surplus of approximately $508,000 per year.

If the BAE hotel fiscal model is further modified to assume only 0.35 employees per room, instead of 1.2 employees per room, the fiscal surplus would increase to $520,000 per year. This shows that the effect of the ALH assumption of 1.2 employees per room is to generate a slightly more conservative estimate of the hotel's potential fiscal benefits.

If the employee density is reduced to 0.35 and room rate increases to $200, per the assumption used in the ALH report, the projected fiscal surplus would rise to $642,000 per year. This shows that the ALH assumption of a $200 average daily room rate versus the $161 per night that BAE assumed for the Residence Inn and Wood Hollow hotels contributes approximately $120,000 per year to the Hanna Ranch hotel's potential fiscal surplus.

Conclusion

Overall, the Hanna Ranch fiscal and economic impact analysis includes a reasonable representation of the potential fiscal impacts from the project's hotel component. The fiscal analysis generally incorporates cost projection methodologies and assumptions that are counterbalanced by the fact that the analysis incorporates assumptions which may make the revenue projections somewhat aggressive, including a slightly higher project valuation, and noticeably higher room rate assumptions than what BAE assumes for similar new hotel projects in Novato. To the extent that the revenue assumptions are aggressive, their impact on the projected net fiscal balance is greater than the impact of the conservative cost projections, meaning that the fiscal analysis may be considered somewhat aggressive from the City's perspective. However, the sensitivity analysis provided above indicates that even with a more conservative set of revenue assumptions, the Hanna Ranch hotel project would likely produce substantial annual fiscal benefits for the City of Novato. Thus, it is reasonable to characterize the Hanna Ranch hotel component as being fiscally attractive to the City of Novato, similar to the Residence Inn and Wood Hollow hotel projects in its potential to generate annual fiscal surpluses to the City's General Fund.