

**RESPONSES TO QUESTIONS SUBMITTED BY CITY OF DAVIS FINANCE & BUDGET
COMMISSION – DECEMBER 14, 2015**

A. CITY OF DAVIS /BOB BLYTH ACCOUNTING AND FISCAL ANALYST

Question 1: The discussion of Table 3 references a tax-sharing arrangement for "the recent Covell Village project." I'm confused about the reference given that the project was defeated by voters. Was there an agreement on tax-sharing reached with the county before the public vote? Also please clarify the tax-sharing that was apparently agreed to for Covell Village. If 17.5 percent of property taxes was to go to the city, what percentage would the county have continued to get under the Covell Village agreement?

Response: The Covell Village project did not pass the annexation vote. There was no formal annexation agreement codified during that time. The City did have some discussion with the County leading up to the Covell vote and assumptions were used in the development of the fiscal model and the City's Tax-Sharing proposal that would have gone to the county. The City's proposal stated "While we believe that the City would be justified in seeking a tax-sharing agreement that results in a proportionate allocation of surplus revenues (i.e. 19.05% of property tax revenues to the City), the City is proposing - in recognition of County fiscal pressures - that surplus project revenues be shared equally between the City and the County." Since the project did not move forward the agreement was never pursued. At a 17.5% City share the County would have received 4.5%.

Question 2: Also please clarify the tax-sharing that was apparently agreed to for Covell Village. If 17.5 percent of property taxes was to go to the city, what percentage would the county have continued to get under the Covell Village agreement?

Response: At a 17.5% City share the County would have received 4.5%.

B. PLESCIA & CO. AND GOODWIN CONSULTING GROUP

Question 3: Tax-sharing ratio assumptions on Page 3 of the text - Please further clarify why a 15-85 city-county split of the allocable property tax revenue base was assumed for Nishi. Did it mirror what was agreed to for Covell Village? I realize Andy's estimate preceded the EPS reports, but they estimated a 50-50 split in the later EPS report and am curious about the big difference in approach and what is realistic to assume.

Response: Yes, the 15%-85% split was a conservative assumption based on the 17.5%-82.5% split for Covell Village. The EPS estimate – splitting the available property tax down the middle – is a reasonable

starting point assumption without knowing where the tax-sharing negotiations will end up. We believe the final tax-sharing agreement will look something more like Covell Village, and we also did not want to potentially overestimate the IFD bonding capacity by assuming a larger split for the City.

Question 4: Net proceeds of CFDs on Page 4 of the text - The infrastructure gap identified in this report was about \$9.1 million. Page 4 indicates that an initial CFD bond could make \$11.2 million "available to fund infrastructure" -- or about \$2.1 million extra than the \$9 million infrastructure gap. Likewise, borrowing enough to provide a margin for coverage could make another \$2.4 million available for this purpose, albeit over 30 years. Assuming that project infrastructure costs don't escalate, could a development agreement specify that these extra monies would go to the city for community benefit, akin to the initial Cannery CFD proposal? Andy to respond (can funds be used this way?) but note that infrastructure costs *did* escalate.

Response: Yes, the extra monies could go to the City for community benefit, but the extra monies would need to pay for facilities that are authorized by the CFD law to fund.

Question 5: Table 2 of Exhibit 2 - This table lists the estimated costs of on-site public improvements. It does not include construction tax, development impact fees, or any specific contribution toward off-site improvements in the Richards Boulevard corridor that might be required as mitigation or additionally in a development agreement.

Response: The estimated total development cost for each of the proposed private development uses (residential ownership, residential rental and office/research and development) include a line item called Municipal Fees (see Tables 3, 4 and 5, respectively, of Attachment 1) which included City of Davis development impact, construction tax, Quimby Act, sewer connection and water connection fees; Yolo County impact fees; and Davis Unified School District fees based on information provided by City staff.

The estimated total development cost (public infrastructure cost) does not include any specific contribution toward off-site improvements beyond the estimated supportable public infrastructure figures. If there are any contributions proposed beyond those figures, the funding of such costs would have to be negotiated in the context of the development agreement.

Question 6: Table 7 of Exhibit 1 - How was the proportion of the \$9.1 million funding gap allocated to each segment of the projects?

Response: The allocated amount of public infrastructure cost by proposed private development use at the bottom of Table 6, Attachment 1 is based on percentage of total site area (gross acreage) in relation to the total gross acreage of the site (46.90 acres). The proration of the \$9.1 million funding gap to each of the proposed private development uses is based on the difference between the allocated amount of public infrastructure cost by use (see bottom of Table 6, Attachment 1) and the estimated supportable amount of public infrastructure cost by use (see response to Question 6.B. below).

Question 6A: Table 7 of Exhibit 1 - What calculation determined which costs were "supportable" from residential housing, rental housing, and office/research?

Response: The calculation of supportable public infrastructure cost is based on a residual approach whereby the extent of the estimated public infrastructure amounts indicated for each of the proposed private development uses (residential ownership, residential rental and office/research and development) in Tables 3, 4 and 5, respectively, of Attachment 1 is estimated at levels that yield positive net project value and land values that are considered to be generally consistent with the general Davis real estate market. In other words the amount of supportable infrastructure cost is based on what the proposed private development use can support after taking into account estimated development costs (direct, indirect, financing), revenue/income, developer fees/profit (as applicable) and still yielding positive net project value and land values.

Question 6.B.: Table 7 of Exhibit 1 - The footnotes link to other tables, but those tables don't appear to show numbers that tie out to the numbers in Table 7. For example, Table 7 says only \$2,411,046 in public improvement costs are supportable by the ownership residential component. The footnotes tell me to look at Table 6 for an explanation of that number, but that number appears nowhere in Table 6. The same is true for the other two project components.

Response: For the allocation of public infrastructure costs amongst the three proposed private development uses (Footnote 1 in Table 7, Attachment 1) the information is found at the bottom of Table 6. For the estimated amount of supportable public infrastructure cost by use, Footnotes 2, 3 and 4 in Table 6, Attachment 1 have been revised for each of the proposed private development uses to explain the respective calculation. For example the estimated amount of supportable public infrastructure cost for the residential ownership use component in Table 7, Attachment 1 (\$2,411,046) is based on the figure of

\$1,785,960 under Infrastructure from Table 3, Attachment 1 plus general contractor, contingency, engineering and financing costs totaling 35% (\$1,785,960 times 35% = \$2,411,046).

Question 7: Table 5 of Exhibit 2 - The use of a 25 cents per square foot CFD assessment for the office and research development component seems low, and the relative burden placed on the housing components under the CFD proposal appears to be pretty high. This table shows that homeowners and renters would pay over 90 percent of the annual CFD revenue stream while the office/research segment would pay just 9 percent.

Response: The assumed special tax rate of \$0.25/sf for Office/Research Development and Neighborhood Retail is identical to that for The Cannery project. At this point, before the CFD formation process has even begun, it is just an assumption, one that can be revised. Special tax rates on non-residential land uses are often suppressed to avoid high CFD burdens that may discourage development of these job-generating, sales-tax generating land uses.

Question 8: As the IFD Revenue chart on Table 5 shows, office/research is valued at 34 percent of the total property value for the development. Table 7 of Exhibit 1 shows that office/research space is about 29 percent of the total project square footage. Moreover, Table 6 in Exhibit 1 indicates that 29 percent of the public improvement costs for the project overall would be allocated to office/research. All of this raises the question as to why the \$9.1 million in "gap" money would so disproportionately be coming from the housing side. How would the proposed CFD structure be considered equitable in light of this information?

Response: One of the advantages, actually, of using a CFD is the flexibility it affords in setting special tax rates among the various land uses within a project. The tax rates do not have to be based on the direct benefit from the public improvements that each land use may receive or on the amount of development associated with each land use and, in fact, cannot be based on the value of the property. The special tax rates only need to be set in a reasonable manner, which in most instances relates more to what each land use can support and/or what appears to be a marketable and competitive amount. See response to Question 7 for more information.

Question 9: If the office/research segment paid a higher amount in CFD assessments, would this undermine the competitiveness of the development? How much "room" is there to consider a higher rate

on such commercial properties without impacting the viability of the project? The report indicates that the proposed 25 cents per square foot would not be a problem at all.

Response: Any amount higher than \$0.25/sf would be less competitive relative to the rate being charged in The Cannery project. It is likely that a slightly higher rate would not significantly impact the Nishi project's competitiveness, but a slight increase in the rate for non-residential would not result in a material change to the rates for residential land uses. Still, even a slightly lower rate for the residential land uses may be desirable, so these types of revisions could be explored further.

Question 10: Could a CFD also be structured to potentially maximize the revenues, beyond paying infrastructure costs, to additionally provide a direct fiscal benefit to Davis citizens? Principle #7 of the Guiding Principles calls for assessments to create a positive ongoing revenue generation for the city above and beyond standard taxes. Both the CFD and IFD proposals appear to be limited to covering project costs without providing additional benefit to Davis citizens. How would this portion of the Guiding Principles be addressed if not via a CFD?

Response: As mentioned in the memo, it is recognized that a fiscal impact study may indicate the need for a special tax that would mitigate potential fiscal deficits. A separate special tax to fund public services could be integrated into the proposed CFD for Nishi project infrastructure, or a separate CFD could be established for that purpose. Adding an annual special tax for services would reduce the special tax amounts for infrastructure, which would lower the bonding capacity and the amount of infrastructure that could be funded.

Questions 11 through 14 - Conclusions regarding IFD

Your conclusion that diverting property tax increment to pay for project infrastructure costs makes sense, given the EPS findings of a minor negative fiscal impact of the project for the city. Diverting property tax monies could in theory make the fiscal impact for the city even worse. However, I want to be sure I completely understand the concept:

Question 11: Are you talking in your analysis about IFDs or instead about Enhanced IFDs, a new public finance tool recently approved by the Legislature?

Response: We are talking about an EIFD, which simply makes an IFD easier to use.

Question 12: Please clarify what portions of property tax increment are subject to redirection under an IFD. I assume it is only the portion of the property tax base that the city (and, if they choose, the portion that county and special districts share) and does not affect the schools or ERAF portion.

Response: Correct, and the analysis assumes that only the City's share would be considered.

Question 13: If the city's share of property tax ended up being much better than 15 percent, and were instead 75 percent, as EPS indicated was possible, would it change your comments on its usefulness as a tool here? I'm guessing that would result in a revenue stream of about \$350,000 per year instead of the \$69,931 you estimated.

Response: Yes, just as the revenue would increase five times, so would the bonding capacity and, therefore, the amount of infrastructure that could be funded.

Question 14: Would there be any mutual advantage to a strategy in which the city allowed its property tax to be used for these on-site infrastructure purposes, but the city received some other form of remuneration -- such as an ownership stake in the project land and buildings that it could sell in the future at a profit?

Response: It is possible that trading property tax revenue for an ownership stake in a portion of the project would be mutually advantageous to the City and the developer. Naturally, the many details of such an arrangement that would need to be worked out would ultimately dictate whether both parties could benefit.

Question 16: Developer fee - the developer fee associated with the three components of the project adds up to roughly \$15.8 million. Is this fee in line with the profit to developers for other projects the city has examined (such as The Cannery)?

Response: For the proposed Nishi Property residential ownership use the estimated targeted return-on-investment (profit) is based on a targeted threshold range of 10% to 12% of the estimated gross sales revenue of the units (see Table 3). This is consistent with the project economics analysis prepared for residential ownership uses of the Cannery Project which included an estimated return-on-investment (profit) in that same range (10% to 11% of estimated gross sales revenue). For the proposed Nishi Property multiple-family residential units, office and research development uses the estimated developer

Preliminary Analysis of Project Economics and Infrastructure Funding Alternatives
Nishi Property

fee is based on a targeted threshold range of 4% to 6% of estimated total development costs (see Developer Fee in Tables 4 and 5, respectively) – depending on the development product type, location, market risk, etc. Again this is consistent with other project economic analyses A. Plescia & Co. has prepared for other proposed City of Davis projects.