

## TECHNICAL MEMORANDUM

Date: August 12, 2015

To: Jeremy Krout, AICP, LEED GA, President  
E|P|D| Solutions, Inc.

From: Steve Gunnells, Chief Economist

Subject: **Fiscal Impact Assessment, Encanto Residential Project**

This technical memorandum provides a basic fiscal impact assessment of the proposed Encanto residential project in Lake Forest. Primarily, it is intended to address Lake Forest's General Plan policy 5.7. The memo presents the assessment in six comments followed by a conclusion.

### COMMENTS

#### 1. Project Background

The proposed project would develop a gated residential community consisting of 52 single-family detached residential units and a private neighborhood park. The project site contains about 5.75 acres. Development of the proposed project requires several discretionary approvals by the City of Lake Forest and other responsible agencies. One discretionary approval is relevant to the fiscal impact assessment:

**General Plan Amendment (GPA 9-14-4593).** The Project proposes to change the general plan land use designation of the project site from light industrial to low-medium residential (7 to 15 dwelling units/acre [du/ac]).

#### 2. Purpose

Policy 5.7 in Lake Forest's General Plan states, "Preserve the fiscal well-being of the community by ensuring that land use designation changes for land within the Business Development Overlay will not result in a loss of future net revenue for the City." The project site is at least partially within the Business Development Overlay, as depicted in Figure LU-2 in the Lake Forest General Plan. The purpose of the fiscal impact assessment is to quantify the City's likely net revenue generated by the proposed project and by the project site if the requested general plan amendment is not approved in order to determine if the proposed project is consistent with policy 5.7.

#### 3. Market Conditions

**3A. Residential Market Conditions.** Characterizing residential market conditions is tricky. Relative to the high in number of sales and median prices prior to the recession, most housing markets are down. Relative to the bottom of the market during the recession and early recovery period, most housing markets are up, and growing.

Relative to recession lows and to the performance of other regional housing markets, the Orange County market can currently be fairly described as strong. According to the California Association of Realtors, the median sales price of Orange County homes in June was up 2.9 percent over June 2014. This is lower than the 7.4 percent increase across the Los Angeles metropolitan area (LA and Orange counties), but the median sales price in Orange County, \$716,730, was 60.3 percent higher than the price across the Los Angeles metropolitan area. More importantly, the number of housing sales in Orange County was 16.4 percent higher than the number in June 2014. Sales across the metropolitan area were 16.1 percent higher.

Based on the current strength of the residential market, there appears to be no reason to assume that new housing product in 2017 (the estimated year construction of the proposed project would be completed) would have a problem being absorbed.

- 3B. Industrial Market Conditions.** The general industrial market in Orange County is strong. Vacancy rates have been declining for about three years and are at 15-year lows. Lease rates have been increasing and are expected to continue increasing in the short term. However, in the south Orange County submarket (including Lake Forest) vacancy and availability rates are somewhat higher than in the other Orange County submarkets.

In an August 27, 2014 letter to the City, the owner of part of the project site property documented the lack of demand for the sale of the property for uses allowed under the current land use designation and zoning. In addition to market conditions and the availability of less expensive existing building space on the market, the letter described challenges particular to the site, include higher site development cost and having only one entrance. If the City does not change the land use designation and zoning, it is reasonable to assume that the existing site might sit vacant for a number of years before tightening industrial market conditions make its development for allowable uses financially feasible.

#### **4. Fiscal Assessment Model**

Using information in the City's budgets and comprehensive annual financial reports (CAFR), the fiscal analysis allocates revenues and costs for residential housing units in the city and industrial development (measured by the number of employees).

- 4A. Time Period.** The fiscal assessment model uses average costs and revenues from fiscal year 2010/11 (FY11) through FY13, because these are the years for which data are available on population, number of households, and number of employees working in Lake Forest.

The feasibility assessment reports the estimated costs and revenues as if the site were developed today.

- 4B. Operation and Maintenance Costs.** The assessment assumes that the city's development impact fees have been set as needed to cover the capital costs associated with new development. Therefore the fiscal model actually assesses operational and maintenance costs, primarily expenditures covered under the general fund, and it omits capital outlays.

- 4C. Inflation.** The fiscal assessment model adjusts the revenue and expenditure data for inflation, expressing the data in constant 2014 dollars. Because the data upon which the

model is based are inflation adjusted, the projected expenditures and revenues also represent constant 2014 dollars. Generally speaking, adjusting for future inflation would not change the findings because inflation adjustments would apply to revenues and expenditures.

- 4D. Industrial Development Scenario.** The fiscal assessment model compares the estimated net revenues for the proposed project to the estimated revenues for a theoretical industrial development scenario. The industrial development scenario represents a potential development of the project site assuming that the City does not change the land use designation and zoning. With a typical industrial FAR of 0.35, the site would accommodate an 87,700-square-foot building. With an average employment density of 814 square feet of building space per employee, the industrial development scenario could generate 108 jobs.

## 5. Allocation of Revenues and Expenditures

- 5A. Property Taxes.** The model estimates the site's taxable value in the first year after development and assumes that it will generate real property taxes for the city at a rate of 0.133 percent.
- 5B. Sales Taxes.** Perhaps the single most important distinction in fiscal modelling is the generation of sales tax revenues. A natural instinct would be to assume that sales tax revenues are generated by retail businesses. In reality, retailers are simply the collectors of sales tax. It is households that actually pay the tax.

The fiscal assessment applied a regression analysis to the number of households and the taxable retail sales in Lake Forests from 1997 through 2013 (the time period with publicly available data). The regression analysis suggests that 74.9 percent of retail sales tax revenues are driven by households.

Accordingly, the model allocates 74.9 percent of the retail sales tax revenue to the number of households in each year from 2011 to 2013. On average, each household generated \$274.13 in retail sales tax revenue for the City.

The model allocates the sales tax generated by non-retail businesses based on the total number of employees working in the City, less retail workers and accommodation and food services works, for each year from 2011 to 2013. On average, non-retail businesses generated \$146.10 per employee. One should note that this does not represent spending by these employees, but rather it represents the sales and use tax on point-of-sale purchases at non-retail businesses.

- 5C. Total per Capita Method.** The fiscal model allocates the remaining revenues and all expenditures based on a total per capita method. This is a fairly routine approach, especially in situations in which extensive detailed data are not available. This method divides each revenue or expenditure item by the sum of the population and employment in Lake Forest. These are applied to the proposed project, based on an estimated population of 170 (52 units with an average household size in owner-occupied single-family housing of 3.28 in 2013). The model applies these revenues and expenditures to the industrial development scenario based on the 108 employees (see paragraph 4D). However, the model also assumes that an industrial facility would require only half the level of expenditure on public safety, thereby reducing the cost per employee somewhat.

## 6. Feasibility Comparison

The fiscal impact assessment compares the potential fiscal implications of the proposed project, 52 single-family detached homes, to a theoretical industrial development scenario, as if both were developed today. Table 1 provides the results of the assessment.

The assessment estimates that, if it were developed today, the proposed project would generate \$84,800 in annual revenues and require \$52,600 in annual expenditures. The net revenues would be \$32,200 in the first year. In contrast the theoretical industrial development scenario would generate \$55,000 in annual revenues and require \$28,900 in annual expenditures. The net revenues would be \$26,200.

**Table 1: Potential Fiscal Implications of the Proposed Residential Development and a Theoretical Industrial Development Scenario, in Inflation-Adjusted 2014 Dollars**

	Proposed Residential Development	Industrial Development Scenario
<b>Revenues</b>		
(1) Estimated post-development site value	34,115,000	17,610,000
(2) Property tax revenues	45,500	23,500
(3) Number of households/employees	52	108
(4) Sales tax generated per household/employee	274	146
(5) Sales and use tax revenues	14,300	15,700
(6) Other revenues per household/employee	480	147
(7) All other revenues	25,000	15,800
<b>(8) Total Revenue</b>	<b>84,800</b>	<b>55,000</b>
<b>Expenditures</b>		
(9) Expenditures per household/employee	1,012	268
<b>(10) Total expenditures</b>	<b>52,600</b>	<b>28,900</b>
<b>Net Fiscal Impact</b>		
<b>(11) Net revenues (revenue less expenditures)</b>	<b>32,200</b>	<b>26,200</b>

Source: PlaceWorks, 2015.

### Notes to Table 1:

1. The estimated post-development site value is an assumed value based on current market conditions. For the proposed project, the value is based on 52 units and an assumed average sales value of about \$656,000 across the possible housing types. For the industrial development scenario, the value is based on an 87,700-square-foot building and a value of \$200 per square foot.
2. The annual property tax revenue is based on an assumption that the City would receive about .133 percent of the site's value each year.
3. The number of households is based on the number of housing units the average household size in owner-occupied single-family detached housing in Lake Forest in 2013, as estimated in the 2013 ACS 5-year estimates. The number of employees is based on the building size and an assumption of 814 square feet per employee.
4. Sales tax generation by households is the estimated amount the average Lake Forest household pays in sales taxes in the City each year. It is derived through a regression analysis taxable retail

sales and the number of household for each year from 1997 to 2013. Sales tax generation per employee represents the average point-of-sales tax collected by non-retail businesses in Lake Forest each year.

5. Annual sales tax revenue is the amount that the model estimates households residing in the proposed project would pay in sales taxes to the City of Lake Forest in the first full year after development. For the industrial development scenario, sales tax revenues are the estimated amount that non-retail businesses in an industrial building might generate for the City.
6. Other revenues represent all other taxes and all other non-tax revenues that the City collects each year, expressed as the amount per household or the amount per employee. The data were generated based on the total per capita methodology.
7. Annual other revenues is the total amount of revenues, other than property and sales taxes, that the model estimates that households residing in the proposed project or businesses operating in the industrial building would generate.
8. Total revenue is the estimated annual amount of municipal revenues the proposed development or the industrial development scenario could generate for the city in the first year after development.
9. The total expenditures per household or employee line is the amount the fiscal model estimates the city spends annually to provide public facilities and services to each household or to each business based on employee size.
11. Total expenditures is derived by multiplying the total expenditures per household/employee by the number of households or employees.
12. The net is the amount by which the estimated revenues would exceed the estimated expenditures. This represents the net fiscal impact of the proposed project and the theoretical industrial development scenario.

## **CONCLUSION**

The fiscal impact assessment indicates that the proposed project would generate higher net revenues than the theoretical industrial development scenario. Based on this finding, we conclude that the proposed project is consistent with General Plan policy 5.7.